

THE IMPACT OF CRYPTOCURRENCIES ON AUDITING PRACTICES: A MALAYSIAN BASED CASE STUDY

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Abstract: *This study aims to explore the effect of cryptocurrencies on the field of auditing. As the popularity and prevalence of cryptocurrencies continue to rise, it becomes imperative to understand their implications for the practice of auditing and assurance services. The first objective of this research is to examine the level of awareness and understanding among auditors regarding cryptocurrencies. These factors can impact the reliability and accuracy of financial statements, and auditors need to adapt their audit procedures accordingly. The second research objective is to evaluate the challenges faced by auditors in auditing cryptocurrency transactions. This includes exploring the use of blockchain technology, which underlies most cryptocurrencies, to enhance audit trail accuracy, transparency, and efficiency. Additionally, cryptocurrencies may streamline certain audit procedures, automate reconciliation processes, and reduce the occurrence of fraud and manipulation. The third research objective is to identify the training and development needs of auditors to enhance their capacity in auditing cryptocurrencies and the fourth research objective is to propose recommendations for improving the regulatory framework and guidelines for auditors in cryptocurrency auditing. In order to achieve these objectives, a comprehensive review of existing literature, regulations, and industry practices will be undertaken. Additionally, primary data will be collected through qualitative interviews with auditing professionals, regulators, and technology experts to gain insights into the real-world challenges and opportunities faced in auditing cryptocurrency-related transactions. The findings of this study will contribute to the existing body of knowledge by providing a deeper understanding of the impact of cryptocurrencies on auditing practices. This research will enlighten auditors,*

regulators, and standard-setting bodies about the necessary adjustments and considerations needed to ensure the effectiveness and reliability of audits in the cryptocurrency era.

Keywords: *Cryptocurrency Regulation, Blockchain Technology, Auditing Practices, Reporting and Disclosure and Risk and Fraud Detection*

Introduction:

The rapid growth and adoption of cryptocurrencies, such as Bitcoin and Ethereum, have raised concerns and challenges for traditional auditing practices. Cryptocurrencies are digital tokens. They are a type of digital currency that allows people to make payments directly to each other through an online system. As Malaysia emerges as a major player in the cryptocurrency market, it is crucial to explore the role of auditors and their preparedness for auditing cryptocurrency transactions in the country. This research proposal aims to investigate the current state of auditors' knowledge, understanding, and expertise with regards to cryptocurrency auditing in Malaysia. Cryptocurrencies, such as Bitcoin and Ethereum, have gained significant popularity and adoption worldwide, including in Malaysia. As digital assets, cryptocurrencies present unique challenges and opportunities for auditors, particularly in areas such as financial reporting, control environment assessment, and fraud detection.

Problem Statement:

The rise of cryptocurrency usage is quite alarming, thus the auditors need to understand the challenges incurred in the auditing practices in Malaysia. Policymakers and law regulators need to come up with regulation due to the high degree of anonymity and nature of the system, which is associated with substantial risks.

Research Objectives:

1. To examine the level of awareness and understanding among auditors regarding cryptocurrencies.
2. To evaluate the challenges faced by auditors in auditing cryptocurrency transactions.
3. To identify the training and development needs of auditors to enhance their capacity in auditing cryptocurrencies.
4. To propose recommendations for improving the regulatory framework and guidelines for auditors in cryptocurrency auditing.

Research Questions:

1. What is the level of awareness and understanding among auditors regarding cryptocurrencies in Malaysia?
2. What are the major challenges faced by auditors in auditing cryptocurrency transactions?
3. What are the training and development needs of auditors to enhance their capacity in auditing cryptocurrencies?
4. How can the regulatory framework and guidelines be improved to facilitate effective auditing of cryptocurrencies?

Theory

Institutional theory

The Institutional Theory has been extensively used in accounting research to understand the impact on organisational structures. According to Oliver (1997), it views the organisation

operates within social norms, values and makes assumptions that certain economic behaviour is appropriate and acceptable. Most of the time, organisations comply with the behaviour because they are taken-for-granted as 'the way we do these things'. To remain sustainable in the environment, organisations need to conform to the rules and belief systems. Organisations conform to institutional pressure for change to receive rewards in return. The rewards can be in the form of improved legitimacy, resources, and sustainability (Scott, 1987). Since the usage of cryptocurrencies is growing, organisations are expected to conform to institutional pressure by incorporating it into their operation to meet public expectations and demands. This is also known as coercive isomorphism. As mentioned in the introduction, high prestigious companies such as Wikipedia, Microsoft, and Amazon accept digital currencies for payment. It is believed that it will influence smaller organisations to practice the use of cryptocurrencies to conform to the social norms. In such circumstances, it is undeniable that governance structures such as the accounting professionals, need to follow the norms. Accounting professionals need to be ready to overcome prompting challenges by cryptocurrencies in the business environment. Hence, it is crucial for accounting professionals to understand the underlying factors that affect accounting treatment for cryptocurrencies.

