

**American Accounting Association's Financial Accounting Standards Committee  
Comments on the ISB's Exposure Draft ED 00-2:  
A Conceptual Framework for Auditor Independence**

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The Financial Accounting Standards Committee of the American Accounting Association (hereinafter the Committee) is charged with responding to requests for input on issues related to financial reporting. The Committee is pleased to respond to the ISB's invitation to comment on the *Exposure Draft ED 00-2: A Conceptual Framework for Auditor Independence* (hereinafter the Exposure Draft). The comments in this letter reflect the views of the individuals on the Committee and not those of the American Accounting Association.

Our response to the Exposure Draft is presented in three sections. The first section presents the Committee's views as to characteristics of a conceptually sound framework for auditor independence, noting which of these characteristics are and are not contained in the Exposure Draft. The second section summarizes empirical academic literature on auditor independence that is relevant to the conceptual framework. The third section contains responses to the specific questions posed in the Exposure Draft. These responses are based on the views laid out in the first section and empirical academic research discussed in the second section.

**Conceptual basis for a framework for auditor independence**

The Committee believes the following characteristics should underlie a conceptual framework for auditor independence. These characteristics are classified according to (1) characteristics of persons associated with or affected by auditor independence, (2) characteristics related to consequences of auditor independence, and (3) characteristics related to the evaluation of auditor independence.

*Characteristics of persons associated with or affected by auditor independence*

1. The framework should recognize that independence resides in persons. An independence framework should distinguish the auditor from his/her firm and should acknowledge that the individual auditor faces incentives and penalties that may differ from those facing the audit firm as a whole.
2. The framework should recognize that the entity whose financial reports are the subject of the audit is not a natural person (i.e., the client) with a unique state of mind. Rather, the committee believes the framework should adopt a contracting view, in which a corporation is composed of multiple groups of economic agents, each with

potentially different interests. The auditor has relations and interactions with several of the contracting parties who comprise the entity whose financial reports are being audited. For example, an auditor might interact with members of management and the audit committee of the board of directors. Since the latter have an oversight function with respect to the former, the interests of the two (management and audit committee) cannot be assumed to be identical.

3. The framework should recognize that the benefits of auditor independence depend on the perceptions of individuals who rely on auditors' decisions. These perceptions include both those related to various factors that create and mitigate bias in auditors' decisions and those related to the importance of independence to the overall quality of auditors' decisions. The framework should consider primarily the views of "reasonable" financial statement users who have full information and process this information appropriately.

#### *Characteristics related to consequences of auditor independence*

4. The framework should recognize that the relevant consequence of auditor independence is its effect on auditors' decisions.
5. The framework should acknowledge that auditor independence has both benefits and costs. Such an approach would recognize that auditor independence is not an objective in and of itself, but is desirable if it improves the quality of auditors' decisions and the decisions of individuals who rely upon auditors' decisions. This approach also would recognize that there are costs to achieving auditor independence, which should be weighed against the benefits associated with independence.
6. The framework should recognize that the quality of auditors' decisions is influenced by both their independence and competence (expertise). Specifically, in the assessment of the benefits and costs of auditor independence, the framework should consider potential positive or negative effects on expertise of attempts to achieve independence.

#### *Characteristics related to the evaluation of auditor independence*

7. The framework should evaluate auditor independence in terms of observable factors that are likely to influence whether an auditor's decisions are unbiased, rather than in terms of unobservable factors, such as an auditor's state of mind. Observable factors include both factors that create bias in auditors' decisions and factors that mitigate this bias.
8. The framework should evaluate an auditor's independence in terms of a continuum (i.e., the degree of independence), rather than as a dichotomous variable (i.e., an auditor is either independent or not independent).

The Committee believes that the Exposure Draft largely integrates characteristics 1, 4, 5, and 8 into its framework for auditor independence. In the Committee's opinion, the Exposure Draft's framework integrates characteristics 3 and 7 in a limited fashion and does not integrate characteristics 2 and 6. We discuss issues related to the partial inclusion of characteristics 3 and 7 in our response to question 1 of the Exposure Draft. Additionally, we comment on the exclusion of characteristics 2 and 6 in our response to question 5 of the Exposure Draft.

