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ARTIFICIAL INTELLIGENCE (AI) AND FINANCIAL REPORTING INTEGRITY IN MALAYSIA: A CONCEPTUAL REVIEW OF CHALLENGES AND IMPLICATIONS IN EXTERNAL AUDITING

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Abstract:

The integrity of financial reporting is important for maintaining stakeholder trust and the efficient functioning of capital markets. Independent auditors are entrusted with the responsibility of providing reasonable assurance that financial statements are free from material misstatement, whether caused by error or fraud. Despite established auditing standards and frameworks, financial statement fraud persists globally, as such the recent scandals, Khazanah FashionValet Investment Controversy in 2024 and 1Malaysia Development Berhad (1MDB) scandals that are involving of several countries, raising concerns about the responsibility of auditors in detecting and preventing such malpractices. Moreover, the increasing complexity of financial transactions, combined with the growing reliance on digital technology, has increased the need for effective external auditing processes and external auditor positions to assure the integrity of financial reports. Thus, Artificial Intelligence (AI) has emerged as an invaluable instrument in auditing, including skills such as data analytics, detection of anomalies, and predictive modelling to assist auditors in detecting errors or fraud in financial misstatements. AI assist auditor in planning the appropriate auditing techniques and will help them to enhance their audit quality, efficiency and risk assessment. However, despite the growing adoption of AI in auditing, there is

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a quite challenging to the independent auditors especially in developing country like Malaysia. Therefore, this study will explore the challenges and implications about the auditors' adoption of AI to the financial reporting integrity by reviewing previous literatures and relevant sources such as academic articles, technical report or announcements from regulatory bodies and news. By examining the impacts of the auditors' AI adoption towards financial reporting integrity, this conceptual paper aims to provide the ideas to audit firms, regulators, and standard-setting bodies on the best practices for integrating AI into auditing frameworks. Additionally, this study contributes to the discourse on whether the auditor's adoption of AI can uphold, enhance, or potentially undermine financial reporting integrity.

Keywords:

Artificial Intelligence (AI), AI adoption in Malaysia, Audit Quality, External Auditing, Financial Reporting Integrity

Introduction

The integrity of financial reporting is a cornerstone of investor confidence, corporate accountability, and the smooth functioning of capital markets. In Malaysia, as in many developing economies, maintaining this integrity has proven increasingly challenging amidst a series of high-profile financial scandals such as the 1Malaysia Development Berhad (1MDB) and the more recent Khazanah-FashionValet controversy. These incidents have raised serious concerns regarding the effectiveness of external auditors and their ability to detect or prevent material misstatements and fraudulent reporting. Although external auditors operate within internationally recognized standards and frameworks, the recurring failures highlight the limitations of traditional audit approaches in the face of increasingly complex financial transactions and evolving technological landscapes (Yusof et al., 2022; Salleh et al., 2023).

The existence of artificial intelligence (AI) offers new approaches to strengthen and improve the efficiency of the audit process. AI technologies such as machine learning, predictive analytics, and natural language processing are expected to enhance auditors' ability to analyze large datasets, detect anomalies, and assess risk in real time & quickly (Issa et al., 2020). In other words, AI is a very useful tool in auditing nowadays. It includes skills like data analysis, recognizing unusual patterns, and predicting to allow auditors to detect errors or fraud while auditing financial statements. AI technologies also can assist auditors in planning the appropriate auditing techniques and improve their audit quality, efficiency, and risk assessment throughout the auditing process.

Moreover, globally, many previous studies have highlighted both challenges and implications associated with AI adoption in external auditing, particularly in ensuring the integrity of financial reports. Among them are Issa et al., (2016); Al-Htaybat & Alberti-Alhtaybat (2018); Issa et al., (2020); Sreseli (2023); Mwachikoka (2024); Arham (2025). Those studies concluded that AI could enhance auditors' ability to detect financial misstatements and fraudulent activities, concerns remain regarding data reliability, algorithmic bias, regulatory compliance, and the extent of human judgment in AI-assisted audits (Issa et al., 2016; Al-Htaybat & Alberti-Alhtaybat, 2018). However, in the Malaysian context as developing country, Malaysia's audit sector remains in the early stages of technological transformation. The MIA (2023) reported that many small and medium-sized audit firms face challenges in adopting AI due to high implementation costs, limited digital literacy, and uncertainty regarding return on investment.

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This gap is especially significant given the government's push for digital transformation through initiatives such as the Malaysia Digital Economy Blueprint (MyDIGITAL), which advocates for the integration of AI across sectors including accounting sector.

