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## **Exploring the term of the auditor-client relationship based on the ACR-models**

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**Abstract:** Auditors work under rigorous conditions and are vital to the economic environment as they certify financial reports and provide confidence to shareholders and stakeholders. To achieve that goal, the auditor interacts with numerous people and interested parties who might affect the auditor's actions through their influence. The scope of the paper is to analyse the auditor-client relationship model. To achieve our objective, we apply a deductive approach. As the auditor-client relationship has been debated for a long time, conducting a longitudinal retrospective supports our research by delimiting research periods related to various time frames. The need to analyse the auditor-client relationship is a preprocess for more detailed research on negotiation relationships between the auditor and the client. To develop a comprehensive model of the auditor-client negotiation relationship, the authors analysed auditor-client models to determine the most suitable model for a young audit profession country. To comprehend this dynamic phenomenon, the authors began by analysing the theoretical background of the relationship between the auditor and the client based on the auditor-client models.

**Keywords:** audit; client; relationship; model; audit quality.

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**Biographical notes:** Nicolae Măgdaş is a Lecturer with a PhD in Audit Negotiation at the Faculty of Economics and Business Administration in Babeş-Bolyai University, Cluj-Napoca, Romania. His research interest is in the audit area with a specific focus on audit negotiation, reporting, audit profession, audit education and business law aspects.

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## 1 Introduction

It is essential to describe the nature of the auditor-client relationship (ACR) to delimit the areas of focus in this paper. The literature uses various terms to express different facets of the ACR. Due to its complex nature, some authors prefer to use ACR (Kleinman et al., 2010), interaction or management relationship (McCracken et al., 2008), while others are more direct and focused on a specific area of this relationship using the terms auditor-client negotiation (Brown and Wright, 2008; Church et al., 2020; Hatfield et al., 2022; Salterio, 2012), realignments or disagreements, or even audit-client tenure (Grant et al., 2018; Svanberg and Öhman, 2016; van Nieuw Amerongen et al., 2022). We consider that all of the above terms are suitable as they all reveal different facets of the ACR.

For a clearer overview of the dynamics among the auditor and the client, it is necessary to define the interactions among the ACR and negotiation process. The connection is one of inclusion, as the negotiation process is included, if present, in the auditor-client entire relationship. Therefore, considering the inclusion relationship, the negotiation process is partially defined by the kind of association among the auditor and the client. Basically, the way the negotiation unfolds, when it occurs, is determined to some extent by the manner in which the auditor and client have interacted with each other in the existing relationship. The negotiation process, being included in the ACR, leaves a mark on the future of the relationship, on the factors of influence of the relationship, and the way the relationship is going to develop in the future. Essentially, the connection between the two concepts, the relationship, and the negotiation process, is one of inclusion of the negotiation process in the ACR, generating potential for synergic and mutual influences.

The area of auditor-client encounters is vast and composed of many distinct aspects, and it is necessary to define what will be the object of research of the present paper. Our focus is on defining and understanding the interactions and factors of influence in the ACR so that we can have a solid foundation for a more analytical research of the auditor-client negotiation process that occurs during the audit mission.

Research in the literature is the basis for scientific work. With the researched literature, you will familiarise yourself with a specific topic and find out about the latest research. To identify a goal for a new research, it is essential to analyse the existing literature. The work provides a theoretical basis for better organising and understanding research in the area of ACR. The novelty of the research aims is to the synthesis of the ACR model and at the same time the identification of the basic factors which underlying the relationship between them. The theoretical framework presented in this research provides a foundation for designing, categorising, and integrating research in the area of ACR. Both auditor and client can benefit from this synthesis relating to ACR, as well as the succinct representation of the bases models of the relationship. From a practitioner

perspective, the paper provides a valuable and readable of the dynamics of ACR synthesising significant research not only in accounting and auditing, but also in organisational behaviour, decision science, psychology and sociology.

The paper's structure begins with an introduction, to further continue with the presentation of the used materials and method and reveal in the end results of our findings and offer conclusions and future perspectives.

## **2 Materials and methods**

This section presents the research philosophy, approach, choice of method, strategy and time horizon as well as the reason behind our choices. We concluded a critical realism philosophy with a deductive approach.

The principal choice of philosophy is critical realism (Saunders et al., 2012); thus, a reality exists independent of our perception of it, but when it comes to our research question, we also consider that the data gathered can be misinterpreted depending on how we as individuals perceive it. Thus, the collected data will be analysed in the context of how, when and where it was gathered. Also, since we believe that we are value-laden individuals, the reasons for our choices throughout the research will be described, according to Saunders et al. (2012), to give more credibility to this research paper.

Our approach is deduction, which begins by reviewing current theory (Saunders et al., 2012). For deduction to be applied, there must be existing theory. In this case, the literature is not extensive on the subject overall, but enough research exists to make the connections needed for development of our research questions. Another reason for choosing deduction is that our interest lies more in explaining the relationship and its characteristics.

The exploration of the auditor-client complex relationship is based on a traditional literature review based on the auditor-client models, considering the richness of the literature. As the ACR has been a debated issue for a long time now, conducting a literature review supports our study by delimiting research periods related to different time frames.

We approached the qualitative method of analysis because it emphasises the understanding of social phenomena through direct observation or analysis of texts and can focus on subjective contextual accuracy at the expense of generality. The aim of the study is to deal with the relationship breakdowns which are entitled in the accountancy literature as auditors' changes and auditors' switches, all related to the auditors' independence. The identified gap in literature concerns the overall perspective of ACR and the dynamics within, serving as a starting base for measuring the interactions between the two parties. To provide insight upon the mentioned interactions, there is need for thorough delimitation on the concepts and models that describe the manner in which the two parties engage in the professional relationship. The analysis covers a wide variety of environmental conditions as the models that were selected differ as period of development and geographical/economic context positioning, as the criteria for selection were focused rather on the wide use and coverage of the models in explaining the relationship.

Longitudinal approaches are used in social sciences and economics to observe the trajectory of changes in longer periods (Osinsky and Eloranta, 2014). This method is

consistent and can be adapted to our aim of providing an analysis that features the models at different moments in time. The primary strength of longitudinal research is the ability to examine shift and improvement. Consequently, this research method provides an objective examination (Menard, 2002), because it relies on observational techniques; therefore, the analysis is free of the researcher's bias. A retrospective analysis is a type of longitudinal study that studies the impact of certain elements on the development of a theory or model (Cox and Hassard, 2007), in our case, ACR models. Our research adds to the state of knowledge in the ACR by offering a clear time-based order of events (in our case, models of the relationship), which is a steppingstone to the exploration we have accomplished and perspectives for future research. We present an evolution of the ground theory that contributes to the relation auditor-client, based on the most important models of the ACR that we found in the literature, based on the number of citations. This study offers insight and crucial information about the way auditors behave in the ACR.