## **Review and discussion of empirical research**

The academic research provides evidence relevant to both the Committee's views on characteristics of a conceptually sound framework and the Exposure Draft's proposed auditor independence framework. The discussion of this research is organized into four sections: (1) factors that compromise auditor independence and lead to bias in auditors' decisions, (2) factors that ameliorate impairments of auditor independence and bias in their decisions, (3) benefits and costs of auditor independence, and (4) users' perceptions of auditor independence. Given the distinctive nature of auditors' knowledge, auditing tasks, and the audit environment, we present conclusions about auditors' judgments and decisions only from research which examines auditors doing tasks that are taken from, modeled on or adapted from their work environment, as opposed to conclusions from the general judgment and decision-making literature.<sup>1</sup>

### *1. Factors that compromise auditor independence*

*Research indicates that auditors' judgments and decisions are influenced by observable task and environmental factors. These factors include an auditor's involvement in prior audits of a client and incentives to retain audit or acquire non-audit engagements.*

Tan (1995) shows that auditors' judgments are influenced by their involvement in prior audits of a client. Specifically, in his study, auditors who were involved in the prior-year audit paid more attention to current-year audit information that was consistent with judgments made for the prior-year audit than did auditors who were not involved in the prior-year audit. This suggests that auditors do not evaluate their own judgments in the same manner as they evaluate the judgments of other auditors.

Farmer et al. (1987) show that an auditor is more likely to agree with managers' financial-reporting preferences when the risk of losing an engagement is high versus low. Trompeter (1994) finds that auditors who are compensated based on local-office

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<sup>1</sup> For a discussion, see J. Smith and T. Kida, "Heuristics and Biases: Expertise and Task Realism in Auditing," *Psychological Bulletin* 109:3, 1991, pp. 472-489. This paper contrasts research on biases in auditors' judgments with similar research in psychology on biases in the judgments of other individuals. Smith and Kida conclude that auditors generally exhibit less bias or different types of bias than that found in general psychology research.

profitability are more likely to agree with clients' preferences as GAAP becomes more subjective. Overall, this research suggests that auditors' judgments are influenced by incentives to retain audit clients over time.

Other studies examine across-services incentives for obtaining or retaining non-audit (e.g., consulting) engagements for audit clients. For example, Emby and Davidson (1998) show that auditors' judgments are influenced by client managers' preferences for financial reporting when auditors provide non-audit services for the client. The effect of this factor is less when engagements involve specialized, as opposed to general, non-audit services. This result suggests that auditors are less susceptible to manager pressures when they possess greater economic power in their consulting arrangements with these clients.

## *2. Incentives and institutions that ameliorate impairments of auditor independence*

*Research documents several factors that mitigate the effects of factors that compromise auditor independence. These mitigating factors include environmental forces, such as litigation and reputation loss. These factors also encompass institutional arrangements within audit firms, including auditor rotation, the review process, peer review and compensation arrangements. Finally, some of the contracting parties at the entity whose financial reports are being audited, such as audit committees, also provide counterbalancing forces.*

Several environmental forces mitigate the effects of incentives faced by auditors to compromise or impair their independence, including the possibility of reputation loss and the threat of litigation or other similar sanctions.<sup>2</sup> Individual auditors who face significant penalties if they are caught having performed a defective audit have strong incentives to avoid defective audits.<sup>3</sup> Research indicates that the risk of litigation reduces the influence of manager preferences on auditors' decisions and deters unethical behavior on the part of auditors (Farmer et al. 1987; Trompeter 1994; Shafer et al. 1999). Wilson and Grimlund (1990) also document that audit firms whose reputations have been impaired due to a SEC disciplinary action suffer losses in terms of market share and client retention. These results indicate that environmental forces provide incentives for auditors to enhance their independence by developing and implementing organizational structures and processes related to independence.

Research has examined whether institutional arrangements within audit firms and the audit profession provide mitigating forces against threats to auditor independence. Tan (1995) finds that both auditor rotation and the hierarchical auditing review process reduce

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<sup>2</sup> Other environmental forces include strong self-regulatory mechanisms such as the Public Oversight Board, the Auditing Standards Board, and the Independence Standards Board.

