Auditor Independence: The Performance of Consulting Engagements With Audit Clients

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Abstract

As the size and complexity of client information system needs have risen, CPA firms have found it necessary to co-contract with non-CPA firms as a means of efficiently providing services to clients. The increase in frequency of these engagements has raised concerns regarding the propriety of co-contracting with an audit client. The Securities and Exchange Commission has taken the position that co-contracting with audit clients is unacceptable because it impairs audit independence. Through a series of petitions, the Big Eight (now the Big Six) CPA firms have proposed certain safeguards in an effort to satisfy the SEC's concerns. The purpose of this article is to (1) discuss independence issues related to CPA firms' co-contracting with audit clients, (2) consider arguments both for and against the SEC stance which prohibits contracting between CPA firms and their audit clients, and (3) consider possible regulatory responses from the SEC.

Introduction

The AICPA Code of Professional Conduct (AICPA 1992a, para. ET.55) explicitly requires certified public accountants (CPAs) not only to have actual independence from their audit clients, but also to maintain the appearance thereof.[1] Although the need for CPA actual and perceived independence when performing audits and other attest services is well established,[2] independence is not required when CPAs perform consulting services.[3]

The large CPA firms are currently positioned as providers of comprehensive professional services. They have developed separate consulting departments to provide a variety of services (other than audits), often to clients that also purchase audit services. In spite of the efforts to separate consulting and audit departments, accounting regulators remain concerned about the relationship between the provision of audit and nonaudit services. These concerns were initially expressed in the 1970s by members of Congress engaged in the Metcalf and Moss committees and most recently by the Dingell committee (Dingell Committee 1986; Metcalf Committee 1976; Moss Subcommittee 1978). Central to these concerns is that the auditor-client relationship may be altered by provision of consulting to the client.

The Securities and Exchange Commission (SEC) has devoted significant attention to the situation in which audit and nonaudit services are supplied to the same client. Accounting Series Release (ASR) No. 250, issued in 1978, required certain disclosures of the relationship between fees obtained from the performance of nonaudit services as compared to audit fees. In August, 1981, the SEC rescinded ASR No. 250 based on the premise that the information was of little value to investors. Since then, SEC registrants have not been required to disclose any information about their other professional services purchases. Therefore, while there is a history of concern, at the current time CPA firms are allowed to perform consulting for audit clients.[4]

As the size, scope, and sophistication of client accounting system needs have become more complex, many CPA firms have expanded their services and sometimes co-contracted[5] with non-CPA firms to meet these needs. A situation has evolved in which CPA firms and other firms (e.g., a computer firm) combine complementary skills and resources through co-contracting to provide these services in an efficient manner to a mutual client (Mednick 1990).

The increase in co-contracting, as well as the recent merger activity among CPA firms, has brought new concerns regarding propriety when the co-contractor is an audit client. The AICPA allows such arrangements, as long as the revenues derived therefrom are not material to the CPA firm (AICPA 1992b, para. ET.101). On the other hand, the SEC prohibits all such co-

contracting between CPA firms and their audit clients. That is, the SEC will not allow a CPA firm to co-contract with another company that is an audit client to provide services to a third company, regardless of the materiality of the relationship. The Commission asserted that in these arrangements, the appearance of independence is lessened.

The purpose of this article is to (1) discuss independence issues related to CPA firms' co-contracting with audit clients, (2) consider arguments both for and against the SEC stance which prohibits contracting between CPA firms and their audit clients, and (3) consider possible regulatory responses from the SEC.

Policy Development

Current Situation

Consulting engagements entered into by CPA firms often involve the design and implementation of computerized information systems. As the size and complexity of client information system needs have risen, CPA firms have found it necessary to co-contract with specialists as a means of efficiently performing the requisite services. For instance, a CPA firm may combine their skills and resources with a computer hardware manufacturer and a software contractor in developing a management information system for a common client.

Andersen Consulting, the consulting organization affiliated with Arthur Andersen & Co., has been a leader in this area. This firm has and continues to be involved in major joint venture projects with Compaq Computer Corp., Digital Equipment Corp., IBM, Microsoft Corp., Sun Microsystems, and Xerox Corp. (Cole 1991; Moore 1990; Public Accounting Report 1989). Other large CPA firms are also forming alliances with leading computer companies, in an effort to boost their consulting businesses. Coopers and Lybrand recently formed a joint venture (Meritus Consulting Services) with IBM, to provide management consulting services for package goods and health care supply companies (Carroll 1991; Cole 1991).

