

## Auditing Practice Challenges and Obstacles in 21st Century: The Palestinian Experience

تحديات ممارسة التدقيق وعقباته في القرن الواحد والعشرون: التجربة الفلسطينية

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### Abstract

### ملخص

This study aimed to show the need of local financial language that was born to meet new challenges in auditing practice and look at obstacles that still at the Palestinian community level a subject of modern discussion.

Using the descriptive analytical approach the study shows that the auditing profession practitioners in Palestine are able to experience the accounting diversity phenomenon, reassessing audit strategy should be confirmed by the fully understand of daily business activities, good communication with clients, and the application of ISA's in Palestine is marred by several obstacles. The study recommends that companies have to study carefully the accounting diversity in the local environment and strengthen the overall analysis and review related transactions, and issue local standards for auditing or adopt in principle international standards and apply them compulsively in all companies.

**Keywords** : Auditing Practice, Challenges, Obstacles, 21st Century, ISA, Palestinian Experience.

هدفت هذه الدراسة إلى إظهار الحاجة للغة المالية المحلية التي وُلدت لمواجهة التحديات الجديدة في ممارسة التدقيق والنظر في العقبات التي لا تزال على مستوى المجتمع الفلسطيني موضوع نقاش حديث. باستخدام المنهج الوصفي التحليلي، خُصت الدراسة إلى أن ممارسي مهنة التدقيق في فلسطين قادرون على تجربة ظاهرة التنوع المحاسبي، ويجب تأكيد إعادة تقييم استراتيجيات التدقيق من خلال الفهم الكامل لأنشطة الأعمال اليومية، كما أن التواصل الجيد مع العملاء يخلق علاقات أقوى بين المراجع والعمليل، وأن تطبيق معايير التدقيق الدولية في فلسطين يشوبه عدة عقبات. أوصت الدراسة الشركات لدراسة التنوع المحاسبي بعناية في البيئة المحلية وتعزيز التحليل الشامل ومراجعة المعاملات ذات الصلة، وإصدار المعايير المحلية للتدقيق أو اعتماد المعايير الدولية المبدئية وتطبيقها بشكل إلزامي في جميع الشركات.

**الكلمات المفتاحية:** ممارسة التدقيق، عقبات، قرن واحد وعشرون، معايير التدقيق الدولية، تجربة فلسطينية.

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## **1. INTRODUCTION**

Audit plays an important role as an external corporate governance mechanism, and the governance effect of audit is directly in audit quality. The overall objectives of audit are to obtain reasonable assurance that there is no material misstatement caused by fraud or error in financial statements, and to issue audit reports in accordance with auditing standards and communicate with client management (Tusheng, Chunxiao, & Chun, 2020). The quality of the audit process, and thus the financial statements, is dependent upon the nature of the interactions and relationship between auditors and management who create the financial statements (Arel, Brody, & Pany, 2005).

The accounting and auditing profession has been growing over the past four decades, which is generally well-documented (Eaton, 2016), and today we noted a lot of new daily business transactional that require from the auditor implementing further procedures in his work. This study employs three sources of data to consider the challenges and obstacles of auditing from the point of view in Palestine, which are Accounting diversity and reassessing audit strategy, Communication with client and implementing International Auditing Standards in Palestine.

## **2. Accounting Diversity and reassessing audit strategy**

### **2.1 Accounting Diversity**

Auditing has always been perceived as an integral part of the capital markets (Ibrahim & Badawy, 2018). Regulatory bodies such as Board of Auditing Profession in Palestine and Palestinian Association of Certified Public Accountant, and academic researchers and practitioners on the other hand have all emphasized the importance of high quality audits for the proper functioning of capital markets.

It is important to make sure that accounting and auditing profession is able to experience the benefits that diversity brings (El-Ramly, 2013), but Financial reporting frameworks are oriented to meet the needs for accounting information of the environment in which they are applied, these needs are determined by factors that can be country specific. Hence, different characteristics are found in different countries. Accounting diversity refers to

the differences that exist between the characteristics of the financial reporting frameworks used in different countries and the international diversity in accounting standards and practices has drawn the attention of researchers to the importance of revealing the underlying reasons behind this phenomenon (Alia & Branson, 2011).