Subjectivism

According to Saunders, Lewis and Thornhill, (2012), subjectivism holds the view that social entities are formed based on the perceptions and actions of individuals in society. Therefore, it is crucial to understand the situation as well as the social details of a situation. Collis & Hussey (2014) state that reality is constructed by society and there are numerous realities as each individual has their own perception of reality. At present, no standards regulating the accounting for cryptocurrencies exist and thus it remains unexplored. The accounting for cryptocurrencies depends on the social constructs to make accounting decisions. The assumptions made on the accounting decision need to be captured using a subjective approach. This is because these are influenced by perceptions and actions of social actors and based on judgement. In addition, the presentation of financial statements may vary from one country to another as it is influenced by factors such as economic, social and legal requirements of different countries.

Literature Review

Cryptocurrency Regulations

Investigate the regulatory framework for cryptocurrencies in Malaysia, including the guidelines provided by the Malaysian Securities Commission (SC) and Bank Negara Malaysia (BNM). Examine how auditors are required to comply with these regulations and the impact on auditing practices. In a study conducted by Stephen and Theodor, it is stated that the ultimate nature of the cryptocurrency of not being controlled by any of regulatory bodies is attracted the people to use this system. The cryptocurrency system provides financial freedom to people as it is free from legislation while most of the legislation is enacted in a way that affects their privacy and freedom. However, the rising possibilities of misuse of the cryptocurrency for criminal and terrorism activities call the government for regulation. The study shows that the government has to come with a balanced regulatory system without affects the freedom of transaction (Breu, 2018). Based on the study by Goldmann, the authorities adopted the wait and see approach towards the regulation of the system in late 2017. However, the unprecedented price hike of Bitcoin and the easy access to the system call for the immediate action from the regulatory bodies. As this system is no more than small glitch in the global financial market. The approach that the authorities decided to adapt has to

be clear and detailed. It should not be immediately put into legal guidelines as there are several factors need to be considered. The regulation needs to be flexible without affecting the nature of cryptocurrency (Goldmann, 2018).

Audit of Crypto-related Entities

Explore the challenges auditors face when auditing entities involved in cryptocurrency activities, such as cryptocurrency exchanges, crypto-mining operations, or initial coin offerings (ICOs). This may include evaluating the adequacy of internal controls, assessing the valuation of crypto-assets, and testing the completeness of transactions. Folajimi Festus Adegbe, Abdul-Gafar A. Olawoyin, and Adewale Ogunjirin, (2020) examined the impact of cryptocurrencies on the audit profession, specifically focusing on issues related to audit evidence, control environment, and the competence of auditors in the context of digital currencies. The auditor is likely to include in its inquiries and communication with the entity matters relating to cryptocurrency transactions and transactions to meet these requirements. The critical consideration is whether there are significant transactions with cryptocurrencies in the business of entities outside the scope of regular operations. If any, the auditor should assess whether this causes significant risks (ISA 315, Identifying and Assessing the Risk of Material Misstatements by Understanding the Entity and Its Environment), whether related parties are involved (ISA 550, Related Parties), and whether there is false financial reporting or embezzlement. Business and transactions with cryptocurrencies may include money laundering, terrorist financing or other criminal activities. The use of blockchain technology, which enables direct trade while maintaining anonymity, makes it significantly more challenging to identify illegal activities.

Auditing Practices

Studies have suggested the adoption of innovative audit practices to tackle the unique characteristics of cryptocurrencies. Examples include using data mining techniques to identify anomalies in transaction patterns, employing software tools for blockchain analytics, and assessing the reliability of information provided by cryptocurrency exchanges. Ali Pouriran, (2019) examines multiple dimensions such as the challenges faced by auditors, the potential benefits, and the evolving role of auditors in the context of cryptocurrencies. Charles Cao, Jacobi L. Elliott, and Scott A. Wachter, (2018) focused on the investment opportunities presented by cryptocurrencies. It discusses the challenges associated with valuing and auditing cryptocurrency investments, highlighting the need for appropriate audit procedures to ensure transparency and reliability. Suayb Yalcin and Elizabeth Milne, (2020) focused on the auditing challenges and regulatory concerns associated with cryptocurrencies. It discusses the impact of blockchain technology on audit procedures and outlines key considerations for auditors when dealing with cryptocurrency transactions.

