

# Auditor-Firm Conflict: Theoretical Concepts Application and Analysis of the Power Dynamics Involved.

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**Abstract:** *This study undertakes a theoretical analysis of the auditor-firm conflict. It relied on the review of literature methodology contextualized on auditor's appointment, firm economic pressure, management bargaining power, auditor's fear of losing a firm, firm's management economic power over the auditor, auditor's personal attributes and moral reasoning, auditor's tenure, audit fees, audit market competitiveness, non-audit services, audit firm size, and the firm's financial condition. The study relied on the Goldman and Barlev model, exchange, and dependency theories to explain the likely power positions in the auditor-firm relationship. Deductively, the study based on the contexts indicated the presence of an asymmetric power structure where the auditor and firm have low and high power positions. The study, however, proffered resolution measures such as reputational and litigation costs, strengthening of audit committees, control over auditor's appointment and remuneration, effective discipline of firms and auditors, and strong enforcement of standards. The measures can curtail the auditor's and firm's actions in reducing violations of auditing standards, improving the auditor's independence, reducing the firm's pressure on the auditor, and bringing about a balance of power positions. The paper has implications for understanding the auditor-firm conflict situation and provides opportunities for strengthening audit policy and audit standards development.*

**Keywords:** *Conflict of Interest, Auditor Independence, Goldmn and Barlev model, Interpersonal Exchange Theory, Dependency Theory, and Power Positions.*

## 1. Introduction

Accounting research on the concepts underlining the auditor-firm conflict and the power dynamics at play is an increasingly topical area. While the auditor-firm conflict has remained a great concern, the effect on the auditor's real or perceived independence and autonomy in performing the audit task has continued to attract debates among practitioners, scholars, and experts in accounting. Meanwhile, audit services in the form of an audit report are critical not only to investors' confidence but also to market stability. It underscores the significance of financial reporting and is an important regulatory requirement that both quoted and unquoted firms are expected to comply with. Firms act as the appointer of auditors; they receive the audit report while they bargain the terms, conditions, fees, and scope of the audit on behalf of other stakeholders. This

engagement brings the auditor and firm into a relationship that can seldom be equal, as the social interactions involved reflect a power asymmetry (Kyriake, 2020). Power play is often inevitable in a relationship. It provides the parties involved access to valuable materials (i.e., food, money) or social resources (i.e., knowledge, information, and decision-making opportunities (Fiske, 2010; Keltner, Gruenfeld & Anderson, 2003). Further, it indicates the capability to achieve personal goals and influence other parties' outcomes through the administration of punishments and rewards. Apart from influencing others, it modifies their attitudes and behaviors ( Sturm & Antonakis, 2015). The inherent power dynamics in a relationship create conflict between and among the parties involved, and this conflict can be related to the auditor-firm situation.

Conflict as a phenomenon is influenced mainly by the forces of power in the

relationship, which can direct the party's willingness to search for information about the other partner (Fiske, 1993; Fiske & Depret, 1996). While it encourages questioning that is directed at another partner, it seeks information to test one's beliefs and assumptions (Pruitt & Lewis, 1975). It also gives parties in a conflict the opportunity to explore and exercise power to achieve individual interests. The auditor–firm conflict is not an uncommon phenomenon; it arises when a disagreement occurs between the auditor and the firm management, which could be due to attempts by the firm to influence the auditor's performance in a manner to obtain a specified audit report. The influence acts as a pressure on the auditor to take inappropriate actions in violation of the generally accepted auditing standards and professional ethical considerations (Donald & Kenneth, 1976). This may be against the general notion that an auditor is supposed to be independent and required to comply fully with professional ethics as well as the generally accepted auditing standards while carrying out an audit assignment. This may sometimes breed conflict with the firm, and the auditor's ability to withstand the firm's threat depends largely on whether there is a balance of power in the audit relationship.

It is worth noting that the auditor–firm conflict issue continues to resonate with practitioners, regulators, and academics, which, over the years, has attracted much attention in the literature. It is not surprising, as evident in the literature, that a plethora of factors are identified to be responsible for the conflict. They include the audit item under dispute (Wright & Wright, 1997), the client and auditor's relative power (Knapp, 1985), the moral reasoning of the auditor (Windsor & Ashkanasy, 1995), and the probability of litigation (Goodwin & Trotman, 1995). Some other studies examined the auditor's incentive to compromise independence in terms of non-audit fees (Reynolds et al., 2004; Ashbaugh, Lafond & Mayhew, 2003), total audit fees, audit fees, and non-audit fee ranking (Frankel, Johnson & Nelson, 2002; Francis & Ke, 2003; Siddiqui, Turley & Zaman, 2008).

