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AUDIT QUALITY AND COVID-19 PANDEMIC: LISTED NIGERIAN DEPOSIT MONEY BANKS IN PERSPECTIVE

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Abstract

This study argued on the theoretical impact of audit quality on the performance of listed deposit money banks in Nigeria during the period of COVID-19 pandemic. This study employs the desktop methodology to explore the possible impact of COVID-19 crisis on six key variables for audit quality during the pandemic. These include audit engagement, audit fees, going concern assessment, auditor human capital, audit procedures and audit personnel salaries. Findings from this study reveal unprecedented challenge for auditors and their clients since the global financial crisis of 2008. This study believe that COVID-19 drastically affect audit fees, going concern assessment, audit human capital, audit procedures, audit personnel salaries and audit effort, which may ultimately impact negatively on audit quality. It is therefore recommends that audit firms should invest more in digital technology, such as artificial intelligence, block chain, network security and data function development to assist in making audit staff be more adaptable to work from home to enhance effectiveness and flexibility of communication between auditors and their clients. It is further recommended that stock market regulators and other agencies such as the Central Bank of Nigeria should be more lenient in their compliance requirements to listed banks to help auditors in reporting better earnings figures, which appeared to be positively associated with audit quality. This study finally suggests directions for further study in the areas of questionnaire construction or interviews to provide empirical evidence on the potential impact of COVID-19 on audit quality.

Keywords: Audit Quality, COVID-19 Pandemic, Deposit Money Banks, Financial Reporting, Nigeria

Introduction

The unexpected outbreak of the Coronavirus Disease of 2019 (COVID-19) otherwise known as the Wuhan virus bring about an alarming health, social and economic challenges that is still becoming difficult for the world to concur. The pandemic bring about considerable economic and financial losses globally because of its adverse rule such as social distancing (Goodell, 2020). It further brings huge financial and economic turbulences with business uncertainty that force decline in investors' confidence and reduced firms' financial performance.

These consequently lead to various financial distresses in the banking sector of especially the developing capital markets such as Nigeria (KPMG, 2020). The panic due to the pandemic can significantly influence audit process undertaken by the auditors' by reducing their ability to detect material misstatements (Lenz & Hahn, 2015). Without proper audit procedure in Deposit Money Banks (DMBs), there can't be top quality audit which may finally result in reduced shareholder confidence in the reported earnings figures. The audit report so presented by the auditor may result in increased investment risk

through additional exposure in loan and other advances. This may ultimately, increased cost of equity capital or even leads to bankruptcy of the banks (Goodell, 2020). Due to decline of investors' confidence, there may be more volatility in earnings which is likely leading to declining pattern of share value during the pandemic period (Kousenidis, Ladas, & Negakis, 2013; Arthur, Tang & Lin, 2015).

As DMBs in different jurisdictions around the world such as those of developing economies such as Nigeria just ended their financial year-end (2020), there is need to evaluate the effects of the COVID-19 outbreak on their financial reports. These report are considered by stakeholders as their main source of information and their key means of investment decision-making (Shahzad et al., 2018). Auditors especially of the banking sector are facing unprecedented practical challenges especially due to the physical social distancing rule. This challenge reduces their ability to visit their clients resulting in the fear that many banks may go bankrupt or begin to manipulate their earnings figures during this difficult period.

Previous audit quality scholars have specified the importance of auditing for ensuring the quality of financial statements which enhance investors' decision-making and the integrity of the accounting numbers (Albitar et al., 2020; Tarek et al., 2017; Shahzad et al., 2018). However, this study is motivated by the newly promulgated Financial Reporting Council (FRC) framework issued in relation to the impact of the COVID-19 pandemic on audit quality that provides a guide for auditors on matters that should be considered relative to audit quality while the pandemic lasted (FRC, 2020). According to this international financial reporting body, the following guidelines should be considered in this period of pandemic by the auditors

- i. The auditor's should be thorough on risk assessment by considering whether it needs to be revised.
- ii. The auditor must be able to gather the necessary evidence to be able to report or consider modifying their audit opinion particularly during-group audit engagements.

- iii. The group auditor/principal partner may need to thoroughly review the work of component auditors to meet the required standards, especially where travel is restricted due to social distancing.

- iv. The group auditor needs to be aware that auditor's assessment on going concern due to the uncertainty about the global economy and the immediate outlook for many banks has increased.

