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The Reliance of External Audit on Internal Audit: In Chinese Audit Corporations

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Title

The reliance of External audit on Internal audit in Chinese audit corporations

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Abstract

The objective of this research is to explore how external auditors rely on the work of internal auditors in audit firms in China. This study uses a qualitative method of semi-structured data collection interviews. Semi-structured interviews were conducted with internal auditors and external auditors working in China. On the basis of a summary of the existing literature on internal audit, external audit, the reliance of external audits on internal audit and audit quality, this paper analyses and compares the external auditor's reliance on internal audit and conceptualizes the results of the data analysis. Nevertheless, according to interviews, at present, small and medium-sized enterprises rarely set up an internal audit department, only large companies and government departments in China set up an internal audit, because, firstly, the cost of an internal audit, secondly, the lack of professional internal audit staff and internal audit outsourcing in China is of this kind of legal form. The study showed that the qualitative analysis has provided evidence of the dependence of external audits on internal audits continue to exist in China. In addition, the study showed that Internal auditing needs to maintain independence and objectivity, while external auditing needs to ensure professionalism, independence and authenticity. To a certain extent, external audit relies on internal audit to save time and improve efficiency in order to improve audit quality in china. However, this dependence is based on the independence of the internal audit and the external audit and cannot be entirely dependent on the authenticity that will lead to the recurrence of similar Yin Guangxia incidents.

Keywords

Internal audit, external audit, audit quality, reliance, China

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1. Introduction

1.1 Background

The failure of corporate governance and scandals of large companies such as Enron and WorldCom in early 2000s in the United States and other countries (i.e. Yinguangxia in China) resulted in an increasingly paid attention by securities regulators in many countries to auditing and how to create an effective internal control system (Hu, Yuan, & Xiao, 2017; Xu, & Ziegenfuss, 2008).

Although the role of internal and external auditors differs, they share the same overall goal of serving the public by helping to ensure the highest level of regularity and propriety for the use of resources and promoting effective, efficient and economic management (Al-Twaijry, Brierley, & Gwilliam, 2003). Meanwhile, Internal audit was focused due to its core role in fraud detection and improving compliance to acts and laws (Xu, & Ziegenfuss, 2008). In more detail, it conducts internal supervision, checks the accounting books and relevant assets in accordance with acts and laws, and supervises the authenticity, legality and efficacy of financial statements (Chuanbing, 1997; Xu & Ziegenfuss, 2008). In addition, an effective internal audit function can be an extremely useful resource for audit committees, as well as management and external auditors, in effectively discharging their duties and attaining their governance mandate (Narayanaswamy, Raghunandan, & Rama, 2019). Therefore, in the debacle of WorldCom, the value added by Internal Audit to the financial reporting oversight process was indicated (Xu & Ziegenfuss, 2008).

In connection with that, in July 2002, as a response to these scandals and failure in auditing, USA congress passed the landmark Sarbanes-Oxley Act (SOX). Section 404 of SOX as one of the most important provisions (Li, Zhang, & Wang, 2014), required that in the public enterprises, management should assess the effectiveness of their internal control and financial reporting procedures in addition to provide auditors' reports on the effectiveness of internal control (Hu, Yuan, & Xiao, 2017). The section also stipulated that the effectiveness of Internal Audit should be assessed by External auditors regarding the correctness of financial reporting and publicly disclosing if any irregularities in the internal control audit report (Li, Zhang, & Wang, 2014). On the other hand, the increased presence of the Internal Audit Function pushes External Auditors to cooperate with Internal Auditors (Argento, Umans, Håkansson, & Johansson, 2018). This cooperation

between internal and external auditors is recommended by professional auditing standards (Ho and Hutchinson, 2010), for example, the Hong Kong standards on Auditing (HKSA) 610 (HKICPA 2005) indicated that the “external auditor should consider the activities of internal auditing and their effect, if any, on external audit procedures”.

Also, it was also stated by the International Standard of Auditing (ISA) 610 that in order to reach an evidence, the work of Internal Auditor can be used by the External Auditor. The instantly good performance of Internal Audit may generate opportunities for external auditors to rely on the Internal Auditors’ work (Desai, Desai, Libby, Srivastava, 2017) which results to less external audit work being performed (Al-Twaijry, Brierley, & Gwilliam, 2004) and hence lower external audit’ fees. Considering that reliance, the study of Ho and Hutchinson (2010) found that External Auditors of firms in Hong Kong rely on the functions of internal audit and that subsequently leads to lower fees. Lower external audit fees are associated with a larger internal audit department and certain activities carried out by the internal audit, since larger internal audit departments have likely more developed systems and more professional employees which enable them to perform the audit better (Ho & Hutchinson, 2010).

The necessity to implement this work arises from the need for more research on the degree of external audit’s reliance on the work of internal audit (Argento, Umans, Håkansson, & Johansson, 2018; Desai, Desai, Libby, & Srivastava, 2017), as well as, the rarity of exploring internal and external audits in China spurs the authors to conduct this research. Furthermore, this research uses the qualitative methodology to explore the reliance of external auditors on the work of the internal auditors, in order to deepen the authors’ understanding and generate knowledge.

1.2 Problematization

Independent auditing practices were only implemented in China in 1918 (Lin, 1998), however since the Mao revolution (1941–1967) auditing techniques have been halted and banned due to perceived incompatibility with the structured communist economy (Xia, 1992). That is because the Communism of Mao did not accept a free system and audit activities.

For 30 years after the establishment of the People's Republic of China in 1949, the country went through many major mass political movements caused to put it in isolation from the rest of the world, in particular capitalist countries (Yang, Xiao, & Pendlebury, 2008). Meanwhile, China obtained immense amounts of international capital in the later 1970s, when the Mao system was abandoned, shifted its focus to economic development, began market-oriented economic reforms and adopted an open-door policy in 1978 – in the context of joint projects or other direct or indirect expenditure (ibid). These changes revived the government auditing and independent auditing (social auditing in Chinese terms), which had been replaced by other monitoring mechanisms in the 1950s. The audit has been a crucial factor to complete this process of accountability and openness (Chong & Vinten, 2000; Graham, 1996).

The Chinese government restored accounting standards to address these demands and the first Certified Public Accountants (CPA) Company to be licensed in Shanghai in 1981 was accompanied by exponential growth in numbers throughout the country. By the end of 2017, the country had around 8,605 CPA companies and more than 300,000 orioles working as accountants. In China, one must pass the CICPA examinations in order to qualify as a CPA (CICPA, 2018). However, the exposure of financial fraud in the large companies in the United States and other countries (Guangxia in China), has caused the auditing role to be doubted by the public, regulators and academia, and has resulted in high attention being paid to the quality of audit. In 2001, an essay entitled "The Yin Guangxia Trap" was released, by Caijing magazine, which created a controversy in Chinese financial markets. The authors believed that the business had an unprecedented number, an unimaginable price and a product. In May 2002, in a written decision on Yin Guangxia administrative authorization the China Securities Regulatory Commission

(CSRC) decided that the firm had earned an excessive income of 77,156,700 yuan from 1998 to 2001. The firm also faked all records from the procurement of raw materials to manufacturing, purchases and exports, including purchase arrangements, invoices, bank bills, customs export statements and income tax exemption papers (Ling et al., 2001).

There have been some errors in this situation with regard to auditing, first of all, the auditors have not offset the deals with the companies during review of the consolidated financial statements (Ling et al. 2001). Moreover, the companies were not combined according to the portion of the equity arrangement, thereby unfairly increasing the sum of funds and profits (Ling et al., 2001). Secondly, the auditors have not successfully applied the validation process for receivables (Ling et al., 2001). Throughout the audit time, Mr Guangxia sent all validation letters to debtors, but did not allow them to give the referred letters to the Public Accounting Certification Office (CPA) directly, so letters were sent to the non-auditors Organization. For example, they did not notice or announce a decrease in Yin Guangxia's energy expense when its key business sales increased significantly in 2000, which was very unusual (Ling et al., 2001). In this scenario, the forensic audit argued that the external audit should have little connection to the full reports on the grounds of the concept of impartial audit and hence did not conclude that the company had falsified financial statements.

The case of Yin Guangxia was one of the largest audit controversies in China. This scenario also led to the development of China's internal examination system. Economic changes in China have dramatically transformed the economy and accounting over the last three decades (Chen & Chen, 2011). As a consequence of the introduction of the "open door" scheme in 1979, the central government paid considerable attention to audit results (CICPA, 2008). As a result, in July 1986, the State Council promulgated a new regulation dubbed the "The Regulation Concerning Certified Public Accountants of the People's Republic of China" The Law is intended to improve the supervision of CPA registration and accounting firms (Zhou, 1988). By the end of 2005, China's Internal Audit Association (CIIA) introduced the core rules, twenty criteria of Chinese internal audit and two recommendations for internal audit procedure, which became the fundamental framework of internal auditing in China (CIIA, 2005). With the growth of the capital sector, the Shenzhen Stock Exchange Statement stated that listed companies had to improve internal regulation by developing a strong internal management structure

in 2006 (Shenzhen SE, 2006). In March 2007, the China Internal Standards Committee released quality management guidelines, which claimed that improving internal audit oversight is an essential assurance of a reasonable and equitable organizational climate (Shin, Adolph & Liu, 2012). Internal assessment is an essential aspect of developing business governance to present. The forensic investigation of this essay applies to the examination by certified public accountants. China's Accredited Auditing Requirements for China's CPAs No. 1411 (2010) specifically note that external auditors will allow use of the outcomes of internal audits, such as how the nature of audits and audits is conducive to the production of external audit research.

It also suggests that internal audit research plays a very significant function in the execution of external audits by registered public accountants. The degree of utilization of external auditors in internal audit research directly influences the time, costs and efficacy of external audits, thereby influencing the efficiency of the audit. However, scandals such as Yin Guangsha trap have given rise to the notion of depending on internal audits for external auditing. This exploratory research aims to explore whether an external audit relies on an internal audit, and how this impacts the audit quality in audit firms in China. In fact, this country has used auditing for 2,500 years, however the internal and external audits have developed since the 1980's.

1.3 Purpose of Research

The reliance of external auditors on the internal auditors is studied in this research due to its impact in decreasing the external audit fees (Schneider, 2009). Audit quality plays a role in firm valuation and constraining earnings management in the world's largest transitional economy and emerging market. (Chen H., Chen J., Lobo G.J. & Wang Y., 2011). Hence, the purpose of this study is to explore how external audit relies on internal audit in Chinese audit firms, and how this reliance impacts the audit quality.

1.4 Research Questions

In recent decades, the method of auditing in the People's Republic of China has experienced several improvements. Although the National Audit Office (NAO) responsible for formulating government-owned and state-owned enterprises (SOEs) auditing strategies and Chinese Institute of Certified Public Accountants (CICPA) in charge of developing and publishing professional exams. However, audit guidance is considered autonomous. They need to obtain the approval of the minimum in general. The Government is solely liable for NAO and CICPA policies and operations. CICPA has so far accepted all the recommendations on the audit released by the International Accountants' Federation and the Ministry of Finance (MoF) accepted all such guidelines. The implementation of these international guidelines would lead to simplifying audit strategies and processing, particularly for primary and secondary auditors. The main auditors, typically outside Chinese territories, should have little to no trouble in subcontracting their audit duties to their Chinese colleagues, secondary auditors in China (CICPA, 2019).