The accounting diversity is identified by seven explanatory factors which are (Gorowski & Stando-Gorowska, 2015):

- Legal Systems,
- Providers of finance,
- Taxation,
- The accounting profession,
- Inflation,
- Theory, and
- Accidents.

Legal systems are founded on different premises, and we can distinguish the common law system relying upon a limited amount of statute law and systems of codified law. In the countries with common law systems, specific accounting rules are often established by the profession or by an independent non-governmental body rather than by government or parliament (Doupnik & Perera, 2014). The discrepancies cause different attitude towards following strict regulations (for example, following accounting standards), risk of making errors (which is crucial issue in accounting), feeling of justice and so on. As far as, the providers of finance are concerned, specially, in Palestine where the main sources of financing are families, banks or the authority of Palestine. Taxation can also have a great impact on published financial statements, in determining accounting choice (e.g. choice of depreciation method), and tax evasion activities can strongly distort the quality of financial statements. The strength and competence of the accountancy profession also can affect audit procedures, for example, the lack of a substantial body of private shareholders and public companies can mean that the need for auditors is much smaller. The next factor causing accounting diversity is inflation, and several countries experiencing chronic high rates of inflation and it is often necessary to adopt special accounting rules adjusting historical cost numbers and (Beke, 2013) precise that the effect of inflation can be measured in connection with the evaluation of assets or when

calculating the profit. The next factor theory, the fact is that every accounting system tries to support the solutions applied with a consistent theory, which strongly determine accounting practices and these are sometimes called "accidents", for example the crisis in the U.S. or Enron and worldCome regulations and practice.

The phenomenon of information asymmetry is a result of accounting diversity specially in our Arab world and Palestine, and it means that the company's management are the most knowledgeable person about the company's situation due to the information they have on the financial, real and future value of the company from the investors, which are the pillars that the company qualifies for its active role in the market where this information is used to give the good position to the investors with the ability of the company that the profits are distributed to the company's shareholders, and in the absence of this information and tits differences between the company and the investors. The administration increases the level of voluntary disclosure of the financial statements by revealing information about the company, so the increase in the number of financial analysts inspired by the existence of a lower level of information asymmetry (Rashwan, 2017).

The diversity in accounting practice causes problems that can be quite serious for some parties (Beke, 2013), first problem relates to the preparation of consolidated financial statements by companies with foreign operations, which must be prepared in accordance with local regulations to keep books in local currency using local accounting principles. The second problem caused by accounting diversity relates to companies gaining access to foreign capital markets if they desire to sell and buy in it so they have to prepare a reconciliation statements and this can be costly, and as a result of that a problem comparability lack is appeared between companies from different countries. In conclusion of what we mention above with accounting diversity, the lack of high-quality accounting standards is appeared in Palestine, as another problem.

In such a situation, it is necessary to collect information in different sections, use different methods of valuing assets and liabilities, prepare financial statements according to different patterns, and make various disclosures in the financial statements (Gorowski & Stando-Gorowska, 2015).

## 2.2 Reassessing Audit Strategy

Some experts in auditing believe that poor audit quality is not just the auditor's fault-boards must also get some of the blame. "Management drive to push for lower audit fees has simply resulted in audit firms cutting back on the work they will do, thereby affecting audit quality" said Fiona Czerniawska, director at consultancy Source Global Research. Some companies tend to see audit as a cost rather than a benefit and do not necessarily see quality as a differentiator for something that is mandatory. As a result, clients are pushing down audit fees, or are asking for 'more for less' and in turn, auditors are taking a 'tick-box' approach, limiting their man-hours, using smaller teams with more junior staff, and narrowing the scope of their reviews in some areas (Hodge, 2020), otherwise, financial performance is no longer the sole defining aspect of corporate success, a lot of what makes an organization tick and what makes it attractive to investors and other stakeholders is what the company represents, what it stands for, and how it operates.