### 3 Results

To underline the importance of the ACR, connection improvement is analysed from a process perception; the environment, structure, and method of experiences and events are analysed. Relations are also handled as an evolutionary fact, without a priori phasing or the hypothesis of the deterministic life expectancy. The idea of improvement is utilised in its impartial sense, meaning to the development of substitute relations with their ups and downs, not overly gradual improvement only (Chen et al., 2017; Handfield, 2019).

There are several stages of an auditor-client interaction which start with their first contact and discussion about a potential audit contract and mission, presented in Table 1.

**Table 1** Financial audit process – negotiation occurrence

<i>Financial audit process</i>	<i>Auditor-client relationship negotiation occurrence</i>
Pre-engagement activities	Pre-contractual negotiation
Planning an audit	No negotiation present
Conducting an audit	Negotiation on the auditor's opinion and other elements contained in the audit report
Completion and review	Negotiation on the auditor's opinion and other elements contained in the audit report
Reporting	No negotiation present

Each phase of the audit process where an ACR negotiation intervenes is discussed below.

#### 3.1 Pre-engagement activities

During the initial pre-contracting discussions, there are aspects such as object of audit, length, risk, client history that are tackled by both the auditor and the client. Another topic of discussion, based on the above-mentioned aspects, is related to the price of the audit contract. Naturally, almost all of the mentioned elements of the contract can be the subject of negotiation. That is the first moment in the ACR that a negotiation occurs, and its focus is upon the elements of the contract. Essentially, audit pricing is influenced by the auditor size on the one hand and the negotiation that occurs in the precontractual phase on the other hand (Bonilla et al., 2020; You et al., 2021).

The precontractual negotiation that occurs between auditor and client is situated during the first step of the financial audit process (the pre-engagement activities), as it targets elements of the contract and only an agreement on the terms and a signed contract can trigger the start of the audit mission as presented in Figure 1.

### *3.2 Conducting an audit, completion and review*

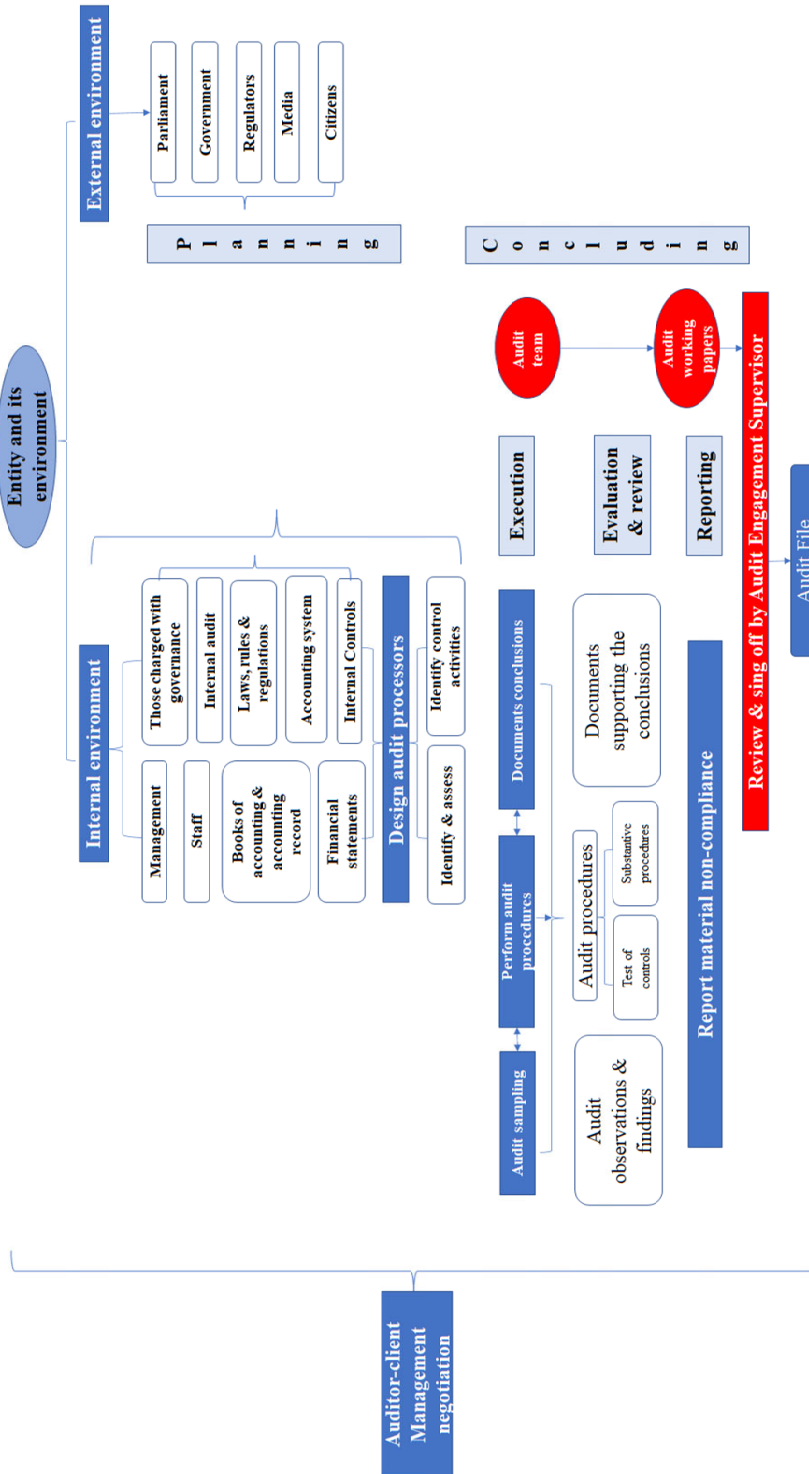
In addition, along the audit mission, there is another step and moment in which negotiations can occur among the auditor and client. In an audit procedure, established on a legal agreement, among the external auditor and client management, a negotiation about the client's financial statement intervenes, having several material accounting and disclosure implications, and frequently arises due to the unclear regulations. Nearly all negotiations resulted in an accord and were resulted in general by the confirmation of the auditor (Gibbins et al., 2001).

Accounting issues represent the negotiation over some issue(s) concerning client financial reporting and reports, generated by an incident initiating with the auditor, client management or stemming from an external change. Furthermore, the accounting result is represented by the end of the official accounting negotiation. There can be contract on one of the initially recognised or selected financial reporting results or settlement, which could involve concerns by either party, no settlement, or extension of a new resolution (Awadallah, 2018; Church et al., 2020; Salterio, 2012). This kind of negotiation occurs during the audit mission in the conducting phase as presented in Figure 1.