Audit Technology and Tools

To investigate the adoption and usage of auditing technologies, such as blockchain analytics tools, to facilitate the audit of cryptocurrency-related transactions. Assess the effectiveness of these technologies in enhancing the efficiency, accuracy, and reliability of audits. Blockchain technology has the potential to also revolutionize the auditing sector by offering a secure, transparent, and automated method of conducting audits. Recent studies by Tušek, B. Ježovita ([2021) and Wang, Y (2019) suggest that blockchain implementation can enhance the speed and effectiveness of auditing procedures. By providing a permanent and unalterable record of transactions, blockchain can help auditors verify the accuracy of financial information and ensure document integrity (Li, X., 2021). Smart contracts allow for automated processes,

reducing time and resource requirements while quickly identifying inconsistencies and areas of concern (Desplebin, 2021). Furthermore, blockchain enables auditors to access and analyse data from various sources more efficiently. It establishes a decentralized ledger that provides a complete and reliable record of financial data, facilitating insights and pattern recognition. Blockchain technology also enhances security and mitigates fraud risks (Bonsón, E., 2019). Suzanne Lowensohn and Michele D. Meckfessel, (2018) explored the potential impact of blockchain technology on auditing practices. It discusses the benefits and challenges associated with using blockchain for transaction verification, financial reporting, and audit procedures.

Risks and Fraud Detection

Study the specific risks associated with cryptocurrency transactions and explore the role of auditors in detecting and mitigating these risks. This may involve examining the potential for money laundering, fraud, or unauthorized access to crypto-assets. According to Abreu, P.W. (2018) concluded that blockchains are a good solution to save time and overlap work in auditing practices as well as good control mechanisms to prevent fraud, but blockchain technology does not have enough evidence and integrity in the auditing profession; a similar result was found in United Arab Emirates by Parmoodeh, A.M (2023). Also, blockchains and artificial intelligence affect real-time trusted data for the AI systems used by auditors to improve assurance and efficiency (Han, H., 2023).

Reporting and Disclosure

Analyse the financial reporting requirements for cryptocurrency transactions and investments, including the valuation and disclosure of crypto-assets in financial statements. Investigate the challenges faced by auditors when providing assurance on these disclosures. Digital currencies do appear to meet the definition of an intangible asset in accordance with IAS 38, *Intangible Assets*. This standard defines an intangible asset as an identifiable non-monetary asset without physical substance. IAS 38 states that an asset is identifiable if it is separable or arises from contractual or other legal rights. Currently, the International Financial Reporting Interpretations Committee (IFRIC) suggests that cryptocurrency be reported as an intangible asset under IAS 38 in financial statements as it meets the given definition as a mode of payment. IAS 38 defines intangible asset as an identifiable non-monetary asset that does not have a physical form, and most cryptocurrencies will fall under the spectrum of being an intangible asset (Chartered Professional Accountants of Canada, 2018). If companies are involved in mining/creating cryptocurrencies with the intention to sell to the market or traders purchase or sell cryptocurrencies to generate profits, they will be classified as inventory under IAS 2 (KPMG IFRG Ltd, 2019).

Methodology:

For this study primary data will be used to conduct surveys and interviews with auditors in Malaysia to gather their perspectives on cryptocurrency auditing. Besides that, secondary data will be used by reviewing relevant literature, reports, and regulations related to cryptocurrency and auditing practices. A sample of 300 registered auditors with the Malaysian Institute of Accountants (MIA) will be used in this research. A representative sample of auditors, including both internal and external auditors from various industries, will be selected for the survey and interviews. The non-probability sampling method, namely, purposive sampling, was used during the data collection process. In this method, respondents are selected based on their knowledge and expertise related to the research topic (Etikan & Bala, 2017). The purposive sampling method helps researchers to select respondents who

were able to provide desired information to meet the current objectives (Sekaran & Bougie, 2013).

Expected Outcomes and Contributions:

This research will provide insight into the awareness and understanding of auditors regarding cryptocurrencies in Malaysia, the identification of challenges will help auditors and policymakers develop strategies to address issues related to auditing cryptocurrency transactions. The research will highlight the training and development needs of auditors, enabling professional bodies and organisations to enhance their educational programs and certifications and will assist regulatory authorities in improving the regulatory framework and guidelines for cryptocurrency auditing in Malaysia.

Limitations:

1. The research's findings may be limited to the selected sample of auditors.
2. The rapid changes in the cryptocurrency landscape may require regular updates to the research's recommendations.

Conclusion:

As cryptocurrencies become more prevalent, auditors in Malaysia face new challenges and opportunities. The regulatory framework in Malaysia has made efforts to provide guidance, but auditors must adapt their approaches to effectively audit entities involved in cryptocurrencies. This research proposal aims to investigate the role of auditors in cryptocurrency auditing in Malaysia. The findings will contribute to the understanding of the current state of auditors' knowledge, challenges faced, training needs, and will help improve the regulatory framework and guidelines for cryptocurrency auditing.

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