Therefore, the primary objective of this study is to explore the challenges and implications regarding the auditors' adoption of AI technologies in auditing process to enhance the financial reporting integrity. Specifically, this conceptual paper aims to explore what is the challenges among auditor in adopting AI technologies for helping them in reshaping audit methodologies to enhance the integrity in financial reporting. By addressing these aspects, this study contributes to the academic and professional discourse by offering insights into AI's evolving role in external auditing and its implications for financial reporting integrity.

Literature Review

Integrity of Financial Reporting in Malaysia

Accounting processes create financial statements, which are used for communicating a company's financial information with anyone who might be interested. Gorety (2017) states financial statements are to obtain financial information about the company that is used by various parties that will help the company in making decisions. Solikhah (2017) states that financial statements can be called a description of the financial condition of a company. The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity (IASB, 2010). Therefore, financial statements must be prepared and presented honestly and correctly to interested stakeholders. In other word, the financial reporting integrity must be maintained by companies to enhance the users' confidence.

According to Khaddafi et al., (2018) and Fadilah & Nurasik (2022), The integrity if financial reporting can be defined as the extent to which financial information in financial statements show a true and honest information. Similarly, integrity of financial reporting refers to the reliability, accuracy, and completeness of the financial information presented in the financial statements. It encompasses the concept of faithfulness to the underlying financial transactions and events, ensuring that the financial statements are free from material misstatement, whether due to error or fraud (IASB, 2010). It serves as a critical component of investor confidence, effective governance, and economic stability (Bakar & Manaf, 2020).

In Malaysia, financial reporting is governed by the Malaysian Financial Reporting Standards (MFRS), Companies Act 2016 and monitored by institutions such as the Malaysian Institute of Accountants (MIA), the Securities Commission (SC), and Bursa Malaysia. Despite these regulatory safeguards, the fraudulent financial reporting and the issue of financial integrity remain a concern. Notable cases, including the 1MDB scandal, have exposed weaknesses in corporate reporting, regulatory enforcement, and the effectiveness of external audits (Sulaiman et al., 2022). Thus, the integration of advanced technologies, such as artificial intelligence (AI) to assist in external auditing during the performance of audits of companies' financial statements can enhance the transparency and accountability of financial statements, and, accordingly, can influence the companies' integrity of financial reporting.

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Overview of Artificial Intelligence (AI)

In general, artificial intelligence (AI) refers to a set of technologies that are capable of cognitive tasks that were previously exclusive to humans (Davenport 2018). Semantics, logic (often expressed as rules), and statistics form the foundation of artificial intelligence. These capabilities can be merged or improved upon to create particular applications, like rule-based robotic process automation (RPA), machine learning-based prediction, and deep learning neural networks, semantics-based computational linguistics, or both, for natural language processing. In similar words, Artificial Intelligence (AI) refers to the area of computer science that focuses on developing intelligent machines capable of performing tasks that typically require human intelligence (Sreseli, 2023). Then, the Organization for Economic Co-operation and Development (OECD) defines artificial intelligence (AI) as "a machine-based system that can make predictions, suggestions, or judgments influencing actual or virtual environments for a certain set of human-specified objectives" (OECD 2021).

AI Technologies In Accounting And Auditing

From an accounting perspective, Dennis (2024) states that AI technology simulates human intelligence. This involves enabling machines to perform tasks that typically require human cognitive abilities, such as learning, reasoning, problem-solving, and decision-making. Some of its capabilities include automating tasks previously performed by humans, such as accounting, tax, and audit data gathering. Currently, in carrying out the tasks, the technology learns from the information it has analyzed and applies those lessons in future tasks to make reasoned judgments and solve problems. This capability is known as machine learning. Machine learning is one of several types of AI and is used in various applications, often in conjunction with other AI technologies. For example, digital assistants such as Apple's Siri and Amazon's Alexa use natural language processing and machine learning to respond to voice commands. Recently a more advanced type of machine learning is a Generative AI. Generative AI tools are using machine learning models trained on massive pools of information to learn patterns from data to create novel content like text, images, audio, or video in response to a prompt. This application is expected to be increasingly used in auditing as its reliability and accuracy are enhanced, and proper controls and other safeguards related to data security and confidentiality are properly implemented (Dennis, 2024).

Thus, the following are among the most widely used AI applications in current and future auditing:

- **Data Analytics and Machine Learning**: These tools allow auditors to analyze entire datasets rather than relying on sampling. For instance, machine learning algorithms can detect anomalies, classify transactions, and predict risks based on historical financial data (Dennis, 2024; Appelbaum et al., 2017, Adelakun et al., 2024; Imoniana, et. al., 2023).

