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Andersen's failure to navigate its institutional environment

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Abstract

Purpose – This paper aims to provide an analysis of the choices Arthur Andersen faced in dealing with the crisis that ultimately let to its downfall in 2001-2002.

Design/methodology/approach – The paper is built around institutional theory. Specifically, it applies the propositions provided by Oliver (1990, 1991) to the historical record.

Findings – The failure to develop a coherent response, combined with a failure to anticipate the specific role of the state led to Andersen's inability to navigate the institutional field.

Research limitations/implications – The usual limitations of institutional theory are acknowledged. These pertain to the lack of a micro-level analysis, the additional impact of pure economic rationality and the chance that every crisis of faith is unique.

Practical implications – The article adds to our appreciation of what not to do in the face of crisis by the government and those in charge of large accounting organizations.

Social implications – The article adds to the recently in the news "too big to fail" problem with successful economic agents.

Originality/value – The article adds to institutional theory by providing a different story than the usual, where everything is cleverly managed and the crisis is overcome.

Keywords Organizational change, Professionalization, Accounting regulation, Institutional theory, Accounting and politics

Paper type Research paper

1. Introduction

Institutional theory has provided accounting researchers with a serious alternative to economic analysis. It has been applied to a diverse set of accounting phenomenon including budgeting (Covaleski and Dirsmith, 1986, 1988), human resource management (Dirsmith and Covaleski, 1985), professional entity evolution (Greenwood and Suddaby, 2006) and standard setting (Fogarty, 1992). As a sustainable paradigm for a sociologically informed history, institutional theory merits our attention and continuing developmental efforts.

Early institutional theory was quite successful in showing how organizations, in the pursuit of social legitimacy, adopted externally visible structures that made their conformity with widely held norms apparent (Meyer and Rowan, 1977). For the most part, the dominant explanation of change was mimetic. As organizations observed their peers, they followed suit.

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Oliver (1990, 1991) introduced more proactivity to the institutional theory. Rather than passively conforming to a pre-ordained script, organizations were said to have a variety of action choices in the face of institutionalized expectations. Following the usual institutional theory description, organizations were expected to successfully master their environmental challenges when they overlaid strategic ambitions on the quest for legitimacy.

In 2001-2002, Arthur Andersen went from one of the most prominent public accounting firms in the world to extinction in a highly publicized debacle triggered by its work for the Enron Corporation. Why it did not survive could be seen as a challenging puzzle for institutional theory.

The purpose of this paper is to apply institutional theory to the Andersen scenario. Specifically, Oliver's (1991) ideas for when organizations might resist institutional pressure are examined as a template. This autopsy extends our appreciation for the institutional theory, and for the ways that large profit-seeking entities attempt to manage a serious crisis.

The paper is organized into five sections. The first provides a brief overview of institutional theory. The second specifies the research questions that are suggested by the theory. The methodology of the paper is detailed in the third section. The fourth section contains the bulk of the application, offering insights on the research questions. The paper concludes with a final section that reiterates major findings, points to future research and recognizes limitations.

2. Literature review

2.1 Institutional theory

Institutional theory is based on four essential axioms. First, organizations exist in institutionalized environments in which key constituents possess expectations for how an organization should act. Second, organizations, needing the legitimacy that these constituents are able to confer, must establish structures that are designed to communicate to external parties that the organization is behaving in accordance with expectations. Third, to actually operate, organizations must act in ways that are not literally congruent with the ways in which they have suggested they will act through their externally visible structures. Finally, organizations that have the appropriate externally consumable structures in place, even if they are factually acting in different ways, are not rigorously scrutinized by their constituents. This section provides a brief discussion of these elements.

Society is the repository for shared beliefs about appropriate behavior. Civilizations are relational and meaning-creating systems that are enacted by customs, sustained by socialization practices and sometimes codified into law. Often, these ideas are not scientific necessities but instead are powerful myths that rationalize and depersonalize prevailing sentiments (Meyer and Rowan, 1977), thus making some choices not within the feasible set. Adherents to these constraints are rewarded with social esteem. Thus, the institutional environment is an elaboration of the rules by which legitimacy is attained (Scott and Meyer, 1982). When applied to formal organizations, the institutional environment can be thought of as a means by which the interests of society and the interests of organizational members can be mediated (Neu, 1991).

The power and rigidity of the institutional environment is not constant. Expectations surrounding those entities charged with conducting the welfare of many should be

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stronger than those enveloping organizations that are admittedly formed for more sectorial purposes. Professions occupy a curious middle-range position on this spectrum. Whereas considerable posturing regarding the public interest is the *sine qua non* that purports to distinguish professions from occupations (Greenwood, 1957), the need to act like a business, and thus be self-interested, would mitigate the completeness of the institutional environment. For present purposes, an apt example can be found in the auditing role performed by accountants. Vested with expectations that it will be executed in a way consistent with a strong and fair capital market (Fogarty, 1996), this work must be capable of supporting the high income sought by its practitioners.

Facing an institutionalized environment, organizations must generate conditions that assure constituents that its behavior will be predictably in line with these interests. Organizational structures are tangible forms whose display makes the point that behavior will not be discretionary, but will instead follow pre-announced rules. To achieve legitimacy, an organization must provide some credible evidence that it merits societal support. Although these structures are mainly symbolic, they must be perceived as efficacious and generative of consistent action (Tolbert and Zucker, 1994).

All professionals must convince the public that their work will be efficacious and honorable (Abbott, 1988). Auditors are obliged to have systems in place that are likely to delivery high-quality engagements and manageable degrees of moral hazard. Audits are nothing if they do not possess the confidence of those that read the audit opinion.

Institutional theory suggests that organizations cannot succeed without considerable "backstage" maneuvering that resolves the tension that exists between ceremonial structures and other goals such as efficiency and revenue maximization. This "loose coupling" between the actual behavior and the official behavior provides a safeguard against failure (Scott, 1985), and an opportunity to seize advantages that emerge in a changing environment (Aldrich and Whetten, 1981). This duality also buffers the technical core where the work must get done, from compromise from other agendas. In this way, the organization achieves much more flexibility in interaction than external third parties would suspect.

