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Reconceptualizing the Management–Auditor Relationship by Applying the General Partnership Contract to Challenge Independence: Ideals versus Reality

Khalid Al-Adeem*

Abstract

The audit function in a corporate model can be a defective tool in monitoring executive management. Arguably, the Sarbanes-Oxley act (SOX) inadvertently has placed auditors in unwanted positions while increasing their independence. Auditors' reliance on their clients for collecting information, financial dependence, and self-bias in processing information restrain them from neutrally and objectively judging corporate reporting. Mandated rules can never substitute integrity and the desired objectivity by shareholders. By reconceptualizing the result of the relationship as a general partnership where trust plays a critical role, this study considers the relationship between management and their auditors, offers an explanation about the audit firms' behavior, and offers reasons for the failure of some audit for committing unethical actions. The analysis leads to testable empirical and policy implications. Accounting theorists should be on board critiquing and retheorizing positively but not normatively: A corporation with the absence of an objective party that shareholders count to attest corporate reporting impartially.

Keywords: independence, partnership, auditor, audit function, audit profession, objectivity, neutrality, shareholders, public interest, Sarbanes–Oxley act, SOX, management, nonaudit services, NAS, partner rotation; corporation.

I. INTRODUCTION

"Accurate and reliable financial statements are critical for corporations to raise capital and are the bedrock upon which investors depend to make informed decisions" (Harris, 2016).[1] Considering that companies do not voluntarily supply information that the public needs (The Economist, 2000), the law grants certified public accountants the responsibilities of providing reliable information to assure the right of equal access to reliable information by all members of society, making accountancy profession the most trusted in the world (Moehrle et al., 2006, xxii, p. 6). By executing "statutory audits," certified public accountants (CPAs) truly stand-in as a watchdog for public interest (O'Connor, 2002).

An auditor has privileged access to information that is unavailable to public and he or she is supposed to be well versed with the client's business and operations (Ittonen, 2010). Participants in the marketplace demand expert's opinions in the matters of economy (Jamal & Sunder, 2011). Contributing an impartial third party opinion on the veracity of financial statements that stockholders believe in for

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[1] A speech delivered at the International Corporate Governance Network (ICGN) Annual Conference, San Francisco, U. S. A. Retrieved November 24, 2020, from https://pcaobus.org/news-events/speeches/speech-detail/auditor-independence-and-the-role-of-the-pcaob-in-investor-protection_616.

investment decisions makes the role of the independent auditor in the capital markets vigorous (Harris, 2016). The market requires audit and independent controls to instill confidence and assurance among participants to mitigate existing market risks (Windmöller, 2000). Without trusting financial statements, rational investors are less likely to invest, which slows down stock prices and escalates the cost of capital for companies listed in the market (Ronen, 2010). The objective of independence in the audit profession is to increase the capital markets' cost-effectiveness (Elliott & Jacobson, 1998). As former chairman of the securities and exchange commission (SEC) Levitt (2000a) states,

> "Without confidence in an auditor's objectivity and fairness, how can an investor know whether to trust the numbers? Sound and verifiable numbers are to financial markets what oxygen is to breathing…financial markets simply cannot work without access to strong, high-quality financial reporting."[2]

The audit function cannot be separated from financial reporting (Plaats, 2000). After every corporate collapse, the public has asked, "Where was the independent auditor?" (U. S. Congress, 1976, p. 7). "Many believe that the failure of auditor independence has contributed to the collapse of corporations, the loss of jobs, and a widespread lack of trust in the US financial system" (Bazerman & Moore, 2011, p. 310). Thus, there was a demand for extra back-to-fundamentals tactic to auditing (Reinstein & McMillan, 2004) requiring and justifying governments' intervention to fix the market, including societies with free-enterprise-based economies with open market or not heavily regulated. Evidently, Enron failure has exposed the need for fixing the audit function (Loewenstein et al., 2002). Corporate scandals imply credibility crisis in audit and accountancy professions and the capital market, which undermines the confidence in the market (Hemraj, 2002). When investors' confidence in the markets is jolted, more regulation is imposed to cure the illness of the profession (Cullinan, 2004) and restore investors' confidence in the profession.

The US government enacted the public company accounting reform and investor protection act of 2002, also known the Sarbanes–Oxley act (SOX), which is deemed a powerful legislation and most influential to the accounting profession since the enactment of the Securities Acts of 1933 and 1934. While the two Securities Acts give auditors the responsibility of safeguarding the public interest (Montagna, 1986), SOX stresses on the responsibility of CEOs and CFOs toward shareholders. Auditor independence through reorganizing the relationship between management and auditor to reduce the dysfunctional management influence on their auditor is another aim of the act. "A primary goal of the Act is to promote auditor independence, which was seen as having been compromised by business development in the accounting profession....." (Bost, 2003, p. 11). As former chairman of the SEC Levitt (2000b) articulates,

> "Independence is at the core of the profession, the very essence that gives an auditor's work its value. It is the space and the freedom to think, to speak, and to act on the truth. And truth is the lifeblood of investor confidence."

[2] Remark by former chairman of the securities and exchange commission (SEC) Arthur Levitt at the open meeting on proposals to modernize auditor independence rule. Retrieved February 1, 2020 from https://www.sec.gov/news/extra/audalvt.htm.

Independence is "synonymous with the objectivity and the ability of the auditor to resist auditee pressure" (Sahnoun & Zarai, 2011, p. 97). In addition to "reputation" (Olson, 1980, p. 80), "auditor independence and ability to resist to auditee pressures are the most fundamental and vital asset possessed by the auditing profession" (Sahnoun & Zarai, 2009, p. 560). Independence, however, may not be applicable for the audit function for the purpose of assuring corporate accountability (Kleinman & Palmon, 2001; Taylor et al., 2003; Turnbull, 2006; KPMG, 2004 as cited in Sanchez et al., 2007, p. 259; and Tinker & Sy, 2017), unrealistic (Mauts & Sharaf, 1982; Xu & Wang, 2004) or even impossible (Olson, 1980; Bazerman et al., 1997; Bazerman et al., 2002; Xu & Wang, 2004; Green, 2008; and Bazerman & Moore, 2011). Auditor independence is a complex latent construct which should be defined in a context before normalizing it culturally (MacLullich & Sucher, 2004), thus making its definition debatable (Green, 2008). Philosophically, an auditor might not be completely independent (Reiter & Williams, 2004), which compromises the audit function in the corporate model for monitoring executive management.

However, until 1997, there were no proposals for substituting the audit function in monitoring private property and controlling management (Young, 1997, p. 56). Alternative roles for auditors, such as that of an "insurer," were suggested recently (Ronen 2006; Ronen & Saget, 2007; Green, 2008; Knechel, n.d.). The decision to hire an auditor is the insurer's responsibility, which potentially solves "the inherent conflict of interest" in the auditor–client relationship (Ronen, 2006, p. 143). Additionally, Taylor et al. (2003), DeZoort et al. (2012), and DeZoort and Taylor (2015) suggested "an auditor reliability framework" to position the auditor by establishing reliability 'in fact' and 'in appearance' over independence. While both insurance model and auditor reliability framework as competing views for independence propose new roles for the auditor to play in society to overcome the issues surrounding the auditor objectivity and integrity, neither explains why no auditor might be independent in the current corporate model. Describing the relationship between managers and an auditor as a general partnership contract explains the auditors' behavior. The application of general partnership contract in this study competes for an explanation for why auditors lack independence; a concept that may arguably never become a reality (Al-Adeem, 2015). Several accounting scholars have proposed that auditors are associates of or even partners with managers of corporations they audit (e.g. Cottell & Perlin, 1990; Businessworld, 2000; Cheney, 2002; Levitt as cited in Bogle, 2002; and Fogarty, 2010) and even attempt to prove its existence in the corporate model (Ballwieser, 1987).

Similar to the proposed conceptualized model of "the auditors' client inquiry process" (Communale et al., 2003), this study contributes to the accounting literature by taking the "general partnership contract" from the law profession and applying it to the corporate model to reconceptualize the relationship between executive managers and their auditors as "a partnership." Based on the "general partnership contract," the interaction and arguably the cooperation between auditors and managers (e.g. Gibbins et al., 2001, 2010; Al-Adeem, 2015) can be conceptualized as a general partnership. Given that such cooperation is unannounced, this study proposes that *implied* partnership contract is the best description. Shareholders should be aware that such unannounced agreement between managers and their auditors is not in their best interest. The manner of dealing with auditors might consequently change.

Moreover, the new observation of the auditor–management relationship might lead to an extension of the theory of the firm. Attempts for theorizing corporation have advanced the current corporate view for about a century (e.g. Davis, 1897; Suojanen,

1954; and Kornhauser, 1989) with no significant development in the theory of the firm compared with the foundation from which it has digressed (Al-Hazzani & Al-Adeem, 2020) stressing the need for continuous theorization for the corporate model (Al-Adeem, 2017). The use of unconventional paradigms in conceptualizing a corporation (e.g. Amer & Sajjad, 2014) can portray some or all the nexus of the relationship that collectively create a corporation.

The study is presented as follows. Section 2 stresses that increasing independence, represented by SOX in the United States, is associated with problems leading to reevaluating and rethinking whether independence is practical. Section 3 reviews literature stating that auditors are partners with managers and includes four requirements of SOX. Section 3 also discusses interpretations of such requirements and suggests that policymakers had felt the negative impact of the close relationship between managers and their auditors. Section 4 demonstrates, from law perspective, the notion of general partnership and the legal organization of a partnership. It emphasizes that deciding whether a person is a partner or not is not the responsibility of the person; the law might consider the person a partner regardless of his or her intention. In section 4, the elements of the general partnership contract are applied to the interaction between managers and auditors. Section 5 presents the argument for the general partnership contract as a superior model to the concept of independence for viewing the inaction between managers. Section 6 concludes by contending that the idea of general partnership dominates the concept of independence because the former explains why some auditors are not independent and invites accounting theorists to contribute to the theorization of corporation with the intent that the audit function may not be objective as shareholders hope.

