Joint provision of external audit and non-audit services: alternative propositions

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ABSTRACT:

Providing jointly external audit and non-audit services to the same client-company remains a major dilemma for the accounting profession. However, recent professional ethics reforms by the IFAC and the AICPA on networks of firms have offered new hopes for a potentially better solution to the problem.

In this study, we propose the following three alternative solutions: (1) a same CPA firm provides jointly both services by using separate personnel teams; (2) a same CPA firm provides jointly both services by using two separate specialized divisions; and (3) two legally distinct CPA firms, both members of the same network of CPA firms, provide one the external audit and the other the non-audit services.

Because we did not test empirically the propositions in this paper, we suggest that future study transform the propositions into hypotheses and test them empirically.

Keywords: Joint provision, External Audit, Non-Audit Services, Network CPA Firms

I. INTRODUCTION

Increasing competition among public accounting firms, following stagnation of external audit revenues in the 1980s, has forced the expansion of Non-Audit Services (NAS) as alternative sources of revenues for these firms. Estimated between only 7% and 21% of the total revenues of the then Big 8 CPA Firms in 1978 (Bernstein, 1978), NAS revenues increased to between 11% and 28% in 1984 (Previts, 1985). By 1993, NAS revenues increased further to 32% of the total revenues of the then Big 6 CPA Firms (Panel on Audit Effectiveness, 2000). Some studies have even put the share of NAS revenues above 50% of the total revenues of the big accounting firms. For instance, NAS revenues were estimated to be 50% of the total revenues of the then Big 5 accounting firms in 1999 (SEC, 2000). Similarly, the Financial Executive Institute conducted a survey in early 2000 that showed that 85% of the responding companies paid their audit firms 56% or more of the total fee for NAS (Investor Relations Business, 2000, 2). Furthermore, Weil and Tannebaum (2001) found that a sample of 307 Standard and Poor's 500 companies paid NAS fees, as much as three times the amount paid for external audit services (or 300% of audit fees). To a lesser extent, Frankel, Johnson, and Nelson (2002) indicated that, for 3074 client-companies filing proxy statements between February 5, 2001, and June 15, 2001, the mean NAS fees, as a percentage of total fees paid to external audit firms, was 49%. Finally, the Wall Street Journal reported that the 30 companies in the Dow Jones Industrial Average (DJIA) paid 62% of an estimated $811.8 million total fees to auditors for NAS in the fiscal year 2002 (Bryan-Low, 2003). Thus, the joint provision of external audit and non-audit services is a real dilemma for the accounting profession.

Its magnitude has generally surprised many, including then Security and Exchange Commission (SEC) Chief Accountant. Lynn Turner was "surprised by the magnitude of the non-audit fees, saying that it raises difficult issues for auditors faced with tough calls on their clients' accounting practices" (Levinsohn, 2001). Weil and Tannenbaum (2001) corroborated that point, by indicating that NAS fees were "far more money than previously estimated." In the current paper, we assume that NAS revenues represent a proportion of audit firms' total revenues greater than the 40% ceiling specified in the Auditors Independence Rules.

The big CPA firms claim that their independence is unaffected by large NAS fees, arguing that the public is more sophisticated than what is represented in the SEC's positions. Indeed, according to the big CPA firms, NAS provides the opportunity for more inquiry into clients' business strategies, processes, and value chains (the knowledge spillover argument), which leads to lower audit failure risks (Bell et al., 1990). However, at least Lowe et al. (2000, 90) point out that the increase in the percentage of NAS to audit clients suggests a decline in the perception of auditor independence. Further, it has been indicated, "Economics does have a firm impact on people's behaviors" (Weil & Tannenbaum, 2001). Thus, increased NAS revenues can negatively affect an auditor's behavior and potentially lead to an audit failure.