- **Robotic Process Automation (RPA)**: While not AI in the strictest sense, RPA is often integrated with AI to automate repetitive accounting tasks such as data entry and reconciliation, thereby freeing auditors for higher-order tasks (Yoon et al., 2015; Adelakun et al., 2024; Imoniana, et. al., 2023).

- **Predictive Analytics**: AI models can forecast financial outcomes or identify potential fraud risks by analyzing historical and real-time data (Richins et al., 2017).

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- **Cognitive Technologies tools**: These include technologies that simulate human thought processes, such as IBM Watson, which have been applied to interpret complex contracts and extract relevant audit information (Sutton et al., 2016; Adelakun et al., 2024; Imoniana, et. al., 2023).

- **Natural Language Processing (NLP)**: NLP tools support auditors in reading and interpreting voluminous unstructured data, such as financial disclosures, news articles, and regulatory filings, thus improving audit planning and risk assessments (Kokina et al., 2025: Moffitt et al.,2018).

Moreover, the integration of AI into accounting and auditing has transformed traditional practices, enhancing efficiency, accuracy, and decision-making capabilities (Adelakun et al., 2024; Heller, 2023). AI technologies, such as machine learning and natural language processing, have transformed the accounting profession through the automation of routine tasks, analyzing large datasets, and providing real-time insight (Kommunuri, 2022; Malladhi, 2023). Besides, the AI technologies also reduce the risk of human error, which is leading to higher-quality financial reporting. These AI technologies are assisting accountants and professional auditors in performing the following tasks, as shown in Table 1 below.

Table 1 Accounting and Auditing Task Performed by AI Technologies

Auditing Tasks	Explanation	Previous studies
Automated Data Entry and Reconciliation	AI assists in extract financial data from various sources, such as invoices, receipts, and bank statements. The automating data entry can help auditors in minimize human error. In Malaysia, firms like JurisTech provide AI solutions for efficient data processing.	JurisTech (2023); Heller (2023); Adelakun et al.(2024)
Financial Data Analysis	AI performs sophisticated data analysis, identify trends, anomalies, and correlations, providing inputs for auditor in forecasting and making decisions.	Heller (2023); Adelakun et al.(2024)
Fraud Detection and Risk Assessment in auditing	AI algorithms can analyze transactions for anomalies, flagging suspicious activities to assist auditor in early fraud detection and risk evaluation for identify fraudulent financial reporting.	Adelakun et al.(2024); Al-Sayyed (2020); Tee et al. (2017)
Preparation of Financial Statement and Analysis	AI automats data aggregation, categorization, and report generation to ensure the compliance with accounting standards, improves accuracy, reduces the time required for financial reporting. can perform in-depth financial analysis to assist in management decision making.	Heller (2023); Adelakun et al.(2024); Issa et al., (2016)

From the above table, we can conclude that in the context of auditing, AI offers the possibility to automate routine tasks, improve data analysis, assisting auditor in detecting fraud, audit risk and strengthen evidence-based decision-making.

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AI Adoption in the Malaysian Auditing Sector

In the Malaysian context, the adoption of Artificial Intelligence (AI) in the auditing profession remains at an early developmental stage, particularly among small and medium-sized audit firms. A recent report by the Malaysian Institute of Accountants (MIA) highlights that while the profession recognizes the transformative potential of digital technologies, including AI, various barriers continue to hinder widespread adoption. These include high implementation costs, limited access to technological infrastructure, inadequate digital skills among practitioners, and uncertainty regarding the return on investment (MIA, 2023).

Therefore, to meet the requirements in embedding the AI technologies in the auditing profession, the Malaysian government has been launched MyDIGITAL initiative under the Malaysia Digital Economy Blueprint and seeks to accelerate the digitalization of the economy, including the professional services sector especially focusing on external auditing (Economic Planning Unit [EPU], 2021). Concurrently, the MIA Digital Technology Blueprint provides a strategic roadmap to guide audit firms in embracing emerging technologies such as AI, with a focus on capacity building, talent development, and digital governance (MIA, 2020). MIA developed the MIA Digital Technology Blueprint in 2018, which aims to guide accountants in developing appropriate action plans for their environment to respond to digital technology (Dhoraisingam et al.,2021).

In addition, at the educational level, Malaysian universities and professional accounting bodies have begun integrating AI and data analytics into their academic programs in preparation for them in future digitalization business environments. However, the pace of integration varies significantly, with calls for more structured and standardized curriculum reforms to ensure that graduates are adequately equipped for a tech-driven audit environment (Azizan et al., 2021; Alias et al., 2022). The next section will review the previous literatures regarding the challenges and implication of AI technologies in auditing profession.