Figure 1 includes the phases of an audit where the type of negotiation that we research might occur. As mentioned before, there is another moment when negotiations tend to occur between auditor and client, and that is when the auditor's position toward a discovered issue is different from that of the client and has the potential to create problems for the client's management. This situation can appear during the conducting phase of the audit mission. More specifically, the time frame reported on the audit mission activities starts after the moment the auditor applied the audit procedures and has drawn conclusions until he makes observations and reveals the findings through the opinion and audit report. The main object of negotiation is the auditor's opinion and other factors contained in the audit report. Essentially, this is the negotiation that we will focus on in the development of this paper.

One of the reasons for choosing to research the negotiation that occurs during the audit mission and targets the auditor's opinion is that this negotiation is potentially more dangerous for the audit profession and what it represents than the precontractual negotiations (Bonilla et al., 2020; Dewanti et al., 2021). The potential failure of the auditor in such a negotiation has vast and very ramified implications for the aim of the audit mission, for the users of the audit report, and for the profession itself as it might affect auditor's independence, audit quality, and several other factors (Jenkins and Haynes, 2003; Salterio, 1996; Salterio and Denham, 1997). Enlightening the quality of accounting data provided to users has been of crucial attention for the accounting vocation and regulators in current years (Koch et al., 2012).

**Figure 1** Planning and conducting phase of an audit (see online version for colours)

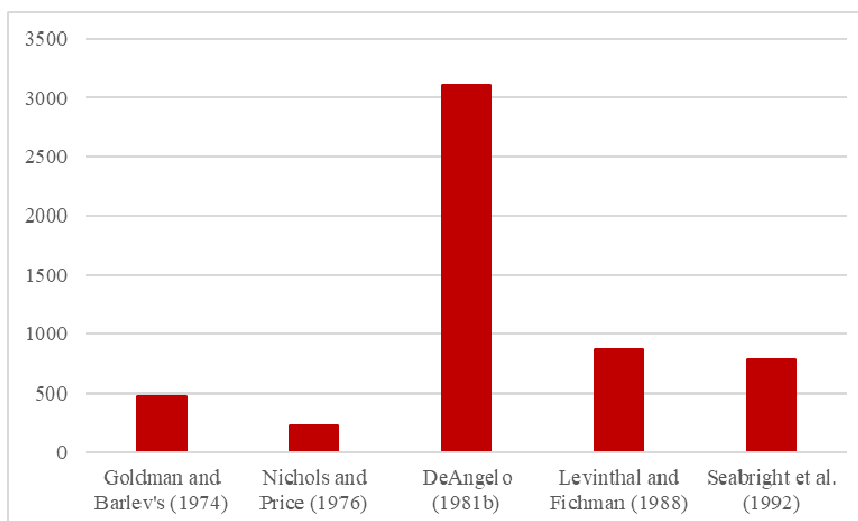


DeAngelo (1981c) describes audit quality as the common possibility that an assigned auditor will also encounter an infringement in the user's reporting procedure, and afterwards, would report that breach. Debates that have this study as a starting point are mainly linked to the relationship involving the audit firm's size and audit quality. The study states the findings that the auditor who was unsuccessful to unveil the separation or did not report that separation would lead to a diminishing of auditors' services value. As auditors receive client-particular charges, consequently, auditors who get a highly formed customer base would be greatly flat to injuries in case an audit failure occurs. Audit companies get additional motivations to offer superior audit quality based on the status of the audit companies' reputation and the auditor independence, this being directly associated to the probability of relating an infringement in client exposure. Big audit companies that receive a lesser amount of proportion as component of the income created since any specific audit mission began are additional expected to oppose the difficulties due to the client concerning the coverage of reporting gaps (DeAngelo, 1981c).

Previous research indicates that even with this condition, auditors still remain to agree to client-favoured reporting techniques when they might not be extremely suitable (Cheng et al., 2017; Holt, 2015). Consequently, understanding the reasons that impact auditors' judgements on client accounting techniques continues to remain an essential investigation question (Sin et al., 2015).

The worldwide concern in auditor cost and revenues management has remained perceptibly engineered as a result of several corporate failures relating to superior-profile and restructuring works aimed at widespread corporate governance (Brooks et al., 2019; Manita et al., 2020). To maintain and further develop audit quality, auditors would be preserved for extended times. Retaining of the auditor creates distinct indirect benefits for the company which, along with decreased costs, will have the leverage to facilitate the auditors to gain more knowledge about its business operations, its personnel, and last but not least, its core values. Nevertheless, having the auditors changed periodically diminishes the company's benefits over these different periods.

**Figure 2** Number of citation ACR models (see online version for colours)





For a better understanding of the ACR, there are several models developed in the literature, out of which, five were selected for our analysis. According to the Google Scholar citations number until March 2021 (Figure 2), these five models are most mentioned in the literature.

Below, each of them is discussed with a particular focus on the ACR.

### 3.3 Behavioural independence model – Goldman and Barlev (1974)

Three conflicts of interest can involve the auditor, with the client and its representatives on the one hand and professional standards on the other (Goldman and Barlev, 1974). The three potential conflicts of interest are determined by various causes that influence the auditor toward not complying with professional standards, leading to a breach of one's independence. The conflicts are:

- auditor-firm conflict of interest
- shareholder-management conflicts of interest
- self-interest-professional standards conflicts (Goldman and Barlev, 1974).

Each conflict or problem has a corresponding solution. To preserve one's own power, the auditor should try either to reduce management's power over them manifested through actions or lowering the range of choice in auditor's actions. However, the auditor could emphasise other actions by attempting to increase one's power by nourishing the main power source: the importance of the provided services. The importance of the services can be measured from the perspective of the amplitude of the problem they have solved and who is the beneficial party (Goldman and Barlev, 1974). Another source of resistance to client pressure is to appeal to professional ethics (Alsadoun et al., 2018). This is more effective, provided that it is well developed and 'vigorously and visibly enforced' (Goldman and Barlev, 1974).

The proposed solutions having the goal of maintaining at acceptable standards level the auditors' independence and the mode the auditing vocation is organised had multiple and various effects. Goldman and Barlev (1974) raised the perspective that the auditor, in the context of disproportionate pressure due to the force association balanced in favour of the company in case of dispute, could be successfully determined to act against the best practice of the professional standards. A proposed model has emerged as follows in Figure 3.

Based on the model developed by Goldman and Barlev (1974), the matrix (Table 2) reflects the extent of the power that a professional in audit has regarding a client. Cell 4 best represents the auditing profession.