As such, audit quality needs to be maintained, and given the dip in performance and increased regulatory scrutiny, it is only fitting that risk managers take a closer look at the audit process, as well as the level of assurance that is being generated internally.

In the context of the Palestinian experience in auditing practice, we assure that reassessing audit strategy should be confirmed the following (Bo, Yilin, & Chenyu, 2020):

The auditor should fully understand the daily business activities, financing and investment activities, ownership and organizational structure of the audited unit, and focus on related parties based on professional suspicious to obtain sufficient audit evidence and make correct professional judgment.

Implement further audit procedures based on understanding of internal controls: the auditors should check all factors that may affect the internal control of the client, improve the reliability of audit evidence and reduce the risk of audit failure.

Strengthen the overall analysis and review of related parties: there are many problems with related transactions of some clients which ended by inappropriate audit reports, and at this stage of issuing the audit report, the

auditing standards clearly require the overall review of the annual report through the analysis process and adopts auditing strategies for verification and proposes appropriate audit opinions.

Furthermore, the new studies in auditing strategy denote new type of audit strategy called information strategy which is based on information communicated from the auditor to the auditee, and this strategy assumes that "auditees adapt their behaviour to audit strategy information", and this assumption is supported by several studies with full-scale experiments on taxpayers or users of social benefits (Appelgren, 2020).

It should be noted that today the primary requirements for auditors are to adhere to and respect professional standards, and take care of any imperfection of methodology of audit regarding identification of financial statements as a result of unfair actions of the economic subject (Bychkova & Skobara, 2016). The methodology and technology of auditing is rather standardized, and still doesn't consider escalating requirements of the parties interested in activity of the economic subject for qualitative financial information.

### **3. Communication with client**

The most important skills that each auditor must have and must constantly develop are communication, negotiation and persuasion skills, as well as cooperation skills and critical thinking, and as we know Communication is the key to any relationship, so that the familiarity and participatory nature of the working environment between the auditor and the employees of the company, must be held meetings from time to time, to see the mechanism of the workflow and to face any problem in the way, as well as to find the best ways to improve the competencies of the team members, but these meetings soon turn into a constraint wrapped around the worker's neck when it exceeds its normal limit or when it is limited to reprimanding employees and criticizing and expressing dissatisfaction with their performance, issuing orders and assignments new, which negatively affects the performance of the company as a whole.

The communication between the client and the auditor is defined as "a technique for expressing ideas effectively, which is the process of conveying information within a business environment" (Gopal, 2009), and as we see that the concept of communication not only expresses the idea of an individual or

other entity "the auditor", but also requires the other party concerned to behave and respond in some way to the idea "the client". How to communicate depends to a large extent on who is involved in the communication and what the person or party who started it wants to achieve through it, so it is important to know with whom one must communicate and through which channels (Fontaine, Herda, & Letaifa, 2013), and good communication often creates stronger relationships between the parties by finding and fixing existing problems.

### **3.1 Lack of Communication undermines your work**

If the organization you are auditing doesn't understand the scope and purpose of your audit program, you risk creating an environment in which the people you're interviewing become less helpful and more tight-lipped with their answers- even to the point of being hostile, here are some ways to avoid this trap and develop healthy, trusting work relationship instead (Johnson, 2019):

- **Avoid techno-babble**; it just leads to confusion and lost opportunities. As an auditor, you're probably super comfortable with all the acronyms and jargon that go along with your line of work, but don't assume that your clients are. As you ask your audit questions, remember to keep them in simple terms whenever possible. You could be asking extremely technical things from staff members who aren't extremely technical. If you ask something and get a room full of blank stares, try explaining it a different way or using an example. For instance, when I ask about a firm's network perimeter protections, I don't mention things like "IDS/IPS" and "next-gen AV." Instead, I start with something like, "Tell me a little about your firewall — is it just doing traditional blocking or does it include more advanced technology that does extra things like scanning for viruses or blocking people from viewing certain websites?"