Professionals constantly live within this tension (Thomas, 1983). Auditors maintain an image of independence, but this is gainsaid by a willingness to advocate client interests. Audit firms can launch public campaigns to restore an unsullied audit culture while failing to assign sufficient resources to the conduct of engagements (Hilzenrath, 2001). Audit firms can simultaneously profess great expertise and also be fooled by their clients and ignore their own expertise (Kulish and Wilke, 2002). Very generous materiality thresholds suggest that auditing is not as good as the public had been led to believe.

Organizations that are successful in saying one thing and doing another are rewarded by the unwillingness of external parties to inspect those organizations. Instead, monitoring tends to be ritualistic with the good faith of organizational participants assumed (Meyer and Rowan, 1977). This systemic confidence is, in its own way, logical in that it both reduces the chance that inconsistent information will be produced and allows the organization to absorb the uncertainty that is inherent in performance evaluation. Thus, external parties engage in a comforting process that confirms their own expectations and allows a certain "taken-for-grantedness" to prevail (Weick *et al.*, 1973; Rogers, 1981). External parties provide considerable degrees of trust that tends to continue the privileging of insiders' interests (Zucker, 1986; Neu, 1991).

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The expertise that professionals possess makes it difficult for non-professionals to do anything other than to suffuse practice with the logic of confidence. Routinely, systems of self-regulation are blessed, notwithstanding evidence of their inadequacy and their impotence. In accounting, peer review programs substituted the investigation of systems of quality control for quality itself (Fogarty, 1996). In normal times, audit opinions could still be taken at their face value, despite the rising tide of earnings restatements. When the Enron breach occurred, however, the flaws of auditing were put in a brighter light (Zeune, 2002), calls for tighter regulation were made (Mallaby, 2002) and even basic competence was challenged (Whitman, 2002). Industry insiders implicitly insisted on the continuation of the old criteria by turning the dialogue toward the need for more diligence (Hilzenrath, 2001), client satisfaction (Tabolt, 2001) and a recommitment to fundamentals (Jost, 2002). Nonetheless, a scandal of this proportion spreads profound unease geographically (Ascarelli, 2002) and makes that was routine to be very problematic (Bryan-Low, 2002a).

In sum, institutional theory provides an explanation for the means by which organizations obtain the legitimacy that they require to continue in the good graces of external constituents. The demands of these groups, as interpreted by insiders, pressure organizations, via coercive, mimetic and normative processes (DiMaggio and Powell, 1983), to adopt similar externally visible forms that tend to become objectified dimensions of acceptability. In usual circumstances, institutional theory fosters an appreciation for a balanced and staple set of organizational relations that require little apparent agency beyond pattern recognition and acquiescence. The expression of self-interest and the choices open to organizations become more discernable and value-laden in times when societal support is threatened. The theory appears to have considerable validity in its application to professionalized organizations (Broadbent *et al.*, 1997).

2.2 Arthur Andersen

Notwithstanding the decade that has passed since the expiration of Arthur Andersen, our understanding of this colossal event remains imperfect. Book-length "insider" accounts such as Toffler and Reingold (2003) and Squires *et al.* (2003) exist, but provide only anecdotal considerations of matters mostly removed from the center of the problem. The bulk of the academic work has focused on the speed and pattern of client departures (Kriskman, 2005; Blouin *et al.*, 2007) and the impact of such turbulence on the quality of the audit work of other firms (Nagy, 2005). Accordingly, this work is not really about Arthur Andersen.

Another portion of the literature has taken up the issue of whether Andersen deserved to be singled out for legal enforcement, producing mixed results (Eisenberg and Macey, 2004; Morrison, 2004). Also, in this vein, are another stream of articles that reviewed the wisdom and propriety of this enforcement (Ainslie, 2006). These pieces tell us much about jurisprudence and social policy, but surprisingly little about Arthur Andersen.

At a lower level of analysis, a few pieces exist on how the employees of Arthur Andersen came to understand what had happened. Here, studies such as Gendron and Spira (2009a, 2009b) and Sellers and Fogarty (2010) consider professional identity as influenced by the necessity of an unplanned mid-career dislocation. This work contributes much to the study of career management in the face of adversity, but is not

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capable of the larger perspective that included a firm struggling to survive as part of an organizational field.

3. Research proposition development

Oliver (1991) altered the face of institutional theory by suggesting that conformity was not always the optimal strategy. She suggested that in particular environments, organizations should pursue a group of strategies that collectively could be called resistance. Resistance includes the specific acts of defiance, avoidance and manipulation, which vary in their degree of explicitness and forcefulness. Resistance, previously not seriously contemplated by institutional theory, would be the organization's optimal response as a result of a particular interpretation of the situation facing the organization, the degree to which constituents could be contextualized regarding the situation and some generalized features of the current organizational environment. For these purposes, Oliver proposed ten specific expectations, all of which are reproduced in the Appendix.

Following the action imperatives opened by Oliver (1991) offers organizations considerable latitude. The strategies previously believed feasible according to institutional theory were often disproportionately expensive and inconvenient, taking the organization in directions inconsistent with its previous trajectory and desires. Resistance promises an organization both social legitimacy and the fruits of the more naked operation of its technical core (Thompson, 1967).

The gauntlet thrown down by Oliver for organizational management would seem precise, although not necessarily clear. An organization should select resistance after careful consideration of their circumstances. However, an untested empirical question exists about how well any organization can understand their position in the organizational field, especially when the magnitude of external forces is particularly strong and salient.

Despite the passage of time since Oliver's refinement of our understanding, not many instances of successful resistance to institutional pressure has been observed. Whereas the idea that strategic necessity might trump the easy path of conformity and acquiescence, the bulk of subsequent use of the idea remains theoretical. The remainder of this section offers the thumbnail case that Oliver's ideas could assist the understanding of the Arthur Andersen case.