II. THEORETICAL PERSPECTIVE

2.1. Concerns with SOX's Attempts to Save the Auditing Profession by Increasing Auditor Independence: A Literature-Based Assessment

SOX attempted to increase auditor independence. Similar to any legislation, SOX is, however, costly (DeFond & Francis, 2005; Leuz, 2007; Mohan & Chen, 2007; Ahmed et al., 2010; Fornelli 2012; and Kranacher, 2012) and may have unintended consequences (DeFond & Francis, 2005; Vakkur et al., 2010; Fornelli, 2012; and Dah et al., 2014) and negative effect on US-listed firms (Zhang, 2007) as well as on cross-listed foreign companies (Litvak, 2007; Rupley et al., 2011). Such consequences may be weighted to balance with its benefits (Rupley et al., 2011).

SOX contains 11 sections that suggest changes to the auditing profession. This study explains two of these changes: having CEOs and CFOs to sign the financial statements and rotating the audit partner. Possible downsides of these changes in the relationship of auditors with managers are discussed as well. After arguing for the natural jointness between the audit industry and the market, a possible dilemma faced by big auditing firms owing to SOX stipulations is discussed.

2.1.1. Highlighting some changes introduced by SOX

The first change that makes CEOs and CFOs along with their auditor responsible toward shareholders does not add significantly to the already established responsibilities borne by both parties by the law. Before the assurance of SOX, "directors and officers incur personal liability for breaching any of the duties they owe to the corporation and its shareholders" (Mann & Roberts, 2000, p. 751; Bagley, 2002). However, it can be argued that making CEOs and CFOs officially responsible may only help auditors. Before SOX, auditors would sign the financial statements and were fully

responsible. Following the introduction of SOX, CEOs, CFOs, and auditors are bound together. Such an association increases the jointness that perhaps already exists (Al-Adeem, 2015).

The second change discussed in this study is the rotation of the leading partner every five years. As proposed by Fornelli (2012)[3], the executive director of the center for audit quality, the rotation requirement mandates that

> "Lead audit partner and engagement quality control review partner rotation, which requires the financial statements to be audited by a "fresh set of eyes" every five years. Certain other partners involved with a company's audit must be rotated after seven years."

A rotation might decrease the bond between managers and their auditors developed over time. Extending relationships between cooperative parties alleviates problems of dishonesty (Radner, 1981 as cited in Ballwieser, 1987, p. 341–342). The effect of the duration that managers and auditors spend together on the auditor–client relationship is however controversial. Levinthal and Fichman (1988) argued that the auditor–client relationships improved over time. Cottell and Perlin (1990) reported that the auditor–client relationship "has stretched" across decades. However, rotating a partner may not be the solution (Turley, 2002). Writing in 1936, Richardson argued that, "The professional man who has been in touch with all the detail of the recent past is better equipped than anyone else can be carry on the work and intelligently to advise the directors and officers of the corporation" (p. 83). Over time, the partner accumulates adequate experience and enough knowledge of their clients and businesses, thus enabling them to understand and appreciate audit risks (Honcock, 1993 as cited in Hemraj, 2002, p. 91). Empirical evidence suggests that either compulsory or voluntary auditor changes impose costs on clients (Lee et al., 2009). Studies also showed that no relationship exists between auditor rotation and audit quality (Siregar et al., 2012), especially for large clients (Manry et al., 2008). Experiment-based evidence revealed that subjects do not differentiate between partner and firm rotation (Kamath et al., 2018). In some jurisdictions, mandatory firm rotation is correlated with substantial costs, including weak audit quality (Fornelli, 2012). Another experiment showed that partners in nonaudit firms "compromise their independence for economically important listed clients after the mandatory audit partner rotation rule came into effect" (Chi et al., 2012, p. 331). At the end of the cooling-off period, the rotating-back partners lean favorably toward treating ex-clients more than in nonrotation situations (Firth et al., 2012). From the users' perspective, rotation of audit firms fails to enhance independence and audit quality (Daniels & Booker, 2011). Partners who manage and lead their audit firms are "salesmen" (Belkaoui, 1989, p. 102). Over time, the auditing profession and marketing have not distanced in practice (Broberg et al., 2013). Partners understand the type of relationship preferred by the client with the auditor and its significance (Fontaine & Pilote, 2012, p. 2). Their topmost obligation is "to circulate, make social contacts, publicize their firm" (Byrnes, 1953, p. 177). Then, to what extent is auditor independence in the corporate model strengthened and enhanced if an individual partner is replaced by another individual whose chief roles are the same?

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[3] Written statement by Cindy Fornelli (2012, March 22), PCAOB public meeting on auditor independence and audit firm rotation, Washington, D.C. Retrieved January 24, 2021, from https://www.thecaq.org/news/written-statement-cindy-fornelli-pcaob-public-meeting-auditor-independence-and-audit-firm-rotation-2/.

Because a partner is more dependent on the auditors from various levels in the engagement, the new partner is subject to the power of lower participants. Given that access to information is a source of power (Mechanic, 1962), auditors at different levels of hierarchy in the engagement have different magnitudes of power, depending on their hierarchical positions. Arguably, auditors directly deal with client's information and thus have direct access to evidence, enabling the partner to access such information. Then, accessing information by the partner depends on not only the effectiveness but also the willingness of other auditors at other levels in the engagement to pass on and communicate information in their possession. Auditors are "social animals" who deeply depend on information than other audit firm staffs (Kleinman & Palmon, 2001, p. 10). However, these auditors are subjecting themselves to risk of being fired by the partner as well as to other legal or professional consequences if a partner discovered such a behavior; yet, it is at the auditors' discretion to share information or to assume the risk of not sharing the information.

Moreover, the new auditor may lack firm-specific knowledge and familiarity (Myers et al., 2003). The new partner should learn a new client structure (Gietzmann & Sen, 2002). "Given the length of time (approximately two years) required for an auditor to gather and really understand a new client company's history," the question, hence, is "how does one think that within a five-year period a new firm will be able to detect previous firm's errors, especially if those errors are intentionally hidden?" (Barton, 2002, p. 10). While Myers et al. (2003) were concerned with the rotation of the audit firms, the same applies to the rotation of a partner who relies on the client to understand the client's business, which further increases the managers' power. Auditors depend on others, including the client, for accessing authentic information (Kleinman & Palmon, 2001) and shared knowledge (Eilifsem et al., 2001 as cited in Fontaine, 2010, p. 12). As "social animals," auditors depend on the information and client's social influences (Kleinman & Palmon, 2001, p. 10). However, clients, particularly larger enterprises, do not like information related to their private affairs to be in the files of professional firms with an extensive co-relationship in the markets (Byrnes, 1953).

Providing nonaudit services (NAS) is an opportunity for auditors to understand the clients' businesses (Read & Tomczyk, 1992; Norris, 2000; Windmöller, 2000; Green, 2008; Lee et al., 2009; Knechel & Sharma, 2012a; Knechel et al., 2012b; Svanström & Sundgren, 2012; Svanström, 2013; and Sherwood et al., 2020), appreciate risks in clients' businesses (Hemraj, 2002), enhance the work efficiency (The Commission on auditors' responsibilities also known Cohen commission report, 1978; Simunic, 1984; Lee et al., 2009; and Knechel et al., 2012b), and augment both audit effectiveness (J. Terry Strange as quoted in Norris, 2000) and audit quality (DeFond & Zhang, 2014). Edwards (1987, p. 115-116) summarizes how CPAs have engaged in providing NAS.

> "The rush of work and shortage of personnel during World War II allowed CPAs to apply their skills and expand their involvement into new areas of consulting. As a result, management services grew rapidly in the 1950s. With the addition of consulting services the issue of independence became a subject of increasing discussion. The securities laws required independence, and a controversy arose over whether there would be a conflict of interest if a CPA performed the attest function and provided consulting services."

Knowledge spillover affects audit quality and efficiency when the same-city office provides both audit services and NAS to a client in New Zealand (Knechel et al.,

2012b). Swedish small- and medium-sized clients or firms reported a positive relationship between perceived audit quality and probability of NAS provision (Svanström & Sundgren, 2012). Knowledge gained through NAS helps an auditor understand a client's complex business (Windmöller, 2000). Reports and statements by accounting professional bodies provide similar results. For example, the commission on auditors' responsibilities also known Cohen commission report (1978, p. 95) declared that providing NAS to an audit client enhances an auditor's understanding and familiarity and helps in conducting the audit, knowing that an audit requires substantial knowledge about a company, its procedures, and business. Empirical evidence revealed that greater access to non-CPAs in audit firm office is correlated with greater audit quality, leading to the conclusion that audit quality depends on the availability of non-CPAs to support audit engagement teams, in addition to its dependence on audit-specific human resources (Sherwood et al., 2020). United States general accounting office revealed in July 2003 (U. S. GAO, 2003 "hereafter," p. 13) that NAS helps audit firms to better understand client complexity. The new financial instruments (derivatives) are an example of what auditors can learn about the clients' business. Considering that a few empirical studies have found that auditors' decisions to qualify their opinions are not affected by NAS provision (Craswell, 1999), prohibition of NAS has led to the unavailability of a valuable source of understanding a client better (Arruñada, 1999). Carey (2008, p. 302)[4], former executive and administrative vice president of the American Institute for Certified Public Accountants (AICPA) in 1970, argues in his speech that NAS "are obviously useful, or they would not be in increasing demand…the evidence has been unconvincing that the performance…[of] such services has in fact adversely affected the objectivity of CPAs in their audit functions." The benefits from providing NAS for the profession in practice are practical rather than theoretical (Mednick & Previts, 1987). NAS provision benefits society and introduces better-informed audits (Olson, 1980, p. 82). Calls for NAS prohibition have not included all services, rather proportional (e.g. Plaats, 2000). The association between tax and audit services is widely understood (Mednick & Previts, 1987). Currently, providing tax services to an audit client is not prohibited under SOX when the prescribed requirements are met.