- **Make friends with IT and security staff**: On many of my audit engagements, my initial conversations are with a C-level business executive, but the bulk of the actual assessment is done with a member of the IT or security staff. Understandably, these folks can feel threatened and get a little defensive when they have to explain to a stranger how the network is architected and secured. The two best ways I've found to ease the tension are kindness and food. Bring donuts to your first meeting with the client's

IT/security department. As conversations get rolling, provide some assurances like, "Just to be clear, my job here isn't to criticize the work you're doing. I want to work together with you to identify risks and then help you make a remediation plan. And I want to hear your insights about what this company needs to better protect its people and data. Maybe you've wanted a SIEM and the security automation capabilities that come with it for years but nobody will listen. Part of my job is to support you and echo these types of requests to management. Ultimately, I want to try to get you some of the things you want." Once the team sees you are on their side, your questions will be answered with more honesty, the audit evidence will be more accurate, the audit quality will be higher, and everyone will get more value out of the assessment.

### **3.2 Communication of auditors via e-mail**

Recently, young auditors are often hesitant to engage older, more knowledgeable client managers in a face-to-face manner due to a social mismatch between the two parties, However, staff auditors were more likely to communicate with the client manager via e-mail, likely to the equalization phenomenon that occurs with computer mediated communication (Saiewitz & Kida, 2018). In the other hand, partners at audit firms have expressed concern regarding the extent to which junior auditors use e-mail for communication with client personnel (Westermann, Bedard, & Earley, 2015) . Most of these junior auditors are "Millennials" (those born since 1980), who have grown up utilizing computer- based communication technology and are often most comfortable sending abbreviated, text-based messages (Lancaster & Stillman, 2010).

Many results of previous studies suggest that there are ramifications to a junior auditor's choice of communication mode for audit inquiries, so client provide responses that are more biased towards information that supports the client's position and away from non-supporting information (i.e., a biased information set), when responding to an e-mail inquiry versus an audio or visual inquiry, in addition, if clients previously provided a more biased information set as a result of an e-mail inquiry, they are less likely to agree with a proposed income decreasing audit adjustment and they are likely to negotiate more aggressively in response to the proposed audit adjustment (Saiewitz & Kida, 2018). Consistent with our expectations, clients provide a

more biased information set when receiving an e-mail inquiry than when receiving a less versus more professionally worded inquiry.

In particular, the trend of young auditors using e-mail for client inquiries increases the likelihood that clients will provide a biased information set. This has several implications for the audit process, (Trompeter & Wright, 2010) note inquiry is a prominent source for investigating potential audit issues.

### **3.3 The effectiveness of Communication**

The need to strengthen the communication relationship is seen as a fundamental solution to avoid possible deficiencies, and to increase the effectiveness of the communication, the following solutions have been suggested (Downey & Bedard, 2019):

- **Tacit Coordination:** Developing common ground among members of the audit team through shared experiences and knowledge.
- **Modularization:** Application of the modules system, pre-planning to unify the interactions between the members of the audit team and reduce interdependence during work.
- **Ongoing Communication:** Continuous, frequent and open communication and the use of methods that provide more situational information.
- Engaging regulators in working to enhance communication between auditing firms by increasing the ability to cross-predict auditors in geographically distributed work.

Nowadays, many companies and commercial organizations buy external audit services, and this is what makes the external audit different from the internal audit (Eilifsen, Messier, & Glover, 2014), and by purchasing the audit service, there is a relationship between the client and the auditor, and relationship between the external auditor and the client can take several forms, but there are rules and regulations that impose restrictions on the relationship between the two parties, and these rules try to guide the auditors in a way that clarifies what is acceptable or not in the context of their relationship, and when the expectations exist between the two parties in line with their own idea of their respective roles, the risk of poor communication decreases (Ahlkvist & Lagerlof, 2017).