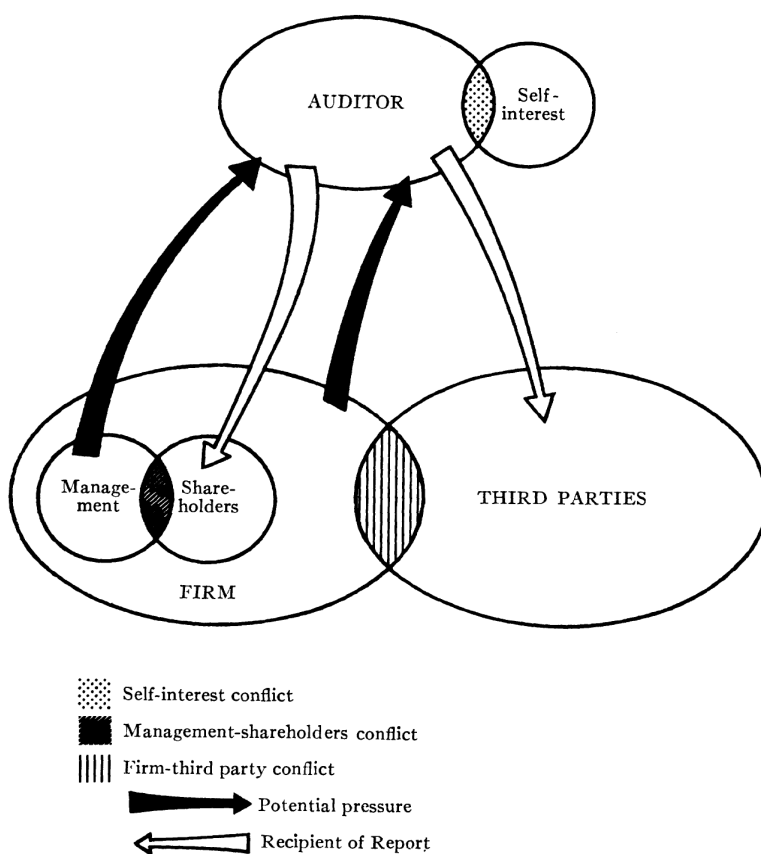
**Table 2** The capacity of influence exercised by professionals versus remunerative customers

<i>Beneficiary</i>	<i>Problem solved</i>	
	<i>Non-routine</i>	<i>Routine</i>
Paying clients	(1) highest	(2) medium
Others	(3) low	(4) lowest

*Source:* Goldman and Barlev (1974)

One of the primary determining factors for the qualification of the auditor is the statement that the auditor is primarily providing services for a third party, stockholders or creditors, and not for the entity (Alsadoun et al., 2018). Another context that leads to a high qualification of the auditor is the routine of the offered services in the case of high degree of standardised procedures, discretionary judgements applied by the auditors being reduced to a very low degree (Goldman and Barlev, 1974). The low-power relationships, according to Goldman and Barlev (1974) model, are best described by the increased performance of highly regular services destined for third parties, even if they are not paying parties. Table 2 illustrates that there is a direct association between the amount of the non-routine activities that an auditor unfolds and the extent of manifested power by the auditor toward the client; the same direct correlation is maintained between the degree of directly delivered services for the paying client and the standing of the services to the client leading increased power on auditor's behalf. According to the presented model, a shift in auditor's positioning from cell 4 to cell 1 has the primary effect of better resisting client's actions meant to determine, through pressure, the auditor to breach professional standards (Goldman and Barlev, 1974) as revealed in Figure 4.

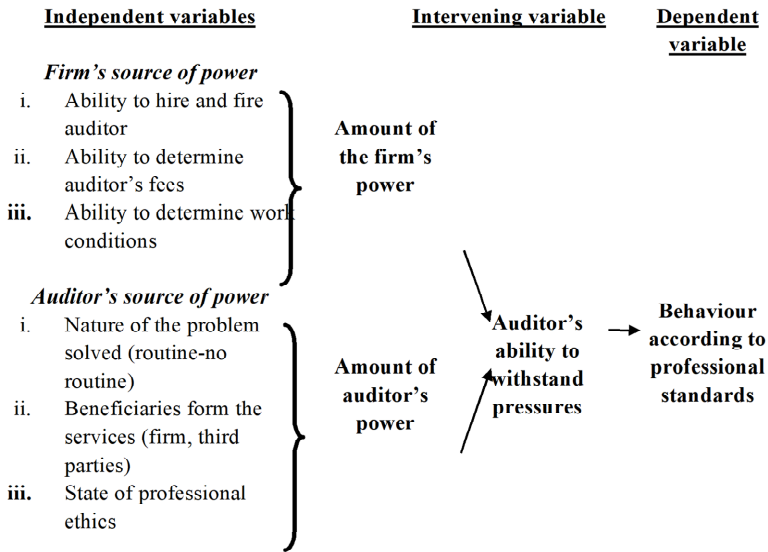
**Figure 3** Auditor firm-third parties' relationship



Source: Goldman and Barlev (1974)

As a starting point, most often, auditors are positioned on a weaker position as compared to the client’s position, the main reason being that auditors generate a product (audit report) and act in a competitive market where the threat of replacement is common (Awadallah, 2018). Goldman and Barlev (1974) argue that ethical code that is applicable to auditors as compared to non-auditors provides supplementary motivation in maintaining their power position toward their client and protecting their beliefs. This increased motivation to persevere in their beliefs is most often encountered in large firm auditors, provided that the environment ensures an optimal combination between power and ethics (Alsadoun et al., 2018).

**Figure 4** Behavioural model of independence



Source: Goldman and Barlev (1974)

The foregoing power relationships’ analysis point out a power asymmetry toward the firm for the reason that the traditional sources of professional power are lacking in auditing. Conversely, as long as third parties’ actions are of major importance to the firm and these actions have a determining factor to some extent in the auditor’s report, then it is confirmed a strong incentive exists for the firm to exercise its power to obtain a more favourable report (Goldman and Barlev, 1974). Consequently, if the auditor’s ability to stand firm to such pressures is limited, the pressures to infringe professional rules of conduct are intrinsic in the firm-auditor relationships. We advocate having this specific feature of the auditing role justify the reason for the continuity of the independence issue, which is an essential issue in auditing (Goldman and Barlev, 1974).

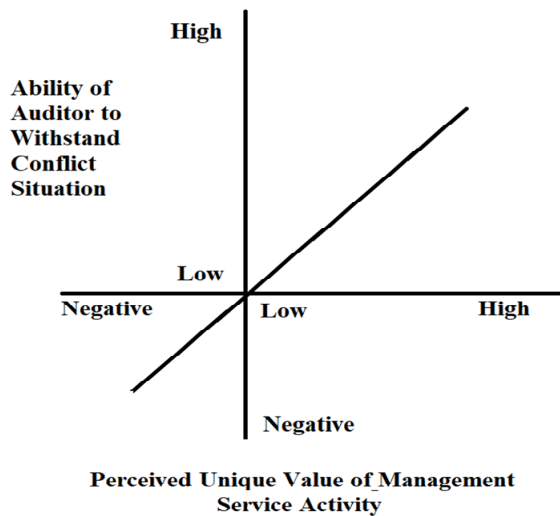
### 3.4 Nichols and Price (1976) exchange theory model

Nichols and Price (1976) examined the presumption of Goldman and Barlev’s (1974) model by applying behavioural skill concepts such as exchange theory and the significant interest for the questions related to the chance for the auditor to accept firm requirements based on balance power toward the firm, to the factors that potentially cause such

imbalance, and to the presumed changes in the ACR that could have the potential of decreasing the chance of auditor accepting firm requirements provided those are made.