Although the CICPA has been implemented for a decade, substantial progress has been made in optimizing audit procedures around the country in line with foreign strategies. It is noteworthy, as CICPA will optimize its restricted capital in designing, enforcing and training professionals how to execute effective auditing strategies around the country. However, the CICPA and the MoF have problems to address. Therefore, this research will try to answer the following questions:

1. To what extent the external audit relies on the internal audit in Chinese audit firms?
2. How the reliance of external audit on the internal audit improve the audit quality?

The remainder of this paper is structured as follows: the next part presents the theoretical framework which is the two theories guiding this study and is followed by literature review, methodology, analysis, result and conclusion.

2. Theoretical framework

2.1 Agency Theory

Following the global financial crises in the United States and Asia, increasing attention has been paid worldwide to corporate governance through the establishment of corporate governance guidelines, including internal and external monitoring mechanisms (Mustapha, 2011; Mihret, 2014).

It also argues that corporate governance mechanisms, such as monitoring mechanisms, are closely linked to agency theory. Agency theory assumes that individuals tend to make decisions that serve their interests with respect to corporations. As shareholders (principals) hire managers (agents) to maximize their utility, managers are suspected instead of seeking to maximise their personal utility instead (Colbert & Jahera Jr., 1988; Mihret, 2014). In addition, principal-agent conflicts arise between shareholders and managers (Maijoor, 2000). The nature of the relationship between shareholders and managers therefore represents the need for auditing, either internal or external, to provide feedback to shareholders through the Board of Directors on the behavior of managers (Colbert & Jahera Jr., 1988). Auditing can help to increase the level of confidence of intended users in the financial statements (ISA 200, 2009). Consequently, the two functions (i.e. internal and external audit) should co-exist to mitigate the agency problem that arises between principals and agents. As the External Auditors are hired by the client (principal), they are considered as an (agent) and suspected to act as opportunistically and seek to maximize their own interest instead of maximizing their client's utility.

The reliance of the external auditors on the work of internal auditors can also be prone to be an agency problem. Specifically, External auditors as they rely on the internal auditors' work, they could act in self-interest and use the work of internal audit, and falsely declare inappropriate information in purpose of pleasing the client or improve efficiency of the audit mission (Argento, Umans, Håkansson, & Johansson, 2018). The risk here is that the External auditors as an agent are not always acting in the best way as their clients think. Since the substantive objective of auditing is to identify and provide an opinion on the risks of material misstatement resulting from fraud or error at the level of the financial statements and assertions, through an understanding of the entity and its environment, including internal control of the entity. In the meantime, provide a basis for

the design and implementation of responses to assessed risks of material misstatement (ISA 315, 2009). As a result, on the basis of agency theory, management introduces internal control mechanisms and, principally, internal audits to show shareholders that management is acting in accordance with the policies and standards established by the Board of Directors, which ensures the management's commitment to take responsibility for maximizing the value of shareholders (Mihret, 2014).

At this stage, management expects internal auditors to conduct internal audit practices at a level that is consistent with the Professional Practice Framework (PPF) standards, and compliance with the PPF indicates that the Internal Audit Department is effective (Fadzil, Haron & Jantan, 2005). The International Professional Practices Framework (IPPF) is the conceptual framework that organizes the authoritative guidance issued by the IIA. A reliable, global guidance body, the IIA provides internationally recognized internal audit professionals with authoritative guidance organized by the IPPF as mandatory guidance and recommended guidance "(Institute of Internal Auditors, 2020). Furthermore, external auditors exist to provide information and to monitor the management activities of outside parties within the company. As a consequence of the results of Colbert and Jahera Jr (1988), the work of the external auditor is generally broader than that of the internal auditor, that is, the results of the external audit are to be used by the parties rather than the board of directors (i.e. bankers, investment analysts, bondholders and outside shareholders, as well as insiders).

External auditors should take into account that the report provided by them should be of benefit to the variety of users covered by the report (Colbert & Jahera Jr., 1988). ISAs required also to assess a number of agency conflicts in the assessment of audit risk (Hope, Langli, & Thomas, 2012). For example, in accordance with ISA 315, the auditor should identify and assess the risk of material misstatement by understanding the ownership and governance structures of the entity (ISA 315, para. 11). In the meantime, the auditor may also be an agent, whether he / she works for the management (internal auditor) or for the shareholders (external auditor), where the agency risks are when the auditor prefers compensation and neglects the effort to maximize his / her own benefit (Hope et al., 2012). In this case, the auditor is likely to provide the minimum amount of effort required to obtain reasonable assurance as to whether the 'financial statements as a whole are free from material misstatement, whether due to fraud or error' (ISA 200, 2009, para. 5).

2.2 Institutional Theory

In general, institutional theory identifies the processes by which social structures are established as reliable guidelines for social behavior, including schemas, rules, norms and routines (Scott, 2005).

In return, institutional theory suggests that the institutional environment is attributed to regulations and rules (procedures and practices) to which organizations must comply in order to obtain / increase legitimacy and survival prospects for organizations (Scott & Meyer, 1983; Meyer & Rowan, 1977; Endaya & Hanefah, 2013). In particular, institutional theory describes why a particular system is found and the role it plays and how it spreads. This theory includes a variety of approaches within; therefore, it is seen as an unstructured complex of ideas linked to each other. "rational choice" is one of these approaches, indicating that organizations are considered to be the rule system used to improve or protect the interests of individuals. Individuals can therefore accept regulations and restrictions if their objectives are more persuaded by institutional procedures (Scott, 2005). In addition, Meyer and Rowan (1977) argue that, in order to increase their legitimacy and their likelihood of survival regardless of the immediate effectiveness of the practices and procedures that have been acquired, organizations combine procedures and practices with institutional concepts of institutional work.

In addition, institutional theory provides a means of understanding the weaknesses of conforming and legitimizing processes that have led to the failure to establish internal audit departments. In line with that, the findings of Al-Twaijry et al. (2003) indicate that based on the institutional theory, that the compliance with rules and regulation in purpose of gaining legitimacy can also increase the effectiveness of the internal auditing. In the organizational environment, rules and regulations are an important factor for the existence of the organization, even if there is nothing that proves their continuity to be adhered efficiently (Meyer & Rowan, 1977). In such a case of uncertainty, as a response to institutional pressures and because organizations tend to organize themselves, they are benchmarking other companies in the same environment, and the best description of this process of homogenization is "isomorphism" which can be divided into two types: competitive and institutional (DiMaggio & Powell, 1983), the latter is what this paper

focuses on. In addition, individuals and organizations are affected by three key external forces: (1) laws and regulations (coercive isomorphism); (2) choices made by other organizations (mimetic isomorphism); and (3) consultations or professional bodies (normative isomorphism) "(Endaya & Hanefah, 2013; Arena & Azzone, 2007).

As a result, when it comes to setting up internal audit departments within organizations, coercive isomorphism encompasses those pressures that governments place on organizations to set up internal audit departments. These pressures can be represented as mechanisms of authority, legitimacy and the power to force organizations to set up internal audit departments that involve a greater review of the economy, efficiency and effectiveness of the activities of the organization and their impact on organizational performance. Mimetic isomorphism usually happens when organizations see that internal audit can contribute to the improvement of organizational control and operational performance that leads to the adoption of this mechanism. Aligned with Al-Twajry et al. (2003) which adopted the coercive isomorphic perspective to explore the internal auditing in Saudi Arabia, the study of Arena and Azzone (2006) finds that development of internal auditing was affected by the coercive, mimetic and normative pressures. As a result, Mihret et al. (2010) argue that the compliance of International Standards for the Professional Practice of Internal Auditing (ISPPPIA) is positively associated with organizational objectives' achievement, which could assess the internal auditing effectiveness.

Consequently, institutional theory is valid to create an effective internal audit. This is also based on the statement of Endaya and Hanefah (2013) "the institutional theory is a valid theory for internal audit effectiveness in both developed and developing countries. And it is a useful theory, which can explain the relationship between some variables of the study, and it is relevant to be embedded in the development of this research conceptual framework" (Endaya and Hanefah, 2013 P:32). As far as external audit is concerned, it provides a normative isomorphic pressure for the development of internal audits. Consistent with the fact that, as Merit et al. (2010) cited, Rittenberg and Covaleski (2001) examined the issue between internal and external audits, they argued that external audits and internal audits involve a willingness on the part of each profession (internal and

external audits) to redefine its role in internal audit activities. The authors demonstrated this concept with the American Institute of Certified Public Accountants (AICPA) view of Certified Public Audit companies providing internal audit services to their clients and the IIA's response by promoting the maintenance of the service internally. It proposes that the interest of external auditors to provide internal audit services should oblige internal audits to provide better services in order to maintain a separate professional status.

3. Literature Review

Chinese have been using auditing as a tool for more than 2,500 years to make absolutely sure of the precision and responsibility of all consumables and stocks belonging to the kings and emperors (Chong 1999). The audit strategy was comparatively complex for those two millennia (Chatfield, 1977; Shuo and Yam, 1987). The procedure emphasized a detailed audit on the financial documents of the Territorial Empire, the integrity of government officials in coping with government money and assets (Tang, Chow, & Cooper, 1992) and the authenticity of payments and transaction reports (Tai, & Yang, 1988). In the search for fraud, errors and irregularities the auditors were actively involved and reported the results directly to the emperors in return for favor and recompense. Criminals normally prosecuted and only those found guilty sentenced to death (Lu 1988, p.132).

The auditors, of course, were hand-picked and held high-profile and powerful positions by the Emperor, and the Emperor had the final say on auditing techniques. The responsibilities, authority and methods of the auditors differ significantly from dynasty to dynasty but the basic mechanism for the detection and investigating of fraud and discrepancies is auditing (Zhou, 1997). While Chong and Vinten (2000) encountered a number of auditing methodologies in the early 1990s, auditing plays a crucial role in China's transformation from the closing doors of the Communist Party to the open doors and market-oriented financial system (DeFond, Wong, & Li, 2000). This is attributed to the absence of appropriate auditing procedures for the execution and recording of audits. In the early 1990s, a vast number of industry and distribution chains around the nation existed under federal and local government regulation. In this administrative sense, the concentrate of the audit was on fulfilling the government's overall priorities and aspirations. The aim of the audit was to protect the interests of the State and resolve

various administrative needs of government authorities, particularly macroeconomic tax collections and market management (Chong, 1999;). The administration privatizing more state-owned corporations (SOEs) has dramatically raised the market for independent auditing services. The need for CPA has outstripped availability.

An individual or organization requires a mentor to work as CPA, typically a government agency or organization. In reality, the retirees and/or incumbents of the funding organizations were mostly the Chinese CPAs (H. L. Huang 1998; Lin 1998). The funding agreements to date are still compulsory, allowing the State to track the activities of CICPA and to guarantee audit standard efficiency (Yu & Tang, 1998). Companies must retain good financial and personnel ties with these sponsors and ensure that there is a steady supply of audit contracts (Y. M. Huang, 1998). Such cozy relationships have profoundly undermined integrity and credibility values (Lin 1998;) and even their own honesty, ethics and leadership. The MoF authorized the creation of the Chinese Institute of Registered Public Accountants in 1993, enabling the professional organization to publish and amend its audit guidance since 1999 (Lin & Chen, 2000) and to extend practice permits to individuals and companies to establish a constructive image of separation state and private operations.