The first research proposition is grounded in the specific historical context of the late 1990s. At that time, public accounting firms were rethinking their business models and how they could continue to accommodate their historical public interest service. The extent to which the new behaviors that had blended the audit with consulting engagements (Fogarty and Rigsby, 2010) remained untested by the court of public opinion. Successful penetration for this approach in the market (Toffler and Reingold, 2003) could have emboldened Andersen to believe that alternative paths existed to the attainment of social approval:

RP1. Andersen pursued a resistance strategy because it did not perceive that its legitimacy depended on conformity to traditional ideas about how audits should be done and how public accounting firms ought to act.

Arthur Andersen considered itself the premier public accounting organization, perhaps to a degree beyond similar firms (Squires *et al.*, 2003). Under the Securities Acts of 1933

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and 1934, the imprimatur of public accountants was a necessary element of the information disclosures that were needed for the operation of US capital markets. In such an environment, the more prestigious the auditor was, the more people tended to believe corporate financial statements. This worldview might have inspired a belief that the position of the firm could survive whatever threat the government posed. When the fines that had been associated with previous audit failures were seen as a "cost of doing business", the idea that a material economic threat to the organization did not exist, seemed realistic at the time:

RP2. Andersen pursued a resistance strategy because it did not believe that large economic gains depended on conformity to traditional ideas about how audits should be done and how public accounting firms ought to act.

The major tension that has existed for public accounting over the past quarter century has been the compatibility of the audit with various forms of client advocacy. The latter, which include consulting and tax planning services, have been greatly demanded by a corporate clientele interested in improving operations and minimizing tax liabilities. The constituency for the audit is more esoteric, diffuse and indirect. One has to rely on notions of the fairness of the capital markets, as they might be enforced by governmental regulation. Although corporations paid for the audit, they had also put considerable price pressure of the public accounting firms that provided that service, and had essentially rendered it into a commodity. Andersen could have read the situation as one of disagreement among constituents:

RP3. Andersen pursued a resistance strategy because constituents held differing ideas regarding conformity to traditional ideas about how audits should be done and public accounting firms ought to act.

Any organization depends on the good will of its constituents. Especially important are the clients that pay for services and return for more. Without the cash flow that clients make possible, the organization could not meet its obligations to its highly paid workforce. While Andersen must have understood its theoretical client dependency, it may have failed to appreciate the odds that massive client departure might occur. In other words, dependence on external constituents might have been approached as a remote theoretical possibility:

RP4. Andersen pursued a resistance strategy because it did not believe the organization was very dependent on external constituents.

In the years preceding the Enron debacle, the meaning of auditor independence had come under unprecedented scrutiny. Established notions about the relationship between auditor and client had been challenged, and appeared to be in play. Specifically, the need for the auditor to be independent in appearance was seen as superfluous in the absence of clear evidence that the auditor's independence in fact had been compromised (Antle *et al.*, 1997). Others, however, maintained that appearance and actuality where inextricably intertwined (Firth, 1980). At this time, an organization could legitimately believe that normative divergence could exist, even concerning such an important characteristic:

RP5. Andersen pursued a resistance strategy because it did not perceive that the norms surrounding audits and public accounting firms were consistent.

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Like other accounting firms, Andersen was a partnership. This meant that the partners enjoyed high incomes by leveraging the work of staff members, the large majority of whom would never be admitted to partnership. In addition, the audit tended to be a low-profit margin service that helped the firm sell more lucrative services to those clients. The idea of a value chain, initiated by loss leader type products, was well understood within the profession (Elliott, 1995). Any solution that added to the costs of the audit would be inconsistent with the general business model that had developed. In other words, Andersen could not afford to engage in radical reorganization as the price of surviving its current predicament:

> *RP6.* Andersen pursued a resistance strategy because it perceived the constraints imposed on the organization under conformity would be excessive.

The struggle by the accounting profession with its legal liability for audit services had become an old story by the turn of the century. This issue had risen to the level of feature story when the American Institute of Certified Public Accountants (AICPA) celebrated the 100th anniversary of the profession in America in 1987 (Amhowitz, 1987). However, over the next decade, the profession had successfully lobbied for legal changes that worked significant reductions in its exposure to investor lawsuits. The accounting establishment had also fended off serious challenges to its combination of audit and consulting services that had been raised by the Securities and Exchange Commission (SEC) in the late 1990s under the chairmanship of Arthur Levitt.

Audit failures continued to occur and to have serious economic consequences for accounting firms. However, these have always been civil matters between aggrieved parties and audit providers. Civil damages and modest reputational damage was the extent of the worst case scenario for firms like Arthur Andersen. While criminal sanctions existed on the books, they had never been used and, therefore, might not have been actively considered:

> *RP7.* Andersen pursued a resistance strategy because it did not perceive a high degree of legal coercion in the situation.

Accountants had always been in charge of the professional standards that governed the audit and the underlying accounting. Although the SEC had full power over these domains for publicly traded entities, this agency had delegated its authority back to the accounting community. Regarding auditing, the AICPA controlled the Auditing Standards Board and its subcommittees. The Financial Accounting Standards Board had been in the business of issuing accounting standards since 1973, and has been exclusively composed of accountants. The idea of self-governance of the profession had been a matter of near-religion in the value constellation of accounting practitioners.

As one of the larger firms, Arthur Andersen participated in the self-regulation process both for auditing and accounting. In the 1950s, the firm (under the guidance of Leonard Spacek), had grown accustomed to a leadership role. To some extent, this situation may have fostered the belief that the environment was less hostile than had it been under the aegis of lawyers and other non-accounting professionals:

> *RP8.* Andersen pursued a resistance strategy because the norms surrounding the audit and the practice of public accounting were voluntarily diffused.

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Many would say that auditing has no value except to the extent that it possesses true independence from corporate management. Whereas the latter group has a vested interest in projecting a certain reality about the corporation, the former should be more motivated by the needs of the capital market for reliable and trustworthy information about past corporate performance. However, as noted above, this conventional wisdom had strained under the equally compelling logic that auditors were well suited to be the trusted business advisors that would guide corporations toward higher levels of sustained success.

With such theoretical debates afoot, the government's position with regards to enforcement had to be even more muddy and different to predict. In 2001, a Republican federal administration came into power, and had fostered more confidence that a pro-business posture would be the default reaction to the corporate world. However, in the face of a sudden and widespread loss of investor wealth, governmental agencies also need to save face and appear to be proactive:

> *RP9*. Andersen pursued a resistance strategy because it perceived a high degree of uncertainty in the application of norms surrounding the audit and public accounting practice.