- v. There must be adequate disclosures in the financial statement by bank management about the impact of COVID-19 on the bank, so that users of the financial statements are properly guided, and the bank's prospects are adequately described to recognise this high degree of uncertainty.

- vi. The group auditor needs to reassess key aspects of their audit as a result of the fast-changing situation. This may need the provision of further evidence and information by management recognising that the audit assessment will take place right up to the point of signing the auditor's report.

- vii. Where the COVID-19 pandemic have had a significant impact on the delivery of the audit, the group auditor will need to consider how to explain this in their report, for example, by reporting this as a key audit matter.

This study is motivated by the above-highlighted points as suggested by Financial Reporting Council (2020). It further relied on efficiency wage theory to argue for higher wages as incentive to improve audit personnel productivity and attract high quality audit personnel.

Underpinning Theory

The Efficiency Wage Theory

The efficiency wage theory argues that firms motivate their employees to work in a more disciplined way by paying high wages. According to Simpson (2018) the history of efficiency wage theory is not clear. The term was first used by Alfred Marshall to describe the wage a firm will be prepared to pay a worker to increase their productivity such that the firm was indifferent between the low efficiency worker and the high efficiency worker. This study employs the traditional efficiency wage theory to explain the wages pay of auditors during this

challenging period of the COVID-19 pandemic. It is a concept in which companies pay their employees a higher wage to motivate them to work harder and stay with the company. Hamel (2020) argue that, one reason why an audit firm might offer high wages is to attract a better pool of job candidates that have adequate skills and knowledge to carry out the assigned responsibilities especially during the period of COVID-19 pandemic. This also impliedly means that banks in Nigeria should be able to pay at least the agreed audit fees prior to the pandemic in order to retain the services of the audit firms and for the firms to continue do a nice job despite the pandemic. This study is desk based and aimed at examining the impact of COVID-19 on audit quality in listed deposit money banks (DMBs) of developing capital markets with Nigeria as a case study. This study theoretically answers the following seven research questions:

RQ1. How can the COVID-19 outbreak impact the quality of the audit process of Nigerian DMBs during the pandemic?

There are scanty number studies undertaken to highlight the economic and social impacts of the COVID-19 pandemic around the world (Goodell, 2020; Albitar, Gerged, Kikhia & Hussainey, 2020). To the best of this researcher's knowledge, a study exploring the possible influence of the COVID-19 pandemic on banks audit quality in developing country hardly exist. This study is therefore unique as it seeks to address this research gap in auditing literature of banks by exploring the possible impact of the COVID-19 pandemic on audit quality. Specifically, this study reviews the potential impact of COVID-19 pandemic on five characteristics related to audit quality. These are, auditor fees, auditor going concern assessment, auditor human capital, auditor procedures and auditor personnel salaries. In doing so, this study provides a systematic picture for future researcher's auditors and prospective investors about the possible impact of COVID-19 pandemic on audit quality. In this case, the study contributes to the existing literature by conceptualising the relationship between COVID-19 pandemic and audit quality. Future research could complement our study by constructing a questionnaire

survey or an interview schedule to empirically examine the COVID 19 pandemic and audit quality nexus.

RQ2. COVID-19 and Auditor Fees

With globalisation comes a rapid change in economic conditions which brings about intense challenge to audit firms and their clients such as the banks. These changes are expected to impact on firm's liquidity, risks exposure and their profitability, which will ultimately impact on settlement of their audit fees (Chen et al., 2019). More specifically, there is a higher risk that borrowing firms may violate the conditions stipulated in the debt contract. Consequently, some borrowing firms and those that lend such as the banks may go bankrupt for lack of patronage as a result of the pandemic. Higher risk levels of banks and the growing concerns of creditors will force auditors to adopt broader audit procedures and spend more time and money in audit work when evaluating firms' going concern assumptions (Ghosh & Pawlewicz, 2009; Noh et al., 2017; Zhang & Huang, 2013; Chen et al., 2019). It is also argued that during this pandemic, the growing demand for assurance and the increased risk of auditor litigation would increase the auditor's effort and working hours (Karim & Zijl, 2013; Yuen et al., 2013). According to DeAngelo (1981) auditor's independence and audit quality are not affected by audit fee reduction because it is a rational competitive response to the expectation of incumbency's technological advantages. It should further be noted that initial fee reductions are sunk costs to be borne by the audited firm in the future. A study by Xu et al. (2013) reported an increase in audit fees during the financial crisis in Australia. These researchers argue that it was because of an increase in client's business risk that caused an additional audit effort. Other prior studies found that during the global financial crisis, firms negotiate lower prices for audit engagements (Krishnan & Zhang, 2014; Alexeyeva & Svanström, 2015; Karim & Zijl, 2013; Bozec & Dia, 2017; Chen et al., 2018; Chen et al., 2019). As the pandemic forces work-from-home due to social distancing, it appears there is an increase in the audit working hours and auditor's effort. However, despite the difficulty in the audit process due to the "new normal" some clients have started asking for the reduction of audit fees (Chen et al., 2019). Consequently,

