Auditor Independence, Accounting Firms, and the Securities and Exchange Commission

Application of the Issue Life Cycle Model

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The authors apply the issue life cycle model to analyze the 1999 through 2001 dispute between the Securities and Exchange Commission and the accounting profession concerning auditor independence. The analysis also brings additional insights that extend understanding of the issue life cycle and issues development. This analysis highlights the roles of a trigger event, the shift of an issue from a technical concern to a public debate, and likely recurrence. The reappearance of the auditor independence issue in 2002 with accounting scandals is consistent with the article's findings and highlights the use of the issue life cycle model and issue evolution.

Keywords: social responsibility; corporate social performance; accounting; auditing; auditor independence; issue life cycle; government relations; Securities and Exchange Commission

Accounting scandals at Enron and WorldCom and the related indictment and collapse of the Andersen accounting firm made the role of the auditor in the corporate governance structure a major public policy issue. The U.S. Congress acted quickly to pass the Sarbanes-Oxley Act of 2002 that

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places substantial restrictions on auditors and changes the structure of the development of accounting standards. Ironically, the U.S. Securities and Exchange Commission (SEC) and the accounting profession debated many of the same issues during the 1999 through 2001 time frame.

The 1999 through 2001 dispute between the SEC and the accounting profession is a classic example of a conflict arising from changes in the business environment that affect stakeholder alliances and expectations. The factors underpinning a previously acceptable relationship may change, in effect, causing one or more parties to demand a "renegotiation" of the "contract." One avenue that management researchers have developed to explore the evolution and resolution of these conflicts is the issue life cycle model (Bigelow, Fahey, & Mahon, 1991, 1993; Buchholz, 1988, 1990; Post, 1978; Wartick & Mahon, 1994). This model holds that disputes have common steps in the development, negotiation, and resolution process. The model also provides a means for analyzing factors that determine the degree of endurance of an issue.

The purpose of this article is to examine the 1999 through 2001 dispute between the SEC and the accounting profession regarding auditor independence issues in the context of the issue life cycle model. The debate gives a view of the public policy process prior to the promulgation of regulations and rules, allows identification of factors involved in this process, and helps to improve analysis of the external environment for future conflicts. At that time, the debate took place in the context of the *possibility* of audit failures. With actual audit failures at Enron and other publicly traded firms in late 2001 and into 2002, the auditor independence issue has taken a "crisis" path to entering the broad public policy agenda (Rochefort & Cobb, 1994).

The accounting profession faces a potential loss of legitimacy and credibility in addition to the ability to self-regulate. Auditor independence is of interest to other stakeholder groups as well. For example, the investing public relies on auditor independence for impartial financial information. In addition, small businesses may pay more for accounting services if the audit and nonaudit services are required to be performed by different firms. Cutting across all publicly traded corporations is the concern that further regulation of the accounting profession may bring additional regulations in other areas such as corporate governance and capital formation (Kinney, 1999). The application of the issue life cycle model to the auditor independence issue has implications for the general understanding of the dynamics of an issue, the role of a regulatory agency, and stakeholder strategies.

The findings are consistent with the general pattern theorized in the issue life cycle model; however, our analysis of this issue also brings additional insights that extend the understanding of the issue life cycle and issues development. The analysis highlights the roles of an issues champion and trigger event, the shift of an issue from a technical concern to a more intense, public debate, and the likely recurrence if the resolution does not address the underlying, conflicting values and interests. For example, it is now evident that a trigger event has a far different impact on an issue than an individual trying to garner support for preventative action.

The first section of the article provides background on the auditor independence issue. The second section provides an overview of the issue life cycle model. Third, we apply the model to the 1999 through 2001 debate, identifying strategies that were used in negotiation and resolution. Next, we identify ongoing elements of the issue, findings consistent with the theorized model, and extensions to the model suggested by the analysis. Finally, these extensions lead to future research questions in issues management.

BACKGROUND

Economists have long recognized that asymmetric information leads to contracting complications between principals and agents (Coase, 1937; Jensen & Meckling, 1976). One of the major applications of this dynamic is in the area of investors and publicly traded companies. Investors have an incentive to reduce the amount of resources they are willing to supply a firm due to their inability to directly view the actions of management. Many structures exist with the purpose of reducing this "agency cost." For instance, the SEC plays a role in reducing agency costs through collective "agreements" in the form of rules and regulations (Beaver, 1989). Likewise, the accounting profession has traditionally played a major role in this process through its design of accounting standards and monitoring of adherence to the standards.

The designation "certified public accountant" (CPA) gives the holder the legal right to attest to the conformity of a company's financial statements with generally accepted accounting principles (GAAP). One of the bedrock assumptions underlying this function is that the CPA is independent of the firm under audit (American Institute of Certified Public Accountants [AICPA], 1988). According to the principles promulgated in the AICPA Code of Professional Conduct, "A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services" (AICPA, 1988, Section 55).[1] Professionalism, as defined by the

AICPA, depends on independence and has always been essential to the profession's relationship with the general public. Indeed, the stable market system depends on the trust of investors in the reliability of a corporation's financial statements.

For the same reason, auditor independence has long been a concern in the securities regulatory environment. Rules that define and regulate auditor independence have been part of the securities law since the 1930s (Chatov, 1975; Lowe, 1987). During the 1970s, the SEC studied the provision of nonaudit services to audit clients. It came to the conclusion that the amount of nonaudit services performed for audit clients was relatively small and that audit committees and the profession had been successful in monitoring any resulting independence concerns (SEC, 2000b).

This view was not universally supported, and in the 1970s and 1980s there were attempts by some in Congress to raise the independence issue and other concerns with the accounting profession. Specifically, Congressman John E. Moss (D-CA) introduced a bill in 1976 that would have established an independent oversight board for the accounting firms that performed audits on SEC registrants in a move to promote the independence of the auditor from the client (Briloff, 1977-1978). Similarly, Congressman John D. Dingell (D-MI) "proposed legislation under which public accounting firms would have been prohibited from offering consulting services to their audit clients" (Mahon & McGowan, 1997, p. 79). Those efforts did not gain momentum or public support; the supporters were not able to explain the issue in terms that caught the general public's attention or concern (Mahon & McGowan, 1997).[2] At this time, the SEC was aligned with the accounting profession in defending the status quo and minimizing regulation. However, with the increase in the percentage of nonaudit services as total revenue, the concentration of accounting firms, political changes in Congress and the SEC, and the rise in the number of individual investors, auditor independence became ripe for consideration again.

As a precursor to the 1999 through 2001 dispute, the SEC began to act on the notion that the status quo was no longer acceptable. Lynn E. Turner, then SEC chief accountant,[3] commented on changes in the business environment, stating that "the firms aren't anything like they were. Quite frankly, there has been no examination of these issues [nonaudit services and independence] for 25 years" (Peel, 2000, p. 32). Given a shift in sources of revenue and the level of overlap of audit and nonaudit work over this period, the SEC questioned both the fact and appearance of independence of accounting firms.