However, investors perceive a possible conflict when the same firm provides NAS and audit services (Hemraj, 2002). Empirically, at high total relative fees, NAS provision results in a threat to shareholders' perceived independence (Holland & Lane, 2012). A review of the literature over 40 years confirms that stocks are priced lower when corporations pay their auditors large fees for NAS (Francis, 2006). Empirical evidence also revealed that NAS provision is negatively associated with the perception of auditor independence (Beattie et al., 1999; Alleyne et al., 2006). Users of auditors' opinions desire attestation of the dependability of financial statements from a party outside of management and the entity being audited (Olson, 1980, p. 80).

Ironically, accounting professional bodies and regulatory agencies have reported controversial evidence and reached different conclusions about the effect of NAS provisions by auditors on their independence. While reports by the U. S. Congress (1976) concluded that auditors' independence is impartial due to supplying NAS to their audit clients, the AICPA (1969) had concluded the opposite. Evidence that proves

[4] As the abstract of the document states, "*The original version of this paper is, previously unpublished, was delivered to an accounting seminar at the university of Illinois in 1970…This paper was first published in 1987 and reproduced from the Catalyst magazine with permission from The Ohio Society of CPAs.*"

that NAS caused a particular case of audit fraud is as difficult as it is to prove that a particular lung cancer is caused by smoking (Moore et al., 2006). Survey-based accounting research does not support the existence of a linkage between NAS provision and audit failure (Windmöller, 2000). NAS do not affect auditor independence (Arruñada, 1999). Audit fees do not affect auditors' tendency to qualify an audit opinion even with NAS fees (Craswell et al., 2002). The AICPA, SEC Practice Section, and Public Oversight Board, in their joint report (1979, p. 21), concluded "that impairment of independence in fact has not been demonstrated and impairment of the appearance of independence can be cured with greater awareness." In 2020, the AICPA defined independence as

a). Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

b). Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party, who has knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.

Moreover, for several audit firms, the fees collected from NAS were more profitable than those from audit services (Cottell & Perlin, 1990). During the 1990s, revenues from NAS grew from 12% to 32% (Ashbaugh, 2004, p. 145). In 1998, audit and accounting fees represented 34% of the total revenue for the big 5 (down from 70% in 1976), whereas NAS contributed 40% increase from 15% (Turner, 2000, as cited in Beattie et al., 2001, p. 4). In 2000, the consulting fees, compared with the auditing fees, were "3.7 billion vs. 1.2 billion in" (Levitt as cited in Bogle, 2002, p. W1). Another survey containing 100 auditors revealed that the average ratio of the fees from auditing compared with the fees from NAS was 1 to 9 (Fisher, 2003, p. 30). The significant amount of wealth generated by NAS to auditing firms raises a concern that such fees could bias the auditors' judgment. Maintaining objectivity may be challenging when comparing the fees from NAS provision to fees from providing objective attestation services, although Craswell et al. (2002) found that NAS fees do not contribute to auditors' tendency to even qualify an audit opinion. Positivist accounting researchers argued for a market resolution for auditor independence. Specifically, the market mechanism guarantees or even forces auditors to limit their list of NAS they are offering to their clients (Watts & Zimmerman, 1981; 1982; and 1983). Auditors are conjectured to be economics agents serving their self-interest (Antle, 1982) and having incentives to maintain independence from their clients (Antle, 1984) or facing market consequences if not properly monitoring corporate reporting (Watts & Zimmerman, 1983).

The impact of NAS provision on auditor independence is an ongoing debate in the accounting literature and among accounting professionals and regulatory bodies. Sharma (2014, p. 67) illustrated how NAS provision became a long-standing apprehension in auditing profession,

> "NAS became a significant concern following deregulation of the audit market in the 1970s. The intent of deregulation the audit market was to create competition and increase audit quality. However, competition and active advertising including pursuit of clients by audit firms resulted in

> discounted audit fees and paring of margins. To compensate, audit firms entered the consulting market which rapidly became very lucrative. The audit was a loss-leader commodity as firms low-balled to secure new clients."

Hence, there is ongoing debate about NAS provision in the auditing profession (Sharma, 2014, p. 85). However, the accounting literature related to this debate is inconsistent (Anandarajan et al., 2008). Those who argued against NAS provision by auditors to their audit clients are in support. Similarly, those who argued for permitting an auditor to provide NAS to their audit clients can justify their argument, for example, using audit quality enhancement because of the knowledge accumulated by the auditor through a better understanding of the client's business.[5] There may not be a right answer for such a status quo (Lowe & Pany, 1994). Empirical findings revealed that the effect of providing both audit and NAS services to the same client on audit quality varies, depending on whether the corporation is healthy or weak (Cheng et al., 2019). The reviewed accounting literature suggested that the impairment of audit quality by NAS provision differs by counties (Tepalagul & Lin, 2015). Preventing NAS by policymakers and governments may be perceived as policymakers' reaction toward the negative impact on auditors while providing auditing to their clients. Reviewing accounting research over 40 years, Francis (2006) concluded that no correlation between NAS provision and audit failures exists. Although "[t]he profession is continually reviewing ways to maintain independence. [In addition to] [a]ll personnel in a CPA firm are subject to the same independence requirements when providing service to publicly held companies, regardless of their particular specializations" (Edwards, 1987, p. 115-116), the big corporate failure at the beginning of the Millennium and recurrences should silence the argument for no association between providing NAS and lacking independence, unless proven that failed corporations had associated themselves with their auditors such that it exceeds offering them the opportunity to learn about their business and operation by helping them provide NAS.

In addition to this component of the post-SOX environment, prohibiting NAS and required rotation placed a new partner in a disadvantaged position compared with their client management because of the increased dependency on the client, an outcome that is undesirable and unintended by SOX, yet should be faced. Although SOX has been enacted to address the illness faced by the audit market, the act seems to have put the big 4 in an undesired situation by strengthening the existing association between the big 4 and large multinational corporations. Apparently, audit firms follow the model adopted by the companies in the market. Forming multinational corporations has called for multinational audit firms that can meet the need for such giant corporations. Accounting firms are legally organized in the form of partnerships. Hinings et al. (1991, p. 375) stated that, "… [accounting firms] have a significantly different authority structure from corporations because of their control through a partnership of professionals." Moreover, accounting firms were not planned for today's giant and more complex businesses (Squires et al., 2003, p. 167). Because of the limited capability inherited in the partnership structure of raising capital (U. S. GAO, 2003, p. 4 and 15), audit firms were left with no choice other than to consolidate to form larger multinational firms. In the late 1980s, the audit market experienced waves of consolidation that left the market with five big firms instead of eight, later becoming

[5] For a comprehensive review of the literature on NAS and auditor independence, Schneider et al. (2006) and Sharma (2014).

four after the disappearance of Arthur Anderson. The goal of such consolidation was to "build bigger practices that will provide more services to the clients" (Cooper, 1989, p. 1). This wave of consolidation may be a consequence of the mergers and acquisitions that had occurred in various industries, starting from the 1950s (Jeter & Chaney, 2001), but perhaps those in the late 1970s and 1980s had more impact on the audit market. It is naïve to isolate the audit market from the corporate model or to ignore the market structure for publicly traded corporations while studying and analyzing the audit market. However, ties and associations already existed between the big 4 and large multinational corporations. According to U. S. GAO (2003, p. 5), "Participants in the market often expect public companies to use the big 4." "A big 4 audit of a company is still a symbol of prestige and power" (McKenna, as reported in The New York Times August 2, 2005). U. S. GAO (2003, p. 26) also finds that "large public companies have limited number of accounting choices." The big 4 enjoy a significant competitive advantage because "no firm is able to grow to be able to compete the big" (U. S. GAO, 2003, p. 45). Watts and Zimmerman (1986, p. 316) asserted that, "[i]n large capital markets, it can be very costly for an individual auditor to establish a reputation for independence and competence." Small firms face certain entry barriers to the audit market (U. S. GAO, 2003, p. 6 and 45): (1) the lack of staff resources and expertise, (2) their inability to raise capital to expand their operations to be compatible to the big firms, (3) the inability to bear the cost of insurance associated with engagements of large multinational corporations, and (4) the market or users' perception of financial statements. The markets prefer the big 4 because of their reputation.

While SOX increases the ability of non–big audit firms to deal with client pressure (Kao et al., 2013), the tie between big clients and big Audit firms may have been strengthened. SOX has forced the big 4 to prefer big public companies for them to earn the highest possible return and hence to be economically efficient in their operations. U. S. GAO (2003, p. 45) stated that, "Because the audit market has become more concentrated, the big 4 have been increasing their focus on gaining contracts of larger public companies." Hence, the big auditing firms are for big corporations. However, the audit market's oligopoly structure subject it to accept the "too big to fail" ideology, where no more audit failures occur even when committing misconduct (Cunningham, 2006).

SOX may be regarded as an effort to prevent some of the motivation for and to stop creating an alliance between managers and their auditors by increasing auditor's independence. Academics, however, expressed doubts about the effectiveness of the solutions proposed by SOX (Green, 2008; Fogarty, 2010; and Adelopo, 2012). Measuring the effect of the enactment of SOX on auditor behavior is relatively premature (Kao et al., 2014).[6]

Creating financial markets that nurture auditor independence through only government regulation is insufficient (Defond et al., 2000, p. 269) because rules are neither a substitute for personal truthfulness nor do they eliminate the inborn conflict between serving the public and sustaining profitability (Squires et al., 2003, p. 172).

[6] Kao et al. (2014) replicated Li's (2009) study by extending the sample. The findings of Kao et al. (2014) do not support that of Li (2009) that SOX enhanced auditor's conservatism. Kao et al. (2014) attributed the divergence between the findings of both studies to the periods included in both studies. While Li's (2009) study represented the immediate reaction by the profession to the passage of SOX, Kao et al. (2014) contended that, eventually, the effect of any new regulation requires time for full implementation and for its effect to be observed.