<sup>3</sup> The argument that the Private Securities Litigation Reform Act (PSLRA) of 1995 reduced the penalties for bad audits depends on whether the pre-PSLRA environment was one of merit-based litigation or one of random losses imposed by a legal system where merit did not determine outcomes. Random "enforcement" of rules would not be expected to induce compliance since the penalties are decided on bases other than breaking or adhering to the rules.

auditors' overemphasis on information that is consistent with their prior judgments. Similarly, Shafer et al. (1999) show that peer review deters unethical behavior on the part of auditors. Certain types of auditor compensation arrangements also appear to mitigate the effect of incentives for client retention. Trompeter (1994) finds that auditors do not use the flexibility in GAAP to justify clients' preferences when firm-wide, as opposed to local-office, profitability is emphasized in auditor compensation arrangements (large-pool compensation). Carcello et al. (2000) indicate that the type of compensation plan (small- versus large-pool) interacts with client size in determining the likelihood that an auditor issues a going concern opinion. These results suggest that audit firms' compensation plans play a role in whether auditors compromise their professional judgment in light of pressure from corporate managers.

Certain corporate governance arrangements, such as the audit committee of the board of directors, also appear to mitigate forces that compromise auditor independence. McMullen (1996) documents that the presence of an audit committee is associated with lower auditor turnover involving an accounting disagreement. This finding suggests that the presence of an audit committee enhances auditors' ability to withstand pressure from client management.

Another governance arrangement that supports auditor independence is direct or indirect monitoring of the amount of non-auditing services provided by auditors. Parkash and Venable (1993) find that the amount of recurring non-audit services purchased by audit clients varies with proxies for the level of agency costs between client managers and shareholders. Specifically, they find smaller purchases of non-audit services from auditors when share ownership is dispersed and management owns a relatively lower percentage of stock. Firth (1997) documents a positive relation between the purchase of non-audit services from the auditor and ownership concentration (measured as director shareholdings and the percentage shareholding of the largest owner), implying that lower ownership concentrations--a proxy for agency costs--are associated with larger purchases of non-audit services from auditors. These results suggest that either corporate managers or audit committees (or both) are sensitive to issues related to auditor independence when purchasing non-audit services from their auditors.

### *3. Benefits and Costs to Auditor Independence*

*Research has documented several benefits of higher quality audits, including reduced risk perceptions on the part of capital market participants and reduced earnings management on the part of corporate managers. The research uses general proxies for audit quality, which do not distinguish between the effects of auditor independence and auditor competence.*

*Recent survey evidence documents one potential cost to auditors' independence. Specifically, this evidence suggests that placing restrictions on auditors' provision of non-audit services to audit clients may reduce auditor competence. The survey documents a decline in students majoring in accounting and attributes this decline in part to*

*students' perceptions that auditing provides a less-rewarding and challenging career than other careers such as consulting.*

Several studies document benefits associated with higher audit quality, with audit quality typically defined in terms of CPA firm size or audit fees. Beatty (1989) documents that the degree of underpricing in initial public offerings is lower when higher-priced (i.e., higher quality) auditors are associated with a company's financial statements. Relatedly, Menon and Williams (1991) find that investment-banking fees charged for initial public offerings are lower for firms that employ national (Big Eight) auditing firms. Results of both of these studies suggest that market participants attribute less risk to firms audited by large CPA firms. Becker et al. (1998) find that clients of Big Six auditing firms exhibit smaller amounts of income-increasing earnings management than companies audited by non-Big Six auditing firms. Although these studies document benefits of audits provided by higher quality CPA firms, the proxies used for auditor quality are imprecise and do not distinguish whether the higher quality of large CPA firms is due to greater independence or greater competence.

A recent study published by the American Accounting Association suggests that a potential cost of increasing auditor independence via restriction of certain activities is a reduction in the competence of persons choosing the auditing profession.<sup>4</sup> This study shows that the accounting profession currently faces problems acquiring high quality professional employees. Specifically, the study indicates that the number of accounting graduates (per year) has decreased approximately 25% from 1995-96 to 1998-99. Additionally, 80% of educators and 46% of practitioners believe that accounting students are currently less qualified than in the past. Educators and practitioners attribute this decline primarily to two factors: (1) the relatively lower starting salaries in accounting compared to other business disciplines such as information systems and finance and (2) students' perceptions that accounting is less challenging and rewarding than other fields of study. Approximately 90% of the practitioners and accounting educators surveyed in the study strongly agree that consulting work in CPA firms is viewed as challenging and rewarding; however, only about 60% of these two groups strongly agree that audit services in a CPA firm are challenging and rewarding. Thus, improving auditor independence by imposing restrictions on auditors' provision of consulting services may further reduce the quality of students who choose employment at CPA firms.