## **4. Implementing ISA's in Palestine**

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The local Palestinian environment is distinguished by features that differ from it from the rest of the Arab countries in many aspects socially, economically, politically and culturally, as the application of international standards of auditing in Palestine is marred by several obstacles manifests in the development of legislation and laws regulating the profession, since the last professional law of 2004, no any new laws are issued that is in line with the current situation and developments in the world, in addition to the low dependence on professional ethics and oversight, as well as the complex nature of some of the global standards established that are not appropriate to Palestine local environment.

#### **4.1 Obstacles of implementing ISA's in Palestine**

There are some obstacles that limit the application of international standards on auditing in Palestinian companies, such as the prevailing conditions in Gaza Strip of poverty and high unemployment (Nashwan & Al Tawil, 2017), and we can summarize the challenges and obstacles of implementing ISA's in Palestine in the following:

- Non- professional cooperation between the auditors themselves with a non – professional competition market.
- Lack of awareness among many agencies of the concept of the auditing profession and its importance when the auditor gives his neutral opinion on the financial statement.
- The instability of the political and economic situation constitutes an obstacle to the application of ISA's and oversight of their application by professional bodies in Palestine.
- The professional law of auditing in Palestine is old and not compatible with the current local environment and new technologies.
- The difference in companies law and local tax laws is also an obstacle to the application of ISA's because they don't fit together.
- The standard related to investments and financial derivatives are difficult to apply in Palestine due to several considerations, the most important of which is a single financial market, the Palestine Securities Exchange.
- Environmental and regulatory factors are different in Palestine from

other countries.

We see that, the rapid changes in the economic environment and the expansion of financial markets, and thus the changes in the needs and requirements of users of financial reports, should be reflected on the objectives of financial reports and the characteristics of the information then contain, which must ultimately be reflected in the process of developing systems accounting.

#### Obstacles if implementing ISA's in Palestine



Source: (the researcher, 2020)

Despite the high quality that is characterized by International Auditing Standards, we must take into consideration that these standards have been prepared for application in an advanced financial and professional environment, and have appropriate application means such as the suitable information of fair value for example, and professional expertise qualified to deal with the problems and difficulties of implementation if ISAs depends on observing the environment in which these standards will be applied.

#### 4.2 Professional bodies of auditing in Palestine

Ensuring the quality of local auditing is important in the current globalized business and economic environment, and thus the professional bodies are based on increasing the quality of audits by increasing confidence in the financial statement (Kleinman & Lin, 2017). With the expansion and development of auditing profession in Palestine, auditing professional bodies differ in the requirement that they impose on entering the work and determining the necessary education and training, there is a broad tendency among many professional to develop a clear curriculum that includes two levels.

The first level is primary education and often consists of a specific type of program, Bachelor's degree or diploma in a college or university, and the second level is specific professional training and takes a variety of forms that may be at the level of universities and colleges or is limited to a number of regional centers and a specialized training institution (Harvey, Mason, & Ward, 2014), and the most appropriate type of training is that suits the different behaviors of all employees, that is, dynamic training (Nehme, AlKhoury, & Al Mutawa, 2019).

**The professional bodies in Palestine are represented in three institutions which are:**

- Board of Auditing Profession (BOPA).
- Palestinian Association of Certified Public Accountants (PACPA).
- Palestinian Syndicate of Accountants and Auditors.

**And the strategic objectives of these bodies are as follows:**

- Developing the level of scientific and professional competence of members.
- Developing and documenting the spirit of cooperation between the members of the association, caring for their interests, and strengthening the independence.
- Maintaining the performance and behaviors of the profession, its principles and traditions, regulating its practice and contributing to its development, including carrying out training work.
- Coordination with the local, Arab and international federations that are related to the profession and obtain the membership of those bodies and participate in their activities.

#### **4.3 Professional Legislation in Palestine and ISA's**

The auditing profession in Palestine suffered during the occupation period due to the lack of interest in the profession and its failure to keep pace with the developments that occurred at the global level and even at the regional level, due to the application of laws that were in effect before the occupation and that over time became inappropriate due to the development of economy, and despite of the establishment of the Palestine Securities Exchange in 1995, the profession has remained stagnant for a period of nearly ten years.