Rules-based accounting system subjects CPAs to the executives' requests to meet the letter of the rules (Mano et al., 2006), but not necessarily the intent (e.g. Alexander & Jermakowicz, 2006; Benston et al., 2006; and Mano et al., 2006). Defining the rotation requirement as a change in the lead partner within an auditing firm, SOX lacks a provision to rotate firms conducting the audit and lacks the provision to prevent a client from firing an auditor (Bazerman et al., 2002). Such limitations incentivize auditors "to keep their clients happy" (Bazerman et al., 2002, p. 8). Even during the post-SOX era, auditors perceived the effect of jail time as a function of economic consequences (Ugrin & Odom, 2010). When penalties increase, moral reasoning on auditor independence reduces (Yu, 2011). SOX first might increase the auditor's dependence on their clients by rotating the partner who is in charge. Second, augmented independency should lead to reduction, but not necessarily elimination, of the manager's influence over the auditors when managers and their auditors are negotiating the implementation of accounting standards or accounting procedures (Fogarty, 2010).

SOX does not entirely solve auditor-independence-related issues (Xu & Wang, 2004). There is limited knowledge about the quality of audit firms in the post-SOX corporate environment (DeFond & Francis, 2005; Lennox & Pittman, 2010). Although independence should lead to better-quality audits (Rahmina & Agoes, 2014), various threats to auditor independence remain strong, despite all proposed remedies to mitigate the threats to auditor independence (Livne, 2013; McKenna, 2013), which makes independence impossible under the current audit system (O'Commor, 2002; Tanlu et al. 2003). In his speech, Harris (2016), a PCAOB member, warned that, "investor protection is still not in the DNA of the auditor" and hence "..... investors should be concerned about the emerging threats to auditor independence from the evolving firm business model."[7] Considering that audit standards do not assure the discovery of fraud (Carmichael, 1975; Belkaoui, 1989; Bayou & Reinstein, 2001; and Sanchev, 2002), why would one believe that SOX can detect independence destructions? (Brehmer, 2013). Without identifying and defining the causes of audit failures, the same obstacles that constrained auditors from being truly and entirely independent professionals may still exist in the post-SOX reformed audit environment (DeFond & Francis, 2005). Therefore, attempts to increase independence may not have been successful. Achieving an optimal balance between sustaining wide-ranging and productive client relations and the auditors' responsibility to shareholders and regulators for the good for all parties benefiting from corporate reporting and auditor opinion is always a challenge for an auditor (Sanchez et al., 2007, p. 242). Promoting accounting *ideals* cannot be a sound remedy for the damage that auditors keep bringing to their society.

2.2. Signals of Auditors Being Partners with Managers

2.2.1. Sections of SOX indicating dysfunctional audit client relationship

The SOX stipulations can be seen as manifestations for the latent stimulus of the policymakers to safeguard public interest from a dysfunctional auditor–client relationship. Analyzing motivations of and the underlying intentions for particular sections of SOX supports the perception that executive managements are to build close relationships with their auditor.

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[7] Retrieved November 23, 2020, from https://pcaobus.org/news-events/speeches/speech-detail/auditor-independence-and-the-role-of-the-pcaob-in-investor-protection_616.

Section 203 stipulates changing the partner who is in charge after five years. Policymakers felt the negative impact of the evolved relationship between managers and auditors. Executive managers, who experienced a change in their auditor, reported less satisfaction compared with those who had not experienced a change in their auditors (Daugherty & Tervo, 2008).

Section 201 prevents audit firms from providing NAS to their clients to whom they provide audit services. Before enforcing the act, there was a dispute for decades over providing NAS to clients whose financial statements were audited by the same audit firm. The concern was the effect of NAS provision on auditor independence.

Section 301 requires forming an audit committee to deal with auditors. Apparently, the policymakers recognized the power that management has over their auditors, and to reduce it, SOX reinforces the requirement that auditors must be hired by a party other than those whose work is reviewed by the auditors to issue opinions. To make an explicit concern about management's power, Section 303 considers exercising improper influence by management on the auditor as lawful. Accounting researchers, however, have doubted the effectiveness of audit committee as a corporate governing mechanism (Abdolmohammadi & Levy, 1992 as cited in Gibbins et al., 2001; Adelopo, 2012; Al-Adeem, 2015; and Fogarty, 2003) and their need to improve by following a learning curve to acquire the necessary skills (Fornelli, 2012). Executive management remains powerful in deciding on auditor retention and compensation (KPMG, 2004 as cited in Sanchez et al., 2007, p. 242) as more involvement of audit committee in selecting the lead partner, interviewing them, and determining the attributes necessary for a particular audit engagement are still at the suggestion stage (Fornelli, 2012).

Managers work closely with their auditors (Fogarty, 2003) and are involved in interpreting accounting standards and data, besides timing or structuring transactions that need judgment (Healy & Wahlen, 1999; Nelson et al., 2002). Auditing standard 1001.05 recognizes that, "In the course of his day-to-day practice, the independent auditor encounters a wide range of judgment on the part of management, varying from true objective judgment to the occasional extreme of deliberate misstatement"[8] (AICPA, AU 1001). "[B]ecause auditing is imperfect, management's use of judgment…creates opportunities for 'earnings management,' in which managers choose reporting methods and estimates that do not accurately reflect their firms' underlying economics" (Healy & Wahlen, 1999, p. 366). "An auditor who suspects questionable accounting must…choose, unconscionably perhaps, between potentially harming his client (and himself) by challenging a company's accounts or harming faceless investors by failing to objectively the possible skewed numbers" (Bazerman et al., 2002, p. 5). Auditors can learn about managers' motivation of only through personal interaction when inquiring from the management for attesting corporate reports (Comunale et al., 2003). The corporate model mandates that managers build close relationships with their auditor to jointly generate audited financial statements.

Section 302 makes CEOs and CFOs responsible for the "presentation of material" in their company's financial statements. CEOs and CFOs should safeguard their interests while trying to influence auditors because executives should sign the financial statements. CEOs, CFOs, and auditors have become responsible; the fairness

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[8] Retrieved November 16, 2020, from https://pcaobus.org/Standards/Auditing/Pages/AS1010.aspx.

of presentation of the financial statements is no longer the responsibility of auditors alone.

Finally, section 404 makes the management responsible for assessing the company's internal control (Hamilton & Trautmann, 2002). In short, the SOX stipulations highlight the managers' intentions to maintain close relationships with their auditors, particularly leading partners of engagements. The interpretation of such requirements is supported by observations provided in the accounting literature.

2.2.2. From the accounting literature

Several accounting scholars have demonstrated that, individually, external auditors of publicly traded corporations do not differ from the CEOs of those corporations. Cheney (2002, p. 30) stated, "now, in the eyes of many, 'CPA' is synonymous with 'CEO,' and 'CEO' does not stand for any thing good." Quoting UBS Warbutg investment (Browing & Zuckerman, 2002 as cited in Bost 2003, p. 45) added, "People…don't believe the chief executive when he tells the earning have recovered, and they don't believe the accountant when he confirms it."

At the organizational level, audit firms share aims with management of corporations. Competition among audit firms (U. S. GAO, 2003; Numan & Willekens, 2012) may compel them to choose the client as their top priority and to defend them (Al-Adeem, 2015). This would explain why accounting firms breach the contract with their society (Businessworld*,* 2000). Commenting on the speeches of Levitt, the former chairman of the SEC, Bogle (2002, p. W1) stated that he "also challenged the accounting profession to raise its standards, a reflection of his concerns that audit firms were compromising their integrity by acting as business partners of their clients…" Cottell and Perlin (1990, p. 34) also confirmed that, "As time passes the client and the firm are increasingly identified with one another in the public eye." The price of the services does not trigger a dispute between audit firms and the company if the services are demanded and when the two firms collectively work as partners in the value-added plan (Fogarty, 2010). Coauthoring several papers on auditor independence and self-serving bias, Bazerman demanded prohibiting auditor from "long-term cooperative partnerships with their clients."[9]

2.3. Reconceptualizing the Auditor–Client Relationship: A Positive View Competing with the Normative View

For an auditor to be independent is a matter of choice. The executive director of the center for audit quality, Fornelli (2012)[10] stated,

> "It is up to each individual on the audit team to discharge his or her professional responsibilities to perform a quality audit, and for their firms to cultivate an environment where independence, objectivity and skepticism are visibly valued attributes, reinforced by their internal systems of quality control."

While independence is the auditors' ideal, they may be, in reality, partnering with their client management, if not acting and conducting their audits according to their ideals. Agency as a meta-theory for corporate model permits such a conceptualization (Ballwieser, 1987; Kleinman & Palmon, 2000) in the form of partnership.

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[9] Max Bazerman, creating auditor independence. Retrieved June 28, 2015, from http://pcaobus.org/Rules/Rulemaking/Docket037/ps_Bazerman.pdf.

[10] See footnote 3 for information about this source.

2.3.1. The notion of the general partnership contract

Accounting researchers have focused on the interaction between executive managers and their auditors. They conceptualize such an interaction as a "negotiation" (Murnighan & Bazerman, 1990; Antle & Nalebuff, 1991; Kleinman & Palmon, 2000; Bame-Aldred & Kida, 2007; Wang & Tuttle, 2009; Gibbins et al., 2001, 2010; Perreault & Kida, 2011; and Sahnoun & Zarai, 2009, 2011), "jointness" (Gibbins et al., 2001; Al-Adeem, 2015), "coalition" (Ballwieser, 1987), "allied" (Windmöller, 2000; Gibbins et al., 2001), "non-sum zero game" (Devine, 1999), "harmony" (Fogarty, 2010); and "joint venture" (Windmöller, 2000). The "partnership contract" model encompasses all these views to offer a theoretical explanation that contradicts the independence concept.