Nonetheless, all such operations need the MoF's special permission. The decentralization of the ministry's operations seems promising and motivating, but a range of observers remain suspicious about the authority's unwillingness to let the private professional body grasp and to encourage market forces to succeed. Given the continuing demands from the public, especially the stakeholders and the requesters, for the CICPA to function as an autonomous entity, the progress towards its full autonomy remains sluggish and frustrating (Dai et al., 2000). In the early 1990s, audits became used among the general population as instruments for identifying and documenting fraud. This confusion was the same as in the earliest dynasties (Wang & Chen 1996). As economic reforms proceed, however, the number of SOEs has declined, whilst the numbers of private and international associated companies have increased dramatically. The audit has been described as an essential method to examine the underlying documents and risk management. The auditors are responsible for commenting on financial statements, honesty and justice. Meanwhile, customers and stakeholders tend to seek higher standards of impartial auditing, competence, transparency and legal responsibility (J. D. Liu, 1998).

Such disparities have widened the gap between auditees and auditors — particularly issues related to audit priorities, audit transparency and independence, and auditors' liability against third parties (Lin & Chen, 2004). This disparity compelled the CICPA and its leaders to embrace and adjust external strategies to concentrate investigations on risk-based methods, internal management enforcement and regulatory standards (Chong, 1999). It disrupts the conventional approach to the identification of fraud and tests all recorded transactions by 100 percent. Naturally, this move initially generated several unequivocal challenges and questions for both auditors and auditors. The continuing CICPA and MoF attempts to train auditors on the actual roles and duties of the audit appear to be encouraging.

3.1 Internal Audit

Internal Audit (IA) is as an internal corporate governance mechanism (García, Barbadillo, & Pérez, 2019) and an important part of the internal control system (Al-Twajry, Brierley, & Gwilliam, 2004), it functions to conduct supervision, examine the accounts and relevant assets, and supervise the authenticity, legality and the effectiveness of financial revenue and expenditure (Chuanbing, 1997; Wang, 1997). Consequently, internal audit has become an indispensable management tool for achieving effective control in both public and private organizations (Cohen & Sayag, 2010), since it is an independent, objective assurance and consulting activity designed to add value to and improve an organization's operations.

Additionally, it helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes (IIA, 1941). In the scientific community, it is known that an internal audit like the external audit is not a new invention. However, the origin of internal audit is arguable, some scholars think internal audit is fundamentally rooted to ancient Rome, Egypt and Greece, others believe it has arisen in ancient China in the period (1066-221 BC) (Chun, 1997). In China, according to Wang (1997) internal audit system has developed after the re-establishment of the new China's auditing system in 1983, thereafter in 1987 the Chinese Internal Auditing Society was established, then in the same year it was accepted to join the International Institute of Internal Auditors, since then the Chinese internal audit has evolved rapidly. Internal audit is an activity process that integrates enterprise internal control, corporate governance and risk management as

a whole. In essence, it is the performance of the integration of internal control and governance. Internal audit plays an important role in promoting the integration of the two. On the one hand, the evaluation control with high efficiency and good results continuously improves the internal control, and then keeps the organization to achieve the goal of more effective control.

It promotes the healthy development of risk management and quality control systems by identifying and correcting important risk factors. On the other hand, the proposed comprehensive evaluation system and the governance procedures to improve the organizational functions, have made certain contributions to corporate governance. Internal auditors assist organizations in implementing and improving compliance, governance and risk management-related processes and controls within an organization (IIA, 2004). In sum, according to Al-Twajry, Brierley and Gwilliam (2003), having an internal audit department has two main benefits for the company. The first is emerged from the conventional auditing of financial system and control which mainly focuses on the detection and the prevention of asymmetries, whether they arise from fraud or errors and protect the organization's assets. The second is performance auditing which is related to the economy, the efficacy of different sides of the company, this kind of benefit aims primarily to boost the general economy, efficiency and the effectiveness of the company by improving its operational performance.

Risk management refers to the process in which the company identifies and analyzes various risks in the process of enterprise operation in order to achieve the goal and manages and controls the identified risks. Risk specialists, internal auditors and management accountants, who also increasingly aspire to a greater role in risk management. Companies faced with various risks from the internal and external aspects of the company (Arena M., Arnaboldi M. & Azzone G., 2010). With the constant change of the external environment, the uncertainty of the enterprise's business activities increases. The enterprise not only needs to manage the specific risks separately from the micro or departmental perspective, but also needs to establish the overall comprehensive risk management from the macro perspective. The internal audit should not only evaluate the risk management of functional departments, but also supervise and evaluate the overall risk management of the enterprise from the perspective of the overall situation of the company, and make Suggestions to the company's executives and the board of

directors on the risk management side to help achieve the business objectives (Wu J., 2014). Internal audit input entails the required human and material resources for the internal audit department to perform efficiently, whereas, the process is to make effective utilization of the input to perform the actual task of auditing functions. The output is the result of the process in the way of reporting and recommendation to the management, while the outcome is how this output is, in impacting useful contribution in improving an organization internally operational performance toward achieving its objectives (Gurama Z. & Mansor M., 2018). Generally, the operating department of a company will pay more attention to the risk itself but fail to identify the overall risk of the whole company (Wu J., 2014). In other words, internal audit is not directly involved in specific business management, so it can objectively identify potential risks which were not found by other departments.

3.2 External Audit

On the contrary of the internal audit, which is part of the organization, External Audit (EA) is totally separate from the organization, however, external audit is engaged by the organization since it works to provide an independent opinion regarding the annual financial statements (Endaya, 2014). Aligned with that, an external auditor performs an audit, in accordance with specific laws or rules, of the financial statements of a company, government entity, other legal entity, or organization, and is independent of the entity being audited (IIA, 2010). The reconstruction of Certified Public Accountants (CPA) in China has been rapidly developing since the 1980s.

Along with the social recognition of audit activities, auditing services include not just for the listed company, but also state-owned enterprises and other private enterprises (CICPA, 2016). The Ministry of Finance claimed that state-owned enterprises must get the annual accounting statements reviewed by CPA in 1998 (CICPA, 1998). For instance, when the government makes regulatory decisions of the listed company, the government needs information in order for comprehensive consideration, including financial statements provided by CPAs after reasonable evaluation (ibid). Many scholars have analyzed the advantages and necessity of external audit. Wang and Zhou (2006) state that external audit can improve enterprise's performance and control the capital occupation of shareholders, which empirically tests the good corporate governance effect of high-quality external audit. Liu (2010) states about the necessity of external audit. The

research's object was the listed companies that published and then revised the announcement after the third quarter report in Shanghai and Shenzhen stock markets in 2010. Through the research, it is found that the external audit plays an important role in improving the quality of performance disclosure of listed companies, and it is concluded that the external audit is the gatekeeper of financial accounting information disclosure. Furthermore, external audit, to some extent, can provide information to managers with useful decision-making information. The reason is that audit opinions can correctly classify and judge the indexes such as earnings per share and return on equity to a certain extent (Cao, 2013). The role of the external auditors reflects the increasing focus on corporate governance and internal control from companies and regulators. The external auditor has a controlling function in relation to the internal control system, including the internal audit (Holm & Laursen, 2007).

3.2 The Reliance of External Audit on Internal Audit and Audit Quality

The increasing growth of internal audits over the years has led the external audit to rely on internal audit work in the conduct of external audits (Schneider, 2009). The Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5 (AS5) approved external auditors to rely on the internal audit function when internal audit activities meet specific criteria. External auditors would be more effective when relying on the internal audit's work (PCAOB, 2007). However, Xu (2005) argues that the relationship between internal audit and external audit can be divided into four types: cost-benefit relationship, no relationship, partnership relationship and information sharing. He found the information sharing relationship to be the most effective.

Zhuang & Wang (2007) believed that the external audit function should be supported by an effective internal control system. For example, if the company's chairman and general manager have separate responsibilities, the execution of an independent audit is more effective, and the work of the internal audit department can facilitate external audit firms. Cai, (2009) studied the influence of internal audit quality on audit pricing and earnings management on the basis of data from the manufacturing companies listed in China's 2005-2008 share market. He found that the quality of the internal audit was negatively correlated with positive, but not statistically significant, earnings, and that the quality of the internal audit was negatively correlated with unexpected audit costs. As a

result, to invest this dependence, firms have sought ways to reduce external audit fees by replacing external audit work with internal audit work. In line with this, Kaplan and Schultz (2006) as cited in Schneider (2009) stated that the findings of the 2005 survey of 117 Chief Internal Audit Executives indicated that 88% of the external auditors of their firms relied to some degree on the work of the internal auditors.

Furthermore, the participation of internal audits in the external audit process is perceived to be important by both internal and external auditors (Smith, Drake, & Shaub, 2010). The findings of the Al-Twaijry, Brierley and Gwilliam (2004) study show that the external auditor's dependence on the work of the internal auditor varies depending on the perceived quality of the internal audit department. In addition, a study by Ho and Hutchinson (2010) on non-financial sector companies listed on the Hong Kong Stock Exchange was conducted to provide preliminary support for the notion that the internal audit function helps to reduce external audit effort and fees. Consecutively, the dependence of external audits on internal audits in Chinese audit firms can reduce external audit fees subsequently. There are several advantages to relying on external audits for internal audits, rather than avoiding unnecessary duplication of audit actions, which can also be beneficial for external auditors, since internal auditors generally have more knowledge.

Schneider (2009) stated that external auditors could rely on the internal audit function as part of the company's overall system of internal audits. However, the external auditors can rely on the internal audit work already done on the internal auditing of internal audits or the auditing of accounts or trans-audits. In addition, based on the empirical studies conducted by Al-Twaijry et al. (2004), the dependence of the external audit on the internal audit was influenced by a number of factors (i.e. objectivity, competence and work experience). The coordination of the efforts associated with the completion of the audit of the financial statements is guided by internal and external auditing standards. It has the potential to increase the effectiveness of the contribution of the internal auditors to the audit of the financial statements and to increase the overall efficiency of the audit by reducing the duplication of the audit effort. However, Gramling and Maletta (2001) show that the level of coordination between internal and external auditors has a positive impact on the level of dependency on internal audits.

3.2.1 The Reliance of External Audit on Internal Audit Impacts on The Audit Quality

Recent studies have shown that effective cooperation between internal and external audits can result in a number of advantages, not only for internal and external audits, but also for the client for whom they work, such as improving efficiency without loss of effectiveness (Endaya, 2014). However, cooperation and reliance on internal audit by external audit means, in particular, the sharing of knowledge and better service for the client company (ibid), the elimination of duplication of audit work (Argento et al., 2018; Hay et al., 2008) and less external audit fees (Argento et al., 2018; Hay et al., 2008; García, Barbadillo, & Pérez, 2019). Specifically, eliminating duplication of audit work gives external auditors the opportunity and availability to carry out further work that could result in better service and audit quality (Endaya, 2014). Furthermore, the reduction may result in a reduced audit risk assessment that has a negative impact on the quality of the audit (Schneider, 2009). However, close cooperation between them may negatively affect the quality of external audits, such as the perception that external audits are not professional and independent (Argento et al., 2018).

