ETHICAL CLIMATE, THE PERCEIVED IMPORTANCE OF ETHICS AND SOCIAL RESPONSIBILITY, AND EARNINGS MANAGEMENT

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ETHICAL CLIMATE, THE PERCEIVED IMPORTANCE OF ETHICS AND SOCIAL RESPONSIBILITY, AND EARNINGS MANAGEMENT

by
LAM Mo

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ABSTRACT

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by

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Master of Philosophy

The practice of earnings management not only adversely affects the long-term economic prospects of a particular business enterprise by eroding public confidence in the company, but also may severely undermine the reputation of Hong Kong as an international financial and trading centre. Given the devastating effects of such practices resulting from corporate scandals such as Enron and WorldCom, earnings management has received unprecedented attention in the past decade. The incommensurability between the far-reaching effects of ethical issues relating to earnings management and the paucity of prior research on the subject in Hong Kong triggers my interest to study this topic.

The study examines the influence of organizational ethical climate and the perceived importance of corporate ethics and social responsibility on practicing accountants' ethical decisions regarding accounting and operating earnings management. Structural equation modeling (SEM) is used to test the hypotheses. Based on 206 survey responses from practicing accountants, the models for both accounting and operating earnings management provide general support for the hypotheses. The results indicate that participants' perceptions of the ethical climate in their organization influence their attitudes toward the perceived importance of corporate ethics and social responsibility, which in turn influence ethical decisions (judgments and intentions) regarding earnings management.

DECLARATION

I declare that this is an original work based primarily on my own research, and I warrant that all citations of previous research, published or unpublished, have been duly acknowledged.

(Lam Mo)
August 27, 2012

CERTIFICATE OF APPROVAL OF THESIS

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TABLE OF CONTENTS

CHAPTERS

LIST OF APPENDICES

LIST OF FIGURES

LIST OF TABLES

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Ethical Climate, the Perceived Importance of Ethics and Social Responsibility, and Earnings Management

Chapter 1: Introduction

This study examines the relationships among organizational ethical climate, the perceived importance of corporate ethics and social responsibility and attitudes toward earnings management. Although employee perceptions of the ethical climate or ethical culture in their organization have recently been shown to influence a variety of ethical decisions among professional accountants, little attention has been given to the role of ethical climate in decision making processes relating to earnings management.

The perceived importance of corporate ethics and social responsibility has also received relatively little prior attention in the accounting literature. Shafer and Simmons (2008) found that attitudes toward the importance of corporate ethics and social responsibility significantly influenced Hong Kong tax practitioners' willingness to condone aggressive tax avoidance schemes. Elias (2002) found partial support for the hypothesis that such attitudes influence ethical judgments relating to earnings management. However, that study did not recognize the potential relationship between ethical climate and attitudes toward the importance of ethics and social responsibility.

The current study extends prior research by developing an integrated model of the relationships among organizational ethical climate, the perceived importance of corporate ethics and social responsibility and ethical decisions regarding earnings management. Specifically, I hypothesize that perceptions of the organizational ethical climate will affect professional accountants' views toward the importance of corporate ethics and social responsibility, which will in turn affect ethical decisions (morality judgments and behavioral intentions) relating to accounting and operating earnings management.[1]

By focusing on potential influences on earnings management such as corporate culture, the findings of the research should shed light on how to discourage earnings management by professional accountants. For instance, if it is documented that the organizational ethical climate in organizations influences attitudes toward the importance of corporate ethics and social responsibility and consequently affects the likelihood of earnings management, then the quality of earnings reports may be improved by efforts to foster more ethical organizational climates. Behavioral research on earnings management provides a distinct advantage over market-based studies in this regard by focusing on the factors that influence the decision making processes of professional accountants, the people who actually make decisions or acquiesce to demands to manage earnings.

Chapter 2: Literature Review

2.1 Earnings Management

Earnings management has long been recognized as a critical ethical issue for the accounting profession, and has been investigated by accounting researchers for many years. In the current paper, my focus will primarily be on previous behavioral or attitudinal studies of earnings management in accounting.

Earnings management was defined by Healy and Wahlen (1999, p. 368) as managers using "judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers." I consider this definition appropriate in the contemporary business world as the definition comprises both accounting and operating aspects of earnings management.

Merchant (1989) brought the issue of earnings management to the attention of the business community in a widely-cited article published in the *Harvard Business Review*. This article reported results from a survey using a questionnaire to measure attitudes toward earnings management. This questionnaire, which became influential in the accounting literature, contained thirteen earnings management scenarios. The scenarios can be categorized into two basic types of earnings manipulation, namely accounting manipulations and operating manipulations. Accounting manipulations involve situations that violate Generally Accepted Accounting Principles (GAAP) in order to achieve desired results. Operating manipulations involve changing earnings through operating decisions, such as intentionally delaying expenditures for repairs and maintenance to reduce current year expenses, or running sales promotions near year end to boost reported sales and income. In contrast to accounting manipulations, operating manipulations do not involve the intentional manipulation of accounting rules or regulations.