General partnership is a form of organizing efforts to achieve certain objectives and accomplish specific tasks. Bagley (2002, p. 749) stated that, "A general partnership is created when two or more persons agree to place their money efforts, labor, or skills in a business and to share the profits and losses." Once a partnership is formed, the persons are legally called partners. They have equal rights to control the partnership and share liability for the partnership's debt (Mann & Roberts, 2000).

Furthermore, flexibility in organizing partnerships can be because of "[t]he statute of frauds does not apply expressly to a contract for the formation of a partnership" (Mann & Roberts, 2000, p. 620). Consequently, the absence of a written contract does not imply that there is no partnership (Mann & Roberts, 2000). The law can consider any business relationship a partnership even in the absence of a written agreement (Bagley, 2002). "A partnership may result from an oral or written agreement between the parties, or from an informal arrangement, or from the conduct of the parties, who become partners by associating themselves in a business as co-owner" (Mann & Roberts, 2000, p. 619). Therefore, there is neither a prescribed form for creating a partnership nor a precise procedure that should be followed for the law to recognize the creation of a partnership. In other words, "…[partnership] is formed without any formality and no documents need to be filed" (Mann & Roberts, 2000, p. 616) because a general partnership can be formed as easily as by a handshake (Bagley, 2002, p. 756).

Furthermore, the law might consider individuals as partners, regardless of how they identify themselves, "if two or more individuals share the control and profits of business" (Mann & Roberts, 2000, p. 619). Hence, the agreement between partners "can be express or implied" (Bagley, 2002, p. 749). In other words, "[t]he legal existence of the relationship depends merely upon the parties' explicit or implicit agreement and their association in business as co-owners, not upon the degree of care, intelligence, study, or investigation that preceded its formation" (Mann & Roberts, 2000, p. 619). Hence, a person would be a partner in a general partnership even if he did not intend it, if he is involved in carrying "on as business co-owner for profit" (Bagley, 2002, p. 749). Defining a partnership as an association of two or more persons to carry on a business for profit as co-owners, section 6 of the Uniform Partnership Act of 1997 (UPA) offers three elements to the existence of a partnership (Mann & Roberts, 2000, p. 620). First, there is an association of two or more persons. Second, a business should be conducted for profit. Third, those persons should co-own the business. These three elements are considered while deciding whether cooperation among people should be treated as a partnership.

The three components together are used for examining the existence of a partnership. The criticality and usefulness of such an examination occur when

partnership among people should be proven while those people claim otherwise. This test can be applied to the auditor–management relationship.

2.3.2. Appling the "general partnership contract" to the manager–auditor relationship

A society whose members have the right to choose needs at least three professionals: lawyers, physicians, and auditors (West, 2003). Similar to other professionals, auditors are confronted with challenges to their independence (Bazerman et al., 1997, p. 90), but much more in magnitude. Considering the auditing as a negotiated process, Antle and Nalebuff (1991, p. 31) describe the audit function as an auditor "curse," stating that

> "Financial statements should be read as a joint statement from the auditor and manager. The statement becomes a joint venture if the auditor is unwilling to provide an unqualified opinion on management's stated representations. At that point, the auditor and client begin negotiations in which the auditor may offer a revised statement. The client may threaten to dismiss him and find one more accepting of its views."

Under such a curse, the public depends on the auditor for maintaining independence. An auditor's independence can be protected by securing all sources that undermine his professional judgment. They occur for two main reasons. First, when an auditor bears a managerial role with his client, his professional judgment is prejudiced by the evaluation of his own work. The SEC released ARS 126 in 1972, reaffirming its position on prohibiting provision of bookkeeping by corporate auditor to their listed clients.

> "A part of the rationale which underlies any rule on independence is that managerial and decision-making functions are the responsibility of the client and not of the independent accountant. It is felt that if the independent accountant were to perform functions of this nature, he would develop, or appear to develop, a mutuality of interest with his client which would differ only in degree, but not in kind, from that of an employee. And where this' relationship appears to exist, it may be logically inferred that the accountant's professional judgment toward the particular client might be prejudiced in that he would, in effect, be auditing the results of his own work, thereby destroying the objectivity sought by shareholders. Consequently, the performance of such functions is fundamentally inconsistent with an impartial examination. However, it is the role of the accountant to advise management and to offer professional advice on their problems. Therefore, the problem posed by this dilemma is to ascertain the point where advice ends and managerial responsibility begins."

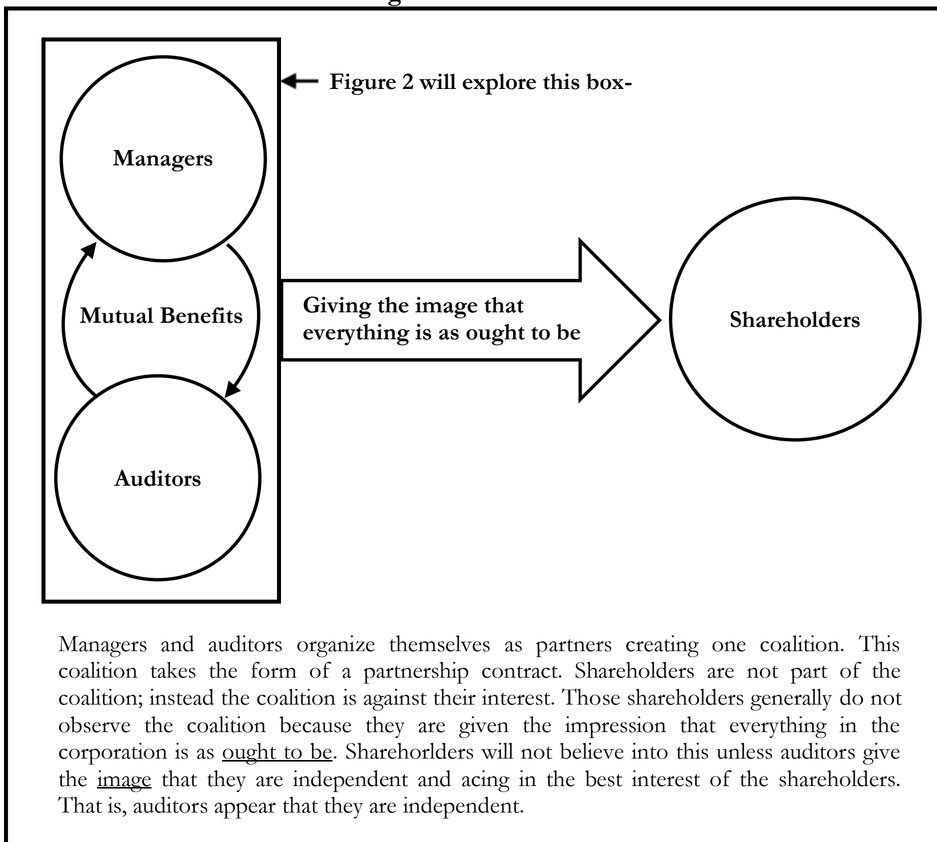
SEC's position on prohibiting auditors from offering bookkeeping services to their audit clients was integrated into SOX (Keyser, 2020).

The second reason that impairs auditor judgment is receiving their compensation from whom they audit. As one of the big 4 illustrates the corporate auditor's predicament and functions in society as a professional:

> "Auditors are tasked with ensuring that financial statements are free from material misstatements while at the same time maintaining a financial working relationship with client management who have responsibility for creating the financial statements and have substantial influence over issues such as auditor retention and compensation." (KPMG, 2004 as cited in Sanchez et al., 2007, p. 259).

Professional corporate managers may behave improperly against the interest of investors and shareholders (Previts, 1985). During interviews, auditors and executive managers revealed that the auditor may be unable to safeguard against third parties from management fraud (Baldacchino, 1992). Arguably, managers and auditors can enter a coalition that is unfavorable to the shareholders (i.e., the owners). Agency theory is proposed to model the auditor–client relationship (Antle, 1982, 1984; Ballwieser, 1987; and Devine, 1999). Agency theory model "explicitly" forms the interaction among three parties: owners-shareholders-, managers and auditors (Kleinman & Palmon, 2001). The model permits "coalitions" between any two of the three parties in ways that may be unfavorable to the third (Kleinman & Palmon, 2001) (Figure 1). This particular "…coalition-forming cannot be ruled out" (Ballwieser, 1987, p. 339). This coalition can be better understood through the application of the general partnership contract. The elements of such a contract are applied to the manager–auditor relationship and further discussed.

Figure 1
How the Coalition between Managers and Auditors Looks Like



2.3.2.1. Signing the general partnership contract

Bagley's (2002) description of the implied agreement among partners fits the relationship between managers and the auditor. The contract is implicitly agreed upon between managers and their auditor through their actions. The security of such an implicit contract might be of concern to the auditor. Such a concern is justified as in any cooperative effort; agency issue is a problem (Jensen & Meckling, 1976). What is the guarantee for the auditor to compel the other party (management) to perform its duties without trapping him? *Trust* plays a critical role among the players in such

coalition. Thus, the agreement in this general partnership can be rhetorically similar to the agreement in organizations, even illegal ones. Trust is the mainstay for establishing organizations, even illegal ones, for example, Mafia, to collaborate (Zimmerman & Forrester, 2020) and maintain their existence and continuation. In this case, signing a contract is irrelevant, because if one party failed or decided to leave the contract unfulfilled, the counterparty could not file a lawsuit, because the subject and action they agreed upon are discouraged by the law or is illegal. Thus, managers do not establish explicit relationships with their auditors unless they are confident that auditors would not default. In their study on the interorganizational relationship between auditors and management, Levinthal and Fichman (1988, p. 366) stressed that "initiating a relationship" refers to some "optimism" about the "validity" of the auditor–client relationship. Levinthal and Fichman (1988, p. 366) further described this "initiated relationship" as an asset that guards the relationship from "unfavorable outcomes." Fontaine and Pilote (2012, p. 4) found that "…clients want a cooperative…trusting, and long-term…relationship." Directors of companies are influential in appointing their auditors based on "personal chemistry" (Hussey, 1999). Evidently, managers are unhappy when their auditor changes as mandated by regulation (Daugherty & Tervo, 2008).