Previous research usually suggests that the user's capability to manipulate the auditor's decision reduces as the amount of routineness or form fundamental in that opinion improves. Nichols and Price (1976), as an example, assert that with decidedly repetitive or organised auditing actions and accountancy values, the company would be excluding probable to compression the auditor. They similarly state that the fewer structures essential in the significant practical standard, the less probable the auditor is to obey the management strains. One out of not so many empirical studies concerning audit conflict (Monger, 1981) yielded results usually supporting the Nichols and Price (1976) assertion regarding the probability that management will try to manipulate its audit firm's professional judgement. Moreover, the higher management's performance is, also the higher is the importance of all auditor's provided services, leading to an increased firm dependency toward the auditor; Nichols and Price (1976), based on the previous assumption, manage to describe the relation linking management's performance and auditor's independence (Figure 5).

**Figure 5** Relationship of management service activity to audit independence



*Source:* Nichols and Price (1976)

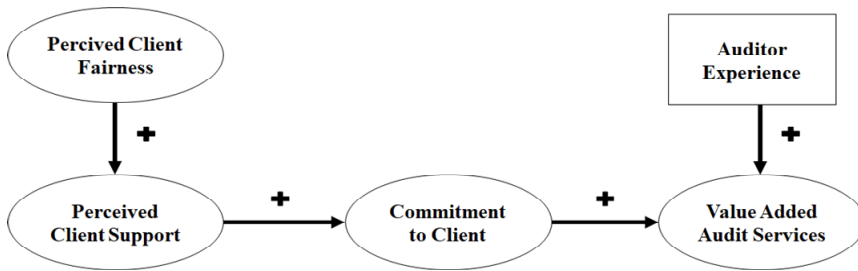
Based in the relationships of Emerson (1962) with a power-dependence character and to counteract auditor-client perspective explored in previous paragraphs, Nichols and Price (1976) show that the higher the character of routine regarding auditor's services, the higher ability to face threats of replacements does the auditor have. Moreover, after Emerson (1962), the relationship between auditor and client has been resumed in two equations that capture the interactions and power balance (Nichols and Price, 1976).

“ $P_{ab} = D_{ba}$  – the power (P) of the firm (a) over the auditor (b) is equivalent to the dependency (D) of the auditor (b) on the firm (a)

Pba = Dab – the power (P) of the auditor (b) over the firm (a) is equivalent to the dependency (D) of the firm (a) on the auditor (b)”

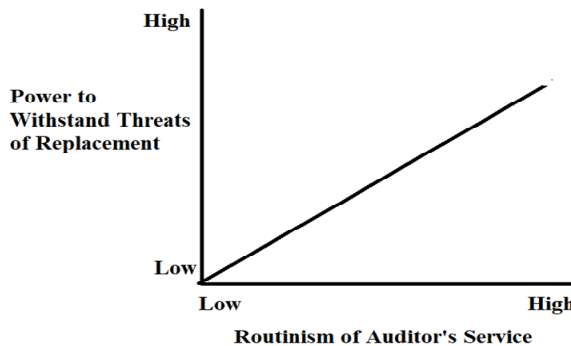
Two aspects act as a firewall protecting the auditor against external pressures: highly routine applied procedures and accounting principles prevent the client from pressuring the auditor, and vice versa, positively determine the auditor to maintain own position contrary with client’s expectations (Herda and Lavelle, 2013a). Another motivation to act so is the balance that leans in favour of succeeding guilt and potential sanctions as compared to the possible gains generating from the contrary approach (Dodgson et al., 2020). However, exchange theory further implies that, based on the dedication that auditors have toward the clients, benefits the last, as auditors feel indirectly morally constrained to deliver an increase value of their services (Herda and Lavelle, 2013b). This relation is described as shown in Figure 6.

Figure 6 Model of value-added audit services



Source: Herda and Lavelle (2013b)

Figure 7 The relation between power and degree of routine of attest function



Source: Nichols and Price (1976)

A further analysis of Nichols and Price (1976) and Goldman and Barlev’s (1974) approach toward the auditor-client conflicts reveals similarities between the two. On the other hand, a significant difference can be seen in the perspective of auditor power: the Goldman and Barlev (1974) model sustains a lower auditor power in the presence of routine regarding the audit function considering the hypothesis that the source of power lies in the auditor’s professional expertise while Nichols and Price’s (1976) model states that, oppositely, a higher degree of auditing and accounting procedures creates a routine

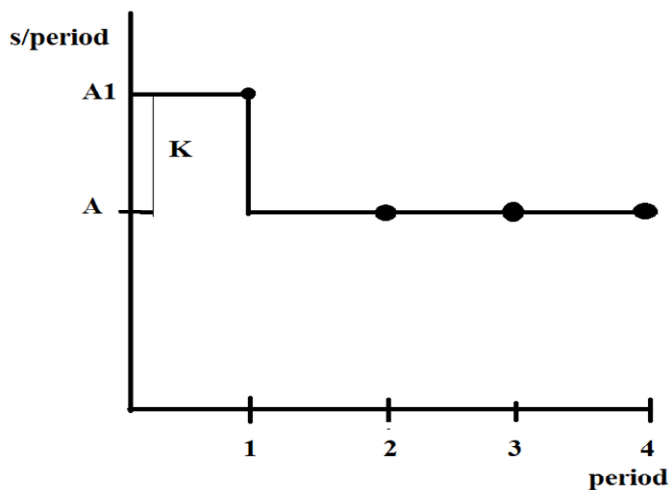
context, which leads to increased auditor power. The suggested anterior point of view in the second previous model is that the connection between auditor's capability to resist pressure and the audit function routine degree is actually an inverse one as shown in Figure 7.

Both previously mentioned models essentially start from the same common grounds, yet in routine cases, the models sustain arguments either in favour of or against routine audits (Goldman and Barlev, 1974) or desire through their suggestions to obtain the opposite effect.