Challenges and Implication of AI Integration in External Auditing

Computerised accounting and digitalization in business landscapes make auditing very challenging. Millions of transactions are not entered manually by individuals but scanned by the cashiers at the point of sale. Hence, when a risk-based audit approach is utilised (audit risk model), it influences the audit planning and gathering of audit evidence to arrive at an audit opinion on the financial statements. Thus, the adoption of AI technologies is important to enhance the efficiency of auditors in examining the truthfulness of financial reporting. This is because the use of AI provides a starting point to analyse the data for any unusual transactions or patterns documented in the audit plan for further audit testing and gathering of audit evidence. The adoption of AI aids in identifying red flags where potential misstatements (errors or fraud) may occur in companies' financial statements and reporting (Dhoraisingam et al., 2021). However, despite the benefits, the adoption of AI in auditing presents several challenges to the auditing profession.

According to Adelakun et al. (2024) and Richins et al. (2017), among the main challenges is that auditors' over-reliance on AI technologies may compromise auditors' professional scepticism and their professional judgment. In other words, auditors may become overly dependent on AI tools, potentially neglecting critical judgment on certain matters. Thus, the human intervention in making decisions is questionable. This is in line with the study from Kokina et al. (2025). Among professional auditors in the US, they found that the main AI

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adoption challenges are related to transparency and explainability, AI bias, data privacy, robustness and reliability, auditor overreliance on AI, and the need for AI guidance.

In addition, Adelakun et al. (2024) have concluded in their study regarding navigating challenges and opportunities of AI in auditing careers that one of the primary challenges is ensuring transparency and accountability in AI decision-making processes. Because AI systems often operate as "black boxes," understanding and explaining their outputs can be difficult, potentially leading to issues of trust and compliance. Ethical accounting necessitates that AI systems be designed with transparency in mind, providing clear explanations for their decisions and actions. They also found that data privacy and security represent another critical ethical challenge in the adoption of AI technologies in auditing processes. Besides that, the extensive use of financial data by AI systems necessitates robust measures to protect sensitive information from breaches and unauthorized access.

Then, the previous studies from Sutton et al., (2016) have highlighted the ethical and legal considerations that challenge the auditing field regarding the adoption of AI technologies or tools in assisting auditors to examine the truthfulness of companies' financial reports. They conclude the use of AI raises concerns about data privacy, algorithmic bias, and accountability. Their finding is in line with the study performed by Munoko et al., (2020), whose performed a bibliometric analysis of publications to explore practical ethical challenges that could be encountered in AI-enabled audits. They also found that the issues are the lack of transparency, concerns related to data privacy, fairness of data use, and user autonomy and accountability (Munoko et al. 2020). In addition, Lehnar et al., (2022) also identify the five challenges to AI-based ethical decision-making in accounting and auditing. There are objectivity, privacy and data protection, transparency, accountability, and trustworthiness. Accordingly, those studies also raise questions about audit quality, professional skepticism, and concerns over AI tools' influence over their users, governance of AI, and auditor competence.

Moreover, workforce readiness is a significant barrier, as auditors require new technical competencies to interact effectively with AI systems (MIA, 2023). The issue regarding skill gaps in the adoption of AI technologies among professional accountants, especially in developing countries like Malaysia. This argument is supported by the study from Ilias et al., (2020). They have examined the readiness of accounting practitioners in Malaysia to embrace new technology in the era of digitalization and examined the difference in technology readiness among gender, age, level of education, and profession. They concluded that the overall readiness might differ due to a different use of technology in accomplishing their work as accounting practitioners. A different view on optimism and discomfort has been found among age, level of education, and profession. In relation to accounting practitioners' views on the technology and their attitude, respondents with 41-50 years and 31-40 years would have a more positive view and believed in how technology could increase job efficiency and enhance people's lives at work. In addition, different professions among accounting practitioners would also bring different courage in using any technology with positive attitudes toward technology (Ilias et al., 2020). In other opinion from Mohd Razali et al., (2025), the study revealed that that external auditors' effectiveness is enhanced if they are skillful in using audit software to plan and manage audit processes, organize and distribute audit information, analyze audit data, and run audit quality programs. In other words, the adoption and proficiency in AI technologies significantly give the positive impact to an external auditor in fraud risk assessment during performing financial statement audit.