2.3.2.2. The pay back: How each party benefits from the partnership

Why would auditors and managers be willing to cooperate with each other and create an alliance against the third party, risking themselves to lawsuits? There must be benefits. The management desires external certification in the form of an unqualified opinion. The management significantly reduce the cost when it obtains such an opinion from the current auditor by preventing the market reaction when an auditor switch occurs (Fried & Schiff, 1981; Smith & Nichols, 1982; Schwartz & Menon; 1985; Eichenseher et al., 1989; Neu et al., 1991; Klock, 1994; and Gibbins et al., 2001). The auditor seeks reselection to offer NAS, mainly tax services and, before SOX, all services when possible and solicit managers' reference to their colleagues about his services (Neu et al., 1991; Gibbins et al., 2001; and Investor Relations Business, 2002). In fact, auditors select their clients strategically (Johnstone, 2000; Johnstone & Bedard, 2003). Both parties develop a personal relationship such that each party considers the other a valuable service (Neu et al., 1991; Gibbins et al., 2001).

2.3.2.3. The subject agreed upon and duties

This partnership pushes the corporation forward and continues its existence. However, the shareholders are not part of this alliance. Such a goal would require each party to play a particular role. The auditor wants to be reelected, paid well, and to offer NAS when permitted. Before the passage of SOX, auditors were allowed to offer NAS (Simunic, 1984). After SOX, the auditor can only provide tax services, which could still be a good source of business for audit firms. Reciprocally, the auditor should approve the management's performance and make the financial results as attractive for the investors as possible so that the shareholders do not back out. The wealth of the corporation is the main source to fund and finance the coalition. The loyalty is, however, given to this partnership at the expense of the shareholders.

2.3.2.4. How is the contract enforced?

This contract is not enforced by law because the subject agreed upon is neither ethical nor lawful. Each party trusts that the other would play his part in this partnership, since it is a contract based on trust. Trust is a condition for developing the relations between managers and the auditor (Levinthal & Fichman, 1988); hence, it is a preexisting condition for organizing the partnership—*no trust, no partnership.*

"'Relationship' implies that the association between client and firm is more than a simple transaction… It is often the case that the client shares private or confidential information with the firm, and hence a level of trust is established. Both the client and the firm come to know each other and gain an understanding of how the other works" (International Federation of Accountants, 2018). A relationship can move from professional to personal only with reciprocal trust (AICPA, 2020). Such a relationship becomes symbiotic, in that each party takes and receives mutual benefits. Theoretically, such a relationship can exist (Al-Adeem, 2015).

Unlike the contract of corporations, partnerships, where purposes are legally permissible, the law does not stipulate every detail related to the partnership contract. The law assumes that the partners know and trust each other. While discussing a partnership contract from a legal perspective, Mann and Roberts clarified that "A fiduciary relationship exits…Based on high standards of trust and confidence …[partners] place on one another…Each partner owes…Loyalty to his partners" (2000, p. 645). Therefore, any type of partnership, whether defined by the law or created to organize coalitions between managers and auditors, is ultimately built on trust. This explains why managers and auditors act such that they are not responsible toward the third party (shareholders). The idea of general partnership contract explains such an attitude by claiming that managers and auditors view shareholders as secondary because their first obligation is toward their general partnership.

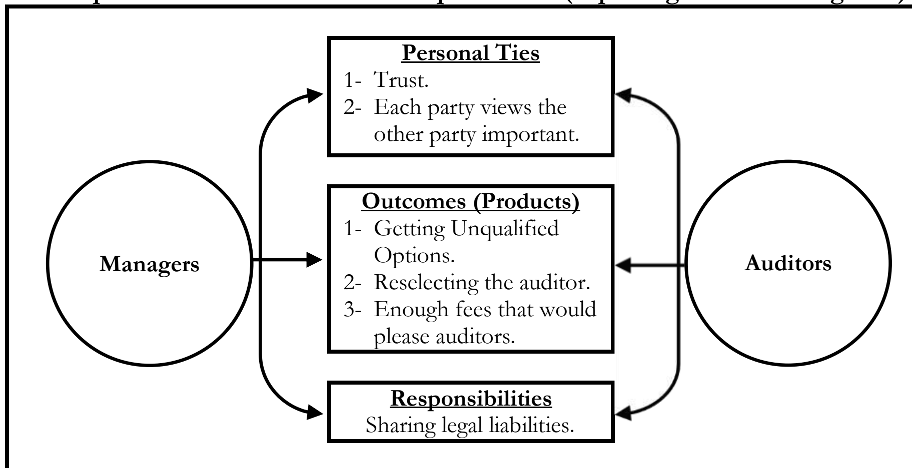
2.3.2.5. Unlimited legal liability

The law holds the managers (particularly, the CEOs) liable for their actions if it is proven that the decisions were made with bad faith and not in the best interest of the people who had hired him (the shareholders). Mann and Roberts (2000, p. 749) claimed, "Directors and officers will…be held liable for bad faith or negligent conduct." They also reported that "directors and officers incur personal liability for breaching any of the duties they owe to the corporation and its shareholders" (2000, p. 751). Moreover, the law allows shareholders to file a lawsuit against the auditors who issued clean opinions despite being aware that the corporations were facing difficulties, because shareholders may have decided to buy stocks in the corporation based on the auditor's opinion.[11] Both parties have a stake in legal liability risk (Palmrose, 1991). Professional bodies such as the AICPA also take actions against the auditor, such as suspending their licenses for violations of professional responsibility. In the post-SOX era, the association between managers and their auditors became official.

Overall, the actions of managers and auditors, along with the surrounding situation, lead to theorizing that managers and auditors are best viewed as partners, and their relationship is best described as a general partnership. While they do not declare such a partnership, their actions imply that a general partnership is already organized. Prudence in choosing an auditor replaces the need to have an official and written agreement. Both benefit from this deal and, therefore, they should have obligations toward the partnership. Each party is engaged in specific tasks necessary for the partnership's survival. Trust between them diminishes the fear that the other party may default. Being personally liable makes managers and auditors similar to partners, who are liable for their partnerships. Figure 2 illustrates the implementation of the partnership contract.

[11] See, for example, Bily v. Arthur Young & Co. (1992); Soderberg v. McKinney (1996); for more discussion on the legal liability, for example, Kiger and Scheiner (1997, ch. 6).

Figure 2
The Implementation of the Partnership Contract (exploring the box in Figure 1)



III. DISCUSSION

3.1. What if it is True that Auditors Act as Partners with their Clients Management? Ideals versus Reality

In their relations and effects on observed reality and practiced procedures, theories in accounting are divided into two categories: normative and positive (e.g. Ijiri, 1975; Watts & Zimmerman, 1978; Wolk et al., 2004; and Schroeder et al., 2010). Normative theories prescribe "what ought to be" practiced in reality, while positive theories describe practices. The concept of independence can be considered normative and ideal. Complete independence can be deemed ideal (Xu & Wang, 2004). Fogarty (2010) used the term "idealizations" to describe firm ethics and independence. Alternatively, the general partnership contract theory can be considered positive.

Independence might be a relevant concept to a perfect world where ideals can be implemented. Realistically, an ideal concept in practice may not be easily placed to serve in an imperfect world. "Auditing, unfortunately, does not have any 'built-in' characteristics that assure the skeptic of its integrity and independence" (Mautz & Sharaf, 1961/2006, p. 253; Xu & Wang, 2004) because "auditing suffers from what can be described as 'built-in anti-independence factors'" (Mautz & Sharaf, 1961/2006, p. 254). Complete and literal independence from the client should not be used for proper definition of independence (Green, 2008). It is a concern to what extent an independent audit can be delivered within "inherited independence-impairing conditions" similar to those between auditors and their clients (Kranacher, 2012, p. 80).

"Self-serving biases" also result in impossible auditor independence (Bazerman et al., 1997; Bazerman et al., 2002; and Bazerman & Moore, 2011). Auditor independence may be mentally unrealistic because auditors' self-serving bias inadvertently occurs while making judgments (Bazerman et al., 1997). Biased judgments possibly prevent auditors from making virtuously impartial objective decisions (Bazerman et al., 1997, p. 90). Self-serving biases exist because humans are imperfect information processors (Bazerman et al., 1997, p. 91). Even experienced CPAs "are not immune from bias" (Bazerman et al., 2002, p. 6). Experienced auditors work as client support in audit situations as they are under tax circumstances in which there is an unambiguous client inclination for substantial, income-aggregate reporting classification and the appropriate generally accepted accounting principles (GAAP) standard is based

on a principle that is similar to a ruling in a tax situation (Roberts, 2010). This is probably because "[i]t is not easy to refuse acceptance of the client's accounting strategy" (Montagna, 1986, p. 111). Overall, as Bazerman et al. (1997, p. 90) stated, "Under current institutional arrangements, it is psychologically impossible for auditors to maintain objectivity; cases of audit failure are inevitable, even with the most honest auditors."

The reality may be that independence is similar to impartiality in that its measurement might be attainable if factors affecting are known and can be controlled (Kleinman & Palmon, 2001, p. 9). The entire audit independence is unfeasible (Olson, 1980, p. 80). Principally, this term is ambiguous (Mautz, 1972; Kleinman & Palmon, 2001; Reiter & Williams, 2004; Green, 2008). Very little ambiguity produces biased judgments and even stricter accounting rules cannot eliminate ambiguity (Bazerman et al., 2002). In their analysis, Kleinman and Palmon (2001, p. 9-10) concluded that "such impartiality is probably impossible to attain…[and] total impartiality is probably too much to require."