Based on an analysis of the revenue streams of the larger accounting firms in the 1990s, management consulting services (nonaudit services) grew at an annual rate of 26% compared to 10% and 13% for audit services and tax work, respectively (SEC, 2000b). The SEC's report highlights that nonaudit services accounted for the majority of overall revenue. Attestation, the function traditionally associated with the large accounting firms, made up less than a third of overall revenue. The SEC used these data as evidence of the growing importance of nonaudit services to the Big Five/Six public accounting firms over the period 1993 through 1999 and as circumstantial evidence of independence problems.

The SEC's concerns regarding the prevalence of overlap of audit and nonaudit services provided to audit clients was supported by a survey of members of the Financial Executives Institute (FEI). The survey found that 85% of the reporting companies paid their audit firms for nonattest services (FEI, 2000). However, the survey also reported that the management of many companies felt that an audit firm has the best understanding of the company's business and can provide consulting services in an efficient and economical manner.

On the political front, the relationship between firms and regulators had changed. Arthur Levitt, as the SEC chairman (Levitt, 1996), placed a focus on investor protection.[4] This emphasis was partly a result of the large increase in participation of individual investors in the stock market. Chairman Levitt often mentioned the increased responsibility brought about by this increase in participation (Dwyer, 2000; McNamee, Dwyer, & Schmitt, 2000).

The SEC's concern resulted in proposed rules in June 2000 that would have imposed very strict segregation of work requirements for audit firms performing work for SEC registrant clients. The Big Five firms countered that the rules were a restraint of trade that would not serve the public good. In addition, the larger firms argued that the SEC's proposal would affect smaller firms through a "trickle down" effect to other regulatory agencies such as state boards of public accounting (AICPA, 2000). In November 2000, the SEC and representatives of the profession came to an agreement on a set of rules regarding auditor independence to be implemented beginning in 2001.

A question that arose from the profession's point of view during the initial stages of the debate was "Why now?" At the time, there was no obvious failure in the auditing practices of the firms and no apparent accounting problems with the SEC-registered companies. However, there was a distinct change in the role of the SEC under Chairman Levitt. Consistent with Post and Mahon's (1980) proposition about a regulatory agency acting as a change agent, the SEC shifted its role from acting as a buffer to reframing the auditor independence issue and changing the status quo operations of the accounting firms.[5] Combined with other changes in the environment such as the increasing importance of nonaudit revenue and changes in the political environment, these developments brought the subject of auditor independence and the role of the accounting firms into debate within the industry. Not all changes in the environment lead to public issues or require an active response from the firm (Rochefort & Cobb, 1994); however, scanning the environment for changes, forces, or trends may assist firms in developing strategies to affect the issue. The following section discusses the issue life cycle model as a method of analyzing public policy discourse.

ISSUE LIFE CYCLE MODEL

Understanding the evolution of a controversy may help firms recognize, understand, and address relevant catalyst issues while there is a greater opportunity for the organization to influence the resolution (Bartha, 1982). With this goal in mind, various scholars have proposed and refined a sequential issue life cycle model to understand the dynamics of issue development (Bigelow et al., 1991, 1993; Buchholz, 1988, 1990; Post, 1978; Wartick & Mahon, 1994). The robustness of the model is evident in its application to a variety of contexts. For instance, in the public relations area it has been applied to examine changes in the business environment (Gonzalez-Herrero & Pratt, 1995; Meng, 1992; Wartick & Rude, 1986). In the management and public policy field, analyses have drawn attention to the stakeholders, their powers and pressures, stages of planning and implementation, and various options at different stages based on the political, legal, and social environment (e.g., Bigelow, Arndt, & Stone, 1997; Peery & Salem, 1993; Winsemius & Guntram, 1992).

We detail the four phases of the model and note some important events in the 1999 through 2001 dispute regarding auditor independence in Figure 1. As indicated by the solid line, the issue life cycle model predicts that the level of stakeholder awareness gradually increases from Phase 1 to Phase 3 and may level off or decline in Phase 4. One of the primary tenets of the model is that the ability of management to control the ultimate outcome decreases as the issue moves through the process (Mahon & Post, 1987; Mahon & Waddock, 1992).

The first phase of the issue life cycle begins as a difference evolves between an organization's behavior and stakeholders' expectations. Changes in the macro-environment, such as demographic and economic changes, may alter stakeholder expectations, resulting in a performance-expectations gap (Post, 1978). The extent of this gap is directly related to the intensity and diversity of the groups' interests and values (Bigelow

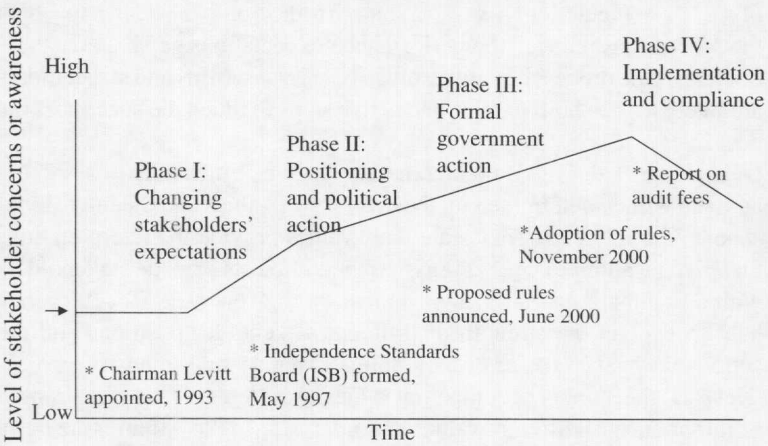

Figure 1: Issue Life Cycle Model
Source: Adapted from Post, Lawrence, and Weber (2002).

et al., 1993). If the gap is wide enough, the issue moves into the second phase, political positioning. At this early stage, the organization may be able to recognize and take proactive steps to close the gap before the issue moves further into the cycle.

The second phase is the political action phase. In this stage, stakeholders raise awareness by communicating to the public and other stakeholder groups to campaign for support. Stakeholders and coalitions of stakeholders are involved in political action and trying to influence the public and the government. In this stage, groups are also attempting either to forestall further action on the issue or to redefine the parameters of the dispute to favor their position. The second phase transitions to the third phase, usually with a proposed law, regulation, or policy.

The third phase is the positioning and negotiation phase (Bigelow et al., 1991). In this phase, the firm's ability to control or influence the resolution decreases relative to the positioning stage (Post et al., 2002). The third phase solidifies interpretation of the issue and allows for stakeholders to interact with each other in a more formal setting and perhaps come to a resolution. In a regulatory setting, the resolution often takes the form of a formal government action such as passing a law or approving a final regulation.

The fourth phase is the enforcement phase. This portion of the life cycle includes the actual implementation, compliance, and enforcement of the law or regulation. A key to a smooth transition is the degree to which the process has reduced the performance-expectations gap among stakeholders. If the process has not resolved core issues, firms and stakeholders are likely to take both passive and active steps to block the success of the new rules.