However, accounting research has found that auditors, who increasingly interact with the firm, maintain positions of lower power when it comes to auditor–firm interaction (Mellisa, Christine, & Gregory,

2023). However, whether or not the auditor possesses the powers to actually maintain his independence as prescribed in the audit professional standards has been a recurring question. Research endeavors with reference to the application of theoretical concepts in analyzing the power dynamics of the auditor and firm are relatively scarce. This has, in a way, limited the theoretical and practical knowledge of the auditor and the firm power position should a conflict arise. In recognition of this gap, the study objective is to shed light on the power relations between the auditor and firm in the contexts of auditor's appointment, firm economic pressure, firm management bargaining power, management economic power over the auditor, auditor's personal attributes and moral reasoning, auditor tenure, audit fees, audit market competitiveness, non-audit services and to provide resolution methods to address the asymmetrical power positions.

The motivation for the study is based on the scarcity of studies that address the theoretical analysis of the power dynamics in the auditor–firm conflict situation and the general belief that the auditing profession relies so much on the independence principle to guarantee the objectivity of the auditor devoid of any influence from the firm's management. The study is different from earlier studies as it extends the theoretical literature on the auditor–firm conflict situation and attempts to provide a deeper analysis of the power structure of the auditor and the firm. The study contributes to the literature in the areas of expanding the existing literature on the auditor–firm conflict, providing a synthesis of analysis, and contextualizing the power structure in the auditor–firm relationship. It proffered policies and practices aimed at reducing the occurrences of conflicts that have regulatory and practical implications.

The remainder of the paper is structured as follows: The next section is the theoretical perspective, followed by the underpinning theories. The following section dwells on the methodology applied. The next section, which is the literature review, dwells on the concepts linked to the auditor–firm conflict and analyzes the possible power positions of the auditor and firm. Section four focuses on the resolution measures to the auditor–firm conflict, while section five presents the conclusion of the paper.

## 2. Theoretical Perspective

An auditor's role, according to regulators and researchers, is based on the professional perspective, which maintains that the auditor is appointed to serve the users of financial statement interest by verifying the information overtly disclosed in the financial statements and determining whether material misstatements exist or not. While audit standards strongly emphasize that the auditor's work should consider the interest of users in terms of deciding on the materiality level, the regulators emphasize the user perspective in developing the standards. Users of financial statements, however, expect different quality outcomes from audit exercises in relation to those of the regulator (Limei, Emma-Riikka, & Tobias, 2022). Auditors have interests that are expected to align with those of the firm's stakeholder groups through education (Li, Qi, Tian, & Zhang 2017), training (Che, Langli, & Svanström 2018), regulation (DeFond and Zhang 2014; DeFond and Lennox 2011) and oversight (Westermann, Cohen, & Trompeter 2019). Professional views insist that auditing should be internalized by the auditor, which can shape his or her professional identity and form his or her personal work priorities. Apart from having good knowledge of the standards, the auditor may desire to receive high audit fees or strive to satisfy the firm's management's interest instead of the shareholders. This, in some ways, may affect not only the auditor-firm relationship but also the auditor's independence, which may alter the power relations with the firm.

### 2.1. The Field Theory of Power

The field theory of power was developed by Wartenberg (1990). The author defined power by relating it to ongoing human relationships and interactions occurring within a dynamic social context. The theory recognizes the existence of power which can be exercised in all aspects of human social life. To the author, there is positive and negative power, and there is a difference between the positive power, which is power to the people, and the negative power over, which is power over the people. Power over the people refers to the power exercised by an individual over another individual or group by way of constraining circumstances within which the weaker party

will act. Wartenberg (1990) argued that the mere presence of a powerful group or individual alters the social sphere of another individual or group. The dominant party acts in a manner to constrain the circumstances of the subordinate by force, coercion, or influence, which invariably limits the subordinate's behavior. In the power equation, the dominant party needs to expend much energy and effort to constrain the subordinate's actions. Whether power is positional, personal, or contextual, it influences the direction of a conflict (Kyriaki, 2020). Thus, the study is anchored on the field theory of power because, in the auditor-firm relation, the firm is viewed as the dominant party that has power over the auditor to act or make decisions in a constrained audit environment.