this may force auditors to reduce their efforts in order to minimise the loss on the engagement. Owing to this exogenous shock of the COVID-19 pandemic, auditors may be under pressure from clients to cut audit fees during the crisis which may ultimately impact negatively on audit quality.

RQ3. COVID-19 and Going Concern Assessment

The current COVID-19 pandemic forced many companies close some of their branches and other businesses because of reduced level of sales. Auditors are finding it difficult to assess whether the current situation cast critical doubts on the company's ability to continue as a going concern. It further cast doubt for some companies as to or whether the going concern concept itself is still appropriate as a basis for the preparation of corporate financial statements (KPMG, 2020). Additionally, there are lots of questions begging for answers as to whether companies and auditors need additional time to fully consider the impact of this epidemic to fully address them (PWC, 2020). Previously, Xu et al. (2013) indicates that auditors have taken conservative measures during the global financial crisis by not only increasing their propensity to issue going concern opinions but also by expanding the audit effort. This is to protect them from higher risk exposure during the global financial crisis. However, Mareque et al. (2017) find that the percentage of reports issued with going concern qualifications before and during the crisis were similar.

It is therefore essential that auditors are skeptical when conducting the ongoing concern assessment, and that their working documents should show evidence of such skepticism. This also raises the challenge of risking internal control operations due to work-from-home strategy (PWC, 2020). In addition, it is essential for auditors to spend sufficient time on the assessment of going concern and accept that it will take a longer time than usual for most clients. This work may be more sophisticated during the outbreak of COVID-19 as the uncertainty level is higher, which implies the crucial necessity to use the appropriate level of staff and to provide the appropriate and provide sufficient support to

auditors (Arnold, 2020; KPMG, 2020). Auditors must continue to expect the unexpected because new issues will continue to arise occasioned by the pandemic (Murphy, 2020). There is a need for auditors to remain focused on their ethical responsibilities and the public interest in this trying period of COVID-19 pandemic and ensure that the subsequent review of events continues until final signing of the audit report (PWC, 2020).

During the COVID-19 pandemic, the most common reason for issuing audit reports with uncertainty is because of doubts about the continuity of the firm. These uncertainties are attributable to the lack of liquidity and the deterioration of economic development of the company's activities as well as the economic crisis that the world is currently suffering caused by the COVID-19 pandemic in most sectors (KPMG, 2020). All of these circumstances have led many companies and especially the banks to have higher business risks due to their level of exposure. Therefore, once again, because of this pandemic, we should expect it to have a considerable impact on the completion of the going concern assessment, which seems to be associated with audit quality (Salehi et al., 2020).

RQ4. COVID-19 and Audit Evidence Collection

According to Appelbaum, Budnik and Vasarhelyi (2021), the traditional methods of collecting audit evidence by auditors rely upon in-person procedures which are impossible or impractical now and for the near future due to the global COVID-19 pandemic. The United States generally accepted accounting standards (GAAP) defines audit evidence as "all of the information used by the auditor in arriving at the conclusions on which the audit opinion is based" (US GAAP, 2020). The COVID-19 pandemic has resulted in enormous pressure on auditors in the audit market to find alternative means of collecting audit evidence and to complete the engagements (Whiting, 2021). Today audit firms had to rely on remote virtual audit by utilizing FPV cameras and drones, video feeds, AI video assessment tools, and other technologies to conduct their audit assessments. Thus, given the nature of the current constraints, lenience by regulators, creativity by auditors, and flexibility by clients are

necessary. These may significantly facilitate the ability of the auditor to adapt to emerging technologies. It may also prove to be an evolutionary measure that are superior to traditional audit evidence collection methods and be incorporated into audit practice by regulators going forward.