Audit firms possess several discrete constituents. Although one could say that they form an integrated system pertaining to the provision and use of capital, fissures among these parties are well-known. Managerial discretion over the operation of publicly traded companies was seen as sufficiently strong so as to dominate the official legal oversight provided by Boards of Directors. Even more remote, shareholders had little meaningful power other than to "punt" by selling their interest in the face of displeasure. The dominant paradigm in management and accounting research, agency theory, assumed that asymmetry of information and moral hazard existed for high-level corporate officers. These groups tended to operate in some degree of opposition to the others, despite a rhetoric of cooperation and an ideology of mutual interests. The work of auditors, perhaps only truly understood by top corporate management, tended to exploit these discrepancies.

In this environment, government had been content to stay largely on the sidelines. Corporate governance was lightly regulated, perhaps because it was believed that an enlightened company would take appropriate self-interested measures to have a well-informed and proactive board, and provide shareholders with adequate means to voice their positions. Auditors, bound by professional norms, played a critical role in ensuring quality corporate stewardship, and, therefore, needed little overt sanctioning. The system, on paper, was well integrated, but in reality, it was quite disconnected as each party pursued a set of self-chosen objectives:

> *RP10*. Andersen pursued a resistance strategy because it perceived a low level of interconnectedness among its constituency as it related to its operation.

In sum, propositions drawn from Oliver (1991) provide a plausible rationale for Andersen to have pursued a resistance strategy. Although Oliver's ideas predate the Andersen situation by over a decade, and were not necessarily intended for accounting organizations or for firms in this particular regulatory climate, not much creativeity is needed to fashion a particularly worthwhile application.

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4. Method

This paper uses the mass media reporting of the Andersen imbroglio as the data for analysis. For these purposes, this coverage ranged from the inception of the news that Andersen employees in the field had shredded Enron documents to the point where client abandonment ensured that no meaningful entity would survive the scenario. The mass media outlets included many publications that covered the story to some degree. However, the lion's share of this material was originally published in the *Wall Street Journal* and the *New York Times*, two highly respected publications that tend to bestow more coverage to financial news. In addition to mass media content, the paper also considered documents produced by Arthur Andersen during the period in question.

The examination of news coverage of this massive audit failure is consistent with the effort to capture the audit firms' reaction to the crisis. That phenomenon exists within the changing whirlwind of who did what when, and who said what when. Firm posturing, complete with its inconsistencies and temporally based phantoms of possible plans and reported reaction, is ideally captured by the contemporaneous media coverage provided by trained journalists.

This paper does not depend on individuals that authored these accountants knowing the exact nature of the corporate reporting shortcomings of Enron and the motivations of their primary personnel. In fact, insofar as what Andersen did or did not do was also an evolving story, the paper does not pass judgment with the benefit of historical hindsight. Instead, the core facts needed by this paper had been only recently made public, a process in which the media played a central role.

5. Results

5.1 Introduction

Evidence consistent or inconsistent with the ten research propositions is presented in this section, following an initial section that establishes basic facts. For these purposes, the best support is summarized and developed in the various subsections of this section.

5.2 Did Andersen resist?

Resistance, as a meta-strategy, constitutes the exception to the rule regarding organizational response to institutional presence. *Ceteris paribus*, saying one is sorry and promising to reform (i.e. acquiescence), seems easier and much more logical when proof of wrong doing is present and incontrovertible. Resistance is a difficult path to plow and without many precedents of success.

Nominally, Arthur Andersen did acquiesce during the trauma of Enron and the government's criminal indictment. The firm did not contest most of the factual basis of an audit failure and the shredding of documents. It reiterated its desire to cooperate with the government's investigation and its commitment to serve the public interest (Volcker, 2002). Andersen also dismissed (albeit belatedly) the lead partner on the Enron engagement for his "bad judgment", a rather unusual outcome for a public accounting firm.

Andersen's resistance was more subtle than would be implied by the dictionary's definition of that word. In general, any tacit agreements that were reached were approached gradually, tentatively and with such reservation that their sincerity was effectively compromised. At no point did the firm offer a sincere *mea culpa* for its Enron

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work (Norris, 2002) or for its evidence destruction behavior. These actions formed a pattern that legitimately could be seen as *per se* non-cooperative (e.g. shredding documents in the face of litigation). In many ways, the firm instead mounted an offensive that insisted on the technical correctness of its work (Norris, 2002). Most of its compliance was performed in the spirit of regretfulness and with a timetable that was too late to be effective, and more of a reaction to its mounting losses than to the wrongfulness of its behaviors.

5.3 RP1*: non-contingent legitimacy*

Andersen's belief in its invincibility could have been based in its size and scope. In 2001, Andersen had 85,000 employees and 9.3 billion in worldwide revenues (Brown and Dugan, 2002). Critical mass of this sort may not guarantee success and further growth, but it should allow a firm to be sustainable against normal crises and routine business downturns.

The firm also possessed considerable reputational capital. Arthur Andersen had the cache of history that included stories of the impeccable personal integrity of the namesake founder (Zeff, 1987). Being in the vanguard of those that recognized the ways in which informative technology would revolutionize business processes and record-keeping created more recent credit (Squires *et al.*, 2003; Accenture, 2005). Unlike the other large firms that had blurred their identity through mergers, Andersen had a strong hold on the legitimacy of tradition and persistent value added. The claims about organizational specialness told in many venues had considerable credibility (Andersen, 1974; Toffler and Reingold, 2003). Starting to believe their own press clippings had begun at the company well before the Enron debacle.

Andersen had recent chances to learn of its vulnerability. The audit failures at Sunbeam and Waste Management that occurred shortly before Enron could have shown the firm that their credibility as an auditor was wearing thin. However, in that the firm had been able to settle investor claims on a civil basis, legitimacy might not have been made into the issue. In fact, these past audit failures might have emboldened the firm through the belief that the downside was not that steep, and would never put the existence of the firm at risk.