In addition, since internal and external audits are corporate governance mechanisms, cooperation between them can boost corporate governance. Corporate governance parties help to maintain the effectiveness of corporate governance (Endaya, 2014). Consistently, there is a multifaceted coordination between internal and external audits. By which, as well. In addition, according to Simunic (1980) as cited in Hay et al. (2008), the central concept of auditing is that improved internal management limits the requirement for foreign auditors to conduct rigorous audit research. In addition, a number of recent internal control researchers have concluded that improved internal monitoring would require reduced external audit work (Hay et al., 2008). The decrease in external audit costs may be the result of a reduced audit risk assessment associated with the commitment of the internal audit to the internal control system (Schneider 2009). On the basis of the literature reported, the scholars addressed different aspects of the variables affecting the effectiveness of the audit. Audit accuracy is at the heart of the role of the International Auditing and Assurance Standards Board (IAASB) as a regional benchmark for auditing. Previous studies have generally indicated that internal audits and external audits should be replaced by one another in such a way that stronger compliance oversight is correlated with lower audit fees, for example (Hay, Knechel, & Ling, 2008). Although

there is no general agreement between scholars on the impact of trust between auditors on external audit fees, Schneider (2009) agrees that coordination between internal and external auditors increases the effectiveness of audits and reduces audit fees. As cited in Endaya (2014), Wallace (1984) noted that the reliance on internal audit led to a 10 % reduction in audit fees. Ho and Hutchinson (2010) suggest that lower external audit costs are substantially linked to the larger internal audit department and to the internal audit activities carried out in the areas of financial reporting, the nature of growth and implementation, operational performance and effectiveness, and fraud investigations. Similarly, a reduced external audit rate is unlikely to be achieved if the external auditor is highly dependent on the performance of the internal auditor (Al-Twajjry, Brierley & Gwilliam, 2004). García, Barbadillo and Pérez (2019) argue that the partnership between internal and external audits is substantially related to audit fees. Furthermore, as the partnership between the internal audit and the external audit may be complementary or substitutive (Hay, Knechel, & Ling, 2008; García, Barbadillo, & Pérez, 2019).

3.2.2 Auditor Size and Audit Quality

The size of the audit firm has been identified as the most important factor affecting audit quality. However, DeAngelo (1981) suggests that the efficiency of the audit can be determined by the size of the business. Scale alone changes the expectations of auditors in such a way that, *ceteris paribus*, bigger audit companies offer better audit results (DeAngelo, 1981). The accounting companies are classified between the top ten and the non-top ten (Nichols & Smith, 1983; Simunic, 1984). The study has demonstrated that the earnings control condition indicates that the audit rating of the top ten companies is better. Francis (2004) used evidence to perform analysis and discovered that the higher the scale of the accounting firm, the lower the percentage of audit litigation would be. As a consequence of this trend, the audit efficiency of accounting firms is positively associated with their size. Ho, Li S. (1998) examined the association between the size of accounting firms and the efficiency of audits by relating to listed companies in China as a research topic and observed that the proportion of changed audit opinion provided by large firms is higher than that of small firms. The auditors confirm that the financial statements reflect the company's operating reports and circumstances equally in all relevant ways, suggesting that the financial statements are accurate. Liu H and C.P. &

Zhang (2018) focused on analysis of the efficiency of the audit of big companies is greater than that of small firms.

3.2.3 Audit Tenure and Audit Quality

Audit duration and standard audit Long-term audit obligations are seen as a significant challenge to the preservation of auditor independence, and so regulators have developed compulsory rotation guidelines in several countries around the world. Blandón and Bosch (2013) suggested that the longer the auditors audit the same business, the more probable the auditors are to develop a private partnership with the firm, and to focus on the client economically, which directly affects the auditor's independence and objectivity in auditing. This eventually influenced the efficiency of the audit, Li and DeAngelo (1981) based on theoretical analysis, observed that the effect of the expansion of the accounting firm's contract on the integrity of the audit does not explicitly increase or reduce the quality of the audit. However, it is observed that the more the auditor remains in position, the more probable the auditor is to modify the audit opinion (Li S. and Wu X., 2003).

3.2.4 Customer Importance and Audit Quality

There appears to be an increasing frequency of conflict between client management and the audit firm. M.C. (1985), Li and Chen (2004) stated that the greater the importance of the audit client, the greater the room for auditors to allow the management to manipulate the surplus, and therefore the lower the quality of the audit. Ni (2008) carried out a research on data from A-share listed companies in China in 2005 has shown that the importance of audit clients has a greater impact on the improvement of audit quality before it exceeds a certain amount. If this amount is exceeded, the negative impact of the importance of the customer on the quality of the audit will increase significantly. In addition, the relationship between audit quality and the importance of the customer is inverted into a u-shape. Ni (2008), suggested that without an audit committee, the relationship would have improved considerably. However, he indicates that, if the company does not have an audit committee, the importance of the customer has a significant impact on the quality of the audit.

3.2.5 Corporate Governance and Audit Quality

Corporate governance is defined as the system by how the organizations are directed or managed (Cadbury, 1992 cited in Shah & Napier, 2014). Also, audit quality is defined as “the probability that the auditor will both detect and report a breach in the contract to provide fair accounting information” (Soliman & Elsalam, 2013).

However, prior researches asserted that corporate governance is positively associated with the quality of the audit (Bett & Olouch, 2017). On one hand, good governance increases public confidence in addition to enhanced audit activities and significantly raises the standard of audit quality (ibid). On the other hand, the poor corporate governance often decreases the quality of financial reporting and causes changes in and overstating the profits and fraud in financial statements (Salehi, Moradi, & Paiydarmanesh, 2017). Therefore, the organizations have always been striving to improve their financial reporting via methods such as corporate governance. The main role of auditing is to reduce the information asymmetry from the financial statements as well as the residual loss resulting from managers’ opportunism in financial reporting, hence, the high quality of auditing is needed to produce beneficial effects as a monitoring device (Soliman & Elsalam, 2013). The previous study concluded several corporate governance key elements associated with audit quality namely: board independence; Chief Executive Officer (CEO) duality, audit committees as well as the size of the audit firm.

Regarding the independence of the board, Hay, Knechel and Ling (2008) state that, from the responsibility of the independent directors is strengthening the internal control, securing external investment and protecting their reputation they employ more funds to obtain higher audit quality that serves their duties. Accordingly, the board independence is positively associated with audit quality. The duality of CEO means that the roles of (CEO) and the Chairman of the board are merged together. Typically, such boards are perceived ineffective, due to the conflicts of interests which may arise (Soliman & Elsalam, 2013). Consequently, the duality of CEO is negatively associated with audit quality. Furthermore, “The audit committee is responsible for recommending the selection of an external auditor, ensuring the soundness and quality of internal accounting and control practices, and monitoring the external auditor’s independence from senior

management” (Soliman & Elsalam, 2013). In line with that, the audit committees deal with complex methods of corporate governance to ensure that the shareholders are receiving high quality financial reporting and to protect their rights (Salehi et al., 2017), therefore, the composition of audit committee is significantly associated with audit quality (Ogoun & Perelayefa, 2020). Additionally, a number of past researches addressed that the size of the audit firm has a significant relationship with the quality of audit. In other terms, bigger audit firms are better than smaller ones at detecting errors because they have greater resources and can attract employees with professional skills and experiences (Soliman & Elsalam, 2013).

3.3 Professional Standards and Regulations

Professional standards have become handy in shaping how external audits rely on the internal audit function (IAF). While the Institute of Internal Auditors (IIA) standards provides internal auditors with the guidelines to follow in the conduct of their audit (Breger, Edmonds & Ortegren), the Internal Standard on Auditing (ISA) 610 (2013, revised) mandates, guides and addresses the responsibilities of external auditors when relying on IAF, (Reiner Quick & Philipp Henrizi, 2018). According to the Chartered Institute of Auditors (2020), the two functions are complementary functions within the assurance framework, and both are essential for the effective governance of an organization.

As a result, ISA 610 (2013) allows for collaboration between the external auditor and internal auditor either by the external auditors relying on the direct assistance of the internal audit or using their work as audit evidence (Argento, et al., 2018). However, external auditors must be wary of the work of internal auditors as the quality of their may impact on the overall audit quality (Glover et al. 2008). Al-Twajjry, Brierley and Gwilliam’s,(2004) study in the Saudi Arabian context reveal the extent of external audit reliance on internal audit. According to the study, reliance on IAF varies with the quality of internal audit department – competence, objectivity, experience, and adherence to Generally Acceptable Audit Practices (GAAPs) are critical factors for reliance. Ideally,

internal auditing ought to bring a logical, disciplined approach to assess and enhance the effectiveness of control, risk management and governance processes (IIA, 2005). Unfortunately, prior studies (e.g. Bailey, 2011) suggest that internal auditors seldom comply with the IIA standards. In Saudi Arabia for instance, many companies lacked professionalism and independence from management, a situation which impacts on the reliance by external auditors (Al-Twajjry, et, al., 2004). ISA 200 (2009) therefore stipulates that external auditors should consider the implications for audit quality before making the final decision to rely on internal audit.

3.4 Summary

In this section, the authors follow Chinese audit history; this nation is rich in audit knowledge and used it over 2,500 years as a tool to verify the precision and responsibility of all consumables and stocks belonging to the kings and emperors. In China, both internal and external audits have been developed since the 1980's. As part of the control system, Internal Audit is an internal corporate governance mechanism, it functions to conduct supervision, examine the accounts and relevant assets, and supervise the authenticity, legality and the effectiveness of financial revenue and expenditure. Through this systematic disciplinary approach, it helps an organization to achieve their objectives in evaluating and improving the efficiency of risk management, control and governance processes.

External Audit is the gatekeeper of financial accounting information disclosure, and consistent with Internal Audit, it performs an audit in accordance with specific laws or rules of the financial statements of an organization, government entity, other legal entity, and is independent of the entity being audited. Moreover, with so doing, external audit can improve enterprise's performance and control the capital occupation of shareholders, which empirically tests the good corporate governance effect of high-quality external audit. The reliance on the internal audit's work can contribute to improve the external audit's effectiveness hence, the performance. Specifically, this is because the internal audit has generally more knowledge about the internal situation of the organization which

facilitates the external auditor's work and prevents the duplication of the audit work. Although, the reliance on the internal audit can reduce the audit efforts exerted by external auditors, it also decreases their audit fees which may affect the audit quality negatively.

However, there are several factors affecting audit quality namely: (audit firm's size, audit tenure, customer's importance and corporate governance). Along with that, previous studies found that the audit efficiency of an audit firm is positively associated with the size of that firm, in which bigger firms obtain better audit results. Differently, long tenure is not significantly associated with audit quality; long tenures of dealing with the same customer leads to developing private relationships with the audit firm, as well as relying on the customer economically, which affects the auditor's independence and objectivity. Similarly, the importance of the audit customer is negatively associated with audit quality. In this regard, prior researches assert that, the more important the audit customer is, the more space is available for auditors to allow management to manipulate the surplus, and consequently, the lower the quality of the audit. In relation with corporate governance, Audit Quality is positively influenced by board independence, audit committee and the size of the audit firm. And negatively with CEO duality.

In particular, Audit Quality is positively influenced with the independence of directors in the board. As they are responsible for strengthening the internal control, securing external investment and protecting their reputation, they tend to invest more funds to achieve higher quality audit. Additionally, Audit Quality is positively influenced by the composition of audit committees, since the audit committees work to ensure the quality financial reporting is high to protect shareholders' rights. Furthermore, the bigger size of the audit firm has a positive relationship with Audit Quality, as the larger audit firms have more professional resources as well as they attract skilled and professional employees, these firms can provide a high-quality audit. Conversely, the Audit Quality is negatively influenced by the CEO duality, since the conflicts arisen between the CEO and Chairman roles reduces the effectiveness of the board, hence, the audit quality (see Figure 1).