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In conclusion, AI can significantly contribute to the enhancement of financial reporting integrity. Through real-time anomaly detection and automated risk assessments, AI facilitates a more robust audit approach that can detect fraudulent transactions or reporting inconsistencies more efficiently than traditional methods. Furthermore, AI-enabled audit tools can analyze extensive datasets, generate insights rapidly, and ensure compliance with complex regulatory frameworks, thereby strengthening transparency and stakeholder trust (Appelbaum et al., 2017). The adoption of artificial intelligence by auditing firms increases audit quality. It also plays an active role in decision-making and helps improve their skills by providing mixed-value and artificial intelligence consulting services that are more useful than traditional auditing (Seethamraju & Hecimovic, 2020)

Research Methodology

The main purpose of this study is to explore the challenges and implications of the auditors' adoption of AI in upholding the integrity of financial reporting. Thus, This study adopt a descriptive conceptual review approach by performing a literature-based conceptual analysis. This method facilitates the consolidation of findings from existing research and professional publications to form a coherent understanding of current practices, theoretical perspectives, and emerging trends (Levy & Ellis, 2006). Sources of this study are gathered from different credible sources, including peer-reviewed academic journal articles (from Scopus, Web of Science, and Google Scholar databases), technical whitepapers and audit firm reports (e.g., Big Four firms' reports on auditing and AI, regulatory reports and pronouncements by Malaysian authorities such as the Malaysian Institute of Accountants (MIA), Audit Oversight Board (AOB), and Securities Commission Malaysia (SC), International standards and frameworks by IFAC, IAASB, and PCAOB and news bulletins and case studies for recent Malaysian corporate scandals. Then, a systematic literature review strategy was employed to collect and screen relevant literature published between 2015 and 2025, using key search terms such as "AI in auditing," "financial reporting integrity," "auditor responsibility," and "Malaysia." Articles were selected based on relevance, citation frequency, and recency. Then, from the variety of sources, we are summarizing the challenges and implications of the adoption of AI technologies in assisting the auditing process in the discussion section.

Discussion

The objective of this conceptual paper is to explore the challenges and implications about the auditors' adoption of AI technologies to the financial reporting integrity. Based on the reviewing and consolidation of the findings from the current literature, we can conclude there are three (3) general categories in relation to the challenges and implications on the auditors' adoption of AI technologies to the financial reporting integrity. The following table summarizes the challenges and implications of external auditors adopting AI technologies to enhance the integrity of financial reporting during auditing processes.

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Table 2: Summary On The Challenges And Implications of AI Technologies Adoption By Auditors To The Financial Reporting Integrity

The main challenges and implications	Explanation	Previous literature
Over-reliance on AI technologies will impact on human intervention in professional judgment	Over-reliance on AI could undermine auditor independence and professional skepticism	Kokina et al. (2025); Adelakun et al. (2024); Lehnar et al. (2022); Richins et al. (2017)
Significant ethical concern like client data privacy and security	The use of AI raises concerns about data privacy, algorithmic bias, and accountability in AI decision making process. There is quite challenging to determine who is responsible for AI driven decisions.	Kokina et al. (2025); Adelakun et al. (2024); Dennis (2024); Munoko et al. (2020); Sreseli (2023); Heller (2023); Lehnar et al. (2022)
Readiness to AI adoption and skill gap (lack of training and infrastructure in small and medium size of audit firm)	Auditors' readiness in adoption of AI technologies become challenges for small and medium size of audit firm, thus, auditors are required to enhance their technical expertise in AI technologies and deep understanding of accounting principles.	Kokina et al. (2025); Dennis (2024); Sreseli (2023); Heller (2023); Yoon et al., (2015)

Conclusion and Recommendation

The application of artificial intelligence in external auditing has high potential to improve the quality of financial reporting in Malaysia. However, addressing the challenges of adoption requires concerted efforts from audit firms, regulatory bodies, and educational institutions. By bridging the identified gaps and fostering a supportive environment for AI implementation, the auditing profession can leverage technological advancements to uphold the credibility and reliability of financial reporting. From the study, we can conclude that many studies have been done globally regarding the AI adoption in auditing, but there remains a dearth of research focused on the Malaysian context. Hence, the proposed future research is to investigate how adoption of AI in external auditing can enhance financial reporting integrity in Malaysia's unique regulatory, cultural, and professional setting. After all, the findings and conceptual insights of this study are expected to contribute meaningfully to academic field, industry practitioners and for developing nation, Malaysia. For academician, especially accounting lecturer, they must integrate the using of AI technologies and data analytics during their academic programmes' delivery and development for students' preparation in future digitalization business environments. Meanwhile, audit firms and professional such as Malaysian Institute of Accountants (MIA) must provide a clear understanding of the challenges and implications of AI tools to the accounting profession in

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enhancing of financial reporting integrity and transparency. Through these contributions, the study also serves as a practical guide for industry and policy stakeholders in advancing AI-driven audit practices in Malaysia.

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