Bigelow et al. (1993) predict that the degree of difficulty of resolving an issue will be determined by the diversity of values and the intensity of stakeholder interests. They state that "values provide the interpretations that give meaning to emerging issues, and interests provide stakeholders with a pragmatic basis for involvement on a given issue. Together they help to explain the strength of different stakeholder positions and the actions they take" (p. 25). They define diversity and intensity, respectively, as "the number of competing values and interests" and "the strength or importance of different values and interests" (p. 26). If an issue has a high level of diversity (many competing values and interests) and a high level of intensity (strength of different values and interests), the issue may be resolved for a specific situation but is subject to reemergence as the environment or positions change.

APPLICATION OF THE MODEL TO AUDITOR INDEPENDENCE

Watts and Zimmerman (1986) point out that the only way an audit will reduce agency costs is if investors believe there is a nonzero probability that auditors will report any discovered contractual breach. The auditor's ability to discover a breach is a function of competence. The auditor's willingness to report a discovered breach is a function of independence (Watts & Zimmerman, 1986). In the 1999 through 2001 dispute, an expectations gap evolved as stakeholders' perceptions changed regarding auditors' willingness to report discovered breaches. The SEC sought to "renegotiate" the scope of the involvement of audit firms with nonaudit work.

Beaver (1989) argues that the regulation of financial reporting rests on the premise that

> a public agency, such as the SEC, has a comparative advantage in forming collective agreements of a certain form (e.g., when the potential beneficiaries or affected parties are numerous and difficult to identify and hence when it is more costly or simply not feasible to attempt to deal with the same issue via market forces). (p. 188)

These collective agreements regarding accounting reports have "economic consequences" through their impact on the decision-making behavior of business, government, unions, investigators, and creditors; therefore, the interests of affected parties must be taken into account (Zeff, 1978/1995).

The issue life cycle model suggests that the negotiation and the agreement are related to the diversity and intensity of the values and interests of the participants. Values of the participants in the dispute included independence, objectivity, and allegiance to the public good, whereas interests included revenue sources and the desire to maintain political power. Stakeholders faced a large gap in terms of both diversity and intensity regarding this particular debate on auditor independence. This issue reappears cyclically as the business environment interacts with these values and interests.

We tracked the business community awareness and intensity of the 1999 through 2001 auditor independence issue through an examination of articles appearing in *The Wall Street Journal* from January 1990 through December 2001.[6] We considered articles in *The Wall Street Journal* because of its broad appeal, wide circulation, and general reflection of the U.S. market (Shaffer, Quasney, & Grimm, 2000, use a similar technique). This is consistent with Hall and Jones's (1997) use of *The Wall Street Journal* as "indicative of the specialized public focusing on capital market activities" (p. 54). The data source for these articles is the Dow Jones full-text archive. Examining the content of the articles, we identified those relevant articles that addressed this auditor independence debate.[7] The cumulative number of relevant articles is shown in Figure 2, and it mirrors the expected levels of stakeholder awareness predicted by the issue life cycle model (see Figure 1).

The issue life cycle model implies a gradual increase in stakeholder awareness in Phase 1 followed by a rapid increase in awareness through Phase 2. The rate of increase in the level of awareness seems to reach its maximum in Phase 3 with a gradual leveling off in interest in Phase 4. This suggests that stakeholder awareness of an issue follows the form of a logistic response function (Govindarajulu, 1988). A curve estimation test of the timing and number of *The Wall Street Journal* articles indicates that a logistic response function models the trend shown in Figure 2 with an adjusted R^2 of .98 ($p < .001$). Although the count of articles follows the theorized increase in awareness and intensity of the issue, we use these *Wall Street Journal* articles and other sources to map the events in terms of the issue life cycle model.

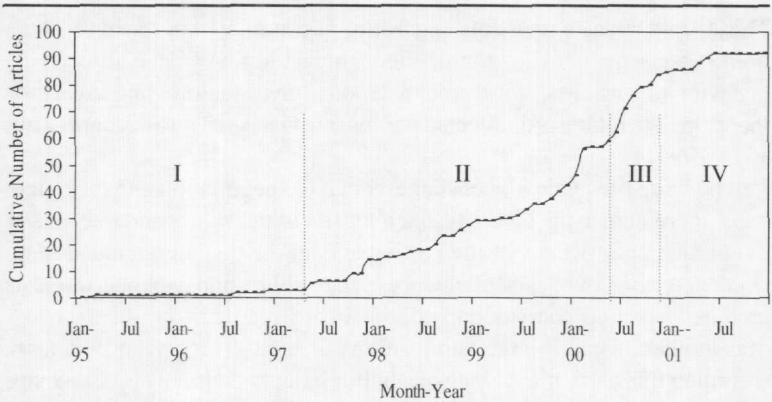

Figure 2: Relevant Articles 1995-2001: Auditor Independence

Phase 1: Changes in Stakeholders' Expectations

The issue life cycle begins with a difference between an organization's behavior and the expectations of at least one stakeholder. The topic of auditor independence was not a "front-burner" issue for 25 years due to self-regulation of the industry, the SEC acceptance of the status quo, and a perceived acceptable level of nonaudit service revenue from audit clients. However, as the business and political environments changed, the views of the Big Five accounting firms, the AICPA, and the SEC diverged.[8]

Even in 1996, in a move coming from outside the SEC or the accounting profession, the U.S. General Accounting Office (GAO) recommended that the SEC consider new forms of regulatory oversight. Although there is no study indicating that the number or percentage of audit failures increases during the 1990s, given the shifting environment, any reported problems may have taken on increased importance to the SEC.

In the testimony before the SEC regarding its proposal, participants referred to various audit failures as raising general concerns regarding audit quality. Two of the more publicized audit failures were in the cases of Cendant Corporation and Sunbeam Corporation. In the case of Cendant Corporation, the company used fictitious revenue, improper use of merger reserves, accelerated revenues, and delayed recognition of credit card cancellations to overreport revenue by $300 million (Garrity, 1998). The price of the stock dropped 17% the date the necessary restatement of revenue was announced. Sunbeam Corporation, also, overstated revenue over a 3-year period. As with Cendant Corporation, the outside auditors did not detect or report this fraud. The value of Sunbeam stock decreased 89% during the period of inquiry into the accounting improprieties (Brannigan, 1998).

The problems described above provided real-case examples of failures in the accounting systems. The SEC used these events to revisit the question of auditor independence (Byrnes, 1999). However, there was no explicit evidence of a firm's acting inappropriately when providing audit services for a nonaudit services client. In a review of recent audits, the Panel on Audit Effectiveness (PAE, also known as the O'Malley Panel) found 37 instances wherein nonaudit services were provided to audit clients. There were no negative consequences found, and in several instances the provision of nonaudit services had a beneficial impact (PAE, 2000).

The early identification of stakeholders' concerns affords the opportunity to implement a strategy to stop the issue before it reaches larger proportions. Initially, the accounting profession and the SEC sought to work together to resolve the growing independence issue. For instance, the joint development by the SEC and the AICPA of the Independence Standards Board (ISB) in May 1997 was to "establish independence standards applicable to audits of public entities to serve the public interest and to protect and promote investors' confidence in the securities markets" (SEC, 1997, p. 2). This action, in addition to alleviating SEC concerns, was a means for the profession to maintain control of the process. At the time, AICPA President Barry C. Melancon commented that establishing the board within the auspices of the AICPA would rationalize the current system of providing guidance on independence issues ("The ISB," 1997, p. 14). AICPA leaders also added the comment that the SEC's decision "to effectively transfer its existing independence authority to this new private sector standards-setting body is a major breakthrough and an indication of the commission's confidence that self-regulation is working" ("The ISB," 1997). However, this optimism was premature.