RQ5. COVID-19 and Audit Human Capital

The Financial Reporting Council believes that skills, personal qualities and training of audit partners and employees are important factors in determining auditor quality (FRC, 2020). They further believe that constant training will aim at enhanced employees' expertise and competency and thereby improving audit quality. Francis (2011) posits that the training of auditors is at the heart of the audit profession. Consistent with this vision, previous studies pointed out that investment in human capital can improve the audit quality (Cheng et al., 2009; Antonio and Rodrigues, 2016). Consequently, audit human capital appeared to have great potential to play a critical role in the audit process by impacting positively on audit quality.

The certified knowledge and skills of auditors has an indelible connection with individuals, and it can improve performance during the audit process (Bianchi et al., 2019). The professional expertise and knowledge of the auditor can be obtained through indirect and direct experiences. The indirect experiences include training and workshops while the direct experience is more to do with interactions between an auditor and customers in the firms (Lennox & Wu, 2018). Chen et al. (2008) found that professional experience gained during on-the-job training can substantially improve audit performance, hence audit quality.

Although audit firms have the ability to arrange monthly training sessions, workshops and similar professional development activities for their employees, the COVID-19 social distancing rule has forced all audit firms to cancel their training, workshops and other professional development programmes for their auditors at all levels virtually until further notice (Deloitte, 2020). This becomes the new plan of cutting costs and obeying the

social distancing rule caused by the COVID-19 pandemic to the audit profession. The effect of the social distancing rule is expected to be directly reflected on the efficiency and the ability of auditor and may have a negative impact on audit quality. Additionally, there is a likelihood of personnel loss due to illness or quarantine, which collectively might affect the performance of audit firms, their efficiency hence audit quality.

RQ 6. COVID-19 and Audit Staff Salaries

In recent years auditors 'salaries has become an important issue due to major changes in public accounting which resulted in more complexity, increased responsibilities and workloads on auditors (Persellin et al., 2018). Although the salary of the auditor may be significantly attributed to audit quality, a few studies have considered the relationship between the salary of the auditor and audit quality, which is mainly due to data constraints. Since the beginning of the COVID-19 pandemic, extraordinary measures have been put in place to help workers and corporate entities such as the banks throughout the period of the outbreak. Some firms even started talking about pay cuts, offering unpaid leave or even downsizing of personnel (Deloitte, 2020). However, the association between audit personnel' salary and audit quality is as yet unclear.

The efficiency wage theory argues that higher wages should improve audit personnel productivity by either motivating greater effort or attracting higher quality audit personnel (Hoopes et al., 2018). Therefore, it is expected that the COVID-19 pandemic would affect audit personnel salaries, which in return might negatively affect the performance of audit personnel as they would have few motivations to do their duties in the most efficient and effective manner. Thus, we argue that any reduction in the salaries of audit personnel can have a potentially negative effect on audit quality.

RQ7. COVID-19 and Audit Procedures

Another issue that can be affected by the current pandemic is the performance of analytical procedures that is representative of an integral part of the audit process (Messier et al., 2013). Analytical procedures are used for audit planning, fieldwork and audit conclusion,

evaluation and reporting stages (Messier et al., 2013; Noh et al., 2017). During the COVID-19 pandemic, because many companies could go bankrupt or manipulate their reported earnings during this crisis, auditors have to increase the use of analytical procedures due to the fact that analytical procedures have the lowest cost and are relatively easy to calculate (Rose et al., 2019). Analytical audit procedures are desirable in terms of cost and can be used to guide auditors and equip them with relevant pieces of evidence to support their conclusions (Appelbaum, Budnik & Vasarhelyi, 2021). These procedures usually involve a diagnostic process that determines the cause of unexpected fluctuations in account balances or the risk of major misstatement due to fraud during the audit plan (Rose et al., 2017; Rose et al., 2019).

There is a potential threat to audit quality associated with generating many explanations when considering fraud risks in the banking sector (Rose et al., 2019). This is because generating many alternative explanations does not consistently activate critical thinking and may even have the opposite effect (Kadous et al., 2006). In addition, auditors will try to rely more on analysis procedures that help them to have a comprehensive understanding of the companies' financial position, thereby reducing the number of detailed tests that are so expensive and take a long time taking into consideration that most of the communications during the COVID-19 pandemic are by emails (KPMG, 2020). The quality of audit evidence is very important to ensure that the auditor's conclusions are correct. If the reported information is not very strong or the quality is low, then the audit risk of making a wrong audit opinion is high (Rose et al., 2017).

