Advances in Accounting xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Advances in Accounting

journal homepage: www.elsevier.com/locate/adiac

# The impact of self-deception and professional skepticism on perceptions of ethicality[☆]

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ARTICLE INFO

*Keywords:*
Self-deception
Professional skepticism
Ethicality
Perceptions

ABSTRACT

This paper examines the impact of two contradictory psychological traits, self-deception (SD) and professional skepticism (PS), on individuals' assessment of ethicality of various earnings management choices. Whereas, SD allows individuals to reduce cognitive dissonance arising from self-serving unethical behavior, PS would force individuals to question such self-serving behavior and, as a result, could make them less likely to act unethically. Our results indicate that SD, PS, and participant type significantly affected the participants' ethicality ratings. Managers exhibiting high (low) SD and low (high) PS view the earnings management techniques that were generally considered to be unethical, as relatively more (less) ethical. However, the SD and PS scores of accountants are not significantly related to their ethicality ratings. This result could be driven by the fact that accountants tend to have greater exposure to information that emphasizes ethics (professional standards and education) and hence psychological traits have a lesser effect on their ethicality ratings.

## 1. Introduction

Prior research has investigated how business factors such as management compensation plans, competition, need to raise funds, weak internal controls etc. have created pressures and opportunities which in turn have resulted in fraudulent behavior in a business context (Hogan, Rezaee, Riley, & Velury, 2008). However, there is still a great deal that we do not know about why a specific individual will engage in opportunistic behavior while another individual in the same organization—facing similar pressures and opportunities—will not. This study addresses that gap in the literature by examining two psychological traits that could help us understand and predict an individual's perceptions of various earnings management scenarios.

This paper examines how two psychological traits; self-deception (SD) and professional skepticism (PS) affect individuals' assessments of the ethicality of various earnings management choices. Self-deception allows individuals to reduce cognitive dissonance (Festinger, 1957) arising from their self-serving behavior which could be unethical (Audi, 1988; Sanford, 1988). Professional skepticism or trait skepticism (Hurtt, 2010) on the other hand, would force individuals to question such self-serving behavior and, as a result, could make them less likely to act unethically. Therefore, it would be interesting to investigate how these two relatively contradictory traits affect perceptions of the ethicality of different types of business transactions.

Very little research till date examines how an individual's predispositions or traits affect perceptions related to the ethicality of earnings management. We argue that the relatively sparse literature in this area may be, at least in part, due to the difficulty in measuring the potential psychological traits that could predict individuals' propensity to act unethically. We add to the existing literature by identifying two instruments namely the Self-Deception Scale (Paulhus, 1986) and the Professional Skepticism Scale (Hurtt, 2010) which could help in measuring the participants' psychological traits that could help us in understanding their propensity to act unethically.

SD involves the invention of reasons, true or untrue, which render one's current attitudes, beliefs, or actions an appearance of acceptability and, also providing an explanation for one's attitudes, beliefs, or actions when the true explanation is something very different (Pennelhum, 1966; Sanford, 1988). Based on these definitions, it can be assumed that individuals who are more likely to self-deceive themselves are more likely to experience less cognitive dissonance after committing an unethical act. This in turn would make the high SD individuals more likely to act unethically. Additionally, the concept of SD appears to be one of the primary factors that lead to rationalization which is one the three fraud risk factors mentioned by SAS No. 99. For example, Batson, Kobrynowicz, Dinnerstein, Kampf, & Wilson (1997); Batson, Thompson,

☆ We would like to thank the participants of the AAA Western Region Meeting (Seattle 2016) and Dr. Dennis Caplan for their insightful comments on this paper.
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http://dx.doi.org/10.1016/j.adiac.2017.04.002
Received 9 December 2016; Received in revised form 4 April 2017; Accepted 10 April 2017
0882-6110/ 

Seuferling, Whitney, & Strongman (1999) argue that the ability to deceive one's own self may be important to the goal of deceiving others. Therefore, in this paper, we examine if there is a negative relationship between individuals' SD scores and their ethicality ratings of various transactions.

According to Hurtt (2010), PS comprises of six major characteristics: a questioning mind, suspension of judgment, search of knowledge, interpersonal understanding, autonomy, and self-esteem. Based on the characteristics of PS as defined by Hurtt (2010), it appears that while SD allows people to act unethically without feeling dissonance, PS could prevent individuals from acting unethically by making them question their actions. Therefore, we examine if a relatively higher level of PS is positively related to perceptions of ethicality. Additionally, we also investigate the relationship between the level of SD and PS observed among our participants. Considering the contradictory nature of the two traits, we specifically examine if relatively higher levels of PS are observed in conjunction with relatively lower levels of SD and vice versa.

We conducted a within-subjects experiment where participants were first asked to answer questions on the SD (Paulhus, 1986) and PS (Hurtt, 2010) scales and then they were asked to rate the ethicality of ten earning management scenarios. The earnings management scenarios were adapted from Bruns and Merchant (1990) and the numbers were adjusted to exhibit current business context. We got usable responses from one hundred and three mid-level managers from three of India's largest companies and seventy-seven Chartered Accountants (CA)[1] employed by two Big four accounting firm in India. The ten earnings management scenarios varied in terms of ethicality and the overall results indicate that participants exhibiting high (low) SD and low (high) PS view the earnings management techniques that were generally considered to be unethical, as relatively more (less) ethical. The results indicate that the participant type (CA versus Managers) had a significant effect on the ethicality ratings. Therefore, we separated the CA data from the manager data to conduct further analysis.