The composition of the ISB proved unsatisfactory to Chairman Levitt. He wanted an ISB dominated by investors and academics, and he boycotted the first meeting because he felt the board was too dominated by accountants and their allies (McNamee et al., 2000). As the relationship between the SEC and the large accounting firms worsened over independence, the large firms approached various joint stakeholder groups of the firms and SEC such as the AICPA, other accounting firms, members of Congress, and the media to put pressure on the SEC. Combined with the stated mission of Chairman Levitt and the SEC to promote investor confidence in the reliability and integrity of public firms' financial statements and the breakdowns described above, the auditor independence issue erupted.

Phase 2: Positioning and Political Action

Phase 2 begins as various stakeholders position themselves politically. It is not clear that the ISB ever obtained legitimacy from key stakeholder groups. The failure to come to a quick resolution demonstrates the diversity and intensity of interests involved. The SEC's impatience with this board is evident in the fact that the SEC released its independence proposal without input from the ISB and while the ISB was still performing its evaluation of independence issues. Before release of the SEC's proposal, the ISB had completed three standards and was in the process of developing a conceptual framework regarding independence.

Even after the establishment of the ISB, the number of stories during 1998 indicates that the issue was far from resolution. Stakeholders began more aggressive political positioning. In August, the SEC called a meeting questioning why more companies were having accounting problems. The SEC meetings were prompted by the "recent rise in corporate accounting fiascoes at publicly traded companies" (MacDonald, 1998a, p. A2). The stakeholders attending the meetings included representatives of the FEI, accounting analysts from certain investment houses, the Financial Accounting Standards Board (FASB), and the Big Five accounting firms.

A second notable story during this period was in September that discussed small accounting firms losing independence. In this story, MacDonald (1998b) comments "accountants have become more like investment advisers who sell a whole host of products, from equity funds to annuities to insurance" (p. B8). The story mentions that the SEC was looking at the independence of accountants who recommend public companies as investments when they also perform the audit work for the public company.

In 1998, the ISB completed its first standard regarding auditor independence. The new rules required that auditors disclose to public companies' audit committees the level of nonaudit services provided to the client. In addition, the auditor was to discuss this in terms of ability to maintain independence. This standard was in line with the profession's belief that the existing oversight infrastructure of the corporate audit committee was sufficient to meet independence norms. In an address to the American Accounting Association's Financial Accounting and Reporting Section on August 16, 1999, Donald J. Kirk, vice chairman of the Public Oversight Board, emphasized the positive effects of an independent corporate audit committee (Kirk, 2000).

During this time frame, the SEC used alleged violations at PricewaterhouseCoopers of the current independence rules to focus attention on the issue. The violations involved thousands of instances of

PricewaterhouseCoopers audit managers and partners owning interests in organizations audited by the firm.[9] The SEC went so far as to require Compaq, a PricewaterhouseCoopers client, to obtain a new auditor (Kehoe & Michaels, 2000). This finding seemed to fuel the further advancement of the independence issue at the SEC.

A second major development during 1999 was the Big Five accounting firms' beginning to examine divesting of their consulting units either through a sale to another company or an initial public offering. For instance, in December 1999 Ernst & Young was considering selling its consulting unit to Cap Gemini (MacDonald, 1999, p. A3). Although this change seems to be in accordance with the SEC's wishes, it signaled a quickening of the pace of change in the accounting environment. The movement to divest of the consulting units may have been a political response or a response to the economic changes; however, the move did affect the perception of some stakeholders that the accounting firms were trying to assure independence.

In 2000, the independence issue was clearly at the forefront of the policy agenda. In May, Chairman Levitt delivered a major policy speech that effectively announced that the independence issue was about to enter Phase 3 of the issue life cycle. He expressed a desire for the following measures:

- SEC rulemaking to clarify activities that may be inconsistent for an independent auditor of financial statements to perform for audit clients;
- support for a plan by the profession's independent overseer, the Public Oversight Board, to enhance its powers and responsibilities; and
- a self-evaluation by each of the major accounting firms of past compliance with the SEC's and the profession's financial investment rules and their system of internal controls for monitoring these investments (SEC, 2000b, p. 1).

We identify this proposed rulemaking as a transition between Phases 2 and 3. Phase 3 of the issue life cycle involves formal government action, and we consider the proposed rules as a formal action. Although it may not be formal action as in enactment of legislation, a formal acceptance of the SEC to a new policy or requirement would be essentially the same thing for this industry with its extent of self-regulation and public/private oversight groups. No longer is the government agency discussing the issue in a forum with other stakeholders; the SEC is setting up specific rules to govern the actions of the accounting profession. Although political activities, debates, and negotiations about the issue continued, they were framed by the proposal. The discussions took place in a more formal setting, with the scope and timing constrained in a comment period. The accounting firms and industry as a whole had less discretion at this point to come to a resolution because they had to address specifically the proposed rules within the comment period.

Phase 3: Formal Government Action

On June 28, 2000, the SEC (2000b) released "Proposed Rule: Revision of the Commission's Auditor Independence Requirements" in the Federal Register. The SEC (2000b) proposed that an accounting firm would not be allowed to perform 10 specific types of nonaudit services for its SEC registrant audit clients. The SEC's (2000b) proposal also codified a formal appearance standard stating,

> The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or would not be *perceived* [italics added] by reasonable investors to be, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. (Proposed Rule 2-01(b)).

In addition, the SEC (2000b) stated that it would use four overarching principles in determining the independence of an auditor: (a) if the auditor has a mutual or conflicting interest with the audit client, (b) audits his or her own work, (c) functions as management or an employee for the audit client, or (d) acts in an advocacy role in relation to the audit client (Proposed Rules 2-01[b][1]-[4], 2-01[e]). Effectively, the rules would have precluded any joint venture activities with audit clients.

In Phase 3, as shown in Figure 2, there was opportunity for the accounting industry to have some influence on the resolution of the issue, although it was more limited than it was in Phases 1 and 2. The SEC provided for a 75-day comment period for the proposal, essentially setting the time frame for Phase 3, from the initial proposal to final adoption. A successful resolution for the accounting industry would consist of a variety of responses from some relaxation of the proposed rules to complete retraction. It was important to the profession to retain as much self-regulation as possible. For a successful resolution for the SEC, some concessions would likely have to be made by the industry. A complete retraction of the proposed rules would leave the government agency with an image of ineffectiveness.

Both sides immediately sought to strengthen their position. The accounting profession took an aggressive stance against the proposed rules. The Big Five accounting firms and the AICPA attempted to rally the profession and actively lobbied Congress to muster support for their position.[10] Because the SEC's purview is for SEC registrants only, the SEC's proposed rule did not apply to accounting firms performing work for non-SEC registrant clients. The larger firms, those with SEC clients, had to request support from smaller firms on this issue. The AICPA's response to the proposal included the following points (AICPA, 2000): (a) The SEC based its decision to move forward with the rule prohibiting nonaudit services without facts or evidence, (b) the proposed rule would set a precedent for other regulators (thus making an appeal to firms without SEC registrant clients), (c) the SEC ignored the conclusion of a panel it helped organize that found that the audit process is fundamentally sound, and (d) the rule would have a negative effect on recruiting and retention of the best talent.