The quality of audit evidence mainly depends on the form and source of the evidence. Due to COVID-19, auditors are more likely to rely on evidence virtually or from external sources such as evidence obtained directly from external parties such as customers, suppliers or banks (Murphy, 2020). These sources of evidence according to PWC (2020) are more reliable than those obtained from clients. For example, the account receivable confirmation obtained from client's customers is more reliable than the

records prepared by clients. However, the level of reliability of evidence obtained from clients is determined by the reliability of client internal control (Rose et al., 2019). On the other side, the COVID-19 pandemic has decreased the use of the original forms, for example, original invoices that used to support the payments transactions that are more reliable than the copy invoices sent by email; thus, the working-from-home strategy would affect the sufficiency and reliability of audit evidence and consequently might affect audit quality (KPMG, 2020).

Conclusion and Recommendations

This study believes that the COVID-19 outbreak is a huge health, financial and social risk that could degenerate into something worse than the global financial crisis in the long run. The effect of the COVID-19 pandemic would be the toughest challenge for auditors and their clients since the 2007–2008 global financial crises. This is because of the unprecedented level of uncertainty about the economy, future earnings of banks and many other inputs that represent fundamental elements of financial reporting. This paper theoretical and aims to discuss how audit quality can be affected by the COVID-19 pandemic, and proffer suggestions for the use of telecommunication technology during the period of the pandemic. This study further offer suggestion for future study by researchers and suggest possible way out to auditors in their audit engagements following this exogenous shock. Although there has been calls for reduction in audit fees as a result of this pandemic, this study by relying on the efficiency wage theory is of the view that firms and especially the banks and even the audit firms are better off living their wages as they are because of the huge possibilities of personnel loss through resignations which is expected to impact negatively on the quality of audit process.

This study has several theoretical, practical and policy and implications by the DMBs. Consequent upon the COVID-19 outbreak and with the employment of work-from-home strategy, audit firms are highly recommended to invest more in targeted digital technology training and telecommunication technology such as artificial intelligence, block chain, network security and data

function development by utilizing FPV cameras and drones, video feeds, AI video assessment tools, and other technologies to conduct their audit assessments. These technology gadgets would help them to be more adaptable to working from home which is ultimately expected to enhance the effectiveness and flexibility of communication between auditors and their clients.

At a result of the lockdown strategy which leads to increase working hours and efforts for auditors, this study recommends that stock market regulators such as the Central bank of Nigeria, Nigerian stock exchange, the securities exchange commission and the financial reporting council should be lenient in checking the compliance requirements of the firms. For example, Nigerian stock exchange can extend the timelines for filing of financial results to enable DMBs complies accordingly. This is expected to assist firms such as DMBs in Nigeria that apply the work-from-home strategy to report better earnings figures, which appeared to be positively associated with audit quality. Furthermore, this study recommends the extension of tax payment deadline by the tax authorities and also apply special measures to taxpayers such as the banks that are the most affected by COVID-19 to help them mitigate the impact of this pandemic. There are as at today very few studies that explore the potential impact of the COVID-19 pandemic on audit quality especially in the banking sector of a developing capital market economy. This study although theoretical is expected to provides rich source of reference for future researchers, auditors and bank

managers on the impact of COVID-19 pandemic on the international financial markets and economies.

Suggestions for Further Study

As stated earlier this study is desk based however future studies can use the present study as a base to construct primary data research instruments such as questionnaire or interviews to provide empirical evidence on the potential impact of COVID-19 on audit quality. As a limitation of this study, no empirical evidence of the possible effects of the COVID-19 pandemic on audit quality was provided. Future research could complement our study by providing empirical evidence on the impact of COVID-19 crisis on the independent variables discussed. Secondly, future research could examine the potential consequences of reduced audit quality during the COVID-19 pandemic on the quality of financial statements. Thirdly, this study relied only on the relationship between COVID-19 pandemic and audit quality. Future studies should dwell on the possibility of banks withdrawing, maintaining or expanding their corporate social responsibility (CSR) activities during this period of pandemic. Finally, Albitar et al. (2020) provide evidence that corporate governance moderate the relation between Environmental, Social and Governance (ESG) and performance of DMBs in Nigeria. Further research could also investigate whether audit quality of DMBs in Nigeria moderate or mediate the link between CSR or ESG disclosure and firm performance during the pandemic.

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