II. PRIOR STUDIES

Since the early 1960s, accounting scholars (Mautz & Sharaf, 1961; Schulte, 1965; Briloff, 1966; Titard, 1971; Hartley & Ross, 1972; Firth, 1980; Shockley, 1981; Reckers & Stagliano, 1981; Pany & Reckers, 1984; McKinley et al., 1985; Pany & Reckers, 1988; Mednick, 1990; Bartlett, 1991, 1993; Lowe & Pany, 1995, 1996; Craswell, 1999; Lowe, Geiger, & Pany, 1999; Swanger & Chewning, 2001; Sharma & Sidhu, 2001; Flaming, 2002; Frankel, Johnson, &

Nelson, 2002; Defond, Raghunandan, & Subramanyam, 2002; Ashbaugh, Lafond, & Mayhew, 2003; Kinney, Palmrose, & Scholz, 2004; Quick & Warming-Rasmussen, 2005; Krishnan, Sami, & Zhang, 2005; Francis, 2006; Khurana & Raman, 2006; Hill & Booker, 2007; Basioudis et al., 2008) have been investigating the joint provision of external audit and non-audit services to same client-companies. For the purpose of the discussions in this paper, we divide this literature into two streams: (1) market-based studies and (2) behavioral or experimental studies.

2.1. Market-based Studies

The most recent of what we refer to as "market-based" studies include Frankel et al. (2002), DeFond et al. (2002), Chung and Kallapur (2003), Ashbaugh et al. (2003), Krishnan et al. (2005), and Khurana & Raman (2006). These studies have essentially used market-based multi-regression methods, archival data, and dependent variables like discretionary accruals, cumulative abnormal returns, or earnings response coefficients. Like most joint services provision studies, the results of these previous studies have not been very consistent. For instance, Frankel et al. (2002), Krishnan et al. (2005), and Khurana and Raman (2006) found affirmative evidence that the joint provision of external audit and NAS does compromise auditors' independence. In contrast however, DeFond et al. (2002), Chung and Kallapur (2003), and Ashbaugh et al. (2003) failed to find significant evidence to conclude that the joint provision of external audit and NAS compromises auditors' independence.

2.2. Behavioral or Experimental Studies.

Lowe et al. (1999), Swanger and Chewning (2001), Hill and Booker (2007), and Abbott et al. (2007) are among the most recent studies we refer to as "behavioral or experimental" studies. Following Pany and Reckers (1984) and Lowe and Pany (1995), Lowe et al. (1999) focused on what has become a personnel arrangement, as a proposition of possible solution to the joint provision of services dilemma. These authors investigated bank loans officers' perceptions of external auditors' independence under five different scenarios, including: (1) joint provision of the traditional external audit and outsourced internal audit to the same client by the same CPA firm using different personnel team and (2) the provision of the two types of services by two distinct CPA firms. Surprisingly, Lowe et al. (1999, 17–18) found that an external auditor's independence was perceived as better (not perceived impaired) when the same CPA firm performed jointly both services (score = 7.39 on an 11-point scale) than when two distinct firms performed the external audit and the outsourced internal audit respectively (score = 6.71 on an 11-point scale).

In contrast however, Swanger and Chewning (2001, 123) found correctly mean independence variables significantly higher when the internal audit was outsourced to a different CPA firm than when the same CPA firm performed jointly both services. Specifically, analysts in Swanger and Chewning (2001) thought that independence in appearance was significantly better (not perceived impaired) under a two-firm scenario (score = 7.64 on an 11-point scale) than under a single firm scenario (score = 6.43 on an 11-point scale). In the same behavioral perspective, but focusing rather on nonpublic entities, Hill and Booker (2007) used active members of state boards of public accountancy (proxies for regulators). They found a significant negative difference in perceived auditors' independence when the same CPA is providing jointly external audit and internal audit to the same nonpublic client without separate personnel teams.

In contrast, they did not find any significant negative difference in perceived auditors' independence when a CPA firm is providing the external audit only to a nonpublic client versus when that same firm is performing jointly the external audit and internal audit to the same client using separate personnel teams. Thus, separation of personnel teams made an important difference in Hill and Booker (2007).