The overall results for the manager data indicate that participants exhibiting high (low) SD and low (high) PS view the earnings management techniques that were generally considered to be unethical, as relatively more (less) ethical. However, the results related to the CAs indicate that their SD and PS scores are not significantly related to their ethicality ratings. This result appears to be driven by the fact that CAs tend to have greater exposure to information that emphasizes ethics such as their professional standards and education and hence psychological traits did not affect their ethicality ratings. The CAs also rated the relatively more unethical transactions (accounting based) to be significantly more unethical than the managers. Additionally, the CAs exhibited relatively higher PS and lower SD than the managers, and their SD scores were also significantly negatively correlated with their PS scores.

## 2. Literature review

Relatively few studies have examined characteristics that could induce individuals to engage in unethical practices in a business context. Ponemon (1992) and Abdolmohammadi, Read, and Scarbrough (2003) suggest that characteristics of cognitive thought processes have a significant impact on accountants' perceptions of ethicality. In an accounting context, Stevens (2002), finds that managers who believed lying was unethical were less likely to produce false budgets that favored them and adversely affected the overall organization. Evans, Hannan, Krishnan, and Moser (2001) reported that the likelihood of honest reporting is related to perceptions of the fairness of payoff outcomes. Olsen, Dworkis, and Young (2013) and Majors (2016) report a positive link between Narcissism and aggressive financial reporting. Murphy (2012) indicates that individuals exhibiting higher levels of MACH experience relatively less cognitive dissonance and hence are able to rationalize their wrong actions with relatively more ease. This in turn makes high MACH individuals more likely to act unethically. We intend to add to this stream of literature by identifying two additional factors namely SD and PS, which could further our understanding of how personality traits could explain the propensity to indulge in unethical behavior.

According to research in social psychology, an individual's intentions are indicative of the likelihood that they will engage in a particular behavior (Ajzen, 1991; Ajzen & Fishbein, 1977; Fishbein & Ajzen, 1977). These intentions are also closely related to perceptions (i.e., beliefs) about behavior (Cherry & Fraedrich, 2002; Pan & Sparks, 2012). Additionally, the criminology literature suggests that an interaction between personality characteristics and organizational factors (e.g., an individual's role within an organization) contribute to improper behavior (Kelman & Hamilton, 1989; Sutherland & Geis, 1949).

Thus, we argue that individuals who perceive questionable or aggressive accounting practices as ethically acceptable may be more likely to engage in such practices in the future.[2] Research also indicates that the propensity to act in a corrupt and self-serving manner tends to escalate over time (Zyglidopoulos, Fleming, & Rothenberg, 2009). Prior research also indicates that companies where financial fraud has been discovered are more likely to have aggressively managed earnings in the years leading up to the year in which the fraud is uncovered compared to similar companies which, have not been the victim of a fraud (Perols & Lougee, 2011). Therefore, identifying individuals who are more likely to engage in unethical or self-serving behavior a priori, could be useful; in designing appropriate training programs and control systems, or in hiring and/or promotion decisions. Thus, it is important to understand the factors that affect an individual's propensity to aggressively manage earnings.

### 2.1. Self-deception

Neutralization and cognitive dissonance theory suggest that the likelihood that an individual will employ techniques of neutralization to justify their actions primarily depends on the situation rather than the person (Festinger, 1957; Sykes & Matza, 1957). For example, the extent to which the particular action is considered to be unethical is driven by social norms or concerns about punishment and conflict. However, certain social psychologists suggest that an interaction between individuals and situations accounts for more variance in behavior than either on its own (Bowers, 1972; Argyle & Little, 1972; Endler, 1973; Baker, Hunt, & Andrews, 2006; Taylor & Pattie, 2014).

Consistent with this perspective, in a business context, Murphy and Dacin (2011) suggest that situational factors and ethical climate within an organization interact with personality traits to affect the likelihood that an individual will engage in fraudulent financial reporting. Moore, Tetlock, Tanlu, and Bazerman (2006) suggest that the nature of relationship between the auditor and client could “morally seduce” auditors to serve their client best interests. Similarly, Herron and Gilbertson (2004) indicate that the inherent traits of the auditors interact with the type of audit standards (rules based versus principles based) to affect auditors' client acceptance decisions. Based on this research it can be deduced that individuals may possess traits or characteristics that, in certain situations, will significantly affect their behavior. In the earnings management context, we argue that one such

[1] The Chartered Accountant in India is the equivalent of the CPA in the US. In most commonwealth countries like Australia, UK etc. public accountants are referred to as Chartered Accountants rather than Certified Public Accountant like in the US.

[2] This study examines ethical behavior in an indirect manner. However, based on prior research (Ajzen, 1991) it can be inferred that such an indirect measure could be a reasonable proxy for the actual propensity to behave in a particular manner.