The accounting industry's strategy consisted of five general approaches to influence various stakeholder relationships: (a) protesting that the comment period was too short for what they called an unexpected move by the SEC; (b) claiming that, with the release of its proposal, the SEC preempted the work of the ISB, a coalition designed to address independence issues; (c) working with the accounting profession across the United States through the AICPA, such as spearheading a letter-writing campaign; (d) increasing political contributions to lawmakers and otherwise seek their support; and (e) communicating with corporations about the efficiency and benefits of maintaining the current structure and policies. The SEC promoted its proposal by appealing to lawmakers and the public, emphasizing that its proposal would improve investor confidence in auditor independence.

For the SEC's part, stories in business media began to appear indicating the SEC was attempting to bolster its argument for the proposal. For instance, *The Wall Street Journal* reports on August 9, 2000 ("Pinnacle Holdings," 2000), that the SEC was examining the independence of the auditor of Pinnacle Corporation relative to nonaudit services. Again, on August 25, 2000 (Schroeder, 2000a), *The Wall Street Journal* reports that the SEC was probing Arthur Andersen regarding a conflict of interest with Waste Management, Inc. *Business Week* reported that the SEC was searching for a "smoking gun" to prove its point regarding auditor independence (McNamee et al., 2000).

One of the interesting elements of this issue is the opportunity to view the interaction of the opposing points of view in a public hearing. At the hearings the SEC held on the proposed rule, the question of whether or not there is a problem took center stage. The dialogue revolved around the idea of independence in fact versus the perception of independence. An excerpt of an exchange at the SEC hearings on the proposed rule between Chairman Levitt (acting as chair of the meeting) and Mr. Joseph F. Berardino, Arthur Andersen's managing partner for Assurance and

Business Advisory Services for North America, are indicative of this discussion and appear in the appendix.

Both sides had overlapping constituency groups. Each side attempted to use these other groups for leverage. For instance, on September 18, Chairman Levitt delivered a speech to the National Association of State Boards of Accountancy (NASBA) in which he was highly critical of the AICPA. The speech was an appeal to the smaller accounting firm/ sole practitioner. Chairman Levitt attempted to make the case that the large accounting firms and the AICPA had turned their backs on the values held dear by the general accounting profession. Chairman Levitt (2000a) stated the following:

> I believe that the time has come for the profession's own broader membership—the smaller, independent accounting firms—to stand up and take back what some are trying to take from them: the pride and privilege of serving the American public and its investors as the most rigorous, objective, and independent accountants in the world.

At the same time, the big accounting firms and the AICPA approached members of Congress to rein in the SEC. The main argument was to allow the accounting profession to supervise itself through voluntary agreements. In 2000, the Big Five firms and the AICPA spent over $12 million in lobbying (Center for Responsible Politics, 2002; Labaton, 2002). The lawmakers stated that they preferred that the profession and the SEC work out their disagreement themselves; however, Congress put some implicit pressure on the SEC. Leaders of Congress threatened to introduce a provision that would block the SEC from adopting an auditor independence rule during 2000.

On October 25, 2000, the SEC announced that it "might back away from" its proposed rules (Schroeder, 2000b, p. C1). With this announcement, the issue was still in Phase 3 of the issue life cycle because the SEC and accounting firms were still engaged in political activities to influence the resolution and some formal government decision was expected. Discussions were held with the SEC, the accounting industry, corporate financial executives, and other interested stakeholders. The SEC and representatives of three of the Big Five accounting firms negotiated over an agreement for "disclosure of fees for such consulting services in SEC filings" (Schroeder, 2000b, p. C1). In a press release November 6, 2000, Chairman Levitt announced there would be an open meeting on November 15, 2000, "to consider adoption of rules governing auditor independence" (SEC, 2000d). Chairman Levitt acknowledged the input of various stakeholder groups such as the Big Five firms, the AICPA, investors, the accounting profession in general, Congress, and the public.

On November 14, 2000, a set of rules for auditor independence were agreed upon by the SEC and four of the Big Five firms, and the SEC voted to adopt these revised rules (SEC, 2000e). The negotiations noted above resulted in common ground between the parties. Each side got some of what it wanted. The SEC did not lose political power through the large firms' appeal to Congress, and the SEC reaffirmed its authority by initiating and passing rules on auditor independence. The accounting profession did not lose its power of self-regulation. The key components of the final agreement were the following: The four overarching principles in determining independence were taken out of the adopted rule itself and were used in the preamble as general principles; the rule's restrictions on nonaudit services were modified to conform with existing independence rules (i.e., no new additional restrictions); the final rule maintained the appearance standard; and companies were required to state the fees for audit, consulting, and tax services in proxy statements along with a statement that the audit committee took into account these fees in determining the independence of the auditors. The November 2000 rules were the transition from Phase 3 to Phase 4, which represents implementation and legal activities regarding the issue resolution.

Phase 4: Implementation and Compliance

The issue life cycle model continues with implementation, compliance, and enforcement activities. In this stage, one begins to see if the movement through the first three stages has led to a resolution that reduces the gap between the stakeholders' values and interests. If not, one or more stakeholders may regroup and reignite the process. At the beginning of the implementation stage, it became apparent that the rules had not sufficiently closed this gap with regard to auditor independence. The continuing diversity of interests and values created an environment in which revisiting the issue was likely in the short term.

For instance, after adoption of the final rules, a report comparing the amount of audit fees and nonaudit fees paid to the accounting firms by some of the largest U.S. companies showed that audit fees of these companies averaged \$2.2 million whereas other nonaudit fees averaged \$5.9 million (Hilzenrath, 2001). Officials at the SEC expressed surprise regarding the high ratio of nonaudit fees to audit fees: Lynn Turner of the SEC commented, "Had the data been available months ago, the outcome of the fracas between the SEC and the accounting industry might have been different" (Hilzenrath, 2001, p. H1). A study of the first reports submitted to the SEC following the effective date of February 5, 2001, found that 17% of filings did not comply with the rules (Weil, 2001). Some in the profession expressed the belief that the SEC's rule for disclosure of fees was an attempt to find a smoking gun and then revisit the rules (Rockness, Ivancevich, & Keaveny, 2001).

Two other related matters complicated the issue: the divestiture of consulting services and the role of external auditors in conducting internal audits. In negotiating the final rules, the SEC may have taken some comfort in the trend toward divesting of consulting practices, as Andersen had split its audit and consulting services. However, at the end of 2000, divestiture was still a voluntary action. In addition to separation of audit and nonaudit services, the big accounting firms also conducted an increasing amount of internal audit services for their clients. With the outsourcing of internal audit, accounting firms faced even greater potential conflicts of interest. Rockness et al. (2001) pointed out that the rules pertaining to internal audit outsourcing may be a "sleeper" issue because this work is housed in major firms' audit departments, not in the divested consulting divisions.