#### *4. Users' perceptions of auditor independence*

*In general, financial statements users express greater concerns about auditor independence than do auditors. Research suggests that these differences are related in part to experience and knowledge differences between users and auditors. Research has focused on effects of one specific factor that may compromise independence, the provision of non-audit services to audit clients, on users' perceptions of auditor independence. Results of this research generally suggest that financial statement users*

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<sup>4</sup> See W. S. Albrecht and R. J. Sack, *Accounting Education: Charting the Course Through a Perilous Future*, Sarasota, FL: American Accounting Association, 2000.

*believe relatively small amounts of consulting services have little effect on auditor independence and increase auditor competence. Separation of the audit staff from the staff performing consulting services also increases the perceived independence of auditors.*

Several studies show that financial statement users express greater concern than do auditors that factors such as competition, the provision of non-audit services, and incentives to retain clients negatively affect auditor independence (Shockley 1981; Reckers and Stagliano 1981; Firth 1980).<sup>5</sup> This result may be due in part to users' lower levels of knowledge about the auditing profession and the audit environment. For example, Reckers and Stagliano (1981) find that a larger percentage of MBA students express concerns about auditor independence than do financial analysts. Analysis in Shockley (1981) indicates that partners in Big Eight CPA firms have more complex mental models for evaluating auditor independence than the mental models of commercial loan officers and financial analysts. Thus, some financial statement users' concerns about auditor independence may reflect a lack of understanding of the checks and balances in the audit environment, regardless of whether the issue is over-time or cross-sectional threats to independence.<sup>6</sup>

Results of research on users' perceptions of the effect of non-audit services on auditor independence suggest that various factors mitigate users' concerns about compromised auditor independence. For example, several studies show that users perceive little impairment in auditor independence when the amount of non-auditing services provided to clients is small (Lowe and Pany 1995; 1996). Studies indicate that users perceive that small amounts of non-audit service enhance, rather than reduce, audit quality (McKinley et al. 1985; Pany and Reckers 1988). Additionally, the use of separate staffs for providing audit and non-audit services reduces users' concerns about auditor independence (Lowe and Pany 1995). Overall, these results are consistent with the idea that users believe that there are positive synergies between auditing and consulting. Users perceive the benefits of these positive synergies to exceed negative effects on independence as long as the consulting fees are not material to an individual office, and audit and non-audit services are provided by different individuals within the firm.

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<sup>5</sup> Much of the research on financial statement users' perceptions of the effect of non-audit services on auditor independence was conducted during the 1980s, a time period in which the level of non-audit services provided was less than that provided in the 1990s. The results of these older studies should be evaluated in light of this limitation.

<sup>6</sup> These results for financial statement users are consistent with research on the psychology of attitude formation. Psychology research finds that peoples' beliefs about groups to which they do not belong (e.g., college students' beliefs about senior citizens) are less complex than their beliefs about groups to which they do belong (e.g., college students beliefs' about other college students). These simpler belief structures lead to more extreme beliefs for out-groups than in-groups (Eagly and Chaiken 1993, 120; Linville 1982).

## Responses to questions posed in the Exposure Draft

*Q1 The proposed conceptual framework defines auditor independence as “freedom from those pressures and other factors that compromise, or can reasonably be expected to compromise, an auditors’ ability to make unbiased audit decisions.”*

*Is this definition appropriate? If not, what changes would you suggest, and why?*

We believe that the definition should be modified to state “freedom from the effects of those pressures and other factors that can compromise...” The definition as stated implies the *absence* of factors that significantly compromise an auditor's ability to make unbiased decisions. This approach is inconsistent with subsequent portions of the Exposure Draft’s conceptual framework, specifically the independence risk model in which threats to auditor independence can be mitigated by safeguards. The Committee’s modification to the definition of auditor independence incorporates the idea underlying the independence risk model, i.e., that safeguards can mitigate the effects of independence threats on auditors’ ability to make unbiased decisions.

We agree with the definition’s focus on auditors’ decision making and on observable factors that can influence auditors’ decisions, as indicated in points 4 and 7 in our discussion of the conceptual basis for a framework for auditor independence. However, as noted above, the Exposure Draft’s definition does not reflect the idea that safeguards can mitigate threats. Since both threats and safeguards are observable factors (at least to certain groups), the Committee believes that the definition of auditor independence should reflect the effects of both threats and safeguards, consistent with point 7 of our discussion of the conceptual basis for a framework for auditor independence.