### 2.2. The Goldman and Barlev model.

The Goldman and Barlev (1974) model recognizes the position of power in a social relationship. It argues that attempts to influence the auditor to take certain actions that may not be in conformity with professional standards and compliance with the general auditing standards can only be successful due to the existence of an asymmetrical power relationship that favors the firm in a conflict situation. The power of the auditor, as a professional in relation to the firm, is best characterized by cell 4 in the matrix shown in Figure 1 below. The auditor is classified in cell four because it is believed that he or she provides an audit service that is beneficial to the stakeholders of the firm instead of to the firm that pays the audit fees. In addition, the external auditor's audit responsibility is seen as a routine service. As such, under any situations where the auditor performs highly routine audit service which primarily benefits non-paying stakeholders of the firm, the auditor is in a low-power relationship with the firm. The matrix represented in Table 1 indicates that if the auditor performs a higher proportion of non-routine services, he or she is likely to wield more power in relation to the firm. Again, the higher the proportion of non-audit services that the auditor renders directly to the firm, which it pays for, the more the firm finds these services important to it, and the greater the auditor's power.

**Table 1.** Power Wielded by Auditors Vis-a-Vis Paying Firm

Beneficiary	Problem solved	
	Non-routine services	Routine Services
Paying firm	(1) Highest	(2) Medium
Other Stakeholders	(3) Low	(4) Lowest

Source: Donald and Kenneth, 1976.

According to the model, the auditor's movement from cell 4 to cell 1 would cause his or her powers to increase, and as such, he or she can withstand the firm's influence to pressure him or her into violating professional ethics and generally auditing standards. The model asserts that a firm has power over the auditor but fails to provide the nature of the power. The model was chosen purely because it presents a better understanding of the underlying causes of the conflict between the auditor and firm and refers to the power relations between the parties.

### 2.3. Interpersonal Exchange Theory

The interpersonal exchange theory was developed by Tibaut and Kelly (1957). The theory's key assumptions revolve around the concept of power, which enables parties in a relationship to engage in exchange. Power, according to Cartwright and Zander (1968), is the capability of one party to influence the behavior or attitude of the other party. It can arise from various sources, which are grouped into two broad categories, namely structural (positional) and personal power. Structural or positional power results due to people's status and position in an organization and is used to ensure compliance of individuals and team members to achieve predetermined outcomes and common goals. It consists of legitimate power, coercive power, and reward powers. Personal power is used to win the hearts and minds of people to get things done as expected, which inspires people to rise to greater heights and set the bars high for creditable performance. It consists of expert power and referent power (French & Raven, 1959). The levers of power in an interaction can bring about an unequal relationship, which in most cases creates a situation of power asymmetry where power holders can act asymmetrically to enforce their will and determine the process as well as the outcome in a conflict situation (Kyriaki, 2020). As such, in an auditor-firm conflict situation, the firm

has the power or ability to influence the final audit report. The auditor equally has power conceptualized in his or her independence. This is the auditor's ability to withstand the firm's attempts to influence him or her. It is the expert power derived from having unique, in-depth information, expertise, and firm in a relationship based on the exchange of services. This underscores the very importance of interpersonal exchange theory, which takes into account the rewards mediated by the firm and auditor for services rendered.

### 2.4 Dependency Theory

The dependency model is yet another important theory that provides an understanding and explanations of the auditor-firm conflict. Emerson (1962) described the model as involving two-party relationships where the power of one party rests implicitly in the other party's dependency on the first party. The greater the dependency of one party on the reward and /or punishment, which the second party can mediate, the greater the power of the party to gain the compliance of the other party. Reward power is derived from a person's ability to reward others for doing what is needed to be done, while coercive power is the ability to punish others for not complying with rules and regulations or for not complying with what needs to be done (French & Raven, 1959). Power in a dyadic relationship is a function of the dependency of one party on the other. As such, an alleged asymmetrical power structure exists between the auditor and the firm. This can be analyzed using the dependency patterns between them. Emerson (1962) described the auditor-firm relationship using a pair of equations, as shown below.

$$\begin{aligned} P_{fa} &= D_{af} \dots\dots\dots 1 \\ P_{af} &= D_{fa} \dots\dots\dots 2 \end{aligned}$$

Equation 1 infers that the power (P) of the firm (f) over the auditor (a) is equal or equivalent to the dependency (D) of the auditor (a) on the

firm (f). Equation 2 shows that the power (P) of the auditor over the firm (f) is equal or equivalent to the dependency (D) of the firm (f) on the auditor (a).