Finally, Abbott et al. (2007), consistent with Beck et al. (1988), focused on the differential effects of providing routine NAS as opposed to non-routine NAS on independence. It should be recalled that Beck et al. (1988) showed analytically that the effects on independence of consulting services depend on whether the consulting engagement is recurring or non-recurring. Drawing on Beck et al. (1988), Abbott et al. (2007) distinguished between routine (recurrent) NAS and non-routine (non-recurrent) NAS. They argued that non-routine NAS are unlikely to lead to the kind of economic bonding that would impair auditors' independence. In other words, they thought that the probability of non-routine NAS of impairing auditors' independence (even in a context of joint provision of services) is lower than that of routine NAS. Their empirical results supported this hypothesis.

To sum up, even though prior studies have made important contributions to the extant NAS literature, crucial questions remain unaddressed. For instance, while some of the prior studies have compared separation of personnel teams and separation of specialized divisions (Pany & Reckers, 1984), or separation of personnel teams and separation of firms (Swanger & Chewing, 2001), none has directly tested simultaneously the three alternative propositions (separation of personnel teams, separation of specialized divisions, and separation of firms). Hence, the merit of this paper is to compare the three alternative propositions.

III. Regulatory Background

The issue of joint provisions of external audit and NAS to same client-companies by same CPA firms has been a major source of concern for regulators and other stakeholders for several decades. In 2002, following major high-profile accounting and financial scandals (eg, Enron, Global Crossing, WorldCom, Adelphia, etc.), Congress, through the Sarbanes-Oxley Act of 2002 (SOX, US House of Representatives, Committee on Financial Services, 2002), has prohibited CPA firms from providing jointly the external audit and any of the following NAS to their audit clients:

1- Bookkeeping or other services relating to accounting records or financial statements;
2- Financial reporting systems design and implementation;
3- Appraisal or valuation services, fairness opinions or contribution-in-kind reports;
4- Actuarial services;
5- Internal audit outsourcing services;
6- Management functions;
7- Human resources services;
8- Broker-dealer, investment adviser or investment banking services;
9- Legal services and
10- Expert services unrelated to the external audit.

It should be noted however that SOX (2002) does not specifically prohibit the provision of external audit by one firm on one hand and the performance of NAS by another firm on the other hand to the same client-company, even if the two CPA firms belong to the same Network of CPA Firms. To summarize, up to 2005, regulatory actions on NAS were limited to cases in which single (same) CPA firms were providing jointly external audit services and NAS to their client-companies, by using same or separate personnel teams, or separate specialized divisions. Before 2005, there were rarely concerns about auditor or audit firm's independence and/or audit quality when two legally distinct CPA firms were providing, one the external audit and the other NAS. However, such concerns started appearing from June 2005, when the International Ethics Standards Board for Accountants (IESBA) of the International Federation of Accountants (IFAC) issued an Exposure Draft to revise its Section 290 "Independence-Assurance Engagements." Subsequently, in July 2006, the IFAC adopted guidelines for network firms in its Code of Ethics for Professional Accountants, effective for reports dated on or after December 31, 2008.

Following the IFAC's move, the American Institute of Certified Public Accountants (AICPA) Professional Ethics Executive Committee (PEEC) developed and issued its own Exposure Draft aimed at proposing a new interpretation (101-17) regarding Networks and Network Firms on August 13, 2007. One hundred and seven (107) written comment pages were received from 29 different sources as of April 22, 2008. The final guidance of AICPA was effective on July 31st, 2011. From these new regulatory developments (from both the IFAC and the AICPA), a new rule has emerged, according to which, "a network firm is required to be independent of financial statement audit and review clients of the other network firms in the network if the use of the audit or review report for the client is not restricted as defined by professional standards" (AICPA, 2007).