Independence cannot be strictly defined partially because auditors are paid by auditee (Green, 2008). While attesting a client's financial statements, auditors maintain a "financial working relationship with client management who possess significant influence over issues regarding auditor retention and compensation" (KPMG, 2004 as cited in Sanchez et al., 2007, p. 259). Auditors are the "only professionals who act independently from the client but depend financially on the client" (Xu & Wang, 2004, p. 14). This financial dependence makes auditors "dependent on the employing organization for the design and execution for their services" and for their payment and promotion (Belkaoui, 1989, p. 23). Individual auditors' contract and careers also depend on the success with particular clients (Bazerman et al., 2002, p. 5). With increasing competition, the risk of losing independence increases (Shockley, 1981, p. 785). Even at the firm level, audit firms compete to earn and sustain audit clients at any cost (Squires et al., 2003, p. 173). The International Federation of Accountants (2018, p. 309) acknowledged that "[i]ncreased competition demands that accountants shore up their client relationships so that clients are less vulnerable to persuasion from competitors." The relationship with client distorts auditors' judgment, considering a relationship involving millions of dollars (Bazerman et al., 2002, p. 6). Auditors lack independence because they are hired, paid, and fired by organizations they audit, but not the people they "ostensibly represent" (Bazerman et al., 1997, p. 90).

Independence makes auditing a profession and assures its existence (Jenkins, 1999) such that Mautz and Sharaf (1961/2006, p. 285) used the term "independent auditing." (Jeanette Franzel as quoted in Kranacher 2012, p. 80) noted, "Without auditor independence, an engagement is not an audit, but, rather, a consulting engagement conducted on behalf of the management."[12] Awareness of the value of auditing affects the quality of performed audit (Institute of chartered accountants in England & Wales, 2011 as cited in Francis, 2011, p. 321). If those who read auditor's opinions are not self-reliant, then auditors are of no value (Fogarty, 2003) to the market participants, who are deemed third (non-contracting) parties (George, 1992), and to auditors' society at large. Third parties agree that without independence, there is no value for accounting and auditing profession (Salehi, 2009). "Auditor independence is

[12] A remark delivered in Marah (2012) at the public meeting held by the public company accounting oversight board (PCAOB) to discuss possible ways to improve the independence.

the bedrock of auditors claim to profession status and public stewardship" (Kleinman & Palmon, 2001, p. 5). Independence is "the cornerstone" of the audit function and its "precious asset" (Hemraj, 2002, p. 92). Independence is *the ideal condition* for the audit profession to exist.

Independence is not a realistic concept for accounting and auditing. It is just an abstract concept (Nouri & Lombardi, 2009). Because "[a]bsolute independence…is almost certainly unnecessary, might be impossible and is, in any event, very costly" (Green, 2008, p. 409), attempts to improve audit independence are naïve and unrealistic for auditor psychology (Bazerman et al., 1997, p. 91) and "very costly" (Green, 2008, p. 409). Independence is relative rather than absolute (Olson, 1980, p. 80). Even internal auditors in public institutions do not understand their roles, which increase the need for educating them about the compliance with the principles of independence, objectivity, and integrity (Aveh et al., 2016). Rulemaking bodies, namely, the AICPA, explain independence principles as "rules" to professional auditors to help them act professionally "with integrity and exercise objectivity and professional skepticism" (AICPA, 2020, p. 1). Rule making is a possible approach for regulating the audit market (Windmöller, 2000). While professionalism is to exercise professional judgment, the application of rules by professionals does not entitle those who belong to such a profession to status quo of being professionals (West, 2003). A shift is observed in the code of values of big audit firms from virtue ethics to ethical legitimacy by reducing expectations to limit their attesting role to the extent to which financial statements are aligned with accounting standards (Hooper & Wang, 2015). Rather than strict imposition of accounting rules, audit firms match corporate accounting needs to appropriate accounting methods (Squires et al., 2003, p. 171). Because of its lack of just-footing, audit concepts including independence need reformation and possibly reconstruction on a well-founded moral ground (Reiter & Williams, 2004).

Advocated normative guidance to emphasize the maintenance of independence in reality and in appearance (e.g. Hassan et al., p. 2003) may not help the auditing and accountancy professions. Stipulations by law for annual reports have benefited the audit profession (Young, 1997, p. 25), but certainly not in defining critical concepts as independence. In the twentieth century, the definition of independence varied over time (Nouri & Lombardi, 2009). All independence rules by the SEC and AICPA (O'Connor, 2002) including SOX may just be of hoax (Green, 2008). Auditor independence may not have been adequately addressed by remedies that SOX defined to regulate the audit profession (Khurana & Rawan, 2006). Instead, of providing a precise definition for independence, title II of the act lists in section 201 what can be labeled as 'not to do list' for activities, roles and tasks that breach auditor independence in an audit engagement. Given that codifying factors and derivers that affect audit quality is an approach for regulating the audit profession (Windmöller, 2000), O'Connor (2002, p. 42) articulated that "it is no wonder that the regulations they promulgate appear fragmented and lack cohesiveness," especially "if regulators are not clear on what the real purpose and value of independence is." In reality, because an auditor does not participate in structuring transactions, the auditor–client relationship can be sustained compared with other accountant–client relationships (Arya & Glover, 2014). The genuine "test of an auditor's independence is the nature of his relationships with the audit client" (Olson, 1980, p. 82). Only auditors know for fact and in magnitude where they are located on the continuum of independence from their client management. In terms of auditor independence, in fact, "only the auditor himself or herself knows for sure whether it has been compromised" (Schneider et al., 2006).

Since auditors are judging the fairness of the accounts prepared by managers, they may "lie" about their independence if they do not fully act independently from the executive management according to the definition of a judge in court (Turnbull, 2006). However, an auditor ought to be perceived "independent even if his judgment is not totally impartial" (Kleinman & Palmon, 2001, p. 10). Owing to limitations in how auditors process information, independence remains a problem for even the most moral, honest auditor (Bazerman et al., 1997, p. 91). The claim is not that they are corrupted; rather, biased judgments prevent them from making purely impartial objective decisions (Bazerman et al., 1997, p. 90) because humans are imperfect information processors (Bazerman et al., 1997, p. 91). For society's belief in the use of professions, namely, auditing and judicial, independence in fact and appearance must be maintained (Kleinman et al., 2012, p. 38). The independence of judges in court is true and real because they depend on neither clients' finance nor endearment to continue serving in the office (Mautz & Sharaf, 1961/2006, p. 253). However, when there is a demand for defining auditor independence, auditors are allowed to offer other services. For example, Carey[13] (2008, p. 302) suggested that

> "Independence should not be defined liberally as to permit relationships which would be likely to erode public confidence in the CPAs' objectivity, but it should not be defined so strictly as to inhibit the rendering of useful services when the likelihood of such erosion is remote."

The general accounting office (as cited in Rouse & Previts, 1998) acknowledged that independence is a long-standing issue as the standing auditor–client bond remains. Doubt cast the independence of auditors from client-managers (Hussey, 1999).

Because the expression "independent" is lost in the morass of intricate terms used to define "independence" with respect to auditors in the law, regulations, auditing standards, and professional codes of conduct, auditors may claim their independence while they lack judgment, integrity, and objectivity (Turnbull, 2006). While adjusting journal entries is deemed bookkeeping, those proposed by the auditor is not deemed bookkeeping that violates SEC independence rule (Keyser, 2020). This discourse is a demonstration of "[t]he critical distinction which must be recognized at the outset is that the concept of independence is more easily defined than applied" (SEC Accounting Releases, 1972). Because "…the phrase 'auditor independence' traditionally has had no precise meaning" until the mid-1980s (Antle, 1984, p. 1), it still exists to date. Diverse stakeholders, for example, public, profession, users, legislators, politicians, journalists, and contestants of the audit profession, have different understandings of auditor independence (Plaats, 2000).When exchanging their wealth for shares in corporations, shareholders accept and perceive that the audit function is neutral and that auditors are objective and impartial. The auditing profession depends on the belief that it delivers the desired outcomes (Devine, 1999). Without its essence and practicality, the perception of independence becomes a depiction to the public. Such segregation of the concept of independence affects society. Self-definition in the audit profession of its role and tasks owed to the public (Young, 1997, p. 25) contributes to the divergence between public expectation and an auditor's performance and impartial opinion. Independence in appearance leads to gap in the expectation (Moore et al., 2006). An auditor in failed audits does not become mentally independent despite his/her probable intention to be objective and failure to act professionally and

[13] See footnote no. 4 for information about this source.

responsibly (Tanlu et al., 2003). Perceived as an ideal public accountant in Britain in the 1800s, William Quilter, who was praised among other qualities of his independence, was known for losing "business by reason of his strict and unbending conscientiousness" (The Accountant as quoted in Parker, 1986, p. 26-27). This is how an auditor should be and must behave. However, when an auditor does so, he bears the consequences of safeguarding public interest and representing the interests of passive stakeholders, namely, shareholders. Abdullah Shaher, a CPA in Saudi Arabia, fought in court because of a lawsuit against him by the corporation's board of directors (AlOmran, 2007) for issuing an adverse opinion on the financial statements of his audit client Bishah agriculture development corporation. Other substantial personal costs that Abdullah Shaher incurred was that other publicly held Saudi corporation management groups and boards of directors were cautious in engaging him for auditing their financial statements (Abdullah Shaher, Personal Communication, 2014). The audit function is sensitive to social ties and networks such that they can enter "sweetheart" deals, for example, audit fee premium through their cozy interpersonal relations with audit committee and CEOs (He et al., 2017; Kwon & Yi, 2018). Managers, if subtle, can motivate their auditors to accept aggressive accounting management (Koch & Salterio, 2015). Empirically, auditors are less likely to adjust the financial statements for large clients (Nelson et al., 2002, p. 198). Partners of non–big audit firms compromise their independence for economically important clients (Chi et al., 2012). From the economic theory of auditor independence (DeAngelo, 1981; Watts & Zimmerman, 1981), Chung and Kallapur (2003) postulated that auditors' incentives to compromise their independence are related to client importance. Disregarding a multimillion-dollar engagement today does not bear the same type of financial outcome from upholding accounting principles and disregarding a client in the past (Squires et al., 2003, p. 166). "Surely it can be…forcefully argued that a client incurring a $1 million audit fees able to influence the auditor's actions that one incurring $100,000 audit fees" (Mednick & Previts, 1987, p. 226). Bost (2003, p. 11) argued that "…auditing firms too often lost their independence and become overly accommodating to their clients in deferring to questionable accounting stratagems." Concerns of losing a client's business lead to unenthusiastic auditor, even where the state of affairs deserves it, to qualify its accounts and publish an opinion that is concerned with going-concern assumption of the client business (Bruce, 1992 as cited in Hemraj, 2002, p. 91). Once an auditor associates his own interest with that of another party, he interprets data to favor that party; hence, attachment breeds bias (Bazerman et al., 2002, p. 5).