Bruns and Merchant (1990) conducted a survey of 649 U.S. managers to assess their attitudes toward earnings management using the Merchant (1989) instrument. Participants' ethical judgments lacked a high degree of consensus regarding the acceptability of earnings management practices. As suggested by the researchers, this indicated that managers adopted different approaches for analyzing the moral issues. The researchers also found that participants judged operating manipulations more favorably (as opposed to accounting manipulations). Managers explained to the researchers that they considered accounting manipulations to be purposeful distortions of "truth". On the other hand, the managers thought that even though operating manipulations change the course of business decisions, the facts will still be reported accurately.

Merchant and Rockness (1994) administered the Merchant (1989) questionnaire to general managers, staff managers, operating unit controllers, and internal auditors in the U.S. From the data collected from 308 respondents, the researchers found significant relationships between ethical judgments and the manipulation characteristics, such as type, size, timing, and objective of the actions. More specifically, they empirically identified the following relationships: (1) consistent with Bruns and Merchant (1990), participants judged accounting manipulations more harshly than operating manipulations; (2) no significant differences in judgments were found between manipulations that increased earnings and those that decreased earnings; (3) earnings management of material amounts were judged to be less acceptable than manipulations of immaterial amounts; (4) year-end manipulations were judged to be significantly less acceptable than quarter-end manipulations; and (5) actions with primarily selfish purposes such as to make budgeted profit targets (as opposed to continuing some important product development projects) were judged more harshly.

In a survey of 265 members of a regional organization of accountants in the U.S., Rosenzweig and Fischer (1994) found that accountants with more experience and at higher position levels were more tolerant of earnings management. In another study, Fischer and Rosenzweig (1995) surveyed undergraduate accounting students, MBA students, and practicing accountants. Consistent with Bruns and Merchant (1990), the research found that all three groups of respondents adopted more lenient attitudes toward operating manipulations than accounting manipulations. Indeed, they reported that virtually all respondents did not consider operating manipulations to be of ethical concern.

Two papers by Kaplan (2001a, 2001b) investigated evening MBA students' ethical judgments regarding earnings management. These studies adopted three earnings management scenarios from the Merchant (1989) instrument representing operating gains, accounting gains, and accounting losses. Kaplan (2001a) found that, in the operating gain scenario, earnings management intended for the company's benefit (as opposed to the personal benefit of the manager involved) was regarded as more ethically acceptable by respondents assuming the role of shareholders. Kaplan also found that intent did not affect morality assessments of respondents assuming the role of non-shareholders.

Kaplan (2001b) again used participants' role and earnings management activity as independent variables. This study assigned MBA students to the role of either a shareholder, a manager unfamiliar with the manager in the scenario, or a manager familiar to the manager in the scenario. The participants were then asked to provide, based on three earnings management scenarios, their ethical judgments, fairness judgments, perceived seriousness of consequences, and perceived likelihood of financial suffering. The results indicated that participants with manager roles tend to view earnings management more leniently when they knew the target manager in question. Also, for accounting manipulations, participants with manager roles tend to view earnings management more harshly than those with shareholder roles. However, for the operating manipulation scenario, role seems to play little influence on participants' ethical judgments.

Elias (2002) investigated the effects of the perceived importance of corporate ethics and social responsibility [using the PRESOR scale developed by Singhapakdi, Vitell, Rallapalli, and Kraft (1996)] on responses to the Merchant (1989) earnings management scenarios. The sample included 763 accounting practitioners, faculty and students. The findings indicated that participants who placed more emphasis on the importance of social responsibility and long term (as opposed to short term) corporate profitability tended to judge earnings management more harshly. The study also found that high idealists were more likely to view earnings management as unethical. Elias (2004) conducted a survey of 583 CPAs in public accounting, industry and academia that examined the effects of perceived corporate ethical values [using the Hunt, Wood, and Chonko (1989) scale] on attitudes toward earnings management. The results indicated that respondents who perceived the ethical standards of their organization to be relatively high (low) regarded earnings management as less (more) ethical.

Greenfield, Norman, and Wier (2008) surveyed 375 senior-level undergraduate business students to investigate the impact of ethical position (idealism and relativism), professional commitment, and personal benefit on earnings management behavior. They adopted Clikeman and Henning’s (2000) earnings management scenario in two versions, one with personal gain opportunity and the other without such an opportunity. They found that individuals with higher professional commitment were less likely to express an intention to engage in earnings management. Results also indicated that those participants who scored higher (lower) on idealism (relativism) expressed a lower (higher) likelihood of engaging in earnings management behavior.