Clearly, implementation and enforcement issues remained a concern for the SEC, publicly traded firms, and the accounting profession. The continuing diversity of interests and values created an environment wherein the revisiting of this issue was likely in the short term. The resolution of this 1999 through 2001 dispute may have followed the same pattern as earlier attempts at regulation of the accounting profession from the 1970s and 1980s when the status quo was essentially preserved. However, the revelation of Enron's accounting procedures in late 2001, the subsequent legal action against Andersen, the bankruptcy of WorldCom, and other corporate scandals moved the issue onto the public agenda opening the door for stronger reform. The next section describes strategies associated with the issue life cycle model that influenced the implementation of 2000 rules and the subsequent reignition and elevation of the auditor independence issue.

STRATEGIES FOR ALIGNING STAKEHOLDER VALUES AND INTERESTS

Not all changes in the macro-environment lead to public issues or require an active response from the firm. However, awareness of the macro-environment and information collection may help firms identify trends in the economic, political, technological, or social forces affecting the business environment. Once identified, firms are better prepared to effectively communicate with stakeholder groups and possibly avoid a dispute or at least minimize the scope of the disagreements.

Strategies and stakeholder relationships may change during different phases of the model. Bigelow et al. (1997) identify five major activities/strategies that may be applicable at different points in the issue life cycle. The five major strategies are (a) information gathering and environmental scanning, (b) communication with stakeholders, (c) goodwill building, (d) political strategies, and (e) compliance strategies. For example, there was evidence of the first three activities primarily in the first two phases of the issue life cycle model, whereas political strategies were evident in Phases 2, 3, and 4.

The analysis indicates that the 1999 through 2001 recurrence of the auditor independence issue moved quickly into Phase 2, political positioning. It does not appear there was much discussion of the auditor independence issue from 1990 through 1998 in the accounting profession. That may be why a number of constituents felt the issue had "come out of nowhere" (see testimony quoted in appendix). Similar arguments were used by the accounting profession in earlier iterations of the auditor independence issue (see Mahon & McGowan, 1997, for analysis of earlier defenses of the accounting profession's self-regulation).

It is interesting to note the political strategies employed by the SEC, AICPA, and Big Five accounting firms. In the September 2000 speech, Chairman Levitt attempted to create a split between the large and the small- to medium-sized accounting firms. He stated that the AICPA and the largest accounting firms did not uphold the traditional values of the accounting profession as did the smaller firms. He implied that the smaller firms were being used by the larger firms as pawns in the dispute.

Likewise, the AICPA and the larger accounting firms sought to put political pressure on the SEC through such strategies as press releases, lobbying of Congress, and coordinated letter writing and comment campaigns. Throughout the process, the leaders of the accounting profession sought to retain self-regulatory power through advocacy for the ISB and disputing the initial SEC proposal. Ultimately, the profession's political strategy proved effective in blocking the more far-reaching aspects of the rules.

Firms face choices of actions and combinations of actions they can take during the implementation stage: (a) choose to comply, (b) choose not to comply and wait for enforcement, (c) continue lobbying, or (d) try actively to overturn the regulation through lawsuits. The extremity of the firm's response is related to the degree of dissatisfaction with the ultimate outcome. If the industry or profession is not satisfied with the outcome, the response is likely to be a combination of compliance strategies and continued lobbying. However, in 2001 it seems the outcome was favorable for both the SEC and the accounting profession, so the response was to concentrate on goodwill strategies.

A goodwill strategy is the process of trying to repair any damage done to the stakeholder relationship. It involves rebuilding trust between the parties. An effective goodwill strategy involves a nonconfrontational attempt to realign stakeholders' values and interests. Indeed, Chairman Levitt proposed such efforts to strengthen communication and cooperation to prevent such public, antagonistic behavior.[11] The window of opportunity for goodwill strategies was short lived with the announcement of the Enron problems in the fall of 2001. Instead of a question of fine-tuning the relationships. it became a question of the basic role of accounting and the accounting industry.

The analysis also supports the propositions of Post and Mahon (1980) about the role of a regulatory agency in change and the response of the regulated industry. Their first proposition is that "when a regulatory agency chooses to act as a change agent, it will focus on articulating change at the technical core of the business" (p. 406). The SEC's proposed rules in 2000 were aimed at procedural requirements.

Post and Mahon (1980) also propose that the ongoing relationship is complicated in a regulated environment. The industry has no option to exit the relationship. Therefore, the industry's response must take into account the short-term issue and the impact on the longer term relationship. As we discussed previously, the stakeholders in the 1999 through 2001 debate had to address the specifics of separation of audit and nonaudit services, but they also had to address their relationships over the long term. The short-term issue was addressed in the final rules; however, as noted above, the process of repairing the permanent relationship was interrupted by the emergence of accounting scandals.

Finally, Post and Mahon (1980) propose that when an industry only addresses the narrow short-term issue or technical concern, "it can be led to reflex actions that are successful in neither the short nor the long term" (p. 406). In the 1999 through 2001 debate on auditor independence, the accounting firms focused on changes to the technical procedures of reporting, although some firms did proceed with divestiture of their nonaudit services. The success of each firm's strategies and those of the accounting organizations has yet to be determined.

EXTENSIONS TO THE MODEL

The issue life cycle model aids in the analysis of the development of the auditor independence issue; however, the development of this issue offers new insights into aspects of the model. We examine the ways in which this application offers new ideas for the model and suggest future research. First, the debate may be initiated by a key person as well as previously identified triggers such as an event or special interest group. Furthermore, this particular issue of auditor independence may be seen in a larger context as one episode or iteration in a recurring issue, especially if the resolution does not address the basic conflicts in values or underlying structural problems. Finally, the development of this issue supports the idea of the integration of the public affairs functions with the overall corporate strategy planning process.

Trigger Event or Person

The presence of a key event that triggers an issue has been described by a number of scholars (Buchholz, 1990; Mahon & Waddock, 1992; Post, 1978). It is generally accepted that a crisis or trigger event occurs in Phase 1 that brings about action, or, broadly, starts the issue life cycle model. However, in the 1999 through 2001 iteration of the auditor independence debate, it was an individual who brought the potential, or perceived, problem to stakeholders' attention. Chairman Levitt could be considered an issues champion, similar to Ralph Nader, a champion of the consumer protection movement. Chairman Levitt's actions are similar to Kingdon's (1984) policy entrepreneurs, except Kingdon studied groups who framed an issue and set an agenda, not individuals. Instead of the issue's being framed by pressure groups or a key event as indicated in the previous literature, this issue was framed or interpreted by one trigger person with the power to influence the discussion and set an agenda.

In the case of the 1999-2001 debates, there was no evidence of compromised auditor independence in the audit services provided by the accounting firms to firms for which they provided consulting as well (as pointed out in the O'Malley Report). In our survey of articles in *The Wall Street Journal*, we did not find any articles that reported a concern on the part of the individual investor. The issue was brought to the forefront because of the SEC's efforts to reform the auditor independence rules. Chairman Levitt played a substantial role in bringing this issue to the forefront, fueling its debate, issuing proposed rules, and guiding the negotiations for adopted final rules.