We also agree with the inclusion of the clause “or can reasonably be expected to compromise” in the definition of auditor independence. This clause reflects the Committee’s view (point 3 of our discussion of the conceptual basis for a framework for auditor independence) that the benefits of auditor independence depend on the perceptions of individuals who rely on auditors’ decisions. For the benefits of independence to accrue, it is not sufficient that auditors are unaffected by factors that may compromise unbiased decisions; reasonable users who rely on auditor judgments must also perceive that such factors do not compromise auditors’ decisions. Additionally, the inclusion of the word “reasonably” in the definition is consistent with research indicating that financial statement users’ views about auditor independence depend on their knowledge about auditors and the audit environment. Financial statement users can have unreasonable beliefs about auditor independence for two reasons: either they are not fully informed or they fail to process information rationally. The Committee suggests the possibility that the group most likely to avoid both conditions is corporate audit committees, because of their expertise and access to information.

While we agree with the inclusion of the words “reasonably expected” in this clause, we disagree with the Exposure Draft’s approach for assessing “reasonable expectations.” As indicated in paragraph 56 of the Exposure Draft, the ISB plans to incorporate users’ views by soliciting comments from users, while formulating standards based on the ISB’s evaluation of these views and the ISB’s judgment about how to best meet the goal of auditor independence. While this approach may be appropriate for the ISB, it limits the applicability of the conceptual framework for other groups who are not in a position to solicit users’ views. The Committee proposes that the Exposure Draft take the second approach stated in paragraph 56, that of incorporating the viewpoint of fully informed financial statement users, such as audit committee members. The approach stated in the Exposure Draft (i.e., having the ISB solicit users’ views) can be viewed as the *method* by which the ISB implements this second approach. Other independence decision makers, such as corporate audit committees, may choose other methods, such as using their professional judgment as a surrogate for reasonable views of financial statement users.

*Q2 The proposed conceptual framework states that the goal of auditor independence is “to support user reliance on the financial reporting process and to enhance capital market efficiency.”*

*Is this goal appropriate? If not, what changes would you suggest, and why?*

In general, we believe that this goal is appropriate. This goal is consistent with both the Committee’s view (stated in point 5 of our discussion of the conceptual basis for a framework for auditor independence) and research indicating that auditor quality (competence and independence) influences capital markets participants’ assessments of the risk of investments. We believe, however, that the goal should emphasize more strongly that auditor independence is important for *all* users of financial statements (including, for example, creditors, employees, suppliers). While the focus on investors in the capital markets is consistent with the mission of the ISB as stated in paragraph 42 of the Exposure Draft, an emphasis on multiple users of financial statements will broaden the applicability of the conceptual framework.

*Q3 The proposed conceptual framework contains basic principles related to four concepts of auditor independence: threats, safeguards, independence risk, and significance of threats/effectiveness of safeguards. The concepts and basic principles contained in the proposed framework are intended to serve as guidelines for independence decision makers to analyze and resolve independence issues.*

*Are the concepts and basic principles appropriate and sufficiently operational? If not, what changes would you suggest, and why?*

We agree with the concepts of threats to auditor independence and safeguards against those threats. These concepts are consistent with both the Committee's view (expressed in point 7 of our discussion of the conceptual basis for a framework for auditor independence) and empirical accounting research. Specifically, research documents that at least two of the threats listed in the Exposure Draft (self-interest threats and self-review threats) can influence auditors' judgments. Research also supports the efficacy of various factors that mitigate these threats, including factors in both categories listed in paragraph 14 of the Exposure Draft. We also agree that independence threats and safeguards combine to determine independence risk, as noted in the definition of independence risk. We comment on the Exposure Draft's independence risk model in Q4 below.

*Q4 Paragraphs 49-53 describe the elements of a risk model for auditor independence in which independence risk is a function of the significance of threats to auditor independence and the effectiveness of safeguards to auditor independence.*

*What are your views on the appropriateness of the independence risk model? Is there research that the Board should be made aware of that would be helpful in expanding the model or otherwise making it more useful for independence decision makers? If so, please describe that research.*

As noted in the response to Q3, we agree with the concepts underlying the independence risk model, i.e., that independence threats and safeguards combine to determine independence risk. We believe that the independence risk model would be more useful for independence decision makers if it were stated with greater specification, using an approach similar to that for audit risk. In the audit risk model, audit risk is typically viewed as a multiplicative function of inherent risk, control risk, and detection risk (SAS No. 47). Similarly, the independence risk model can be viewed as a multiplicative function of two risks: the risk that threats to independence exist and the risk that safeguards do not eliminate these risks.