Dependency is a function of the value placed on the rewards offered by one party to the other and the availability of these rewards in relationships. In the auditor-firm relationship, power imbalance seems to be present, and this is due to the patterns of dependencies between the auditor and firm. Besides the difference in power, all kinds of power have a common dependency characteristic (Kyriaki, 2020). Regardless of the type of power involved, dependency allows for power play. Thus, the greater the dependency of a party on the rewards and /or punishment that a second party can mediate, the greater the power of the second party to enforce compliance with his or her wishes. Whereas when a person is less dependent on the other person, he or she becomes more powerful, and where he is more dependent on another, the more powerless he becomes (Emerson, 1962). Dependency in a relationship may be conspicuous or not, and this exists in the relationship between the auditor and the firm. The degree is influenced by the available rewards, which account for the level of powers that can be exercised either by the auditor or the firm. This explains the importance of the dependency theory in explaining the power positions the auditor or firm can exercise when conflict arises.

### 3. Methodology

The study is a purely theoretical paper. It relied on a review of literature methodology on a number of concepts found in the literature that are responsible for the auditor-firm conflict. The concepts reviewed were the appointment of the auditor, economic pressure from the firm's management, management bargaining power, the auditor's fear of losing a firm, the firm's management economic power over the auditor, auditor's personal attributes and moral reasoning, auditor's tenure, audit fees, audit market competitiveness, non-audit services, audit firm size, and the firm's financial condition. Given the concepts reviewed that underline the auditor-firm conflict, the knowledge of relevant theories reviewed was applied to contextualize the concept of power in terms of the exchange of

services and dependency between the auditor and the firm. Rewards, significance, and value perception of the firm with respect to services mediated between the firm and auditor in the audit relationship formed the basis of analysis. After that, the study adopted deductive reasoning to analyze the power positions of the auditor and firm should a conflict arise.

### 4. Theoretical Analysis of the Auditor and Firm Power Positions in Audit Relationship.

Understanding the auditor-firm conflict is primarily based on the auditor's independence concept. The auditor's independence is impacted when the auditor shows reluctance to disclose fundamental breaches found during the audit process (Norziana & Nur'Atiqah 2020). Threats to audit quality make auditors struggle to fulfill their professional responsibilities and, in the process, ingratiate themselves with the firm. Such audit quality-threatening behavior of the firm is in the form of avoidance and ghost-ticking. This suggests that there is an ongoing power disparity between the auditor and the firm, which can impair the auditor's operational independence (Mellisa, Christine, & Gregory, 2023). As it is, the firm possesses both coercive and reward powers, while the auditor has expert power. However, the presence of attractive alternatives to both parties determines the degree of dependence on each other, which determines the power positions that can either threaten or strengthen the auditor's independence (Kyriaki, 2020).

#### 4.1 Appointment of Auditors

The firm's appointment of auditors is based on situations. This situational power of the firm's management gives it an overriding edge and power over the auditor in their audit relationship. The firm has legal power to appoint auditors. It also has the responsibility to negotiate the auditor's conditions of employment (Goldman & Barlev 1974). There are power relationships in terms of the client management controlling the conditions of employment of the auditor (Goldman and Barlev, 1974). In shadow negotiation of the employment conditions, auditors appear to give the firm's management the upper hand by not applying moves and asserting themselves (McCracken, Salterio & Gibbins, 2008). The

audit relationship is emotionally charged when the firm has power over the auditor (Wartenberg 1990), as the auditor's employment depends largely on the firm and its management (Goldman & Barlev 1974). Given that the power to appoint the auditor resides with the firm, it is more likely for the auditor to depend on the firm and more likely to concede to the firm, as the asymmetric power structure tends to favor the firm. The perceived reward of appointment mediated by the firm to the auditor provides the firm with a high power position and puts the auditor in a low power position. Should there be any threat from the firm, either to withhold or terminate the auditor's appointment, this can constrain the auditor to accept the firm's pressure for fear of losing the appointment, more so when the auditor's clientele base is low, he or she is relatively new in the audit market and have low firm referrals from clients.