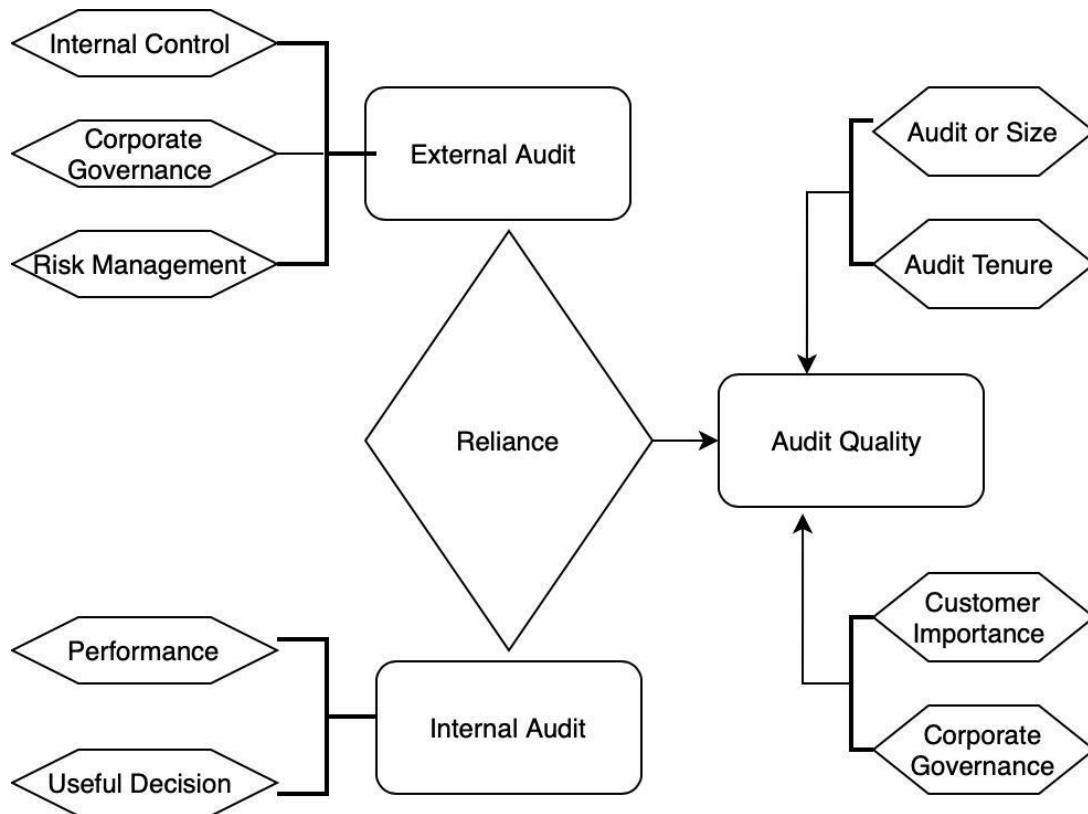


Figure 1: the factors that affect the audit quality

4. Empirical Methodology

Methodology refers to how the research should be conducted (Saunders, Lewis, & Thornhill, 2009), hence, it is a major part of any research by which can accomplish the practical side of the study aiming to provide the required data and analyze it to reach results, the results will be explained to achieve the study objectives. The methodology adopted in this research is qualitative, as this type of research is characterized by its richness and fullness (Saunders et al, 2009) and aims to examine the way people feel towards their own touchable real-life experiences in their minds and in their own words (Cropley, 2015). Qualitative research is also consistent with the philosophy adopted by this study namely: interpretivism. Qualitative approach is consistent with the abductive research approach in this paper, which uses interpretation and reformulation of individual phenomena to discover new things i.e. variables, relationships (Dubois & Gadde, 2002; van Hoek, Aronsson, Kovács, & Spens, 2005) which opens the door to adopt the case

study as a suitable strategy. Consequently, strategy used in this research is case study; it is designed to answer questions about experience, meaning and perspective, most often from the participants' perspectives (Hammarberg, 2016). On that basis, and as a predominant data collection tool in qualitative studies as well as exploratory purposes (Saunders et al, 2009), semi-structured interviews are used as the data collection tool in this study. The advantage of semi-structured interviews is that it seeks to gather in-depth and detailed data from feelings, opinions, perceptions and experiences of people (Denscombe, 2009; Saunders et al, 2009; Argento et al., 2018). Moreover, it allows the respondents to develop and further explain their priorities, opinions and ideas (Denscombe, 2016).

4.1 Research Philosophy

In order to accomplish the exploratory purpose of this study, this research should be built on the research philosophy of ontology and epistemology. It is therefore important to understand these philosophies because the research philosophy adopted by the researcher has significant assumptions about how the researcher sees the world, and therefore these assumptions form the research strategy and the methods chosen as part of that strategy (Saunders, Lewis, & Thornhill, 2009). The fundamental reason behind this is that the researcher's goals, objectives and philosophic premises are inextricably related to the work being done (Mack, 2010).

Bahari (2010), however, stressed the value of research philosophy as though the researcher had not been willing to learn about the philosophical issues of study, which may have a significant effect on the standard of science. Ontology and epistemology form the basic philosophy (Metaphysics) concerned with describing the ultimate nature of things as they are (Rawnsley, 1998). Ontology has been very closely linked to metaphysics as if they were synonyms, an explanation of ontology always requires a reference to metaphysics (Rawnsley, 1998). Ontology aims to explore the nature of reality (Saunders et al., 2009, p. 110; Holden & Lynch, 2004, p. 5), which raises the assumptions of researchers as to how the world operates (Saunders et al., 2009, p. 110), and is also a claim related to the nature and structure of existence (Rawnsley, 1998). Ontological philosophy is made up of two key aspects: objectivism and subjectivism. The former is commonly accepted as quantitative studies, assuming that social entities exist in reality

but are independent of social factors and perceptions (Saunders et al., 2009; Bahari, 2010). Objectivism assumes that there is only one version of reality, and to find it, the researcher needs to measure and observe the world independently (Ryan, 2018), which helps the researcher to understand the world precisely and avoid bias.

The latter is usually adopted by qualitative studies, assuming that social phenomena arise from perceptions and actions of social actors (Saunders et al., 2009). Subjectivism considers multiple perspectives of reality, that reality is an individual's own perceptions, experiences and feelings (Ryan, 2018). Consistent with this, subjectivism is preferred in this study to objectivism. Epistemology is a belief in how to know the world (Ryan, 2018) and concerns what forms of acceptable knowledge and the nature of this knowledge in the field of study (Saunders et al., 2009), that is, "How is it possible, if it is possible, for us to gain knowledge of the world? (Holden & Lynch, 2004, p. 3). In other words, epistemology is a philosophic branch that studies the nature of knowledge and what constitutes acceptable knowledge in the field of study and what is considered acceptable knowledge. The issue of epistemology in the social sciences can be shown as whether the procedures and principles used to study the natural sciences are valid for the study of the social sciences. The answer to this question indicates that the knowledge developed from the research process has been accepted.

The epistemological assumption can therefore be considered to be related to the nature of knowledge and the means by which that knowledge can be acquired (Bahari, 2010). Epistemology consists mainly of two paradigm philosophies: positivism and interpretivism, each of which can be adopted by qualitative research (Lin, 1998). The former paradigm assumes that there are social facts with objective reality apart from the individual's beliefs. As far as scientific research is concerned, the positivist approach seeks knowledge based on systematic observation and experimentation, in order to discover social laws similar to those revealed by natural science methods (Roth & Mehta, 2002), thus working to prove or disprove hypotheses and theories. According to this approach, the researcher must be independent of the research and should use objective methods (Bahari, 2010; Ryan, 2018). The latter paradigm refers to how we, as humans, are trying to make sense of the world around us. The aim of this paradigm is to understand the fundamental meanings of organizational life (Saunders et al., 2009). It argues that the researcher should be aware of the differences between humans as social actors, which

justifies the reason why research is conducted between people instead of objects (Saunders et al., 2009). The interpretivist approach assumes that truth and knowledge are subjective, depending on people's experience and understanding (Ryan, 2018). For scientific research, the researcher cannot be independent of his own values and beliefs, which, in turn, have an impact on the collection, interpretation and analysis of data (Ryan, 2018). Interpretivism is adopted in this research on positivism because it seeks to understand the meaning of general concepts and to explain what people think or do (Lin, 1998).

4.2 Research Strategy

Research strategy can be defined as the way the researcher follows in order to answer the research question (Saunders et al. 2009). As the study approach used in this paper is qualitative, although both qualitative and quantitative methods may be used appropriately with any research approach (Saunders et al. 2009), the dominant approach philosophy in qualitative studies is interpretivism (Goldkuhl, 2012). Hence, this study uses the interpretivism research philosophy, and it aims to explore the reliance of the external auditor on the internal auditors' work based on the internal and external auditors' opinions, experiences and perceptions. The case study is a research strategy which focuses on understanding the dynamics existing within a single situation, and it can be a single or multiple cases and levels of analysis.

Further, case studies are typically used in qualitative as well as quantitative studies and use several methods to collect data - i.e. archives, interviews, questionnaires, and observations (Eisenhardt, 1989). Case study strategy is therefore used in this research, this is also aligned with the purpose of this study, since this strategy is suitable for exploratory purposes (Yin, (1981); Saunders et al., 2009). On the other hand, the adoption of interpretivism in the research philosophy spurs the need for a case study which uses interviews, as it focuses on the interpretations of people's own experiences, perceptions and feelings. From the purpose of this research (to explore how external audit relies on internal audit in Chinese audit firms, and how this reliance impacts the audit quality), case studies are conducted to explore in detail "a program, an event, an activity, a process of one or more individuals" (Campbell, 2014). As this study adopts the qualitative

research methodology, this is also consistent with the case study strategy (Eisenhardt, 1989).

4.3 Data Collection

Considering the exploratory purpose of this research, namely, “to explore how external audit relies on internal audit in Chinese audit firms, and how this reliance impacts the audit quality,” it implies that the qualitative research was preferable in this study, as this type of research provides the necessary in-depth and exploratory tools to achieve a clear sight of the process to answer questions related to “why” or “how” a certain phenomenon may take place (Symon & Cassel, 1998 as cited in Srivastava & Thomson, 2009), qualitative studies usually use in-depth interviews, observations or focus groups (Saunders et al, 2009; Yilmaz, 2013). Moreover, this qualitative study is seeking to collect in-depth data based on the perspective of various internal and external auditors in China. The instrument used for gathering data is semi-structured interview, which is also common in qualitative studies (Saunders et al., 2009).

The semi-structured interview consisted of 14 open ended questions as well as yes/no questions that were modified to require more elaboration, each question or several questions were seeking answers linked to one or more keywords used in this study (i.e. reliance, internal audit, external audit and audit quality). In the beginning of the preparation of the interview, face-to-face interviews were considered as the best way, however, due to the pandemic in 2020, it was unable to achieve it. As a result, chatting interviews in text and by call were used. As a response to the participants' demand, the questions were sent to them earlier the interviews, thereafter, the interviews were conducted textually also based on the demand of the participants. Later, interviews were conducted in the way that allows the interviewer to add or change on the questions based on the conversation flow in order to spur the participant to talk about things other than these included in the questions, this way is commonly known as semi-structured interview (Saunders et al., 2009).

4.4 Operationalism

There are 14 open-up interview questions in total. The interview starts with asking the interviewees to introduce themselves about their job positions, education background and other personal information, so that the interviewer can better understand the interviewees' information, such as whether they are internal auditors or external auditors, working years and so on. From the second question to the fourth question were focusing on external auditors, they are mainly asked about their understanding of external audit work. The questions are respectively about the responsibility of external audit, how many enterprises they serve and the trust with customers and employees. Then coming to the fifth and sixth questions, these are for internal auditors, which are about responsibility, objectivity and competence of internal audit.