### 3.5 DeAngelo's (1981a) low-balling model

DeAngelo (1981a) sought to describe the balance fee of audit services and the size of the ACR in reaction to changes in the regulatory environment. In analysis of the nature of audit services, the idea has arisen that individuals who act from their own interest are motivated to collect the benefits auditing has to offer using the division of any arrangements that internalise any externalities (DeAngelo, 1981a). Starting from this idea, if the owners do internalise both the costs and benefits that contracted auditing provides, a conceptual comparison leading to high similarities could be made between the decision-making process of contracting auditing services and any other investment decision made by the entity. DeAngelo (1981b) develops a "model of intertemporal audit pricing when incumbent auditors possess cost advantages over competitors in future audits of a given client." As an adequate counterforce to the advantages of client-specific learning by doing, market competition for audit services and positive transaction costs of auditor rotation, is, according to the presented approach, 'low-balling' (DeAngelo, 1981b). More specifically, at the moment when incumbent auditors add quasi-rents to their income, the phenomenon of low-balling occurs as a result of the competition among the auditors (Figure 8).

**Figure 8** Audit costs per period



Note: A – audit cost per period, K – start-up cost in period and  $A1 = A + K$  is the audit cost in period 1.

*Source:* DeAngelo (1981b)

From a competition perspective, a disproportion is seen in the case of successive audits between incumbent auditors having the upper hand against prospective new auditors due to start-up and transaction costs in the case of new auditors. Nevertheless, anticipating seizing quasi-rents on successive audits results in low-balling in the first audit period as a necessary approach (DeAngelo, 1981b).

Bigger audit companies are negatively linked with unrestricted ‘low quality’ accruals. Apparently, this outcome results from greater expertise (effectiveness) on the one hand and more solid inducements to overstate reports on the other hand (DeAngelo, 1981a). Auditor size outcomes do not classify whether improved recognition capability or better reporting reasons involve overstating reporting. Investigations concerning auditor charges and tenure offer data to determine the impacts of finding capability in opposition to reporting inducements. Inevitably, superior audit charges are absolutely interrelated with auditor expertise and thus with recognition capability, but they are similarly negatively related with auditor independence, and accordingly, with decreased reporting reasons (DeAngelo, 1981a). The predominance of data indicates that above-average audit charges simultaneously with extended auditor tenure are associated with a higher level of quality (or, in any case, not linked with lower quality). This evidence apparently indicates that the impact of the discovery ability controls the independence interests on regular audits. Findings attempting to analyse the independence interests, sustain this assumption certain that the proof of the circling gate procedure and non-audit charges is unconvincing and that independence is a major interest (You et al., 2021).

According to DeAngelo (1981b), auditor-client independence provides benefits as it leads to increased motivation for the auditors and clients to ensure through their contract the likelihood of taking advantage of the potential benefits. Specific factors, exogenous in nature, that occur when providing audit services negatively affect auditor independence by generating a material financial interest on the client’s behalf:

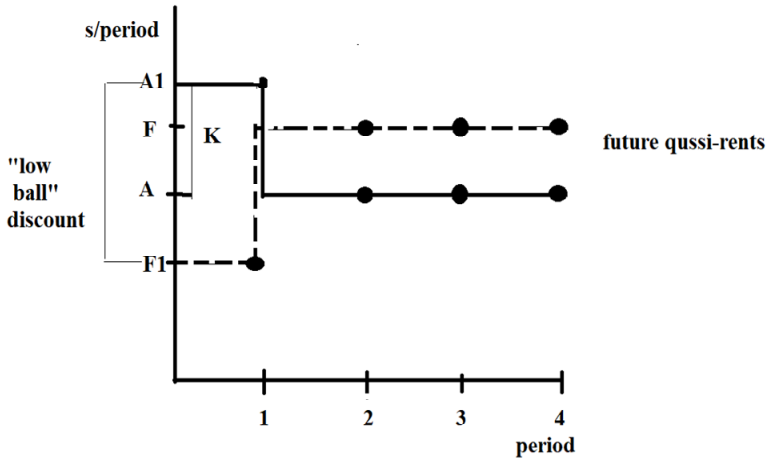
- “learning-by-doing advantages increase;
- the transaction costs of changing auditors increase” (DeAngelo, 1981b).

Smaller audit companies on the one hand and regulators on the other hand stress that audit quality is not directly influenced by audit firm size, thus being an irrelevant criterion in the auditor selection process. Contrary to this view, DeAngelo (1981b) states that audit quality is not entirely independent of audit firm size, even in the case where auditors originally possess equal technological capabilities. Auditors with a wider portfolio of customers have more to lose by being unable to report a revealed gap in a specific client’s data in a situation where incumbent auditors receive customer-particular quasi-charges. As a justification for planned capital transfers from clients and larger audit firms, smaller audit firms have used the idea that audit quality is not linked to auditor size. Nevertheless, in the case where appointee auditors receive client-detailed quasi-rents, a dependency relationship exists between audit quality and auditor firm size (DeAngelo, 1981b).

To seize the initial audit, the bids will be pushed by auditors until no profit remains to be expected. Consequently, low-balling occurs in this case as well, leading to maintaining initial fees lower than production costs for market equilibrium, as revealed in Figure 9 (DeAngelo, 1981b). Figure 9 summarises how the equilibrium of fee structure works over a four-period time span. The named future-quasi rents are equal to the discounted

occurred low-balling in the condition of equilibrium when auditors have zero profits. Furthermore, higher future rents cause auditors to extend to a maximum the low-balling approach necessary for obtaining those rents (DeAngelo, 1981b).

**Figure 9** Audit charges and audit amounts each period



Note: A – audit cost per period, K – start-up cost in period,  $A1 = A + K$  is the audit cost in period 1, F – future audit fee and F1 – audit fee in period 1.

Source: DeAngelo (1981b)

DeAngelo (1981b) demonstrates that ‘low-balling’ ensures non-damage independence, being more a reasonable answer to the prospect of potential quasi-fees to mandatory auditors (due, e.g., to scientific benefits of responsibility). ‘Low-balling’ in the preliminary time is represented by auditors’ competition for these improvements, having the preliminary cost decreases dropped in coming periods and thus not having an influence on the auditor’s independence.

The occurrence of these benefits is caused by considerable start-up charges in audit knowledge on the one hand and transactions charges of substituting auditors on the other hand. Having incumbent auditors seize these advantages allows them to raise upcoming audit charges over the preventable prices of making audits, that is, earning client-particular quasi-charges. The expectancy of client-detailed quasi-fees to compulsory auditors has two major consequences: implying that the best flat of auditor independence, is fewer than seamless independence, and rivalry for the property honesty to tenure leads auditors to ‘low ball’ in the preliminary period (DeAngelo, 1981b).