#### *4.2. Firm Economic Pressure.*

Economic pressure on the auditor from the firm generates conflict, which provides a basis for understanding the asymmetric power positions. Where there are power differentials, the dominant party applies economic pressure, which only gives limited options for the subordinate to make decisions or act (Wartenberg, 1990). A firm desirous of having a good audit report in order to access credit facilities from a financial institution or bank can mount pressure on an auditor to give such a report. However, when the auditor decides to uphold independence to give a true audit opinion on the firm's financial statements, the firm may withhold all necessary information and provision of facilities that can frustrate the auditor's audit assignment. The auditor would be at the mercy of the firm because he or she lacks the crucial source of power as such, would be vulnerable to economic pressure if applied by the firm to acquiesce to its demands for a given audit opinion or risk being replaced (Goldman & Barlev, 1974). The asymmetrical power play in the auditor-firm relationship favors the firm more than the auditor. This places the firm in a high-power position capable of influencing the auditor's actions for a favorable audit report. This would occur especially when the auditor depends sufficiently on the firm for financial sustenance. However, when the firm places

significant value and reward on the auditor's expertise, which it cannot find in any other auditor, it makes the auditor more influential and, by so doing, places the auditor in a high-power position to be able to resist pressure from the firm.

#### *4.3 Management Bargaining Power*

The management bargaining power of the firm provides it with more powers over the auditor. The firm's economic bargaining power is controlled by its management, which can be an inhibition to the auditor's independence (Goldman & Barlev, 1974; Wartenberg, 1990). The bargaining power of the firm can be enforced by applying pressure in the form of a threat to switch auditors or reduce the audit and non-audit services of the auditor. Threats of this nature generate a power asymmetry structure that empowers the firm over the auditor. The firm's urgency or pressure on the auditor to do its bidding for a favorable audit report, which threatens the auditor's independence, can generate a sort of low-quality beliefs whereby the auditor would probably consider both the long-term and short-term consequences that may have a positive effect on his or her revenue profile. Such would lead to a breach of auditing standards and professional ethics by being receptive to the firm's pressures through communication and negotiation of the audit engagement (Salterio, 2012). This may occur especially when the auditor does not have an alternative to getting a new firm but depends on the firm for economic survival. This places the firm in a high-power position, which makes the auditor satisfy its desire or demand while trying to fulfill audit regulatory requirements for third parties. The presence of an asymmetric power structure usually favors the firm since the auditors employed by the firm are through a regulatory structure (Goldman & Barlev, 1974; Knapp, 1985).

#### *4.4 Management Economic Power over the Auditor*

Power differential in a social and contractual relationship places a party in a dominant position over others. It benefits one party in one respect and also harms the party in another aspect (Wartenberg, 1990). Despite the auditor's training, knowledge, and expertise

and being highly paid professionals, his or her perceived independence, integrity, and self-determination depend largely upon the prevailing circumstances in the relationship with the firm. The firm, being the employer of the auditor, possesses economic power over the auditor because it is responsible not only for the auditor's appointment but also for the payment of the audit fees. The economic survival of the auditor is dependent on how much audit services he or she can mediate. Without such mediation, the auditor is economically powerless, which places the firm in a dominant power position to be coercive and significantly influence the auditor to accept its demand or request even though it threatens his or her independence. The failure of audit firms to report the true financial state of a firm in satisfying the regulatory requirements exemplifies the firm's economic power over the auditor. Where the auditor accepts the economic power of the firm as the status quo, any threat from the firm, either for replacement or reduction in audit fees, may be difficult for the auditor to resist. The auditor's dependence level on the firm's economic power places the firm in a high power position while the auditor is in a low power position. This dependency relationship makes the auditor unable or powerful enough to withstand the firm's threat. Economic power gives the firm more powers over the auditor's independent judgment and decisions (Wartenberg, 1990; McCracken et al., 2008).

#### *4.5. Auditor's Personal Attributes and Moral Reasoning*

An auditor's personal attributes and moral reasoning are sensitive to his or her independence in providing an unbiased audit opinion. Audit opinion is expected to be devoid of emotions but objective in verifying the firm's financial statement as a regulatory oversight role in financial reporting (Mautz & Sharaf 1961). Where an auditor is economically dependent on the very firm because of rewards, this may be injurious to the auditor's independence if he or she is required to provide independent verification of the financial information in the public interest. The higher the degree of economic dependence of the auditor on the firm, the more likely it is for the auditor to undermine the firm's strong personal attributes and moral reasoning and breach professional conduct and

judgment, including auditing standards. This may result in obscurity of the honesty of a firm's financial reports, which is considered fundamental to the overall well-being of the firm. Given the dependency of the auditor, he or she is more likely to demonstrate lesser or lower moral reasoning to accommodate the firm's demands and ensure the retainership of the audit job. This would place the auditor in a lower power position while the firm would be in a dominant power position to influence the auditor to do its bidding. In the auditor-firm relationship, moral intensity tends to give the firm power over the auditor, which poses an enormous challenge to the auditor's independence (Wartenberg (1990).