As co-contracting arrangements are becoming increasingly common in the performance of requisite services, the propriety of such arrangements with audit clients has been questioned. Section 602.02g of the SEC's Codification of Financial Reporting Policies states that, "direct and material indirect business relationships, other than as a consumer in the normal course of business, with a client... will adversely affect the accountant's *independence* with respect to the client."

Co-contracting relationships explicitly prohibited by this set of policies include: joint ventures, limited partnership agreements, investments in supplier or customer companies, (material) leasing interests, and sales by the accountant of items other than professional services. Prime or subcontractor arrangements while not explicitly prohibited by section 602.02g., have been interpreted by the SEC to be a *direct* business relationship. In a letter to Touche Ross and Co. on May 18, 1981 (Staubs 1981), the Commission stated:

Since a contractor relationship between the client and accountant is a direct business relationship, other than as a consumer in the normal course of business, the staff believes such relationships would impair the accountants' independence regardless of the materiality of the contract.[6]

This interpretation from the SEC is more restrictive than that of the AICPA Code of Professional Conduct (AICPA 1990) which allows co-contracting with clients as long as the financial considerations are immaterial to each party.

Petition Process

Until 1988, the SEC's interpretation, as expressed in the Touche Ross letter, was the only guidance available to accounting firms and their clients regarding co-contracting arrangements. On March 29, 1988, a petition filed by Arthur Andersen & Co., Peat Marwick Main & Co., and Price Waterhouse requested that the Commission modify its expressed views and interpretations as stated in Section 602.02g of the Codification of Financial Reporting Policies. The petition emphasized that since Section 602.02.g was published fifteen years ago, co-contracting arrangements have become a common way of doing business and that there is a need to modify the rule to be consistent with present business practices.

The petitioners' main concerns were that co-contracting arrangements in which there is a prime or subcontractor relationship are "distinguishable from a co-investment or joint venture arrangement in which participants pool their capital and directly share in the fruits of their combined efforts." The relationships that are explicitly prohibited by the SEC relate primarily to arrangements of an *investment* nature. Further, the petition stated that the present ruling of not allowing co-contracting is anti-competitive and deprives the ultimate consumer of the most efficient combination of products, resulting in higher costs and/or lower quality.[7]

Given these concerns, the petitioners requested that Section 602.02.g be modified. The petitioners stated that no evidence exists that supports the proposition that co-contracting relationships with audit clients diminish auditor independence—either in fact or appearance, regardless of materiality.[8] However, they suggested that if there is a concern, a *materiality* standard could be used in evaluating the independence of an auditor with

respect to its audit client with whom a prime or subcontractor arrangement exists.

Arthur Andersen & Co. also provided an October 6, 1988 supplement to the March 29, 1988 petition as a means to expedite the SEC's response. In this supplement, Arthur Andersen & Co. specifically pointed to a recent proposal from the United States Department of Energy (DOE) to audit various contractors engaged in the operation of uranium enrichment facilities. To assist the auditors in evaluating highly specialized internal controls and procedures, Arthur Andersen & Co. proposed to use a subsidiary of ERC International Inc. (ERCI), an energy firm which is highly regarded for its skills in this area. Coincidentally, ERCI had engaged Arthur Andersen & Co. as its independent auditor for the previous year. Due to DOE procurement policies, Arthur Andersen & Co. was required to enter into a subcontractor arrangement with ERCI in this case. Although the relationship was not material, the SEC stated that the relationship was "direct" and further that the firm's independence may be impaired. Given the staff's response, Arthur Andersen & Co. attempted to find a substitute for ERCI but was unable to find another firm with the requisite skills. Arthur Andersen & Co. was subsequently informed that they would not be retained for the engagement.

In a letter dated February 14, 1989, the SEC responded to the aforementioned petition regarding the proposed modification of Section 602.02.g (Katz 1989). The Commission concluded that even a financially immaterial prime or subcontractor arrangement may impair the appearance of auditor independence and may cause financial statement users to question the auditor's independence.[9]

Although the modification of Section 602.02.g to include a materiality standard was denied by the SEC, the issue was considered of such paramount importance to the accounting profession that the Big Eight CPA firms (presently referred to as the Big Six)[10] collectively chose to pursue the matter further. The firms remained somewhat optimistic given the discussion that occurred during the Commission's open meeting on December 19, 1988. During this meeting, several commissioners recognized that the prohibition of all co-contracting arrangements with clients may have been overly restrictive. Commissioners Grundfest and Fleischman, in particular, commented that other solutions should exist that permit co-contracting arrangements without lessening auditor independence. Consistent with this line of reasoning, the Commission's decision (February 14, 1989) suggested that viable alternatives must contain "appropriate procedural safeguards and limiting principles...to obviate the type of independence problems that arise from this type of relationship."