Afterwards, from seventh question to eleventh question, they are designed to the main theme of this research, which is how external audit relies on internal audit in China. In the interview, each auditor was asked whether there is cooperation between internal audit and external audit, and what are the advantages and disadvantages of such cooperation. When there is disagreement between internal audit and external audit, will external audit opinions be the guide? In actual work time, has external auditors ever depended on the internal auditor, and how to guarantee independence of external audit. The next question is how to describe audit quality, which is the key element of audit work. In the end of the interview, the famous scandal in China which is called "Ying Guangxia trap" was mentioned, and interviewees are asked about their solution to avoid this kind of mistake.

4.5 Snowball Sampling

Snowball sampling is a nonprobability sampling technique where existing study subjects recruit future subjects from among their acquaintances. (Goodman, 1961) Thus the sample group is growing like a rolling snowball. Snowball sampling takes a number of people with the desired characteristics as the initial respondents, then relies on them to provide qualified respondents they know, and then these people provide a third batch of respondents, and so on, the sample snowballs from small to large. Snowball sampling is

mostly used in situations where there is insufficient information on population units or in observational studies. In snowball sampling, a group of respondents is first selected, usually randomly. After these respondents are interviewed, they are asked to provide some other respondents belonging to the overall target of the study. According to the clues provided, the subsequent respondents are selected. The process continues, creating a snowball effect. The advantage of this method is that it is convenient to find the respondents in a targeted way, rather than looking for a needle in a haystack. Its limitation is that the sample units must have a certain relationship and are willing to maintain and provide such a relationship, otherwise, the conduct and effect of this survey method will be affected. The sample can be controlled according to some sample characteristics, which can be used to find some rare people in the population.

During the time of this study, because of the coronavirus, most companies are struggling to survive, it is not simple for the authors of this study to find auditors who is willing to accept the interview, so once an auditor is willing to accept the interview, the authors will ask whether there is another auditor such as colleagues and friends who are willing to accept interview in order to expand sampling data.

4.6 Conduct of Interviews

The interviewees of this study are professional external and internal auditors working in China with different levels of experience and from 7 audit firms. They were initially informed that it is acceptable to refuse answering any question, as well as their consent was approved that all the information provided by them will be used for only the purpose of this study, additionally, their names will be anonymous. In order to gather data about both situations of internal and external auditors, 9 semi-structured interviews were conducted during the period May 13-21, 2020 with 7 external auditors and 2 internal auditors whose experiences ranged between 1-17 years. All the interviews lasted between 30-50 minutes and were conducted in Chinese language since it is the native language of the interviewees as well as one of the authors of this paper and subsequently were translated to English by the author. Furthermore, instead of face-to-face interviews, which could be a convenient choice, interviews were implemented textually through a chatting

application called (WeChat), based on the desire of the interviewees, arguing they don't feel comfortable with cameras. Despite that, textual interviews are also beneficial as it could urge the interviewees to type what they feel sure about as well as it allows them to think freely, since it gives them the time to think before sending the answer of the question.

Authors of this paper are aware that physical meetings are the most appropriate for such a qualitative study, since they allow the researcher to capture facial expressions and non-verbal language that could be helpful to translate the respondents' feelings in data analysis (Argento, Umans, Håkansson, & Johansson, 2018). Nevertheless, this is not possible in the current time due to; first, the geographical restrictions and time, and second, interference of the global pandemic disease COVID-19 that banned all kinds of traveling around the world. Additionally, it was also suggested by authors to implement the interviews face-to-face by one of "video communicating application" (i.e. Zoom), however, this was not the best choice for the interviewees for the same reason mentioned above. The interviews included, **14** questions were asked ranging from (introducing the interviewees themselves, their roles and responsibilities, the cooperation between the internal and external auditors, reliance on internal audit, audit tenure, audit quality, suggestions). Additionally, for the questions used in the interviews, authors were inspired by the scientific article: Argento et al. (2018).

This paper presents the respondents' names with the codes (RA-RI) to ensure anonymity. Table 1 presents the respondents' coded names, their positions, date of interviews and time. The first interviewee is an external auditor working in the Audit Bureau in Jinzhou which is a city in the north of China. Through the interview with him, the authors of this research learned a lot about the audit policy currently being implemented by the Chinese government. Respondent B is an external auditor working for 10 years. Respondent C is a senior auditor who has worked as an auditor for more than 17 years. After the interview with respondent C, according to snowball sampling, respondents C provided two colleges who were respondent D and respondent E. Respondent F, respondent G and respondent H are three external auditors from different accounting firms. The last respondent is an internal auditor who is working in Beijing.

The author has tried to interview more internal auditors, but currently only large companies in China have internal auditors working, and due to the epidemic, internal auditors are very busy, so it is difficult to find other internal auditors for interviews.

RESPONDENTS	POSITION	EXPERIENCE	DATE	INTERVIEW TIME
RA	External auditor	1 year	13/5	50 min
RB	External auditor	10 years	14/5	30 min
RC	External auditor	17 years	14/5	30 min
RD	External auditor	3 years	14/5	30 min
RE	External auditor	5 years	15/5	40 min
RF	External auditor	5 years	15/5	30 min
RG	Internal auditor	8 years	15/5	30 min
RH	External auditor	3 years	19/5	40 min
RI	Internal auditor	1 year	21/5	50 min

Table 1: the codes and information of the interviewees

4.7 Research Approach

Research approach is made up for three major approaches deductive, inductive or abductive (van Hoek et al., 2005). However, for some studies it can be a combination of deductive and inductive approaches, however, this is arguable since some scholars see it is closer to an inductive than a deductive approach (Dubois & Gadde, 2002).

Deductive approach presumes developing a theory and hypothesis and designing the research strategy to test this hypothesis (Saunders, et al., 2009). Specifically, it supposes developing a hypothesis from an existing theory and making them testable in the real world (Dubois & Gadde, 2002; van Hoek et al., 2005). This can be done through several sequential stages; (concluding a hypothesis, expressing it, testing it, examining the specific outcome and modifying theory based on findings) (Saunders, et al., 2009). In all that, the researcher should be independent of what is being researched (Saunders, et al., 2009). On the other hand, the inductive approach assumes to collect data then analyze it to build a theory in the result of data analysis (Saunders, et al., 2009; Dubois & Gadde, 2002). Specifically, this process consists of several steps as Ryan (2018) states that, the inductive approach “starts with observation, experiment and measurement, and generalization and finding patterns in data; theory is then developed to describe the situation”.

In this approach, researcher’s confidence is a significant factor that needs to be achieved, to do that, the researcher is likely to make repeated measures in order to feel confident with results that describe the situation (ibid). In this way, the inductive approach provides an easily used and structured set of procedures for analyzing qualitative data that possibly results in reliable and valid findings (Thomas, 2006). The combination between deductive and inductive approaches is increasing, however, this is considered as a dilemma among researchers, as it is related to theory testing or building within the context of a specific study, this called them to enact the abductive approach (Awuzie & McDermott, 2017). The abductive approach assumes exploring a group of facts permitted in order to propose a theory (Dubois & Gadde, 1999). Moreover, it is concerned with

generating new concepts and models instead of verifying existing theories as in deductive approach (Dubois & Gadde, 1999). Additionally, this approach works through interpreting or reformulating individual phenomena within a contextual framework, aiming to understand something in a new way, from the perspective of a new conceptual framework (van Hoek et al., 2005). Finally, this study adopts the abductive approach since it is useful if the researcher's aim is to discover new things, for instance other variables and other relationships (Dubois & Gadde, 2002).

4.8 Sources

The literature used in this study was selected from previous scientific articles as well as e-books that are related in the area of reliance of external audit on internal audit. In order to find relevant articles, the authors searched websites such as the online library of Kristianstad University (Summon) and "Google Scholar". In most cases, the former was used to gain access to the paid literature since it provides access to paid literature for the students freely. Also, Google Scholar was used to check the number of citations of the literature as it is one of criteria the authors followed when selecting the scientific literature. Furthermore, keywords used to find that literature were (i.e. internal audit, external audit, reliance of external audit on internal audit and audit quality in China). In this way the authors were able to catch up important parts to make up the literature review part of this study.

4.9 Ethical Considerations

Over the past decade, ethics of the research practice have been concerning dramatically (Saunders, Lewis, & Thornhill, 2009). Furthermore, in a qualitative study, ethical considerations have a particular resonance due to the in-depth nature of the study process (Siti, 2018). Researchers conducting qualitative research are expected to adhere to ethical principles in all stages of conducting the research starting from research design, data collection and analysis, and the construction and use of research results (Saunders, Lewis, & Thornhill, 2009). The concern of ethical issues becomes more salient when conducting face-to-face interviews with vulnerable groups of participants. They could become stressed while expressing their opinions during interviews. The process should consist of

the following: consent should be given freely, subjects should understand what is being asked of them, and involved persons must be competent constantly (ibid). The anonymity and confidentiality of the participants as preserved by not revealing their names and reporting of the study findings. Privacy and confidentiality of the interview environment were managed carefully during communication, interview session, data analysis and dissemination of findings. Before the interviews, first ask the person whether he is willing to be involved in this paper as respondent, explain the topic and purpose of this thesis to them, and provide them the main interview outline but not the whole interview questions. Due to the epidemic, face to face interviews cannot be used, then ask respondents whether they can make a video connection (i.e, Zoom), some of the respondents didn't want to take up too much rest time then refused, and some respondents are not familiar with camera on. As a result, text chat interviews are used. During the interview, respondents were told that all the interviews are anonymous, their answers will only be used as a reference for this paper.

5. Findings

The 14 open-up questions can be divided into 5 parts, which are internal audit, external audit, audit quality, the relation of external audit on internal audit and respondents' advice. According to the interviews with 9 respondents, the following chapter summarizes the findings of those interviews.

5.1 Internal Audit

First of all, when asked about the definition of internal audit, the highest frequency answer was independence, 5 of 9 respondents, for example,

RF : "An internal audit is an independent, objective validation and consulting activity designed to add value and improve the organization's operations...The internal audit must have full-time audit staff, must not be staff of other business departments concurrently. Internal audit should check, monitor, analyze and evaluate the economic work of the enterprise as an independent third party".

RB : "Internal audit is an independent department with higher authority than the audited department, internal audit is relatively objective".

RH: "It is not easy to be fully fair and independent when conducting internal audits due to the obvious reasons such as limited scope and unconscious bias".

RI: "If we must say 'dependence', there is an 'internal control audit' procedure in the external audit really needs to examine the internal control of the company, to determine whether the internal control of the company is effective, and then continue to determine whether it will have an impact on the company's statement level."

While there are 3 respondents mentioned the keyword "efficiency". For instance,

RA: "Internal audit improves efficiency and accuracy of audit in general...Information provided by internal audit can improve the efficiency of audit process."

RB: "(IA) can understand the enterprise situation faster, help to improve the efficiency."

RD: "More and more companies will set up internal audit departments, which is of great help to improve the efficiency of IA".

In addition, there are 3 respondents mentioning the keyword "impartially".

RF: "In the process of analyzing, judging, reviewing, and verifying various audit services, it is necessary to seek truth from facts based on objective facts and not to make subjective assumptions or distort the facts ... In terms of the essential characteristics of internal audit, the first requirement is that audit staff must work from a fair and impartial starting point, otherwise it is difficult to gain trust. The objectivity of internal audit is the basis of the authority of internal audit".

RD: "Internal auditors shall conduct internal audit activities based on the facts and in a spirit of impartiality".

RB: "IA is an independent department with higher authority than the audited department, IA is relatively impartial".

The other two keywords are "supervision" and "professionalism". For example,

RC: "Internal audit can observe at any time and pay constant attention to whether the objectives of the project can be achieved, whether the project runs effectively as planned, and learn from the failure of the project."