#### *4.6. Audit Tenure*

Auditor tenure can create conflict in the auditor-firm relationship, particularly when the engagement period is very long. A longer auditor tenure with the firm may make the auditor complacent and less rigorous in performing the audit function just to maintain a good relationship with the firm. A long audit tenure is found to be a potential risk that can impair the independence of the auditor (Abu Bakar & Ahmad, 2009; Yip & Pang (2017; Al-Ajmi & Saudagaran (2011; Al-Khoury, Ali, Al-Sharif, Hanania, Al-Malki, & Jallad, 2015). This not only makes the auditor relate closely with the firm but may cause him or her to lose skepticism by relying on the firm accounting practices even though inadequacies characterize them. Maintaining a longer audit relationship with the firm may cause the auditor to show lesser audit effort, professional rigor, and competence to verify the firm's true financial position. This can be very injurious to the auditor's responsibility to the public interest. Preserving the auditor's continuous engagement increases his or her level of dependence on the firm, which tends to make the firm intervene in the auditor's professional judgment, which can jeopardize the independence criterion (Norziana & Nur'Atiqah, 2020). It impairs the auditor's independence when the audit firm is not only small in size but depends largely on the firm for rewards (Sawan & Hamuda, 2014). It creates some degree of bias in the audit reports, which can negatively affect the audit's performance (Ouyang & Wan, 2013; Yip & Pang, 2017). This places the auditor in a low

power position should any threat emanate from the firm

#### 4.7 Audit Fees

Auditor's fee is an important concept in understanding the power positions in the conflict of interest in the auditor-firm relationship. As a cornerstone, it assists auditors in getting more referrals from other firms and can impair the auditor's independence and professional ethics. An auditor who provides quality audit services to a firm may become greedy and request higher audit fee payment; otherwise, the audit services may be withheld. This behavior breaches the independence notion that the auditor is expected to uphold in the profession. (Norziana & Nur'Atiqah, 2020). Audit fees have been found to be associated with a higher risk of the auditor losing the attribute of independence (Abu Bakar & Ahmad, 2009; Al-Ajmi & Saudagaran, 2011; Al-Khoury et al. (2015). Higher audit fee payments by the firm may be used as bait to induce the auditor to comply with the firm's wishes or demands readily. An auditor that depends largely on a firm for a huge chunk of revenue would likely breach professional audit independence in the provision of objective and fair judgment of the firm's financial position, which can reduce the probability of reporting any potential misconduct or breach of regulations by the firm (Holland & Lane, 2012). This places the auditor in a low-power position, which makes it difficult for him or her to resist the firm and may comply with the firm's demand if such pressures exist. Higher audit fees have been found not to be associated with auditor independence (Craswell, Stokes & Laughton, 2002). Higher audit fees tend to improve auditor independence and audit quality (Tobi, Osasere & Emmanuel, 2016; Dart, 2011). Where the dependence levels of the parties are equilibrating or in favor of the auditor, this may likely put the auditor in a strong power position to resist or withstand pressure from the firm. However, when the firm places high value on the auditor's services, which another audit firm can rarely provide to the firm, the auditor may be in a high-power position due to his or her professional skills, competence, and knowledge in the delivery of quality audit services.

#### 4.8 Audit Market Competitiveness

In a competitive audit market, the auditor is expected to offer competitive audit services perceived by the firm to be comparable and of a high professional standard, which may exceed the firm current and future expectations in order to remain in the market. The auditor can employ either differentiation or cost strategy to enhance the market share (Kato, Semba, & Frendy, 2016). Competition amongst auditors might create a conflict of interest on whether to continue providing excellent audit services based on capability or serve more firms with no consideration of quality but more concerned with profit orientation. Without putting the audit capabilities and expertise to bear, it threatens the auditor's independence attribute, which can send signals of poor audit quality. A highly competitive audit market improves the independence of the auditor (Yip & Pang, 2017). However, audit market competitiveness impairs the auditor's independence (Abu Bakar & Ahmad, 2009; Al-Ajmi & Saudagaran, 2011; Francis, Michas, & Seavey, 2013) significantly.