Andersen believed that a positive response to the firm could be produced by persistent reminders that it usually did good work (Berardino, 2002). Theoretically, an organization with immense goodwill could convince the public that its general contributions to society should grant it concessions for an occasional shortcoming. However, Andersen was hardly in such a position. That the firm was such a special actor may have focused the firm around the expectation that could receive some "alternative sanction" that would simultaneously satisfy regulations and impose only acceptable losses to the firm (Mayer Brown Rowe and Maw, Esq, 2002). The high-water mark of such was Andersen's willingness to pay Enron investors $750 million as long as no formal acknowledgement of responsibility was necessary. Throughout, Andersen insisted on such an "all or nothing" settlement that would restore it to its pre-Enron status (Glater, 2002a). Such a resolution was very inconsistent with the complexity of the legal system faced by a global firm that had the ability to touch the financial fates of many others.

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5.4 RP2*: insufficient economic gains*
Retrospectively, the miscalculation of the economic stakes faced by Arthur Andersen could not have been any larger. Could firm leaders not have predicted that the Andersen association would prove so toxic that the clientele would so rapidly and thoroughly defect? How could they legitimately hope that the Andersen brand would not be fatally besmirched?

That Andersen was surprised by what took place suggests that the firm did not appreciate the linkage between stigma and external reaction. This might have been caused by a systematic overvaluation of the value added provided by the firm to its clients. While all evidence suggests that the clientele was satisfied, this result should not be equated with the inability of these organizations to find equivalent value elsewhere in the marketplace. Andersen's belief that the economic gains that could only be realized through acquiescence were small seems to be closely attributed to its belief that the firm was irreplaceable to its customers. This premise fueled the prediction that the corporate community would weather the Enron storm at the side of Andersen. Instead, the value-added proposition put the already questionable audits even more widely in doubt (Pulliam and Berman, 2002).

A major element of Andersen's mistaken idea about the economic stakes involved in its reaction to the Enron situation may have been attributable to forgetting that what Andersen provided was mostly intangible. Audits, for example, are only as good as the credibility and trustworthiness of the auditor. When such an image is shattered, questions may be raised about the information that the auditor has opined upon. Corporations did not value Andersen so much that they could risk such backwash about themselves (Thies, 2002).

Near the turn of the last century, public accounting firms had awakened to the fact that they could earn more profits for their partners. The global firms had taken many steps to reengineer their operations along the lines of this objective (Covaleski *et al.*, 1998). Large margins on corporate advisory services were no longer the incidental byproduct of valuable professional expertise, but instead were its primary goal. This reversal could only be accomplished through some degree of normative displacement wherein a debate about what the right thing to do no longer had a place. Ironically, when pressed to forecast its own future in purely cost/benefit terms, Andersen proved unable to do so competently. Having tasted the rewards of a service mix that featured a vast array of high-end services, the real economic cost was reverting to being an audit firm.

5.5 RP3*: divergence over proper audit firm behavior*
Some would argue that the heart of the Andersen problem for both the government and the public lie in the failure to appreciate what an audit is, and what sort of assurances it produced about corporate health. Thus, one could say that how an audit firm should behave was not clear.

Proper audit firm behavior could be understood in a technical sense of following the letter of auditing standards, and, as a consequence, not allowing corporate clients to deploy accounting techniques outside the approved range of choices. This view allowed Andersen to adopt the position that any mistake made by the firm was confined to just one of the many special purpose entities used by Enron (Berardino, 2001a). This isolated mistake was not even characterized by Andersen as a major one (Brown, 2002). If inadequate auditing existed, the firm characterized and diminished it as merely a matter

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of poor judgment (Schmitt *et al.*, 2002a). While professionals are expected to make informed judgments, major blame for shortcomings in this esoteric area are more difficult, and usually not the appropriate arena for criminal sanctions.

Auditing has always been in the midst of an expectations problem. Investors and other parties external to corporate entities want assurances that the financial statements present an economic reality relevant to future cash flows. As long as Andersen could focus attention on the firm's work for Enron, the downside would merely reflect the magnitude of this corporate collapse, and would probably be mitigated by the very obvious culpability of Andersen's client.

What Andersen did not anticipate is that a strong consensus existed about what appeared to be the destruction of evidence. The image of Andersen staff shredding mountains of documents, shortly after Enron's stock plunge, rendered the episode unique. These behaviors pushed the governmental response against what was being hailed as such a flagrant abuse of fair play. That consensus drowned out the confusion about auditing that Andersen had hoped would work in its favor.

5.6 RP4*: non-dependence on external constituents*

Andersen, at the turn of the last century, had every reason to believe in their self-sufficiency. Its business model, solidified through geographic and product line diversification, was as robust as ever. The firm had a loyal clientele that ranged from the Fortune 100 deep into the middle market. Unlike many of its clients, Andersen was not directly exposed to fickle consumer demand, more technologically sophisticated competition or flagging governmental procurement appetites. It shared a social reality that suggested that the US capital markets had been made safe through corporate governance that mitigated insider abuse and, though the discipline of auditing, ensured that corporate accounting represented good information. In the event of a problem, Andersen and other audit firms had successfully obtained relief from "deep pockets" liability through US securities law amendments. The firm had many reasons to believe that it sat in the proverbial "catbird seat".

The resistance put up by Andersen would not have been so noteworthy but for the failure of the accounting establishment to close ranks with that firm. Given the choice to back Andersen or to insinuate that Andersen was a renegade in the profession, the other firms chose the latter. Once the "new audit" and its altered relationships with clientele became problematized, other firms quietly and quickly reformed their structures to emphasize public interest pursuit (Glater, 2002b, 2002c) and exacerbated their rhetorical allegiance to traditional norms (Ernst & Young, 2002). Andersen, particularly in its Enron engagement was characterized as not representative of the "fundamentally sound" work of auditors by those with the ability to speak on behalf of the profession (Castellano, 2002). To this extent, Andersen's situation proved highly dependent on the normative judgments of others not directly affected by the Enron engagement.