In one of the few studies of earnings management in an Asian context, Noronha, Zeng and Vinten (2008) surveyed managers and accountants in mainland Chinese companies. They found that company size and ownership structure had significant effects on both the incentives for earnings management and the particular techniques used to manage earnings. Their results revealed that publicly owned companies primarily employed earnings management to manipulate management compensation, while privately owned companies were more likely to manipulate earnings to reduce their income tax expense. It was also found that the incentives are significantly stronger for large companies to engage in earnings management for maintaining or enhancing their market value than small companies.

Several observations may be made in light of the above research findings. First, there have been only a limited number of attitudinal or behavioral studies of earnings management in the accounting literature, and most of these studies have used participants from the U.S. Further, several of these studies have focused on the attitudes of students, rather than practicing accountants or managers. While MBA students with significant work experience may be valid surrogates for practitioners, the results of surveys of undergraduate students should be interpreted with caution. Some early studies (Bruns and Merchant, 1990; Merchant and Rockness, 1994; Rosenzweig and Fischer, 1994) of earnings management focused primarily on assessing and reporting attitudes toward such behaviors; thus, a limited number of independent variables affecting such attitudes have been investigated, and accordingly there is much opportunity for further work in this area.

In the current study, I propose a model in which the ethical climate in organizations influences attitudes toward the importance of corporate ethics and social responsibility, which will in turn affect ethical decision making processes (ethical judgments and behavioral intentions) relating to earnings management. I now turn my attention to discussions of these variables.[2]

2.2 Ethical Climate

In their seminal work, Victor and Cullen (1988) defined organizational ethical climate as “the prevailing perceptions of typical organizational practices and procedures that have ethical content.” The ethical climate construct developed by Victor and Cullen (1987, 1988) is a two-dimensional matrix, which captures both the ethical criteria and locus of analysis involved in decision making. Victor and Cullen derive ethical climate criteria from moral philosophy and psychological theories, and loci of analysis from sociological theories. The ethical criteria include egoism, benevolence, and principle, while the locus of analysis may be at the individual, local or cosmopolitan levels. The cross section of the two dimensions forms a 3 X 3 matrix consisting of nine types of ethical climates, as shown in Figure 1 overleaf.

Figure 1

Theoretical Climate Types

LOCUS OF ANALYSIS

ETHICAL CRITERION	Individual	Local	Cosmopolitan
Egoism	Self-Interest	Company Profit	Efficiency
Benevolence	Friendship	Team Interest	Social Responsibility
Principle	Personal Morality	Company Rules and Procedures	Laws and Professional Codes

Source: Victor and Cullen (1988, p. 104)

In the ethical criteria dimension, egoistic climates focus on self-interest, benevolent climates on the well-being of the parties involved, and principled climates on following rules, laws and professional codes of conduct. The locus of analysis specifies the focal point or scope of consideration when making ethical decisions. An individual locus of analysis encourages a focus on self-interest, relationships and personal moral principles of organizational members. The "local" level of analysis is usually interpreted as an emphasis on the company or organizational subunits. Thus, in an egoistic/local climate the primary concern may be on what is considered best for the company, such as short term profitability. In a benevolent/local climate the focus may be on what is best for an organizational subunit, such as caring for the interests of all team members. In a principled/local climate the primary emphasis will be on following internal company rules and regulations. A cosmopolitan focus extends the scope of concern to the societal level. For example, a benevolent/cosmopolitan climate will place significant emphasis on social responsibility or acting in the public interest to maximize the wellbeing of the society. In a principled/cosmopolitan climate, the emphasis will be on following the rules and regulations of collectives such as society as a whole (laws) or professional associations (codes of conduct).

Victor and Cullen (1987, 1988) developed the Ethical Climate Questionnaire

(ECQ), which was later refined by Cullen, Victor and Bronson (1993), to test for the existence of these nine *a priori* climates. Based on an exploratory factor analysis of the items comprising the ECQ, Victor and Cullen (1987) identified six ethical climate types. Using an improved version of the ECQ and a different sample, Victor and Cullen (1988) identified five climate types: an instrumental climate that combined elements of the egoistic/individual and egoistic/local types; a "caring" climate that comprised elements of the benevolent/individual and benevolent/local types; and three separate principled climates corresponding with the initial theoretical conceptualization (independence, rules and law and code climates).