Using this statement in the SEC's decision as guidance, the Big Eight petitioners developed four safeguards which directly addressed the Commission's concerns regarding the effect of co-contractor arrangements on auditor independence. These four safeguards, in addition to a revised materiality standard, were formalized into a petition and filed on May 17, 1989 with the SEC. The first safeguard stated that the CPA firm and its audit client must not have a *continuing* business relationship. The correspondence with the SEC has suggested that the nature of the engagement, non-continuous versus continuous, might affect financial statement user perceptions. A co-contracting relationship in which participants pool their capital or directly share of their combined efforts on a continuing basis may be perceived differently than one entered into on an individual project basis. That is, consulting contracts performed with the same audit client on a repeated and uninterrupted basis may suggest a unity of financial interests and thus may be perceived as being less independent than contracts performed with various partners on an individual project basis.

This condition would preclude joint ventures and other ongoing arrangements between the CPA firm and its audit client in which participants pool their capital together to directly work together on a continuing basis. However, this safeguard would permit CPA firms to enter into prime or subcontractor relationships with audit clients on an individual project basis.

The second safeguard suggested that audit engagement personnel would be different than the individuals involved in the consulting engagement.[11] Formal separation could be accomplished by having audit and consulting engagements performed by different divisions within an office or different offices of a firm. This would ensure the separation of staff personnel involved in auditing a client and staff personnel working with the client in consulting related activities. For almost all firms, this would mean having their consulting personnel perform the co-contracted engagement with the audit client.

The third safeguard proposed that litigation or threat of litigation should not exist between the CPA firm and its audit client concerning the co-contracting arrangement. Thus, if the CPA firm and its co-contractor firm are involved in, or may be expected to be involved in litigation against one another, audit independence would be considered impaired. This safeguard was proposed to eliminate situations in which an audit is to be performed despite an "adversary position between a client and its accountant with respect to the audit services rendered." The existence of litigation might make it difficult for the CPA to be considered impartial or capable of exercising objective judgments while performing the audit.

Finally, a fourth safeguard was proposed to require peer review teams (as part of the peer review process) to test CPA firms' compliance with the four safeguards and the materiality standard. This condition would also require review teams to include as part of their review process, one or more SEC audit clients with which the CPA firm has a co-contracting arrangement.

The materiality standard was also revised from its previous basis on revenue to being based on income. The petitioners now proposed that co-contracting arrangements be permitted where the contract's impact would be immaterial to the income of *either* the CPA firm or its audit client.

The SEC stated that this new "collective" proposal was an improvement over existing proposals because it provides the SEC with "a more concrete set of limiting standards" for assessing auditor independence (Accounting Today 1990). In spite of these improvements, the Commission has not responded to this petition (SEC Accounting Report 1991a). However, the SEC has instigated its own study regarding auditor independence standards (Accounting Today 1990; Berton 1989; SEC Accounting Report 1991a). The results of the study have not been released at this time.

The Unique Situation of Arthur Andersen & Co., S.C.

On April 18, 1990, Arthur Andersen & Co., S.C. submitted a petition to the SEC expressing its position that the firm should be differentiated from other CPA firms regarding the issue of direct/indirect business relationships (Pitt 1990).[12] Pitt, arguing on behalf of Arthur Andersen & Co., S.C., stated that the firm had undergone a major plan of restructuring to enable its consulting division (Andersen Consulting) to be a separate partnership from its accounting division (Arthur Andersen & Co.).[13] Further, Andersen Consulting does not hold itself out as being engaged in the practice of public accounting. Among the points made were that (1) Andersen Consulting is a partnership separate from Arthur Andersen & Co., with its own partners, management, employees, leases, business, substantive capitalization, and client base; (2) Arthur Andersen & Co. and Andersen Consulting will establish separate corporate images, through advertising and the differing nature of the services offered; (3) neither firm has significant influence over the other's operating, financial, or accounting policies; and (4) the economic impact of any particular business relationship between Andersen Consulting and an audit client of Arthur Andersen & Co. would be clearly *de minimis* to Arthur Andersen & Co. Accordingly, Pitt argued, any such business relationships which Andersen Consulting might engage in are *indirect* with respect to Arthur Andersen & Co. and should therefore be allowed when not considered material.