Under the new rule, not only should the external audit firm be independent of the audited client as traditionally required, but also an audit firm's fellow network firms should be independent of that client as well, if the audit or review report is for general use. The relevant research question being raised is whether the provision of an external audit by one network CPA firm on one hand and the performance of NAS by a second legally distinct network CPA firm on the other hand, can reasonably be viewed as impairing external audit firm's independence and/or audit quality. In the remainder of the paper, we develop testable research propositions for future research.

IV. LITTERATURE AND PROPOSITIONS

Consistently with the purpose of the study, we develop propositions based on a relevant literature. Here, we review the literature as thesis for, anti-thesis against, and synthesis for the joint provision of external audit and NAS to same clients.

4.1. Thesis for the Joint Provision of External Audit and NAS

Some have contended that CPA firms can wear both the hat of referee independent auditors and that of coach-providers of NAS without impairing their independence, or even compromising the effectiveness of their services (Klion, 1978; Mednick & Previts, 1987; Mednick, 1990). In particular, Mednick and Previts (1987, 230) comparing the accounting profession to the medical profession, argued that audit firms should be allowed to offer "one-stop shopping"; thus, supporting the position that the same CPA firm should be allowed to provide both the external audit and NAS services to the same client companies. According to Mednick and Previts (1987, 236), "there is no valid evidence…that the relationship between attest services and non-attest services can signal an economic conflict." They further contended, "The pressure on auditors to safeguard their independence far outweighs any pressure to compromise it", and "auditors are bound by professional ethics to serve each client to the best of their ability", regardless of any economic consideration. In general, the accounting profession (AICPA, 1997; Copeland, 2000) has maintained that the joint provision of external audit and NAS does not necessarily compromise auditors' independence and/or audit quality. Specifically, AICPA (1997, 4) has argued that accounting firms have an overwhelming economic incentive (protection against loss of reputation capital) and the necessary legal liability exposure to preserve their independence.

Few empirical studies (Goldman & Barlev, 1974; DeAngelo, 1981; Lowe, Geiger, & Pany, 1999) have also provided supporting evidence for the joint provisions of audit and NAS. Goldman and Barlev (1974) had claimed that non-routine NAS provided by the auditor actually enhances independence. They argued that an auditor providing management advisory services for instance is not as easy to replace, and therefore, has more power to withstand client preferences and pressures. DeAngelo (1981) postulated that the quasi-rents created by repeated audits and the provision of NAS actually increase audit quality because auditors have more to lose, should a failure or a breach in the audited statements be discovered. Thus, according to DeAngelo (1981), the joint provision of audit and NAS to the same client is detrimental neither to auditors' independence nor to audit quality. Similarly, Lowe et al. (1999) found that internal audit outsourcing to external audit firms actually increased loan-officers' confidence in the audit firm's independence and loan approval rate, assuming a different personnel team is used for each type of service within the audit firm. Jenkins and Krawczyk (2001) found that some accounting professionals increased their perceptions of audit firms' independence in the presence of NAS provision. Finally, Larcker and Richardson (2004) reached positive results regarding the joint provision of audit and NAS, suggesting specifically that the larger the fees, the smaller the accruals (proxy for earnings management) become.

4.2. Anti-Thesis of the Joint Provision of External Audit and NAS

The arguments in the previous section assume that auditors can selves-regulate and act ethically without the need of external regulatory interventions. However, the following counter-arguments can be reasonably made. First, there are some major differences between the medical profession and the accounting profession. One such difference is the fact that in the medical profession, physicians have to deal with two-party contracts (physicians – patients), while in the accounting profession, CPAs have to deal with three-tiered contracts (owner – CPAs – management). In fact, in the medical profession, neither is there the kind of principal/agent relation nor the independence need to worry about as in the accounting profession. In the accounting profession, it is imperative for the CPA to be independent (or at least to be perceived as independent) between the owners (principals) of the audited company and the management (agent) of that audited company.