Why were Congressmen Dingell and Moss not able to get the issue on the public's agenda and effect change, yet SEC Chairman Levitt was able to get some changes made (albeit weaker than originally proposed)? Why were more restrictions and compliance requirements passed in the Sarbanes-Oxley Act of 2002? Mahon and McGowan (1997) raise the question of agenda setting and the ability of individuals to get an issue on the public agenda.

Based on their analysis and our analysis of more recent events, we conclude that the confluence of trends involving the rise of individual investors, the merger and acquisitions leading to a concentration of large accounting firms, and the growth of nonaudit services enabled Chairman Levitt to use the SEC as a change agent (Post & Mahon, 1980) and make the proposed rules. However, in response to these rules, the accounting firms were able to negotiate less restrictive rules, in part because they had the support of Congress and the issue was not on the public agenda. It is difficult to say if the 2000 rules would have ultimately made substantial changes in assuring independence in auditing.

While the auditor independence issue was in the implementation stage in 2001, the issue reemerged with even greater force with the more traditional notion of a trigger event of the Enron collapse. With subsequent corporate scandals in 2002, the issue is on the public agenda, and Congress has had to respond to pressure from the public. Further research on the role of a single, charismatic person on the evolution of an issue may draw on the leadership literature and/or organizational theory.

Symbolic Action of Stakeholders

Another contribution of this study to the academic literature is that it supports Mahon and Waddock's (1992) proposition that "moves toward substantive action may be more likely when public policy interest has been aroused and at least symbolic public policy action is under consideration" (p. 29). Symbolic action is defined as that which shapes an issue, frames or interprets it, whereas substantive action is that action trying to address the issue or change in response to it in "specific, identifiable ways" (Mahon & Waddock, 1992, p. 27). How the issue is framed and interpreted for the public sets the agenda and affects how the issue progresses through the life cycle and how subsequent actions are constrained.

Appointed in 1993, Chairman Levitt announced his goal of securing investors' confidence in corporations' financial reports. The initial actions by Chairman Levitt were symbolic—allusions to an independence problem in speeches. Over the next few years, Chairman Levitt started to frame the issue of auditor independence around the potential conflicts of interests in the large accounting firms that conducted nonaudit services for their audit clients. Chairman Levitt's establishment of the ISB in 1997 could be interpreted as a symbolic action of his concern about accounting firms' potential conflicts of interest and investors' confidence in financial reports. For the accounting profession, the formation of the ISB was seen as a symbolic and substantive action. Before their recent dissolution, the ISB developed auditor independence guidelines based on a set of principles derived outside of Chairman Levitt's proposed framework. This is an example of a group trying to take its own symbolic action and reframe the issue (Mahon, 1989) in line with its values and interest.

An interesting aspect from this study is not only that symbolic action had such a great influence in fueling the controversy but also that the lack of data and feedback throughout the process made the dispute environment more uncertain and caught much of the profession unaware. The issue life cycle assumes that feedback among the stakeholders is provided throughout the process. According to Mahon and Waddock (1992), the issue or problem is defined by "indicators, focusing events, and feedback mechanisms that provide data about existing efforts" (p. 24). However, in this case no such data were provided throughout the development of the issue, including the final rule. Although data have been examined since the final rule was enacted (Gore, Pope, & Singh, 2001), data were not used in the political or decision-making process. Observations from the accounting profession were that this issue seemed to happen very quickly. The sense of a shortened time frame, compared to other disputes among the same stakeholders, may be because much of the impetus and action in Phases 1 and 2 were symbolic. Had there been data available at the time showing auditor independence problems with providing nonaudit services to audit clients, there may have been a different resolution to that occurrence of the issue.

At the end of 2001 and into 2002, momentous and substantial evidence surfaced about accounting and auditing improprieties. As mentioned previously, this substantive evidence fueled a reexamination of the issue with greater intensity and with a more formal, comprehensive remedy sought.

Intensity of the Issue

Another application of the model to this recurring issue is the intensity of the issue and the level at which redress is sought. In 1999 through 2001, the concern about auditor independence was dealt with among the accounting firms, the AICPA, and the SEC with minimal intervention from Congress. However, in the subsequent reappearance of the issue in 2001-2002, the general public is aware of the problems and formal action has been elevated above the firms and SEC to the Congress. The recent passage of the Sarbanes-Oxley Act of 2002 indicates the greater intensity of the conflict in the post-Enron era.[12]

The auditor independence issue was elevated primarily from the realm of the accounting industry, trade associations, and a government agency to the realm of the general public, the media, and Congress. Regarding what Rochefort and Cobb (1994) call "proximity," the issue had originally been limited to the larger accounting firms, the leadership of the SEC, and the professional association. On the recurrence at the end of 2001, the proximity became elevated to include most industries, financial services firms, investors, and the general public. The proximity of the issue, the perceived risks, and the level of public awareness may also contribute to the ability of organizations to form coalitions and take action toward a resolution.

Using Bartha's (1982) typology of issues, we classify the debates in 1999 through 2001 as indicative of a technical or selective issue. Essentially a limited number of groups were involved with the issue: the AICPA, accounting firms, and the SEC. Although Congress was brought in, it was only in respect to pressuring the SEC. In 2002, the auditor independence issue was elevated to an advocacy issue for which the general public clamored for some solution. The political leadership involvement was raised to formal action by Congress—the Sarbanes-Oxley Act. This reignition of the issue and subsequent changes in intensity are indicative of what Bartha calls an issue shift.

An interesting investigation would be the possible relationship between the trigger and fuel that maintains the issue through government action and implementation. Public awareness and perceived damage may also affect the development of an issue; for instance, the collapse of Enron and the subsequent revelation of accounting problems affected more of the general public than the perceived problems and conflicts of interest in 1999, even though they are related. The degree of risk, damage, and closeness may be important factors in the issue life cycle as they are in the concept of moral intensity (Chia & Mee, 2000; Jones, 1991; May & Pauli, 2002). Jones (1991) identifies several components of moral intensity that may be relevant: "the magnitude of consequences, the social consensus, the probability of effect, the temporal immediacy, [and] the proximity" (p. 366).[13] It is now evident that a trigger event has a far different impact on an issue than an individual trying to garner support for preventative action.

A general comparison of the two recurrences of the auditor independence issue in the past 4 years may show such a difference in moral intensity, development of issue, action, implementation, and enforcement.

CONCLUSION

We view the auditor independence debates as two recurrences of a larger issue of independence. The issue of auditor independence has been a topic of concern since the first half of the 1900s when corporations began paying auditors' fees (Chatov, 1975). Although the context or the details of auditor independence issues have been different, the main problem has been a potential for perceived or actual conflicts of interest. The issue of auditor independence reflects a potential conflict of interest among the publicly traded corporations, the accounting firms, the profession, investors, and the general public. These values and interests are critical to the efficacy and public confidence in public accounting and therefore would be considered of high intensity in the industry. Bigelow et al.'s (1993) typology describes a recursive issue as one in which there are several competing values and interests and there is a high level of strength or importance of different values and interests to the stakeholders. This explains why the independence issue has reappeared frequently over the life of the public accounting profession. Therefore, within each recurrence of the auditor independence debate, each issue may follow a sequential path and may seem resolved until the business environment or stakeholders' expectations change substantially.