RB: "IA is helpful to strengthen the internal management and control system of the company, to protect the safety and integrity of assets, in order to inspect, supervise and evaluate the performance of the business".

RC: "Through the IA work, auditors provide solutions combined with their own professional knowledge, identify the problem and put forward reasonable suggestions".

5.2 External Audit

After the question about internal audit, the next part is external audit, when the respondents answered their own definition of external audit, all the respondents mentioned the same keyword, which was legitimacy. For example,

RA: "My responsibility is to ensure that the national fund policy can be fully implemented into the project, to avoid any misuse or loss during procedure".

RC: "(EA is to) analyze the annual financial statements of the company to see whether the bookkeeping meets a criterion to the accounting standards, and tax returns comply with the provisions of the tax law or other local administrative regulations".

RE: "Audit work must be rigorous in accordance with the law, adhere to the principles, keep objective and fair, strictly abide by the code of audit matters, responsible to the audit committee and the auditee".

RI: "The PRC (People's Republic of China) certified Public Accountant Auditing Standards require me to abide by the PRC code of ethics for CPA, plan and perform the audit to obtain reasonable assurance as to whether there are material misstatements in the financial statements."

Among the 9 respondents, there are 3 respondents mentioned the keyword "professionalism" as well.

RF: “For some professional audit projects, EA can refer to the professional knowledge to improve the professionalism of audit work”.

RH: “Using and before the field work and work paper preparation stage, we will be trained so that everyone on the engagement is competent in terms of professional judgement and field knowledge”.

RI: “What the client needs is professional audit service.”

Other key words related to external audit are communication, and independence. For instance,

RD: “for EA, it is still necessary to look at what IA provides with an objective perspective and make independent judgement instead of giving any letter”.

RG: “Good communication with customers will lead to more mutual trust”.

5.3 Audit Quality

The next part is the definition of audit quality, answers to this question have been collected in a variety of ways, including results of audit, supervision, considerations, and discussions.

RA: “Audit quality is the quality of audit results, it is significantly associated with social stability”.

RE: “Audit work is a kind of economic supervision activity, economic supervision is its basic function.”

RH: “High quality of audit involves many factors, before assigning the specific team to the engagement, the national office will send out prospective checks and independence checks, each of us need to review those information and report to the national office if we are related to the client. For each work paper, staff or seniors director needs to review one more time, the partner will do the final review. The high quality of the audit process involves a significant amount of considerations, discussions, assessments from different people from different levels.”

5.4 Reliance of External Audit on Internal Audit

After the respondents gave their definitions of internal audit, external audit and audit quality, the most critical question came: the reliance of external audit on internal audit. First, 7 respondents agreed with the existence of such dependence phenomenon, while 2 disagreed. One of the opponents said that the results of internal audit work would only be used by internal auditors. The other opponent said he had no contact with companies that had internal auditors during his career. After all, only large listed companies have internal auditors in China. In this case, he did not believe in such reliance. Respondents who agreed with this reliance responded to the next question about the benefits of this dependency with keywords saving time, efficiency, and professionalism. There are 5 respondents agreed with time saving, for instance,

RA: "the advantage of reliance is time saving and efforts."

RE: "it (reliance) speeds up the efficiency of external audit, greatly reduces the time of external audit and the workload of data collection and evidence collection".

RC: "it is convenient and timely to get the information, which improves the efficiency".

RH: "Effective IA can save time and play a role for EA".

There is one respondent answered with "professionalism", which is from RF, " through the contraction, the first thing is to have a professional language, which is the basis to be more powerful, and persuasive.

On the contrary, 7 respondents indicated that such dependence affects the independence of audit. For example,

RA: "the disadvantage is independence and objectivity cannot be maintained naturally".

RB: "(With reliance) is not guaranteed to keep independence."

RE: "EA cannot completely rely on IA, but to grasp the degree of dependence, EA has their own judgement and bottom line, keeping in mind that IA is one the reference value, not a decision role".

Some interviewees also mentioned objectivity. 2 of the respondents answered with the keyword “objectivity”.

RE: “if EA relies too much on IA, which will affect the EA objectively. The audit is easy to enter the inherent mode and be led, which will have a certain impact on the rigor of the audit.”

RF: “excessive reliance on the results of IA will affect the impartiality and objectivity of EA”.

5.5 Future Suggestions

Finally, as respondents and auditors, they were asked to suggest ways to avoid major audit errors such as the Yin-Guangxia Trap. The answers ranged from improving industry management to stiffening penalties.

RA: “To avoid such scandals, first we need to strengthen the control, relate rules and strengthen supervision. Second, we need to increase penalties, whether for years or fines.”

“There is still a long way to go in China,” said by respondent F, “how to establish the internal audit department and whether it is necessary to establish the internal audit department is still under discussion.” Respondent I indicated that, “external and internal audit, although nominally one tends to the outside and the other to the inside, are actually inseparable.”

6. Analysis

Following the scandals, Yin Guangxia gave rise to the notion of reliance on external internal audits. The issue of external-internal audit relations in China is becoming a serious topic in modern accounting. This exploratory research focused on whether an external audit based on an internal audit, what its benefits and drawbacks are, and how to improve audit results among audit firms in China in these circumstances. In the qualitative research, several analysis methods can be used to analyze data, for instance,

phenomenology, hermeneutics, grounded theory, ethnography, phylogeographic and content analysis (Burnard,1995). In contrast to qualitative research methods, qualitative content analysis is not linked to any particular science, and there are fewer rules to follow (Bengtsson, 2016). In this section, several keywords in interviews were caught by the authors. In the process of analysis, content analysis reduces the volume of text collected, identifies and groups categories together and seeks some understanding of it (Bengtsson, 2016).

Open-ended, written questions cannot provide the same depth that interviews provide, as the researcher has the opportunity to deepen the discussion with the informants (Bengtsson, 2016). In this study, there are six respondents as external auditors from accounting firms, two respondents as internal auditors, and one respondent is an external auditor from the Audit Bureau of Jinzhou city. When performing a qualitative content analysis, the investigator must consider the data collected from a neutral perspective and consider their objectivity (Bengtsson, 2016). In this study, the interview is the way of data collection. With 9 interviews in total, the chapter will follow the structure of the dramaturgy that could be identified through the analysis of the findings. In the following section, interviews are analyzed. The definition of internal audit, external audit and audit quality are firstly analyzed, and effect of reliance is analyzed secondly. At last, future suggestions about reliance are also analyzed.

6.1 Definition of Internal Audit, External Audit and Audit Quality.

6.1.1 Internal Audit

Internal audit has been described in different ways by respondents. However, the majority of respondents, there are 5 of the 9 respondents mentioned “independence”. The IIA definition positions internal audits as “independent, objective assurance and consulting activity designed to add value and improve an organization’s operations”. This definition highlights the importance of internal auditing. Within the internal audit function, competence and independence are important and distinct constructs that must interact to result in quality outcomes (Holm et al., 2007). Scientific and effective establishment of internal audit institutions is the guarantee for internal audit to play its role. (Shen, 2019) What kind of position the IA department determines the balance among business

departments and other functional departments, ultimately determines the degree of independence of internal audit work (Shen, 2019). The function of IA is to supervise and evaluate economic activities to ensure that the company can play a constructive role in internal protection, evaluation, restriction and advice in the process of increasing economic effect, improving efficiency and achieving organizational goals.

The core idea of IA is not only to be good at identifying and summarizing problems, but also to be good at solving problems, at same time, actively proposing to the decision-making level and management to improve audit results. Nowadays, in China, IA is gradually tending to the direction of service management, from a single supervisory function to a comprehensive supervision (Yi, 2016). It requires auditors to be familiar with operation situations in order to analyze and evaluate in various aspects, not only finding problems in operation, but also assisting the management authorities to improve efficiency. Therefore, internal audits inevitably involve the independence of internal audit. Furthermore, respondent G thought internal auditing is especially important for a company's operation with the premise of “the internal audit maintains a relative independence, otherwise it is difficult to give play to its original intention”. In addition, respondent D described his role and responsibilities from an idea that the external audit should be responsible to both the clients and the public, to be fair and legal, which is in consistent with nature of moral and professional responsibilities of the addition as published by Felix et al. (2001).

He stated that the auditing must guarantees the exactness and comprehensiveness of the financial statement of the client; whether the financial statements of the company have been compiled in conformity with the relevant accounting framework; and if the client is equally responsible for his performance and financial status. However, respondent I as IA gave his answer shows that whether it is necessary to set up IA in private firms in China is still under discussion. If IA cannot effectively help the company to make decisions, it will lose its significance. Internal auditors in a key role related to corporate governance. (Holm et al., 2007) Related to corporate governance, there are 3 respondents defined internal audit with the keyword “efficiency”. *Modern companies need to strengthen IA which can promote the management of prosperity, which is the development of enterprises to expand navigation.* Meanwhile, respondent B answered the same question with adherence to the regularities, he said that his role and responsibility is to

“undertake the entrusted business in accordance with the requirements of the independent audit standards, issue audit reports and issue audit opinions”. This opinion in the same line with Mock (1981), he asserted that the role and responsibilities of an auditor in enterprise is to understand the internal controls necessary for the audit in order to formulate audit procedures acceptable under the circumstances but not to offer an opinion on the efficacy of the internal controls (or group's) of the organization.

Another answer mentioned this keyword was by respondent G, “the internal audit work can be used to more accurately and effectively understand the company's operational risks”. The internal audit function assists management in improving internal controls over operations, reporting, and compliance. (Chang et al., 2018) Therefore, as a future suggestion, respondent I suggested that, “(using internal audit) to put forward opinions and suggestions to the management on improving management and improving efficiency”. Furthermore, there are 3 respondents who indicated “impartiality” regarding internal auditing. Attribute Standard 1120 relates to individual objectivity and requires internal auditors to “have an impartial, unbiased attitude and avoid any conflict of interest” (Stewart & Subramaniam, 2010). In order to confirm the impartiality, respondent F indicated as well that, “the information provided by the internal audit will be used for some basic work results, and the information that may affect the objectivity of the audit will not be used directly”. According to the National Audit Office of People's Republic of China, part of the companies in China internal auditors are attached in the financial or other departments, who not even with full-time IA person, this situation is unable to guarantee the impartiality and authority of the IA work.

Auditors' independence and objectivity are the cornerstones of the profession. Independence is the basic requirement of auditing. Without independence, objectivity, impartiality and authority, audit would become a dead letter. There are some other answers regarding the definition of internal audit, which mentioned keywords such as “supervision” and “profession”. According to Wang (2009), she called the IA in China is “supervised leading IA”, she believes that the reason is requirements of national laws and regulations. From the very beginning of new China, IA has been regarded as the foundation of government audit, which adopted the management system of “administrative mode”. The management system of administrative mode leads to the “supervision orientation” of China's IA. The economic supervision function is

particularly prominent in the target orientation, which lays stress on the inspection of mistakes, prevention of defects and the protection of assets. In practice, it focuses on the authenticity and legitimacy of economic activities, but not the entire operation and management activities.

Meanwhile, Lenz, Sarens and D'Silva (2014) state that strategically positioning the internal audit closer to the supervisory board to help the internal audit's performance and effectiveness, must be worthy of consideration. In addition, respondent E asserted that "internal audit is an important part of the audit supervision system. Internal audit is helpful to restrain and supervise the serious loss and waste, embezzlement, cheating and other behaviors, and can improve the internal operation standard and improve the work quality of the enterprise". However, referring to respondent A who is a civil servant working in the Auditing Bureau, the majority of internal audits in the government are conducted by auditing groups sent by the Auditing Bureau. This means that some of them are doing internal audit and external audit concurrently. Respondent A explained that,

"Audit departments will be set up for government agencies in the future, but at present majority of them rely on audit teams sent by the Auditing Bureau ... The government now carries out whole-process auditing, and it is also stipulated that leading officials must conduct an audit every few years, with an irregular cycle".