Accounting nature may not facilitate it to be "neutral" or "independent" as well (Tinker & Sy, 2017). The audit function is "far from being…objective and neutral," which challenges the endorsed images of audit as a deduced and unbiased procedure (Power, 1996, p. 298). In spite of the social loyalty and biases of accounting, though unobvious, are masked by the self-importance of objectivity and independence (Tinker et al. 1982, 167). This is aligned with the argument that accounting objectivity is a "myth" (Hines, 1988; Morgan, 1988; and Young, 2003) and "rhetoric" (Nahapiet, 1988; Thompson, 1991). Society deceptively is left with an imagined world and sufficient with the rhetoric of a profession as important as accounting, and a function as sensitive as auditing, and a concept as critical as auditor independence. Environmental conditions as the context of the accounting profession change, leading to possible redefining of its concepts and revising its practice (Belkauoi, 2017). Objectivity and its use, as well as definition, have developed in human history to become "a multifarious, mutable thing,

capable of new meanings and new symbols: in both a literal and figurative sense" (Daston & Galison, 1992).

An alternative competing view is to perceive and treat auditors as partners to the managers, which is supported by what market has experienced that some audit firms disappeared when some, or even one, of their clients collapsed, such as Enron and Arthur Andersen, for committing unethical actions. Noland (2003, p. 5) opined that "one audit failure is too many." Audit failures are normal and the expected outcomes of an audit client relationship (Bazerman et al., 1997, p. 90). The linkage between failure of auditor to be and act independently and collapse of corporations becomes a tautology in the accounting literature. After the disappearance of Arthur Anderson, big audit firms, although admitting wrongdoing, were not forced to exit the audit industry, which truly raises a moral hazard concern (Cunningham, 2006). Many more downfalls of corporations are expected to occur. Unless the accounting profession shifts from its idealistic concept to reality, there may be a series of audit engagements failure.

No auditor prefers general partnership. Considering such an alliance will force managers and auditors to conceal it because recognizing managers and auditors, as stated by Mann and Roberts (2000), "a legal entity will enforce legal duties on them." Although Mann and Roberts (2000) used the phrase in a business relation, it may apply to managers and auditors as well.

It should not be understood, however, that all managers of corporations and their auditors organize forge partnerships against public interest. Nevertheless, investors should recognize the possibility that such a coalition exists and is unfavorable to them.

IV. CONCLUSION AND SUMMARY

For a sustainable modern corporate model, an objective party must attest the reports produced by the managers or accounting professionals who prepared them under the manager's supervision. In court, independence was cited as the reason for the need for having external auditors compared with the accountants working in the corporation. Remedies proposed by SOX were insufficient. For example, the long-standing argument for prohibiting an auditor from providing NAS to their clients has not addressed the issues to enhance auditor integrity and objectivity. There is a need for intellectual debate in accounting and auditing. The corporate model should be revisited from an accounting perspective, such that partner alternation brings other issues to the auditor–client relationship.

People, mainly laymen, want to invest in capital markets. They, virtually, want to gain without the homework and cautious decision-making procedures. They believe that in considering only the auditor's opinion, their wealth is safe. Such logic does not work in the capital market where a profit is made by being aware of unique information or by having a hunch based on experience and logic that cannot be explained in a textbook or taught to others. If the methodology followed to make investment decisions were to rely only on the auditor opinion, the capital market would be an easy (if not the easiest) market to actively participate. Instead, investigating opportunities to invest is hardly time-consuming. The perceived cooperation between auditors and managers is the cost borne by naïve investors for leaving their investments under the faith that their money is in good hands. Thus, society fails to act and create truly independent auditing function despite paying a dear cost (Bazerman & Moore, 2011, p. 310). Investors, thus, must watch for their investments and stand to guard their wealth.

"Guard your investment" is a wise advice for investors. If investors were unwilling to heed this advice, it is safe to start their own business or at least save their

money. If investors still desired to take the risk associated with investing in the capital market, they should view auditors as partners to managers. In 1914, Brandies (56, as cited in DeLong, 1991, p. 212) declared: "no man can serve two masters." Investors should consider such a statement as a serious warning. Investors who lose money should be blamed.

Some readers might consider this study interesting. If this study and the idea of the general partnership contract were considered an interesting model, it would be a great payoff. "A theorist is considered great, not because his theories are true, but because they are interesting" (Davis, 1971, p. 309). According to Davis (1971, p. 311), "…All *interesting* social theories….constitute an attack on the taken-for-granted world for the audience." The need for independence has been long debated by accounting scholars (e.g. Cottell & Perlin, 1990; Noland, 2003; Xu & Wang, 2004; and Mautz & Sharaf, 1961/2006). The idea of the general partnership contract alternatively states that rather than requiring auditors to be independent, auditors already have incentives to form general partnerships with the managers, and the two groups are, therefore, partners.

General partnership contract may be more than a theory. It is a new paradigm that has emerged because of the failure of the old paradigm (independence). The term "emerging paradigm" is another term for a paradigm shift (Kuhn, 1996, p. 89). A paradigm refers to "A general perspective or way of thinking that reflects fundamental beliefs and assumptions about the nature of organizations" (Kuhn, 1970 as cited in Gioia & Pitre, 1990; Lincoln, 1990 as cited in Gioia & Pitre, 1990). However, the new paradigm may not be easily accepted, because accounting old habits die hard (Chambers, 1970 as cited in Al-Hogail & Previts, 2001). The new paradigm will be challenged before it dominates the old one. Ultimately, the general partnership contract paradigm will prevail, if provide better explanations why auditors lose their independence from their management client, because it explains the puzzle that exists within the old paradigm: why do some auditors fail to be independent? New theories should be developed from such a paradigm, which explains the behavior of auditors, even honest ones.

Because of the sensitivity of the accounting profession to the latent for bias in the audit (the AICPA's code of ethics, as cited in Bazerman et al., 1997, p. 90), doubts in the ability of auditors to reach an unbiased decision raise questions on the objectivity of accounting as a whole. "How could experts disagree so vastly on something that seems objective as accounting?" asked Bazerman et al. (2002, p. 5).

The underlying concepts of the auditing profession, including the concept of auditor independence, can be justified by accepting them as an act of devotion. Before the passage of SOX, it can be argued that the accounting profession and the audit function both required auditors to be semi- (or partially) independent. In other words, "A range of partiality should be permitted around totally impartial mental stance" (Kleinman & Palmon, 2001, p. 10). Recently, the SEC stated that it aims to reduce "unnecessary" auditor independence red flags[14] (Tysiac, 2020).

Doubt in the objectivity of paid self-biased professionals may lead to revisiting the firm as a model and retheorizing independence accordingly pragmatically as opposed to normatively. Accounting researchers have not contributed enough to the theorization of corporation (Al-Adeem, 2017). Regulators of corporation legislation in

[14] Retrieved November 12, 2020, from https://www.journalofaccountancy.com/news/2020/oct/sec-aims-to-reduce-unnecessary-auditor-independence-red-flags.html.

free markets are focusing on fixing the market mechanism on effective participation of an independently contracted party within the nexus of contracts that portray the firm. Given the impossibility of objectivity, the corporate model should be reconstructed such that attestation is made by partially minded professionals. Even before Enron collapse that "impartiality is impossible under the current institutional arrangement" (Bazerman et al., 1997; Tanlu et al. 2003). Enron was inevitable as independence was impossible under the existing audit system (O'Connor, 2002). Given that no more audit firms have disappeared after the evanescence of Enron does not imply that no material wrongdoings by big audit firms have been occurring, nor does it indicate that no more violations are being committed. Regulators have the option of settlement owing to a limited number of auditors to audit big clients (O'Connor, 2002). Vanishing of Enron has mandated the maintenance of the audit market oligopoly. The elimination of one big audit firm has never been and shall not be a solution to fixing the audit market.

The argument and analysis presented in this study is supported by anecdotal evidence and an extensive review of empirical studies, in addition to reports and studies by regulatory and professional bodies. Similar to Ballwieser's (1987) study, this study is based on a conceptualized model leading to empirical testing. Research on auditor–client relationships is theoretical or indirect because of the difficulty in gaining access to real-life information (Dye, 1991 as cited in Fontaine, 2010, p. 13; Beattie et al., 2001 as cited in Fontaine, 2010, p. 13). Similarly, research on auditor's independence lacks evidence because it is a state of mind and unobservable (Sharma, 2014). Such limitations apply to this study as well.

Further research should consider the argument presented in this study to deduce testable hypotheses where data rigorously validate, or invalidate, the legitimacy of the analysis and conceptual model. Studies should investigate the settings where this model can be expected to exist, so that knowing when the situation is probable becomes profound. Awareness of the phenomenon based on conjecture directed by statistics is informative for policymakers. Hence, researchers should consider the phenomenon while studying the auditor–client relationship. Considering the observation would help researchers to explain the phenomena that they are studying and to develop and advance the understanding of this observation.

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