5.7 RP5*: inconsistent behavioral norms*

The autopsy of Andersen had very little to do with that specific organization and very much to do with the trajectory of modern auditing. The emergence of consulting as the center of the firm had sanctioned the approval of highly aggressive accounting (Frankel *et al.*, 2002), if not an accounting that lacked substance. The large firms had all gone down this road together, featuring rampant incentives to cross-sell such that the

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protocols that distinctly demarked auditing had become blurry at many firms (Fogarty and Rigsby, 2010). At no time in history had the line between the auditing and management advisory been as indistinct. This situation would not have been so problematic but for the existence of incompatible norms between the two.

Consulting work constituted a well-understood service. Clients purchased what they believed was worth the price, and accounting firms advocated client's best interests as part of the sale. Auditing, however, was more like a tax imposed on corporations in pursuit of the public interest. Because its value was at best a byproduct, the audit had been commoditized and had been under considerable price pressure (Menon and Williams, 2001). Prior to efforts to integrate auditing with consulting, the former could be used to gain position to sell the former. The high margins earned by public accounting on consulting (Brock *et al.*, 1999) placed its value in ascendency within the firm, such that it no longer could be contained as an afterthought.

Andersen apparently underestimated the extent to which traditional auditing values still captured the public's approval. Only after Enron capitulation did this primacy become apparent. Barry Melancon, chief executive of the AICPA, made the "back to basics" trajectory most apparent with a high visibility address (Melancon, 2002). This effort to recapture the high ground made Andersen's breach of faith all the more apparent.

In the final analysis, Andersen's deeds spoke much loudly than its words. The firm's work for Enron could not be defended except in terms of a value shift toward efficiency and corporate facilitation that apparently had not occurred. With Enron's management proved to be morally bankrupt and without a sustainable business model, Andersen had no alternative public interest story to offer. Its retroactive support for a more traditional set of values proved to be hollow words, and quite inconsistent with the facts.

5.8 RP6*: excessive constraints*

Those familiar with auditing textbooks, but not with auditing itself, might conclude that public accounting firms were tightly controlled by auditing standards and by professional norms in their conduct of these engagements. Audits were planned in accordance with the various risks that existed for specific clients and were designed to supplement the control environment put into place by corporations. Auditing presented itself as a mature and sophisticated technology of assurance. The knowledge created by the work allowed more services to be built, and then to be sold again.

However, the reality enacted by Andersen proved quite different. Andersen hoped that Enron would soon be its largest client, and represent USD100 million in revenue (Hamberger and Brown, 2002). To do this, the relationship was much different than specified by auditing textbooks. Personnel of the two firms worked side-by-side in what Andersen called the "integrated audit" (Knechel, 2006). This provided Enron with seamless and instant consultative advice. As part of this, Andersen either co-developed or blessed a set of highly aggressive accounting practices. The relationship intertwined the organizations in many ways that were inconsistent with the ideals of auditor independence. Enron pushed Andersen to ignore red flags, and to eventually give in to all sorts of requests for an extreme accounting. Andersen helped subvert Enron's auditing committee, and itself became a fortress against clear disclosure. Enron was an aggressive calculated risk that illustrated what Andersen thought it could manage, albeit unconstrained by professional precedent. This represented what Andersen

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wanted to do, perhaps as a shotgun effort, to rebuild the consultancy practice recently spun off as Accenture (Zeff, 2003).

When the circumstances suggested that the Enron situation precluded a "back to ordinary business" resolution, Andersen floated the willingness to make revolutionary organizational changes. Referred to as the "Volker plan", after the esteemed Washington DC insider that would be brought in to operate it, this proposal would have reengineered Andersen into an auditing-only firm whose pursuit of the public interest would have been unquestioned and uncompromised. In essence, Andersen nominally asserted that it was willing to rediscover the shackles of the past as a complete reversal of its venture in business model freedom.

The Volker plan proved to be a stillborn idea, and the world would be denied what would have been an experiment in audit independence. Andersen partners, perhaps realizing how such an organizational design would depress their income, offered tepid support for this proposition. Lacking a strong champion, the idea was quickly cast aside. An aggressive effort at solving the broader problem of which the Enron engagement was a symptom, proved too costly a remedy to take seriously.

5.9 RP7*: insufficiently salient legal coercion*

The failures of auditing to bring about the level of assurance that the capital markets wanted had been well-known for some time. Auditing was, in many ways, a service that could not be fixed, at least at the price point that buyers were willing to pay (Fogarty *et al.*, 1991). However, public accounting firms had managed their exposure to investor lawsuits by contesting legal theories with plaintiffs who claimed economic injury from sudden corporate declines. For the large part, the matter had not been conceived as a criminal matter. The SEC's power over the financial reporting of publicly held companies had been used, but only to obtain consent orders wherein auditors made promises to do better in ways that were not terribly visible to external parties.

Despite the nominal coercion of potential governmental use of existing criminal penalties, audit firms had grown complacent in their belief that these powers would not be fully used. The process remained one of bargaining. However, Andersen discovered that an organization strategy that featured considerable degrees of resistance was incompatible with the posture needed to convince the government not to use criminal sanctions.

In the few years before 2000, Andersen's audit work for Sunbeam and for Waste Management had been found so deficient that, in addition to paying out large settlements, the firm had been essentially placed on probation by the SEC. Even so, this legal and regulatory environment did not seem to counterweigh Andersen's willingness to be seduced by clients that used their wealth to demand an aggressive accounting that evinced arrogance toward usual normative restraint. The serious wrongdoing that had triggered huge losses appeared to be treated as a regrettable, but normal, cost of doing business in the hyperventilated commercialized fever that public accounting had become. Andersen no longer agonized over how it could justify its actions when they failed to reproduce the societal expectation of audit quality. As long as the consequence was only a restatement showing lower corporate earnings, the media attention was apparently manageable (Adler and Milne, 1997).