Second, users of audited information can't just be asked to believe that CPAs will do the right things by behaving ethically on their own because of potential losses of reputational capital and/or exposure to liability. Economic theory tells us that risk is positively correlated with reward, in such a manner that to a higher level of risk, there is a higher return. Therefore, at least some CPAs may try to take risks against their reputational capital and exposure to liabilities with the expectation of higher returns. One has only to look back on the case of Arthur Andersen. A popular press (Toffler & Reingold, 2003) laid the blame on the Arthur Andersen corporate culture. The authors describe a culture of growing emphasis on increasing revenues and profits despite an apparent reputation capital loss risk and/or exposure to huge liabilities. No one challenged questionable decisions by partners and upper level management. Neither pressure on the firm to safeguard its independence nor professional ethics rules prevented the kind of corporate culture that led to the demise of Arthur Anderson. Thus, one can reasonably conclude that not all CPA firms are able to selves-regulate and to do the right things on their own. Further, it is not just actual independence that should matter, but also how external stakeholders perceive CPAs. To sum up, the three arguments advanced by Mednick and Previts (1987) for the joint provision of external audit and NAS would be of little value if external stakeholders do not perceive CPAs as independent third parties.

Furthermore, opponents to joint provision of external audit and NAS to same clients have taken the position that auditors would be impairing their independence and potentially compromising their audit quality by providing jointly external audit and NAS to same clients. A CPA firm providing both the external audit and NAS to the same client would be actually auditing its own work-products. This observation is consistent with the maintained position of the SEC that the provision of NAS to audit clients by CPA firms contributes to impairing an auditor's independence. According to Levitt (2000), the joint provision of external audit and NAS by the same CPA firm to the same client-companies creates conflicts of interests that threaten the auditor's independence. Levitt (2000) was further concerned that large accounting firms have been increasingly using the external audit function as a loss leader (springboard) for attracting clients willing to pay for higher-margin NAS, thereby compromising their perceived independence and/or audit quality. To further support the opposition against the joint provision of external audit and NAS to same clients, we review several empirical studies.

Early studies (including Firth, 1980; Schockley, 1981; Pany & Reckers, 1984; Knapp, 1985) found that the joint provision of external audit and NAS by same CPA firms to the same clients does indeed impair audit independence, and potentially compromises audit quality. Shockley (1981) presented four groups of subjects (Big 8 partners, other certified public accountants, loan officers, and financial analysts) with 16 short business scenarios. He found that high competition, provision of MAS, and smaller audit firm size increased all groups' assessments of the risk that auditor independence is impaired. Further, Pany and Reckers (1984) found that financial statement users were highly concerned about independence impairment when auditors provided consulting services to the audit-client, although they were less concerned if a separate division of the CPA firm performed the consulting services. Knapp (1985), focusing on sophisticated financial statements users' (senior loan officers) perceptions of an auditor's ability to withstand client pressure in a disagreement situation, found that significant MAS provisions increased subjects' estimation of the likelihood that the auditor would cave to client pressure and ignore potential liabilities.

More recent studies (Wines, 1994; Jenkins & Lowe, 1999; Lowe, Geiger & Pany, 1999; Gul & Tsui, 2001; Frankel et al., 2001; Beeler & Hunton, 2001; Swanger & Chewning, 2001; Khurama & Raman, 2006) corroborated the results of the early studies. Wines (1994) argued that auditors receiving NAS fees are less likely to qualify their opinion than auditors that do not receive such fees. Based on his empirical analysis of audit reports issued between 1980 and 1989 by 76 public companies listed on the Australian Stock Exchange, Wines (1994), found that auditors who provided companies with clean opinions received a higher proportion on NAS fees than did auditors who provided companies with at least one qualification. Gul and Tsui (2001) also provided evidence (by also focusing on Australian companies) that the joint provision of external audit and Management Advisory Services (MAS) affects the information quality of earnings. More specifically, the results of Gul and Tsui (2001) revealed that the explanatory power of earnings is lower for companies that received NAS than for those that did not receive NAS from their audit firms.