This approach would separate the assessment of the probability that unmitigated threats to independence exist from the assessment of the implications of such unmitigated threats. In the Exposure Draft, the assessment of the probability of an unmitigated threat (i.e., independence risk) is confounded with the assessment of the magnitude of the impact of the unmitigated threat. For example, paragraph 19 defines the significance of a threat to auditor independence as "the extent to which the threat increases independence risk." While this definition appears to relate to assessing the probability that the threat will affect independence, examples in paragraph 19 of factors that affect the significance of a threat include items that influence the *magnitude* of the consequence of the threat, not the *probability* of the threat. For example, "the importance of the matter that is the subject of the activity" relates more to assessing the magnitude of the effect of a threat than to assessing the probability that a threat exists.

Accordingly, we recommend that the independence risk model separate the assessment of the probability that unmitigated threats to independence affect an auditor's ability to make unbiased decisions from the assessment of the magnitude of effects of these unmitigated threats. The first assessment would emulate the audit risk model, defining independence risk as a multiplicative function of the risk that threats to independence exist and the risk that existing safeguards do not eliminate these threats. The magnitude of consequences associated with threats that are not fully mitigated would then be assessed separately. The expected impact of independence risk would then be estimated by multiplying the independence risk probability by the estimated magnitude of consequences.

Such an approach allows for a cost/benefit evaluation of safeguards that mitigate independence threats. For example, if no safeguards currently exist, the cost of a threat to independence is the probability of the threat multiplied by the magnitude of the consequences of the threat. This cost can also be viewed as the benefit that would accrue if a safeguard totally eliminates the threat. This benefit could be compared against the cost of implementing the safeguard.

We realize that it may be infeasible to specify values for parameters of the model in specific situations; i.e., it may be difficult to estimate the probability that a particular safeguard will mitigate a threat to auditor independence or to assess the magnitude of consequences of such a threat. However, we believe that the structure of this model will enhance individuals' ability to evaluate auditor independence by specifying the different constructs that relate to effects of deviations from auditor independence.

We agree with the focus in paragraph 30 of the Exposure Draft related to considering the views of users of financial reports and other individuals who rely on auditor decisions. As indicated previously (point 3 of our discussion of the conceptual basis for a framework for auditor independence and our response to Q1), the views of reasonable financial statement users are important to assessing the likelihood that threats to independence exist and the probability that safeguards fail to eliminate this threat. Additionally, consequences to individuals who rely on auditors' judgments will be a significant part of the assessment of consequences of independence risk.

*Q5 Are there other issues in connection with the proposed conceptual framework that the Board should consider? If so, what are those issues, and how would you advise the Board to resolve them?*

As indicated in the first section of this comment letter, the Committee believes the Exposure Draft's conceptual framework does not incorporate two important elements. First, we believe the Exposure Draft should explicitly include the view that the entity whose financial reports are the subject of the audit is not a natural person with one state of mind, but rather is composed of multiple groups of contracting parties (point 2 of our discussion of the conceptual basis for a

framework for auditor independence). Separating an audit client into its various groups (e.g., management, audit committee) should aid in the identification of threats to auditor independence that are created by auditors' interactions with these various groups. Similarly, this approach should aid in evaluating the effectiveness of safeguards to threats to auditor independence. For example, auditors' interactions with management are likely to result in threats to auditor independence, while auditors' interactions with the company's audit committee are likely to mitigate some of these threats.

Second, the Committee believes that the framework should incorporate more explicitly the idea that audit quality is a function of both auditor independence and auditor competence, and that achieving high levels of auditor independence can have negative effects on audit firms' ability to obtain high levels of competence in its human capital. While the Exposure Draft refers to such "second-order" effects in paragraph 29, the Committee believes these effects are not given sufficient prominence. In the Committee's opinion, these "second-order" effects are at least as important as the "first-order" costs of developing and implementing safeguards because the second-order effects can result in the failure to achieve the overall goal of auditor independence, i.e., higher quality audits. We believe that auditor independence cannot be evaluated separately from auditor competence given the interactions between the two. Accordingly, we recommend that the interactive effects of auditor independence and auditor competence be explicitly addressed in the conceptual framework.

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