In the post- 1967 periods, the Israeli occupation authorities kept the laws regulating the profession intact in both Gaza strip, and the West Bank, but under the powers of the them, after occupying each of the two areas.

After the Palestinian National Authority received Gaza strip in 1994, the same law continued until the issuance of a presidential decree circulating law No. 10 of 1961, which had to address the profession of auditing without accountability and the private sector without the public sector, as well as defining rights and obligations without defining standards for the profession, and did not include controls, ethics and behaviors to practice the work. In 2004, the Palestinian Legislative Council approved a new law to regulate the profession bearing No. 9 of 2004.

In order to complement the set of laws and legislations regulating the profession, the Board of Auditing Profession (BOPA) in Palestine issued a set of instructions related to controls of professional behavior and practicing the profession in an attempt to raise the level of performance to reach the highest levels of transparency and professionalism, these instructions are as follows (www.bopa.ps, 2020):

- Instructions No. (4) of 2013 regarding licensing natural persons and practicing legal persons.
- Instructions No. (5) of 2013 regarding certificates in the profession.
- Instructions No. (6) of 2013 regarding the professional conduct controls of the practicing legal auditor.
- Instructions No. (7) of 2013 regarding examinations.
- Instructions No. (8) of 2013 regarding the formation and work of investigation committees.
- Instructions No. (9) of 2013 regarding the formation of disciplinary committees and their work.
- Instructions No. (10) of 2013 regarding referring files in the disciplinary responsibility.
- Instructions No. (11) of 2013 regarding imposing penalties and disciplinary measures.

Thus, the researcher did not want to go into the same elements of the role of professional bodies in practicing the ISA's, that the previous researchers talked about and she decided to introduce relatively new elements

that concern the local Palestinian environment in particular. So, we in Palestine need to the following:

- Issue and formulate local standards for auditing or adopt in principle international standards and apply them compulsively in all public and private companies operating in Palestine, and this is followed by the activation of the role of the committees affiliated with the professional bodies operating in Palestine.
- Invite those with high expertise and experience to study the local environment and adapt the work to the standards that are supposed to be issued in it, within the completion of the work on local bodies, which in turn is a member of international bodies.

The existence of international auditing standards impose a set of requirements in general without precisely specifying the nature of the procedures to be followed is no longer sufficient to avoid errors committed by the auditor, so we stressed the importance of activating legal accountability through following a more strict approach from the legal point of view.

## **5. CONCLUSION**

- The auditing profession practitioners in Palestine are able to experience the benefits of accounting diversity, but Financial reporting frameworks are oriented to meet the needs for accounting information of the environment in which they are applied.
- The multiplicity of factors affecting the accounting system in Palestine makes it impossible to achieve uniformity of the accounting practice.
- audit quality needs to be maintained, and given the dip in performance and increased regulatory scrutiny, it is only fitting that risk managers take a closer look at the audit process, as well as the level of assurance that is being generated internally.
- reassessing audit strategy should be confirmed by the fully understand of the daily business activities by the auditor, implement further audit procedures, and strengthen the overall analysis and review of related parties.
- Good communication with clients often creates stronger relationships between the parties by finding and fixing existing problems, and the need to strengthen the communication

relationship is seen as a fundamental solution to avoid possible deficiencies, and to increase the effectiveness of the communication.

- the application of international standards of auditing in Palestine is marred by several obstacles manifests in the development of legislation and laws regulating the profession.

## **6. Recommendations**

- Companies have to study carefully the accounting diversity and meet the needs of it in the local Palestinian environment, and attempt to reduce the accounting differences across countries by harmonization.
- Strengthen the overall analysis and review of related transactions of some clients which ended by inappropriate audit reports.
- the auditor must understand the scope and purpose of audit program and create healthy trusting work relationship with clients.
- Avoid using the e-mail inquiries, in which the client provide responses that are more biased towards information.
- Issue and formulate local standards for auditing or adopt in principle international standards and apply them compulsively in all public and private companies operating in Palestine.
- Conducting more researches on the challenges facing the auditing profession in Palestine and ways to remedy them.

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