The SEC reviewed this submission and in a June 20, 1990 letter, responded to the arguments expressed by Pitt on behalf of Arthur Andersen & Co., S.C. (Coulson 1990). Edmund Coulson, Chief Accountant of the SEC, accepted Pitt's arguments and confirmed that business relationships (co-contracting) between Andersen Consulting and an audit client of Arthur Andersen & Co. would be considered an *indirect* business relationship for purposes of applying the Commission's independence requirements. In other words, Arthur Andersen & Co. independence with respect to its audit client would not be considered to be impaired as a result of a business relationship that is not material to Arthur Andersen & Co., Andersen Consulting, or the audit client. The net result of these actions would enable Arthur Andersen & Co., S.C. to engage in co-contracting arrangements with their audit clients (Blumenthal 1990; Bowman 1990; Moore 1990; Rankin 1990).

Edmund Coulson declined to predict whether other firms would attempt to mirror Andersen's restructuring efforts. However, he did state that future activities of this nature would be evaluated on a case-by-case basis. Given the specificity of the SEC ruling to Arthur Andersen & Co., it may be difficult for the other firms to duplicate these efforts, particularly when the magnitude of restructuring by other firms is such a costly proposition (SEC Accounting Report 1991b). The perceived inequity of this situation has prompted the Commission to consider changes to put other large CPA firms in equal standing with Arthur Andersen & Co. (SEC Accounting Report 1991a).

Arguments/Discussion

If CPA firms are to be allowed to provide consulting services, arguments exist both for and against the SEC stance which prohibits co-contracting between CPA firms and their audit clients.[14]

Arguments in Favor of Allowing Co-Contracting with Audit Clients

Co-Contracting Allows for the Provision of a Better Service. The increasingly complex nature of providing consulting services has created a situation in which the services are provided by combinations of firms, each with its own area of expertise. In many situations, the CPA firm and one of its audit clients may well be able to best provide the desired services. As specialization continues, one might expect the various CPA firms to develop distinct specialties. Accordingly, the problem's resolution is not as easy as simply stating that the co-contracting agreement may be developed between a computer specialist and another CPA firm that does not audit the computer specialist. Not allowing the computer specialist's CPA firm to jointly perform such services may lead to an inferior product. Also, to the extent that

further mergers or failures of large CPA firms occur, the problem is exacerbated as fewer firms remain.

Allowing Co-Contracting Increases International Competition. Consulting is an area in which American CPA firms have competed quite effectively in the international arena. The SEC's stance in not allowing co-contracting relationships with audit clients in essence creates an impediment to these firms and potentially creates a situation in which other co-contracting arrangements, perhaps involving consultants from other parts of the world, impacts negatively on United States business. To the extent that the product delivered is inferior to that which the CPA firm would have been able to deliver, one might also argue that the company purchasing the services has been ill served by this requirement.

Arthur Andersen & Co., S.C.'s Unique Position. The SEC's recent ruling places Arthur Andersen & Co. S.C. in a unique position (relative to the other large CPA firms) in that their co-contracting arrangements with audit clients are allowed. Other large CPA firms have objected to not being able to have the same nonaudit relationship with an audit client, particularly since the costs of restructuring (in a manner similar to Arthur Andersen) may be prohibitive. The SEC is considering changes to put other, large CPA firms on an equal footing with Arthur Andersen & Co. S.C. These changes however, may be difficult to implement and further may result in a situation which simply resembles a ruling that allows consulting with audit clients. An obvious solution would be for the SEC to permit co-contracting with audit clients.

Prime or Subcontractor Versus Joint Venture Relationships. The SEC's initial motivation for its set of regulations on auditor independence was to prohibit CPA firms from obtaining financial interests in their audit clients. A conflict of interest was said to exist from such a relationship. Joint ventures, as well as limited partnership agreements, investments in suppliers or customer companies, and leasing interests, are examples of situations in which the CPA firm and audit client are co-contracting, outside the normal professional service relationship. For instance, a relationship in which the CPA firm and audit client pool their capital to form a continuing joint venture would be viewed as creating a conflict of interest. In comparison, the prime or subcontractor arrangement does not require a co-investment of funds and can be performed on an individual projects basis. Using this reasoning, prime or subcontractor arrangements should be differentiated from joint ventures (and other similar arrangements) through a provision whereby such co-contracting with audit clients would be allowed.