Although the legal system had been anything but purposefully coercive prior to the downfall of Enron, it had the consequence of coerciveness in its awkwardness. The

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government lacked a response that would have allowed it to appear that they were proactively responding to the situation that was short of indicting Andersen for a felony. Handling the situation in the usual quiet and informal way would have been woefully inadequate. Once this criminal indictment had established the battle lines, the government did not have sufficient options but to see the matter through, even as its large and mostly unexpected consequences became apparent (Kulish and Wilke, 2002; Morrison, 2004). A quick guilty plea with a minimal punishment, an obvious solution in other corporate contexts, was not possible for Andersen (Bryan-Low and Geyelin, 2002). SEC regulations disallowed a convicted felon from auditing the financial statements of publicly traded firms. This stipulation, developed to protect the public interest in corporate reporting, ironically hoisted Andersen on its own petard (Nussbaum, 2002). Either Andersen never anticipated the indictment, or did not fully appreciate that the game was over after the indictment. If it had understood these contingencies and early resistance might have been rethought.

5.10 RP8*: voluntarily diffused norms*

What auditing was had always been the product of what professionals in this field had concluded. This norm setting ranged from the highly specific work of the auditing Standards Board to grand articulations such as the *Philosophy of Auditing* (Mautz and Sharaf, 1961).

Certainly, the self-determination of normative standards by accountants over accounting matters was well past its high mark. The complicity of auditing with sudden corporate failure was still disputed by public accounting, but it had proven a difficult position to argue. If auditing could neither detect fraud nor serve as an early warning of corporate collapse, its value and necessity was open to challenge. For several decades, noisy business failures triggered inquiries and commissions that led to progressively more significant intrusions into self-determination by the profession and the autonomy of the firm. The 1990s saw monitoring by the Public Oversight Board, and the maturity of a peer review system of self-regulation.

Nonetheless, Andersen could have believed that the institutional apparatus in place in 2001 was not very invasive. The firm still participated in these processes and had every reason to believe that they could be finessed as needed. Andersen had, just months before, flown through a peer review examination run by another Big Four firm. The large firms, Andersen included, dominated the accounting profession in many ways, including being able to recruit the "best and brightest" of each year's cohort of accounting students.

That the Enron situation would precipitate the Sarbanes–Oxley Act and the establishment of the Public Accounting Oversight Board, developments that have wrestled control over the accounting for publicly traded firms from the profession, could not have been foreseen. Andersen also did not have the necessary perspective about its own behavior to appreciate the gravity of these events and the resultant end of normative self-determination.

5.11 RP9*: uncertainly applied norms*

Ultimately, the Andersen case revolved around cooperation with the legal process. Although broader questions about the nature of auditing are proximate, the propriety of document shredding in the wake of an impending investigation was squarely at issue.

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Andersen had learned from previous audit failures that its own records would be the evidence that would be most persuasive in legal actions against the firm. With these records, prosecutions and juries would learn what the firm knew and when it knew it. Specifically, how the audit firm could/should have offered resistance to the accounting treatments offered by Enron management would be detailed in these documents. Clearly, the shock over what Andersen had permitted Enron to report against the background of the emerging economic reality was strong. However, a naive jury would also be aghast at the negotiated nature of audit work. The absence of a distinct accounting truth might prove even more damning, and such would have been revealed by the full document trail.

Officially, a strong appetite for strong corporate governance existed, especially in the wake of the Enron collapse. After having clearly aided and abetted runaway managerial abuse that ultimately imposed a heavy cost on shareholders, Andersen purported to flop to the other extreme. In the Volker plan, auditor independence beyond its most aggressive manifestation was proposed in an effort to save the firm. Although no normative consensus had formed around ideas such as strict auditor rotation or centralized firm accounting judgments, their contribution to the improvement of financial reporting could be understood and appreciated (Grabowski, 2002). This plan also would have required a radical about-face from everything Andersen (as well as the rest of public accounting) had become over decades of organizational development (Eichenwald, 2002; Bryan-Low, 2002b).

5.12 RP10*: low level of constituent interconnectedness*

Perhaps the strongest position taken by Andersen pertained to the appropriateness of evaluating the facts of the Enron audit on their own terms. This view of events would have allowed the situation to be defined as just another audit failure. Although those harmed by this event were larger in number and scope that other audit failures, such a perspective would have distinct boundaries.

Audit failures can be thought to create constituencies of opposition for public accounting firms. In each one, a distinct set of creditors and shareholders may have lost money. Those who received the audit signals that now have proven false constitute a broader class of participants in the capital market, yet one that has its own limits. In a similar sense, the turbulence that audit shortcomings create for regulators is bounded in space and time. The notion that audit failures are distinct situations that are not part of a broader pattern is buttressed if they are relatively rare and not ordinarily grouped in close temporal proximity.

Arthur Andersen had been implicated in a series of audit failures in the years preceding the Enron debacle. The extent to which this record of malfeasance was a factor in the government's decision to indict the firm is factually uncertain but quite plausible. Criminal sanctions are often arrayed according to more than the instance at hand. Several commentators have reviewed this string of poor performances in the context of its disappointment over the financial payout from its split with Andersen Consulting, reasoning that the firm was under extraordinary pressure to build revenue by pleasing corporate clients (Squires *et al.*, 2003). Even if only partially true, the case could be made that the constituencies that felt aggrieved by the firm's recent underperformances were accumulating.

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Andersen never accepted the interconnectedness of the constituent opposition that it encountered after Enron unraveled. Whereas the firm may have had the strength and unified organizational will to oppose a single oppositional constituent, as it had when investors were the only victims of audit failure, it could not successfully fend off the new collectives that had formed against the audit firm. The firm had made itself a deviant and, therefore, no longer benefitted from the benefit of doubt.

6. Conclusion

Although the record of Andersen's reaction to the Enron situation could best be characterized as confused, mixed or vacillating, it contained strong elements of what Oliver (1991) characterized as resistance. Under certain instances, institutional forces can be repelled and the organization can enact a strategy other than capitulation. The analysis of the contemporaneous reporting of the events of that day suggests that Andersen might have misinterpreted the situation as providing an opportunity for resistance. As things worked out, resistance not only proved futile but compounded the desperate situation that the firm found itself in 2001-2002.

The Oliver (1991) article is a seminal one in the institutional theory literature. It usually is used merely to establish the fact that institutional forces do not condemn an organization to a pure acquiescence strategy. Instead, the organization is said to have many choices if it understands its environment, and acts in accordance with several of its dimensions. The current research contributes to the literature by providing empirical evidence on the plausibility of the underlying relationships in a situation where resistance, with the assistance of hindsight, seems to have been a poor choice for a faltering organization.