A competitive market scenario would increase the auditor's economic dependence on the firm, which can induce the auditor to undermine the independence attribute and give a favorable audit opinion so as to maintain the firm (Reynolds & Francis, 2001). This would likely decrease the firm's dependence on a particular auditor and put it in a high-power position. The firm's threat of replacement would make the auditor very willing to compromise and endanger his or her perceived independence. By this, the auditor would be in a low-power position to put up resistance against the firm's inappropriate actions. Lowballing tactics would be the order of the day, as the auditor would have no choice but to accept unprofitable firms due to the competitive nature of the audit market.

The intensity of the audit market competitiveness condition exacerbates pressure on the auditor to compromise independence in order to retain the firm and receive pay-off for subsequent years (Quick & Schmidt, 2018). Audit market competitiveness also strengthens the auditor's perceived independence (Gul, 1989) with respect to the auditor's competence, knowledge, and skill, which can create a favorable public image for



the retainer ship. A highly disciplined auditor with high expectations about the firm's compliance with accounting guidelines would not hesitate to express dissatisfaction with the firm if it fails to meet accounting standards compliance expectations in the preparation of the financial statements. As such, any threat from the firm may not affect the auditor's power position as he or she would believe that the exchange of services is fair and the degree of dependence is less. He or she would be in a high-power position to withstand threats from the firm and damn the consequences of losing the firm rather than breach professional ethics and auditing standards to satisfy the whims of the firm.

#### *4.9. Non-Audit Services*

Non-audit service provision is one of the most controversial issues (Gul, 1989) that can generate conflict of interest in the auditor-firm relationship. It raises questions about investors' perceptions of the activity and accountability of the auditor's performance, including independence (Dart, 2011). Questions may arise that relate to the sudden failure of firms, including disclosure of questionable payments to auditors for non-audit services rendered and whether such is legal or illegal. The self-review becomes more pertinent as the auditor provides audit services alongside non-audit services, and by so doing, acting in an adversarial situation can lead to a compromise of the auditor's independence criterion. Studies that suggest that non-audit service has a negative effect on auditors' independence include Quick and Warming-Rasmussen (2005), Beattie, Fearnley, and Brandt (1999); Shockley (1981); Quick and Warming-Rasmussen (2015); Ahadiat (2011); Campa and Donnelly, (2016). Other studies that report that non-audit service positively impacts perceived independence include Gul (1989; Kinney, Palmrose, and Scholz (2004). Furthermore, some other studies that report no evidence or inconclusive results include DeFond, Raghunandan, and Subramanyam (2002; Knapp (1985); Sobrinho and Bortolon (2016); Krishnan, Sami, and Zhang (2005); Schmidt (2012). The provision of non-audit service strengthens the economic bond between the auditor and the firm and can increase the auditor's financial reliance on the firm. This puts the auditor in a low power

position to resist the demands or pressure of the firm but places the firm in a dominant power position to use coercive power to influence the auditor's acquiescence to its demand even when it amounts to breaching or undermining auditing standards and independence criterion. This forces the auditor to compromise, which affects not only the audit relationship but also the non-audit relationship, especially when the auditor has a fear of losing potential revenue (Lim & Tan, 2008; Alleyne & Devonish., 2006). However, when a firm places huge value on the performance of non-audit services by an auditor, it increases the auditor's power, which is why the firm's dependency increases. This may put the auditor in a high-power position and can withstand threats that may come from the firm.

#### **5. Resolution Measures**

The auditor-firm conflict and the asymmetric power relation resulting between the parties are well documented. However, it is important to provide countermeasures to the firm's threat and improve the auditor's power base to ensure the maintenance of audit independence and objectivity in the audit. Some of the counterbalance measures include reputation concerns and litigation exposure, strengthening of audit committees, control over the appointment and remuneration of auditors, firms and auditors' effective discipline, and strong enforcement of standards. It is important that firms are aware of the reputational costs and litigation costs associated with the threat to coerce or threaten the auditor. Regulatory bodies such as the Securities and Exchange Commission should establish strong regulations that impose huge fines and levies that may be higher than the benefits to be derived by the firm for demanding an audit report, even when it involves breaches and violations of accounting practices and auditing standards by the auditor. In addition, where firms engage in inappropriate behavior that is inimical to the financial reporting of their operations, the SEC should also assume responsibility for prosecuting and securing the convictions of firms. In the case of auditors, they should also be concerned with reputational and litigation exposure for breaching the professional code and standards, which can erode the significant

role of the audit professional in financial reporting. In this regard, the auditing profession can discipline an erring member by withdrawing the practicing license or imposing severe fines with huge costs that may be higher than the benefits the auditor may obtain for issuing a falsified and deceptive audit report.