The Present Ruling Creates Inconsistent Outcomes. Presently, a CPA firm can provide consulting services to an audit client. In addition, the CPA firm can work with the internal audit department (of the audit client) to jointly develop consulting services for the client. Yet, similar, joint efforts for a third party are not allowed.

Arguments Against Allowing Co-Contracting with Audit Clients

Co-Contracting with Audit Clients may Decrease Perceived or Actual Audit Independence. The SEC has argued that perceived independence is affected when CPAs perform consulting services with their audit clients. To the extent that this is an accurate statement, the reputation of the profession might be negatively impacted by such services. In addition, to the extent that investors are concerned about performance of such services, they might perceive a more risky situation, and therefore modify investment and/or credit decisions. Furthermore, to the extent that performance of such services with audit clients affects actual independence, effects are even more likely to be negative.

Not Allowing Co-Contracting Need Not Result in a Decrease in the Quality of Service Provided. Not allowing CPA firms to co-contract with their audit clients does not eliminate the possibility of efficient combinations of CPA and other firms. It is uncertain that in the typical situation that only one CPA firm will be able to efficiently perform the desired services. Thus, at any point in time, IBM is able to contract with five of the six largest CPA firms, plus any of the smaller CPA firms.

Possible Regulatory Responses

Three possible regulatory responses include (1) not allowing co-contracting between CPA firms and their audit clients, (2) maintaining the status quo, and (3) allowing co-contracting with certain safeguards.

Do Not Allow Co-Contracting by CPA Firms or Affiliated Firms. Currently, CPA firms may not co-contract with audit clients. However, Arthur Andersen & Co. S.C., because of its unique organizational structure is allowed to co-contract. One solution would be to create a "more level playing field" by not allowing co-contracting to be performed by any firm that has any financial ties whatsoever with the CPA firm. The basis for this prohibition would apparently be the effect on perceived independence, rather than direct financial interest.

Maintain the Status Quo. A decision may be made to maintain the current situation. It might be argued that it is fair in that any firm might choose to undergo a restructuring in the manner that Arthur Andersen & Co. S.C. has. It might be shown that arrangements such as that developed by Arthur Andersen & Co. S.C. might address a number of independence concerns.

Allow Co-Contracting, but with Certain Safeguards. The safeguards suggested by the Big Eight CPA firms might well create an effective compromise situation. For example, restricting such engagements to immaterial levels would seem to somewhat mitigate the effects on perceptions of independence. However, careful thought would be required as to the basis for such materiality judgments. For example, what is immaterial to the firm as a whole would certainly be a greater amount than that for any specific office, or division of an office.

Summary and Conclusions

Currently CPA firms wish to be able to maintain audit independence when co-contracting with audit clients. While the AICPA allows such engagements as long as they are immaterial, the SEC prohibits them for CPA firms which have not entered into a restructuring as has Arthur Andersen. There is no obvious "correct" solution to this situation. Neither the benefits nor the costs of the possible options are easily accessible. It would seem that the next move remains that of the SEC. Yet, this is but one part of the overall "independence question." Perhaps the SEC will be able to develop overall workable independence standards that rely to a lesser extent on a case by case legalistic resolution.

Suggestions for Future Research

Future research might be able to address this issue from both the perspective of actual effects on audit independence and from the perspective of third party perceptions of auditor independence. Although effects on actual audit independence are difficult to isolate, a detailed analysis of litigation against CPA firms may or may not reveal "audit failures" pertaining to companies with which a CPA firm has co-contracted. An in depth analysis of both publicly available case information and of the American Institute of Certified Public Accountants' Quality Control Inquiry Committee program related to allegedly "failed audits" may provide information.[15]

Concerning perceptions of CPA independence, a number of the factors discussed in this paper might be manipulated as variables in an experimental design. For example, the large CPA firms believed that co-contracting through prime or subcontractor arrangements should be treated differently than through joint ventures. Similarly, one might test whether financially immaterial co-contracting arrangements affect perceptions of CPA independence. Finally, this research might address whether investment decisions are modified by such relationships. ❧