Using an experimental method, Swanger and Chewning (2001) found that the audit firm's independence is compromised when the same firm is providing both the external audit and the outsourced internal control services to the same client. Further, using a market-based method, Frankel et al. (2002) reported NAS fees that were positively associated with the magnitude of discretionary accruals, suggesting a detrimental effect on the audit firm's independence. Finally, Khurama and Raman (2006) found that investors perceive both NAS and total fees negatively, implying that the higher the fees paid to the external auditor, the greater the economic bond and the threat to the auditor's independence. Thus, the evidence supporting the opposition to the joint provision of external audit and NAS to same clients is well established.

4.3. Synthesis and Propositions

To summarize, the main argument against the joint provision of external audit and NAS by same CPA firms to same clients is the economic bond that arises between an audit firm and a client-company in the context of joint provision of external audit and NAS. Specifically, the cross selling of external audit and NAS in such a context can easily create the perception that an audit firm is increasingly dependent of its client. This can then transform "the role of the auditor from that of a public watchdog to one of managing the relationship with and being answerable to the audit client" (Khurana & Raman, 2006, 982). Frankel et al. (2001) and Gul and Tsui (2001) have convincingly demonstrated a negative association between NAS and (1) stock prices and (2) informativeness of earnings. More recently, Khurana and Raman (2006, 983) have confirmed that it is the economic bond between the auditor and the client that poses a threat to auditor independence. Indeed, as the fees generated from a given client increase in magnitude; the audit firm's economic dependence on that client increases as well. In turn, the increased economic dependence on the client shifts the bargaining power balance in favor of the client to the detriment of the audit firm. Hence, the audit firm is forced to acquiesce to client pressures, paving a way to all kinds of ills of corporate accounting, including earning management. Finally, because of a potential acquiescence to client's pressures, the audit firm can no longer be viewed as that unbiased independent third party, charged to arbitrage information asymmetry between owners (principals) and management (agent).

Bazerman, Morgan, and Loewenstein (1997) have further argued that because of the economic bond, it is psychologically impossible for an audit firm to be independent of the client. An audit firm's economic bond with its client can: (1) erode the audit firm's independence, and (2) deteriorate the audit firm's capacity and/or willingness to resist potential pressure from the client. Further, economic bond can consciously or unconsciously impair an audit firm's independence and lead to potential audit-firm/client-company collusion (McLaren, 1958). Hence, Mautz and Sharaf (1961, 231) had cautioned that auditors "must be aware of the various pressures, some obvious some subtle, which lend to influence their attitude and thereby erode slowly but surely their independence." This threat to independence and/or audit quality is real; it is not present only at the time of the final report; but instead, it does influence the auditors' judgments during the audit itself (Bazerman, 1997; Dopuch et al., 2003). Three series of propositions are likely to mitigate the above problems.

Personnel Teams Separation Propositions

Swanger and Chewning (2001, 119) have argued that the greater the separation (mental, physical, and financial) between two individuals performing two different tasks, the greater the likelihood that one will not influence the judgment of the other. However, the fact that the same firm is still performing both the external audit and NAS should off-set any benefits of a separation of personnel teams. Although separation of personnel is likely to mitigate potential negative effects of NAS on the audit firms' independence and/or audit quality, such an arrangement corresponds only to the lowest level of division of labor within a CPA firm. Thus, the study's first propositions are formulated as below:

> **Proposition 1a:** The use of separate personnel teams to perform each type of service will mitigate the extent to which the external audit firms' independence will be perceived as impaired by the joint provision of external audit and NAS by the same CPA firm for the same client-company.

Similarly,

> **Propositions 1b:** The use of separate personnel teams to perform each type of service will mitigate the extent to which the external audit quality will be perceived as compromised by the joint provision of external audit and NAS by the same CPA firm for the same client-company.