Resistance may be a more viable organizational choice when the institutional force in the opposition is more normative or mimetic. The coercive power of the state makes resistance a difficult choice to make. That Andersen was ultimately vindicated on the technical legal issue upon which its prosecution pivoted (Morrison, 2004) could not be more irrelevant to this strategic choice. Resistance made Andersen's relationship with the government appear purely adversarial. As drawn, these battle lines offered Andersen's clientele no space to occupy that did not vicariously suggest similar resistance to the US government. This posture proved untenable to the clientele, making defection from the Andersen relationship the only feasible solution. Andersen's clients were in their own institutional environments and could ill afford an abnormally close inspection.

Andersen's resistance strategy seemed to be the result of a profound misreading of its environment. The firm overestimated its own place in the world and the extent to which change to foundational ideas had occurred. Nonetheless, one cannot assert with certainty that the firm could have saved itself with a different approach. Much discretion remained in the hands of the government. Whereas resistance by Andersen certainly did not curry favor, reactions to a purer acquiescence would not have produced any guarantees.

Although in hindsight resistance seems like a poor choice, it might have been more successful in an alternative time. Perhaps a more macro-level context needs to be considered. The Andersen scenario played out in the wake of two other meta-events that may have conditioned the government's non-receptiveness to Andersen's resistance. First, the popping of the "dot-com" bubble, an event that had convinced everyone that

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the fundamentals of economy still ruled, was still in its last phases. As people reeled back from their wishful thinking about the new economy, traditional ideas about corporate stewardship, financial accountability and audit independence were again gaining traction. Secondly, the event of September 11, 2001, had steeled the will of the US federal government to higher levels of command and control. The geo-political crisis of terrorism may have cast a cloud that made expressions of private sector autonomy more difficult to accept. Resistance, like that offered by Andersen, may have been better received in a more tranquil and optimistic era. The salience of factors such as these suggests that Oliver's hypotheses must be contextualized by the more general tenor of the times.

Many writers have asserted that the four firms that dominate the provision of auditing services after Andersen's demise constitute a "final four". In that four separate organizations may be a minimum system requirement, these entities may be treated less severely by the government than Andersen was. Less clear is the organizational response to the post-Andersen world. If these firms are convinced that they will not be allowed to fail, they may be emboldened to take more risk by acting contrary to the remnants of auditor independence. Once caught in compromised relationships, the Andersen lesson may be that resistance does not constitute a good choice. Firms cannot imagine anything other than that organizational survival hangs in the balance after every new embarrassment. Ironically, even if "too few to fail" turns into a *de facto* license to steal, it does not enable one to be defiant about it.

For organizations facing legitimacy crises, resistance is a strong statement. So, many organizations have automatically accepted full responsibility and have essentially thrown themselves on the mercy of those empowered to resolve matters, that the occasion of one that does not, appears quite remarkable. As seen in the Andersen case, resistance cannot be used within a broader portfolio of strategies. Initial resistance may preclude the effectiveness of compromise and even make acquiescence difficult to enact. Andersen's protestations of serving the public interest merely appeared self-serving when it was used as a fall-back strategy.

In retrospect, the Andersen saga could be seen as serving the function of altering the trajectory that public accounting found itself on in the late 1990s. Restoring the profession to its traditional wellsprings has not proven very costly, and it may have contributed to the general lack of blame cast upon auditors for the worldwide financial sector meltdown that began in 2008. However useful such a recalibration might have been, it did not require the death of a firm such as Arthur Andersen. Andersen's demise was largely a result of its own mistaken reaction to their predicament.

Oliver (1991) may have underestimated the complexity of resistance in the face of forces that jeopardize the organization's going concern status. At some point, modeling resistance as a strategy against external elements is not sufficient. Resistance also activates divergent interests of internal constituents, some of which will favor organizational termination.

The paper illustrates that the conventional wisdom provided by institutional theory has broad application. Resistance to institutional forces is a high-risk exceptional strategy that requires an unusual configuration of constituents, norms and potential for social change. Oliver (1991) may have oversold its more general usefulness.

This paper also contributes to what could be called the "Arthur Anderson literature", a segment of the literature unlikely to disappear due to the enduring curiosity of its fall.

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A natural complement to the empirical studies of the reaction of the business community is the reaction of Anderson itself. In many ways, the latter can be considered a cause of the former. Whereas we also know much about why the accounting endorsed by Anderson was flawed, this paper assumes that fact and moves the inquiry forward to discern why this firm, unlike many others, could not survive a single audit failure.

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Further reading

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Frank, R., Pacelle, M. and Champion, M. (2002), "Andersen cuts Enron settlement offer by half", *Wall Street Journal*, 20 March, p. C1.

Appendix

Oliver's (1991) hypotheses

H1. The lower the degree of social legitimacy perceived to ebb attainable from conformity to institutional pressures, the greater the likelihood of organizational resistance to institutional pressures.

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H2. The lower the degree of economic gain perceived to be attainable from conformity to institutional pressures, the greater the likelihood of organizational resistance to institutional pressures.

H3. The greater the degree of constituent multiplicity, the greater the likelihood of organizational resistance to institutional pressures.

H4. The lower the degree of external dependence on pressuring constituents, the greater the likelihood of organizational resistance to institutional pressures.

H5. The lower the degree of consistency of institutional norms or requirements with organizational goals, the greater the likelihood of organizational resistance to institutional pressures.

H6. The greater the degree of discretionary constraints imposed on the organization by institutional pressures, the greater the likelihood of organizational resistance to institutional pressures.

H7. The lower the degree of legal coercion behind institutional norms and requirements, the greater the likelihood of organizational resistance to institutional pressures.

H8. The lower the degree of voluntary diffusion of institutional norms, values or practices, the greater the likelihood of organizational resistance to institutional pressures.

H9. The lower the level of uncertainty in the organization's environment, the greater the likelihood of organizational resistance to institutional pressures.

H10. The lower the degree of interconnectedness in the institutional environment, the greater the likelihood of organizational resistance to institutional pressures.

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