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*****Endnotes*****

1. Auditor independence is an important concept from the standpoint of both the appearance of independence and independence in fact on the part of the auditor. The accounting profession, regulatory bodies, and prior academic research have been unable to confirm or measure independence in fact situations and thus have concentrated their efforts on the examination and reduction of the more broad concept of independence in appearance. The emphasis upon independence in appearance has been most evident during the current series petitions regarding contracting arrangements. Jonathan Katz of the SEC, in a February 14, 1989 letter, states that the Commission perceives that the interdependence created by the prime/subcontractor relationship "impairs the auditor's independence, *irrespective* of whether the audit was in *fact* performed in an objective, critical fashion. Where such a unity of interests exists, there is an *appearance* that the auditor has lost the objectivity and skepticism to take a critical second look at management's representations in the financial statements." Furthermore, in their follow-up letter on May 17, 1989, the Big Eight firms specifically state that the procedural safeguards fully "counterbalance and *appearance* that an accountant's independence might be impaired as a result of such arrangements. Given the emphasis upon the concept of independence in appearance during the petition process as well as prior research and regulatory concerns, the term "independence" should be considered as independence in appearance unless otherwise noted.
2. We use the term "audits" throughout this paper, although the more general "attest services" could, in general, be substituted.
3. In January of 1991, the AICPA issued a new series of pronouncements on consulting services, *Statements on Standards for Consulting Services*. This series of pronouncements replaces the previous series, *Statements on Standards for Management Advisory Services*. Throughout this paper we generally use the term "consulting services" which is generally equivalent to the term "management advisory services" or "MAS."
4. Members of the AICPA SEC Practice Section are restricted from providing the following services to audit clients: Psychological testing, public opinion polls, merger and acquisition assistance for a finder's fee, executive recruitment, actuarial services to insurance companies (See AICPA 1990).
5. We will in general use the term "co-contracting" to describe contractual relationships between a CPA firm and another firm. As is discussed later, various forms of co-contracting exist, including joint ventures and prime or subcontractor arrangements.
6. This letter has been circulated to other accounting

firms as a representation of the SEC's views. The letter has not been published or distributed widely to the accounting profession or public.

7. Mednick (1990) states that the present ruling "deprives the public of such efficient arrangements. The result is higher costs, lower quality services or both. In this respect the SEC staff's position constitutes an unfair restraint of trade and competition in technical services."
8. Representatives of the large CPA firms have stated their position that while independence is very important in audits, it may be overplayed in connection with consulting activity. For example, Larry Horner of KPMG Peat Marwick has stated that he does not know of any instances where such relationships have influenced an audit negatively. Therefore, he believes the SEC rules should be lessened somewhat, particularly if the amounts are immaterial. (Cowan 1989b).
9. As a further illustration, Price Waterhouse and Arthur Andersen & Co. canceled their plans to form the world's largest accounting firm in part due to foreseen independence problems. Andersen Consulting, which is affiliated with Arthur Andersen & Co., has joint venture and/or contracting relationships with computer companies, many of which are audit clients of Price Waterhouse. A merger between these two firms would have resulted in a forfeiture of audit or consulting work in order to satisfy SEC requirements (Bowman 1989; Cowan 1989a).
10. Subsequently, Ernst & Whinney merged with Arthur Young to form Ernst & Young; Deloitte, Haskins & Sells merged with Touche Ross to form Deloitte & Touche. The designation "Big Eight" has therefore been changed to "Big Six" to reflect the six largest accounting firms in the world. Since the correspondence involved the Big Eight, we will, for the purposes of our study, still refer to the original Big Eight CPA firms.
11. Separation of personnel in this manner has been common within the commercial and investment banking industries as a means of enabling institutions to engage in activities that might otherwise create conflict of interest difficulties.
12. About 23% of Arthur Anderson and Co., S.C. consulting business comes through audit clients (Blumenthal 1990).
13. Andersen Consulting is a separate partnership distinct from Arthur Andersen & Co. Each has its own management structure, up to the chief executive officer level. The chief executive officer of each of the units reports to the chief executive officer of the parent company, Arthur Andersen & Co., Societe Cooperative (S.C.) For more on the relationship between the firms see Pitt (1990).
14. See Hillison and Kennelley (1988) for an excellent discussion of the overall issues.
15. Accounting firms that are members of the SEC Practice Section of the American Institute of Certified Public Accountants must report to the profession's Quality Control Inquiry Committee allegations against the firm for deficiencies in the conduct of audits of SEC clients. This information might be analyzed in detail for indications of independence impairment. For more information on the overall quality control program see the report of the Public Oversight Board (1993).

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