After checking the official website of China Internal Audit, there is a document named "No. 2309 Specific Internal Audit Criteria - outsourcing management of internal audit business", which clearly stipulates that organizations and enterprises can outsource part or all of their internal audit business to intermediaries. In a nutshell, this kind of outsourcing has the possibility of causing agency problems.

6.1.2 External Audit

Legitimacy is a crucial concern for the institutional field of auditing, given its reliance on perceived legitimacy for its political mandate and license to practice, in addition to its wider credibility and trust amongst stakeholders such as clients, investors and the public. (Whittle, Carter & Mueller, 2014) All of the respondents mentioned the keyword "legitimacy". Legitimacy is a master concept for institutional theory; it has been defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within socially constructed systems of norms, values, beliefs and

definitions” (Whittle et al., 2014). EA is only responsible of the law and the society, not to companies. Along with the market economic system established in China since 1979, administrative constraints, the weakening of the central government to local will gradually happen, however, China’s national conditions and history says that, the central government power weakening inevitably endangering the stability of the country and economic prosperity. (Haung, 2012) In mature market economy countries, the central government not only uses financial economic levers to strengthen the control of local government, but also supervises directly and effectively to local government administrative control.

Other keywords that respondents mentioned about external audit were “profession, communication and independence”. For example, respondent I asserted that “what the client needs is professional audit service”. Respondent E explained about his role according to the audit plan, be responsible for the audit evidence collection, preparation of audit report, responsible for auditing data archives, collecting, and sorting rules work, meanwhile do a good job of subsequent supervision and tracking audit on the auditees situation changes back to work. In addition, respondent H stated that they would be trained so that everyone on the engagement is competent in terms of professional judgement and field knowledge.

6.1.3 Audit Quality

Related to audit quality, first of all, respondent I identified audit quality as “essentially the result of audit work and the realization of audit objectives ... It is a comprehensive embodiment of the objectivity, reliability, accuracy, comprehensiveness, sufficiency, importance, consistency, and timeliness of the audit”. Meanwhile, respondent E claimed that audit quality is the basis of supervision. The quality of the audit is important and the most essential to ensure the accuracy of the financial statement examination and supervision. (Sitepu, Wahyudi & Saftiana, 2020) Furthermore, respondent I stated that communication is important for audit quality as well, “timely communication with internal audit personnel will promote the development of audit work and improve the quality of audit work”. In addition, respondent H summarized that the high quality of the audit process involves a significant amount of considerations, discussions, assessments from different people from different levels. External auditing is a useful mechanism of both corporate governance and external supervision. (Yang, 2014)

6.2 Effect of Reliance

From the interviews, the existence of reliance was affirmed by 7 respondents. For example, respondent E said that, “I think during the actual audit process, there will be some external audit relying on internal audit”. Depending on the assessment of external auditors on the quality of the internal audit function, professional standards permit the contribution of internal auditors to external audit work. (Mohamed, Zain, Subramaniam, & Yusoff, 2012) However, there are 2 different voices. One corollary of this answer is that internal audit is only working for the company itself. According to this interview, there are still a few Chinese companies not setting up internal audit departments, especially small and medium enterprises. Therefore, there are external auditors who have not contacted the internal audit, and they believe that there is no reliance. When respondents were asked about the advantages of such reliance, five of them mentioned time saving. The reliance of external auditors on internal auditors can save their time. This opinion is the same as Abbott, Parker and Peters (2012), professional standards guide external auditors to consider the effect of the client's internal audit work and opportunities to utilize the direct assistance of the internal audit function when planning and conducting audits. In this way, efficiency is another keyword that three respondents mentioned which is the result of time saving. Respondent B said that, “(Corporation with IA) EA can understand the enterprise situation faster, learn from each other to improve the efficiency”. In addition, appropriate reliance by external audit on internal audit can also achieve significant efficiencies including: managing myriad stakeholders; communicating planned objectives; ensuring timely audits are conducted; and avoiding duplication (Pilcher, Gilchrist, Singh & Singh, 2013).

This reliance also allows the external auditors a quicker understanding of the situation of the business and helps to benefit from each other's experiences. The last keyword described by respondents was profession. On the other hand, among interviews the disadvantage of reliance was discussed as well. The answers show that independence is the most important factor, and 7 respondents agreed with this opinion. Another disadvantage is objectivity. The evaluation of the objectivity, competence and quality of the IAs was an important aspect in determining how the cooperation could work. (Argento et al., 2018). According to No. 1411 of Independent Auditing Standards for Chinese CPAs (2019), there are only 6 situations that EA can directly use information provided by IA which are when testing the effectiveness of internal control operation, involving

limited judgements about substantive procedures, supervising inventory, tracking transaction processing in financial reporting information motion system (walk-through test), testing compliance with laws and regulations and auditing or reviewing of subsidiary financial information what is an insignificant part of the group.

6.3 Suggestions

The Yin-Guangxia Trap is that external audit relies too much on internal audit and fully believes in the information provided by the internal audit, which leads to major audit mistakes. The interviewees as auditors as well also have their own answers for how to avoid such mistakes. Respondent G who is currently working in a World 500 company claims that in order to avoid such major mistakes, the audit world should be based on the auditor's professional ethics. It is impossible for a normal person not to notice such a significant anomaly. The domestic enforcement environment is also limited. As a socialist country, China is different from capitalist countries in many places. For auditing, although ancient China had many years of experience, it was built on a serious and rigid background, and dogmatism prevailed. The New China has only a few decades of audit experience, how to improve the level of audit within the institutional system is very important. (Fang, 2004) Respondent A indicated that the government has been urging the internal audit to be carried out. During the interview, we found that although the existence of internal audit is obviously necessary in theory, most enterprises do not realize it and do not want to set up an additional department for internal audit. Whether small and medium enterprises need to set up internal audit systems is still controversial.

As often as not, the government needs to strengthen formal control, publicize its obligation to improve the rule of standards and law, and strive to improve the level of informal control. Control is more important than punishment. The external audit needs the support of internal audit, and the effectiveness of the internal audit should be considered to judge the credibility of the financial statements. (Wu, 2014) The work project of internal audit is also inseparable from the thinking and methodology of external audit to discover the internal problems of the enterprise and finally rectify the problems. Respondent I summarized that, "internal audit and external audit are complementary to each other, promote each other."

7. Conclusion

The purpose of this study is to explore how the reliance of external audit on internal audit in China and how this reliance influences audit quality. This chapter summarizes the research results and conclusions of this paper, and finally looks forward to the future research based on the existing shortcomings of this paper. The internal audit and external control have a direct coordination relationship, and the internal audit needs to review and evaluate the organization's business activities, internal control and risk management. The internal audit function (IAF) assists management in improving internal controls over operations, reporting, and compliance (Chang, Chen, Cheng, & Chi, 2019).

The improvement of the internal control level and the construction of the internal control system provide a reliable working basis for the internal audit. External auditors do audit work based on the internal audit, on the one hand can draw on the internal audit of internal control review and evaluation results, on the other hand, the organization of internal control activities have been through the internal audit review, high effectiveness, in this case it is easier to issue standard internal control audit opinion. The competence and objectivity of the internal audit function are the key factors that external auditors should assess in their audit planning procedures (Chang et al., 2019). Based on the empirical knowledge, this paper proposes the significance of studying the reliance of external audit on internal audit and the influence of this reliance on audit quality. Based on the analysis and summary of relevant theories and existing studies, this paper proposes two research questions and conducts relevant research through nine interviews.

First of all, the internal audit work whether can play an effective role is the key to the independence of the internal audit, enterprise in internal ministry of supervision, set up internal audit function or department nature of work and content should be considered, and make sure the company's assets are true and complete, through the internal audit work independently to achieve the purpose of reduce risk and improve earnings. According to the interviews, at present, small and medium-sized companies rarely have set up internal audit department, only large companies and government departments in China set up internal audit, this is because, first the cost of internal audit, second is shortage of professional internal audit staff and there are internal audit outsourcing in China this kind of legal form (CICPA, 2019). The qualitative analysis proved that the reliance of external audit on internal audit is existing in China. The paper has also touched the role and

responsibility of the internal audit and suggests that it improves the legitimacy and the role of the internal audit, which could in turn related with audit quality. Internal audit needs to maintain independence and objectivity, while external audit needs to ensure professionalism, independence and authenticity. External audit to some extent, relies on internal audit to save time and improve efficiency so as to improve audit quality. However, this reliance is based on the independence of the internal audit and the external audit, and cannot be completely dependent, which cannot guarantee the authenticity, which will lead to the recurrence of similar Yin Guangxia incidents.

7.1 Limitations

The data selected is limited and cannot cover the whole country. This article collected only 9 auditors from 7 different units, rather than a comprehensive analysis of all units in China. Considering the actual pressure of data collection, due to the limited writing time of this article and the fact that various companies are busy with their business in China, which has resumed work after a few months' shut down due to the epidemic, the authors of this article were declined by some companies when asking for an interview.

7.2 Future Research

The future research development direction first is to expand the number of samples. As the situation of resuming work becomes more and more stable in China, the interview data can be used as samples for analysis in the future empirical research. Testing with a large sample to see if we can get the same results. So far, China's IA is still developing, more and more companies are encouraged by the government to set up IA departments. With the increase of IA departments, the problem is how internal audit and external audit work together. The conclusion of the interview investigation in this paper is that EA relies on IA, but the influence of this reliance on the audit quality cannot be determined. After reviewing and literature review, we know that few Chinese enterprises have IA, and most of them adopt the form of IA outsourcing, which can both save cost and play the IA role. However, the disadvantages of this outsourcing are also obvious. Firstly, the relevant legal mechanism is not distinct, and there are still disputes in this aspect in China. The existing laws do not limit the audit subject. Secondly, there is a lack of coordination between the enterprise and IA outsourcing, and there could be information asymmetry between the two sides. Although outsourcing of IA ensures professionalism, there is a

lack of supervision by the internal staff of the enterprise, and the audit quality cannot be guaranteed to be perfunctory. In addition, outsourcing of IA could reduce the density of trade secrets. Therefore, the future research direction can be about the necessity of IA outsourcing.

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Appendix:

Interview guide

Interview guide

1. Please introduce yourself. (profession/place of work/work experience/education background, etc.)

2. How would you describe your role and responsibilities as an external auditor?

3. How many client companies do you cooperate with now? And how was this cooperation initiated?

4. Do you think the communication with clients will affect the sense of trust in the audit process? If yes/no, please elaborate.

Does a separate audit fee make the firm financially dependent on the client?

5. What is your opinion of the internal audit activity?

6. How do you evaluate the objectivity and competence of internal audit?

7. Do the internal auditors perform any work under your guidance as external auditor?

8. How do you use the information provided by the internal audit during the audit process? Are there any guidelines or regulations on how to use the information provided by internal audit?

9. Do you think external audit relies on internal audit in the audit process? What are the pros and cons of this dependency?

10. How long is your average audit tenure with one company? What do you think the advantages and disadvantages of a longer tenure, such as more than 5 years?

11. What do you think are the positive/negative effects of cooperation with internal auditors in the audit process entails?

12. How do you describe audit quality?

13. Have you ever heard of the “Yin Guangxia trap”? What is your advice to avoid such mistake?

14. Do you have any supplement or suggestion on the topic of external audit relying on internal audit?