Although the audit committee is already a regulatory requirement, efforts should be made through amendment of the regulation to empower the audit committee to be responsible for the appointment of auditors and bargaining of the audit fees. This measure would be helpful to minimize threats from the firm and strengthen the auditor's independence and objectivity. Auditor's rotation by restricting the auditor's number of years to be with a firm say four consecutively, should be strengthened. This would decrease the economic bond that exists between the auditor and the firm and cause a possible reduction in the impairment of the auditor's independence, thereby reducing incidences of conflict. The audit profession guidelines, which stress that a newly appointed auditor to a firm should consult with the outgoing auditor to get relevant information about the previous audit work on the firm's financial results, should be strongly emphasized. It would allow the new auditor to have firsthand knowledge about the firm and employ a fresh perspective on the firm's financial reporting, which can encourage the revelation of irregularities that may be associated with the previous audit performance. This tends to be helpful in reducing the probable negative effects associated with longer audit tenure, especially when the previous auditor's work shows a lack of audit rigor, the auditor's complacency level, and high reliance on the firm's accounting practices and integrity.

An auditor's retention for an explicit period of time is suggested because it would be helpful in preventing the substitution of an auditor, providing protection against the firm's pressures, diminishing the firm's opinion shopping opportunities, and enhancing the auditor's independence. The idea of joint audits, where two or more auditors share the performance of a firm and jointly sign the audit report, gives them the ability to resist the firm's pressure while increasing the chances of the joint auditors providing an impartial audit opinion that would improve the perception of

the auditor's independence. It enables audit fees to be shared by the joint auditors, thereby reducing the economic bond that may exist between a single auditor and the firm. Stronger audit regulations that restrict the auditor from providing audit services, as well as non-audit services to the firm, should be adopted. The adoption of stricter auditing standards would likely increase the quality of the audit, guarantee the auditor's independence, and place him or her in a high-power position to withstand threats of any kind that the firm may want to evoke to get a particular audit opinion.

## 6. Conclusion

This paper theoretically examines the concepts that underline the auditor-firm conflict using the review of literature methodology. It contextualizes the conflict situation on the basis of the concepts which are: appointment of the auditor, economic pressure from the firm's management, management bargaining power, auditor's fear of losing a firm, firm's management economic power over the auditor, auditor's personal attributes and moral reasoning, auditor's tenure, audit fees, audit market competitiveness, non-audit services, audit firm size, and the firm's financial condition. It thereafter applied a theoretical background from the Goldman and Barlev model, interpersonal exchange theory, and dependency theory. The Goldman and Barlev model posits that the auditor will generally be in a low power position, acknowledging the presence of an asymmetrical power structure in favor of the firm.

The interpersonal exchange theory stresses that exchange is based on the perceived value, importance, and significance of parties in a relationship that are attached to services rendered and received. The dependency theory argues that power position in a relationship arises based on the degree of dependency of one party on the other. The background of these theories provided the theoretical basis to evaluate each of the concepts that contextualized probable conflict situations between the auditor and firm, which necessitated the application of deductive reasoning to highlight the presence of asymmetrical power structure, which provided the yardstick to analyze the power position of the auditor and firm. As a way of providing a solution, the study identified resolution

measures that can be helpful in the reduction, if not eliminating. These incidences may threaten the auditor's independence and, by extension, impact the power relations between the auditor and the firm. These resolution measures are likely to alter the existing asymmetrical power structure and bring about a balance of power position that may help reduce or minimize incidences of auditor-firm conflict that have severe consequences on the auditor's independence. As such, these may not only strengthen the auditor-firm relationships but also encourage quality financial reporting that would satisfy the financial regulatory requirement intended to meet the varied users of audited financial statements. While the study presented a theoretical analysis of the power positions of the auditor and firm based on a number of concepts that underlie the auditor-firm conflict situation, it proposes that empirical studies should be undertaken to either validate or invalidate the presence of asymmetry power structure and the likely power positions of the auditor and firm.

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