### 3.6 Levinthal and Fichman (1988) auditor-client attachment model

Levinthal and Fichman (1988) focus their research on interorganisational relations, measuring their dynamics and time dependence phenomena. The authors focus on research based on the ACRs’ empirical background as well as corporate annual reports, Moody’s financial manuals, Standard and Poor’s corporate descriptions, and *Who Audits America* (Harris, 1976–1986). The authors conclude that there is a positive duration



dependence included in these attachments, although it decreases over time and could be compared in initial stages as being the ‘honeymoon’ period.

The main focus is on the specific elements of attachment that surface exclusively as an effect of the previous history of the relationship. Such assets could include well-grounded statement summaries and the expansion of trust among those persons caught up in boundary-spanning characters, information of the individualities of a company’s accountancy system, and considerate of the produce market of the client to predict the probable value of inventory. Levinthal and Fichman (1988) state that a qualified opinion consists of a pointer of conflict inside the ACR. Right after the introduction of an ACR, the likelihood of conflict and hence the prospect of qualified opinion is rather low. With the passing of time, perhaps, original good-will diminishes and the probability of conflict increases. However, relationships with a survival span of more than a few years are expected to have low levels of conflict, and thus a low occurrence of qualified opinions. Finally, it is of high importance to recall that the period dependence associated with the relationship ending does not purely mirror the duration dependence of qualified opinions.

A similar approach to Levinthal and Fichman’s (1988) research is the work of Cook (1977) and Cook and Emerson (1978), through which suggestions were made stating that attachments that build up over time tend to ease the calculus of influence and dependency implied by static analyses. Cook (1977) considers that “firm attachments or commitments often develop between exchange partners due to the investments made and the costs involved in establishing and maintaining the relationship. The attachment or commitment serves to prolong the exchange and tends to limit the mobility of the exchange partners.”

In sum, a client and auditor could have a long-term relationship, but an alteration right in the client’s top management might mitigate the significance of that prior history of relations.

### *3.7 Seabright, Levinthal and Fichman – dissolution of interorganisational relations model*

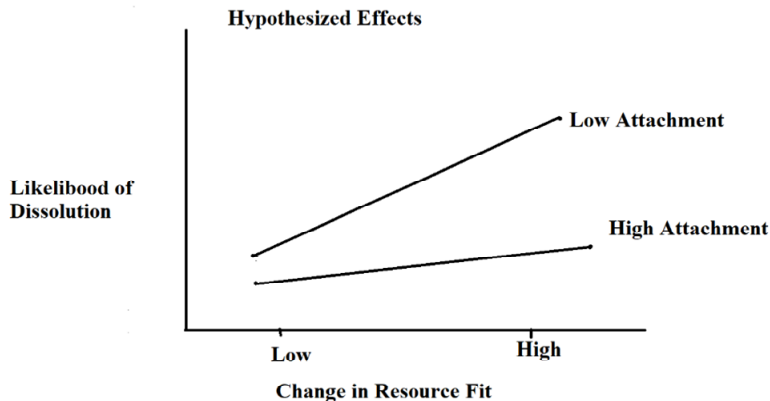
Interchange interactions involving organisations are come to be a significant subject in exploration with reference corporate policy on the one hand (Hladik, 1985) and organisational theory on the other hand (Powell, 1991). An exchange correlation consists of a proper or unofficial collection of agreements among organisations concerning the reassignment of sources or essential services. To ensure the exploration of relationships of this kind, the focus of the researchers was on causes of their development, and to a larger level, on matters of strength and dependence in current associations (Emerson, 1962).

As Seabright et al. (1992) show, relationships are founded on the individual and organisational amounts and ties of ACRs. At the individual level, the ties are based on personal skills and knowledge or interpersonal relationships, while organisational ties rely on arrangements formal or standard exchange and procedures regarding the management of inter-organisational transactions.

According to Salancik (1977) and Staw (1982), a connection is defined as the attachment of one group to another. Furthermore, a connection represents a counterforce to alter sooner than the force for shift. A connection among discussion affiliates accumulates throughout practice in the trade associations and also is a consequence of venture capital made by discussion associates in the association over period. Having

attachment developed could have an advantage to keeping a current affiliation, although it offers less of the required supplies than it applied to or still though an available option presents higher attractiveness. As Figure 10, attachment might soothe the impacts of variations that influence supply fitting on the probability of a connection dispersing.

**Figure 10** Changes influencing resources



*Source:* Seabright et al. (1992)

Sufficient evidence exists that these relational and interorganisational administrative are required to offer substantial advantages to both partners and to make obstacles to change. Seabright et al. (1992) debate that shifts keen on the assets get an influence on the ACR and take the lead to the ending of their interactions. Nevertheless, they argue that the personal and fundamental connections created with conversation associates around schedule will reduce this force for adjustments. They describe that adjustment in clients' assets takes to increase the probability of their shifting auditors, however the connection of people mainly liable for the trade association reduced the probability of changing.

Though we need understood these assumptions in provisions of the relations among auditors and their clients, it would seem that broadly a combination of transactional, supply fit, and fixity concerns motivate provider-consumer relations. Consequently, according to Seabright et al. (1992), parties will be linked by the spirit of the upcoming on one hand and the embeddedness of the relationships on the other hand, while the created ties act as counterforces to change contributing to a decrease in alternative orientation in case matched inherent quality is reduced.

#### 4 Conclusions

Currently, the audit has become a complex, interactive, and judgemental process requiring a high level of technical knowledge, integrity, and interpersonal skills from the audit engagement partners. As a consequence, the audit profession continues to face multiple, complex challenges. However, the investors and markets rely on the ability of the profession to overcome these obstacles. As in the past, the profession will do so, meeting not only the known challenges but also the unknown as they unfold.

Following the existing analysis of the models in the literature, we found no model including all the factors we found in various models. Therefore, we mapped these models in Table 3 to provide an overview of the factors used by each model.

**Table 3** Identified factors

<i>Models</i>	<i>Factors</i>							
	1	2	3	4	5	6	7	8
Auditor-client relationship models								
Goldman and Barlev (1974)		x			x	x		x
Nichols and Price (1976)		x			x	x		x
DeAngelo (1981b)	x	x		x	x	x		x
Levinthal and Fichman (1988)		x			x	x	x	
Seabright et al. (1992)		x			x	x		

Note: 1: audit quality, 2: auditor's independence, 3: audit firm/partner rotation, 4: non-audit services, 5: audit profession between public interest and private interest (conflict of interests), 6: regulations, 7: auditor's trust and 8: competition and client pressure.

Moreover, acknowledging the significance of the relationship between the auditor and the client only provides a better perspective on the means and extent to which this influences the negotiation process. Synthesising the analysed models and the main ideas that stand out of each one materialises in a holistic perspective, for both auditors and clients, allowing them to have more realistic expectations toward the negotiation process, thus, being better prepared for it. The question remains how this translates in concrete benefits for the auditing profession. Having improved audit quality as the outcome of the negotiation is better since the parties know what to expect and can approach it in a manner that is constructive, reaching one of the secondary goals of this paper.