Issues management is more than reacting to proposed legislation or supporting a public affairs department: It is the integration of the public affairs and corporate strategic planning functions. Other scholars cite the benefits of such integration as a more responsive public affairs department and more closely aligned political and compliance strategies with the overall corporate strategy (Bigelow et al., 1997; Marx, 1986, 1990; Post, Murray, Dickie, & Mahon, 1983). With early recognition of issues and such integration, a stakeholder group may be able to shape an issue for its benefit and enhance its ability to influence the issue through its life cycle. We have shown the issue life cycle model to be dynamic. Although the large accounting firms may have the resources to monitor the environment, engage in political activities, and actively influence such an issue, smaller firms tend to rely on trade or professional associations for information gathering, communication, and political strategies. Therefore, it is important to ensure balanced representation in the associations to prevent a fracture that would limit its power. Understanding the progression of an issue through the issue life cycle model and strategies are critical to all stakeholders.

Postscript

Readers will be aware of extensive changes that have occurred since the acceptance of this article. Changes in the industry and the SEC happened quickly, and there are still changes occurring. In this study, we focused on the 1999 through 2001 debate on auditor independence. Further research on the ongoing SEC-accounting industry relationship will be interesting.

Arthur Levitt resigned as SEC Chairman in January 2001, and Harvey L. Pitt was appointed in August 2001. The Sarbanes-Oxley Act of 2002 was passed in July 2002, and SEC Chairman Pitt announced his resignation on November 5, 2002. The former federal judge William Webster resigned on November 12, 2002, as chairman of the new oversight board, and SEC Chief Accountant Jackson M. Day resigned on November 8, 2002. These resignations come at a crucial time—when the SEC is under pressure to address the requirements in the Sarbanes-Oxley Act of 2002 and to restore the confidence of the American investors. Several reforms must be addressed in the next several months—code of conduct for lawyers, analysts' conflicts of interest, and off-balance sheet financing.

As of December 10, 2002, President Bush announced William Donaldson as his choice for SEC Chairman. Mr. Donaldson commented that he was committed to restoring investor confidence in corporations and the financial industry. During revisions of the manuscript, the SEC was, and still is, under pressure to restore its credibility before any steps taken to reform the accounting industry can be seen as legitimate.

Appendix

The following is an excerpt from an exchange at the SEC hearings on the proposed rule between Chairman Levitt (acting as chair of the meeting) and Mr. Joseph F. Berardino, Arthur Andersen's managing partner for Assurance and Business Advisory Services for North America:

CHAIRMAN LEVITT: Joe [Berardino], let me follow up on your very comprehensive and pointed testimony and ask you a few brief questions. Do you think that there has been and continues to be, for whatever reason, whoever caused it, an appearance problem, or do you think that's way overstated, and it simply doesn't exist? What's your personal judgment?

MR. BERARDINO: My personal judgment is the more we talk about it—

CHAIRMAN LEVITT: For right now. Let's say we don't talk anymore, but does it exist today in your judgment?

MR. BERARDINO: No.

CHAIRMAN LEVITT: It doesn't exist?

MR. BERARDINO: No.

CHAIRMAN LEVITT: And if the Commission decided that because of its fairly comprehensive schedule of issues it was going to stand back from this and just drop it totally, would that, in your judgment, make the appearance issue more real or less real?

MR. BERARDINO: I think it depends on how that was done. I think, in the context of some of my earlier comments I think we can declare victory, we collectively, with the proposals put forward for audit committees. Audit committees stand in the shareholders' shoes. It's been very clear through the ISB and comments that the Commission has made that this is an issue all audit committees ought to look at in detail.

CHAIRMAN LEVITT: So that if the Commission stopped there and said, "We've looked at this. Those that have said that there is an appearance problem for 15 or 20 years have probably overstated the case, and we feel that the recommendation to allow audit committees to inquire into this area would provide the kind of prophylactic cure to an issue that really doesn't exist at this time"?

MR. BERARDINO: I'd say the question has existed for years. Some companies have taken positions for years that their auditors should not do nonaudit services. That's their prerogative. And there are many others that have different perceptions and see value in their auditors knowing more about their companies and being more insightful (SEC, 2000c).

NOTES

1. Rule 101, the first rule in the rules section of the code of professional conduct, addresses the issue of independence.

2. The Sarbanes-Oxley Act (2002) includes some of the provisions introduced by Congressmen Moss (D-CA) and Dingell (D-MI).

3. Lynn E. Turner left the SEC in August 2001.

4. Arthur Levitt was the SEC Commission's longest serving chair, holding the position for 7½ years. He resigned in January 2001.

5. Post and Mahon (1980) theorize that a regulatory agency can act either as a buffer or as a change agent for an industry. This theory builds on the concept of an articulated environment (Chin, 1976) in which a stakeholder group, in this case a regulatory agency, can identify and direct environmental change for the other stakeholders.

6. We start with 1990 to ensure that our analysis captures reporting regarding discussions between the SEC and the accounting profession during the period of the concurrent changes in sources of revenue, industry consolidation, etc.

7. We identified the stories with a keyword search on the terms in the following list: *SEC and auditor, Independence Standards Board, SEC and auditing, SEC and accounting, SEC and independence, accounting conflict of interest, Public Oversight Board, accounting firm strategy, nonattest*, and *nonaudit service*. The consistency of using these terms indicates trends across time. The search parameters identified many articles, especially *SEC and accounting*.

8. Changes in the business environment were noted by the SEC (2000a): "To promote investor confidence, we must ensure that our auditor independence requirements remain relevant, effective, and fair in light of significant changes in the profession, structural reorganizations of accounting firms, and demographic changes in society" (Executive Summary).

9. The vast majority of the problems did not involve managers and partners owning interests in clients they directly audited.

10. The degree of the resistance to the proposed rules was not necessarily equal across the Big Five accounting firms. Some commentators viewed Ernst & Young and PricewaterhouseCoopers as being conciliatory to the SEC due to the completion and advanced stage of the divesture of their respective consulting units (Michaels & Peel, 2000).

11. Chairman Levitt discussed a rapprochement with the AICPA, stating, "These past few months, perhaps both of us need to consider whether we have given the other the benefit of the doubt. The sooner we appreciate how fundamentally we agree on long-term ideals—high-quality financial reporting, the auditor's franchise, investor confidence—the better our relationship, and ultimately, this profession, will be" (Levitt, 2000b).

12. The Sarbanes-Oxley Act of 2002 reinstates the majority of the original 2000 SEC proposal including a prohibition on auditors providing nonaudit services. Additionally, the law goes beyond the initial SEC proposal in a number of areas including mandatory audit partner rotation and the establishment of an independent funding source for Financial Accounting Standards Board.

13. An interesting empirical study by Shafer, Morris, and Ketchand in 1999 examined aspects of moral intensity and auditors' ethical decision making and behavioral intentions. Their results indicated that peer review and risk of litigation were effective deterrents but risks of sanction by a professional group were not.

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