Specialized Divisions Propositions

Division of labor between specialized divisions can induce a greater separation (mental, physical, and financial) between two individuals than can a mere separation of personnel teams. This is plausible because Pany and Reckers (1984) found that financial statement users were less concerned when a separate division of the CPA firm performed the consulting services. Further, when Arthur Andersen reorganized itself into specialized divisions in the early 1990s, the claim against the firm's potential non-independence due to joint provision of external audit and NAS to same clients was withdrawn. Moreover, Swanger and Chewning (2001, 19) have argued, "With separate divisions performing the two types of … services and no sharing of staff, we expect that perceptions of independence would be greater than a situation with no separation" of divisions or of mere separation of personnel teams. Therefore, the following two propositions are submitted:

> **Proposition 2a:** The use of different specialized divisions to perform each type of service will better mitigate than a mere separation of personnel teams the extent to which external audit firms' independence is perceived to be impaired by the joint provision of external audit and NAS by the same CPA firm for the same client-company.
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> Similarly,
>
> **Proposition 2b:** The use of different specialized divisions to perform each type of service will better mitigate than a mere separation of personnel teams the extent to which

external audit quality is perceived to be compromised by the joint provision of external audit and NAS by the same CPA firm for the same client-company.

Two Legally Distinct Network CPA Firms Propositions

An arrangement that is likely to lead to the greatest separation (mental, physical, and financial) between individuals completing external audit and NAS to a client-company is a separation of firms. Separation of firms is the natural arrangement, wherein two legally distinct CPA firms perform respectively the external audit and the NAS for the same company. Theoretically, as Swanger and Chewning (2001, 119) indicated it, the greater the separation (mental, physical, and financial) between the two firms, the greater should be the likelihood that one would not influence the other. Further, this no influence situation is likely to remain even when two legally distinct member firms of a network of CPA firms perform respectively the external audit and the NAS. Specifically, because having the same CPA firm performing both services does not bode well; an ideal situation would be, in the absence of having two completely unrelated firms, to have two legally distinct firms, members of a same network of firms, to perform one the external audit and the other NAS. Examples of such scenarios are observed in France, where there exists a dual accounting profession: the “Profession des Experts Comptables”, which can help prepare the books and provide all kinds of NAS, not including external audit services and the “Profession des Commissaires aux Comptes”, which is charged legally to perform external audit services.

A significant body of research indicates however that the behavior of network firms tend to be influenced by their fellow network firms. At least from a social contagion theory perspective, the behavior of a given member firm in a network may be communicated to fellow network firms through various forums. Similarly, institutional theories help us to predict that firms will adopt the same practices as their network fellows because fellow-member firms can convey cultural models, systems of rules, and/or taken-for-granted assumptions that dictate which activities are legitimate (Powell & DiMaggio, 1991). Thus, one can reasonably fear potential behavioral socialization among network firms, likely to influence either positively or negatively independence and/or audit quality. Prior studies (Lowe et al., 1999; Swanger and Chewning, 2001) have provided conflicting empirical results for separation of firms’ hypotheses. Hence; we can only expect, under two legally distinct network firms scenario, where one firm performs the external audit and the other firm performs NAS, the followings:

Proposition 3a: The use of two legally distinct network firms to perform external audit and NAS respectively to a same client-company will best mitigate the extent to which external audit firms’ independence is perceived to be impaired because of a joint provision of audit and NAS to a same company.

Similarly,

Proposition 3b: The use of two legally distinct network firms to perform external audit and NAS respectively to a client-company will best mitigate the extent to which external audit quality is perceived to be compromised because of a joint provision of audit and NAS to a same company.

VIII. CONCLUSION

The joint provision of external audit and Non Audit Services (NAS) remains a major dilemma for the accounting profession. In this paper, we have identified and formulated testable propositions of possible solutions to that dilemma. However, we did not test empirically those propositions. Therefore, we suggest that future studies test empirically the three series of propositions formulated here. This would likely contribute significantly to the literature in this area.

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