The length and the quality of the relationship are good indicators of how the negotiation will proceed and also which model better explain and predict the relationship, considering other contextual factors. In a longer relationship, certain conditions may be preset, such as having each party adopt a more fixed and firm position regarding its role in their overtime interaction with the other party.

The models previously shown have been selected from the literature as being the most relevant for our research as they provide a different and complementary perspective on the ACR. After presenting the models, an analysis is compulsory to determine the common points and differences between the models. Furthermore, based on the determined criteria, the models are selected that we will continue to apply to develop our research.

Regarding the similarities that can be observed between the models, the major one is that all five presented models interfere, indirectly, by the way they comprehend the functions of the interaction between the two parties, with three out of the following eight ACR factors of influence: audit quality, auditor's independence, audit firm/partner rotation, non-audit services, audit profession between public and private interest, regulations, auditor's trust, competition and client pressure. The factors that are addressed by all the models include auditor's independence, the audit profession between public and private interests, and regulators. As we observe, the five models are all sensible to the legal framework as it defines the limits under which the auditor and the client can act. Moreover, the models are all connected to the struggles of the profession between

maintaining its standards and fulfilling client's needs and desires. In the end, the models reflect and impact upon the auditor's independence. This independence factor is the third common factor addressed by all the models as it is the most often challenged – every time the client sustains and asks for a different solution than the one the auditor has, professional independence is put to test.

Goldman and Barlev's (1975) behaviour model of independence and Nichols and Price's (1976) exchange theory cover the same four factors: auditor's independence, audit profession between public and private interest, regulators and competition. The authors essentially reach the same result, the main difference consisting of the mode from which they approach the relationship, starting from the behaviour the parties have as compared to the manner in which the auditor is capable of holding own position influenced by the degree of routine. Levinthal and Fichman's (1988) auditor-client attachment model and Seabright et al. (1992) dissolution of inter-organisational relationships model are quite similar from the perspective of factors that are reached through the perspective and approach of the model. Seabright et al. (1992) reach the following three factors: auditor's independence, audit profession between public and private interest and regulators. On the other hand, the model developed by Levinthal and Fichman (1988) reach the same three factors with one in addition: auditor-client trust.

Therefore, based on the widest perspective and compelling approach from the reached factors criteria, it is the model developed by DeAngelo (1981a), the contractual relationship model that reaches no less than six of the total of eight factors, making it the most suitable from this perspective. To summarise DeAngelo's (1981c) perspective, it can be stated that it is a contractual relationship "model of intertemporal audit pricing when incumbent auditors possess cost advantages over competitors in future audits of a given client."

Another criterion we applied to analyse and differentiate the models found in the extant body of research is the number of citations each model has in the literature. The reason for this approach is that the interest manifested toward a certain model offers insight toward how versatile it is to explain and define the ACR.

From the number of citations, DeAngelo (1981b) model is by far the most cited and therefore appreciated in the literature. The closest two models are Levinthal and Fichman's (1988) auditor-client attachment and Seabright et al.'s (1992) dissolution of interorganisational relationships, yet they do not match up to the numbers of factors that are contained by this model's perspective.

Considering both the criteria of the number of factors reached by a certain model and the number of citations it has in the literature, DeAngelo's (1981a) contractual relationship model consistently differs from the others, thus making it the one with the best chance of realising a holistic synergy with an auditor-client negotiation model, and potentially to be used in further research.

Based on the current published literature, the ACR can be explained from a holistic perspective. The overall phenomenon under study – the ACR – is understood as a complex system that is more than the sum of its parts. The focus is on complex interdependencies and system dynamics that cannot be reduced in any meaningful way to linear, cause-and-effect relationships or a few discrete variables.

This study has its' main focus only on the ACR and also reveals argue that the auditor is potentially involved in three conflicts of interests: auditor firm, shareholders-management and self-interest conflict (Goldman and Barlev, 1974). This conflict

represents various sources of pressures on the auditors to produce a report not according to the profession requirements but to other interests, so it represents a potential threat to own professional independence. So as a future development of our study there is room to analyse the impact of the different conflicts of interest on the ACR.

These findings represent an initial list of factors meant for inclusion into a framework for determinants of auditor-client negotiation model. However, the challenge is to determine a model that can be applied for a young audit profession country, taking into consideration also the social and political aspects and be carried on in our future research. Therefore, the natural way of analysis was to start with the ACR models and prepares for future research the analysis of the auditor-client negotiation models with the ultimate goal to identify the factors that can generate influence upon the ACR. Based on these findings, we want to develop and advance, as a distinct research as it would be to extensive put together, a holistic model for the auditor-client negotiation relationship adapted to the specifics of a young auditing profession country.

The research presents comprehensive multilevel models of the determinants of the ACR. The difficulty with an effort like this is that there are inevitable issues and concerns, perhaps even whole bodies of literature, that have been ignored. Therefore, our concern was to do what we could to make an impossible task manageable. We hope to have shed new light on critical issues facing the ACR. Consequently, the principle of independence is one of the central professional duties of the auditor. Both the auditor and the client must be aware of the auditor's responsibilities. There are several managerial and practical implications of this model for research in interorganisational negotiation. Since financially distressed clients are more likely to switch audit firms, smaller auditors would be more reluctant to qualify their reports or show disagreement with their clients for fear of being dismissed and losing a client. The implication of this finding is that this audit-client relationship can impair auditor independence and weaken audit quality. This in turn has important implications for policy makers since auditor independence may be impaired due to unhealthy competition among the audit firms.

Auditors need to consider ways in which they can develop the psychological bond with their clients. This bond is the basis for the client to believe that the audit firm is superior to others, which has been found to lead to behavioural loyalty in this study. In particular, the management of the auditor brand and reputation, the personal experience of the audit firm, and alumni relations are discussed as ways to improve the psychological bond among client executives. Another practical implication may be that audit firms would benefit from assigning auditors with greater negotiation experience to negotiate with clients who are known to be contentious during auditor-client negotiations.

This research has several limitations, but in this way, we can open a new way for new research. Firstly, we consider that a culture characteristics approach would shed more light on this topic, were not included in our analysis. Second, we have not analysed the effect of different factors on the ACR, we just identified them. Third, we did not consider the types of audit opinion and how the receipt of a qualified opinion could affect the decision to switch or retain the audit firm. Therefore, future studies should consider such variables in models to improve our understanding of the audit environment in different countries and different cultures.

This topic involves various research perspectives. These views include a more detailed analysis regarding the auditor-client concept and the relationship between these factors at the micro level in the context of corporate governance in a different cultural

context, for example, in countries with emerging economies and those with a former centralised economy.

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