This pattern of five climate types has emerged quite often in subsequent empirical studies (Martin and Cullen, 2006). However, it is important to note that significant differences have been found in ethical climate types across studies (Martin and Cullen, 2006; Victor and Cullen, 1988). Indeed, recent studies of ethical climate in public accounting firms suggest an alternative pattern of climate types. In their survey of U.S. accounting firms, Cullen, Parboteeah and Victor (2003) found evidence of seven distinct climates, including benevolent/cosmopolitan (public interest) and principled/cosmopolitan (law and code) climates. Parboteeah, Cullen, Victor and Sakano (2005) found evidence of egoistic/individual, benevolent/local, benevolent/cosmopolitan, and principled/cosmopolitan climates in a survey of employees of U.S. and Japanese public accounting firms. Shafer (2008) found three of the same four climates in a study of Chinese accounting firm employees: egoistic/individual, benevolent/cosmopolitan, principled/individual and principled/cosmopolitan. Shafer (2009) also reported a similar set of four climate types: egoistic/individual, egoistic/local, benevolent/cosmopolitan and principled/ cosmopolitan.[3] Significantly, Cullen et al. (2003), Parboteeah et al. (2005) and Shafer (2009, 2008) all found evidence of benevolent/cosmopolitan and principled/ cosmopolitan climates in CPA firms, including firms in three different countries.

These findings suggest, perhaps not surprisingly, that public accounting firms place significant emphasis on serving the public interest (benevolent/cosmopolitan) and following professional codes of conduct (principled/cosmopolitan) relative to corporations [which make up the vast majority of the ethical climate studies reviewed by Martin and Cullen (2006)]. This raises the question of whether accounting departments within corporate settings will similarly emphasize serving the public interest and following professional codes of conduct. Of course it has long been suggested that professionals working in bureaucratic or corporate environments will be less able to maintain their autonomy and accordingly will place less emphasis on traditional professional values such as serving the public interest [see Shafer, Lowe and Fogarty (2002) for a review of this literature]. However, Shafer and Wang (2010) recently found evidence of both benevolent/cosmopolitan and principled/cosmopolitan climates in corporate accounting departments in China, suggesting that significant emphasis on professional values and ideals does exist in this context.[4]

2.3 Perceived Importance of Ethics and Social Responsibility

Singhapakdi et al. (1996) developed a scale to measure perceptions of the importance of ethics and social responsibility (PRESOR) to organizational success. The PRESOR instrument has been used relatively widely in studies of business ethics, and some consensus has emerged that the scale items may be classified into two broad categories: the stockholder view and the stakeholder view (see Appendix 2) [for a review of related literature see Shafer and Simmons (2008)]. People with a stockholder view regard organizational profitability (serving the best interests of the stockholders to the exclusion of others) as the overriding responsibility of business, in line with Friedman's (1962) classic argument. Those with a stakeholder view, in contrast, recognize that the organization has a responsibility to a variety of stakeholder groups and accordingly should act in an ethical and socially responsibility fashion. They consider ethical and socially responsible behavior to be not only compatible with but also critical to the long term success of business enterprises.

Singhapakdi et al. (1996, p. 1132) suggest that attitudes toward the importance of corporate ethics and social responsibility are “likely to be a key determinant of whether or not an ethical problem is even perceived in a given situation” by corporate employees. Individuals who minimize the importance of corporate ethics and social responsibility should primarily view issues from the perspective of the effects on the company’s “bottom line” profitability, with ethical issues often falling outside their scope of consideration. In contrast, for individuals who believe strongly in the importance of ethical and socially responsible behavior, the ethical implications of business decisions should be more salient. Thus, attitudes toward the importance of corporate ethics and social responsibility provide a lens through which business decisions are viewed.

As noted by Shafer and Simmons (2008), it appears that most prior studies of the perceived importance of corporate ethics and social responsibility have focused on the antecedents, rather than the consequences, of PRESOR attitudes. Singhapakdi, Karande, Rao and Vitell (2001), Ahmed, Chung and Eichenseher (2003), and Axinn, Blair, Heorhiadi and Thach (2004) document cross-cultural differences in PRESOR responses. Other variables found to influence PRESOR responses include ethical orientation (idealism vs. relativism), age, and gender (see Singhapakdi et al., 2001; Axinn et al., 2004).

Relatively few studies have addressed the role of PRESOR attitudes in an accounting context. In a survey of accounting practitioners, faculty and students, Elias (2002) found that participants who believed more strongly in the importance of social responsibility and placed more emphasis on long-term gains (both elements of the stakeholder view) viewed earnings management more harshly. Thus, there is some precedent for anticipating a relationship between PRESOR responses and attitudes toward earnings management.

Shafer and Simmons (2008) appears to be the only other study that has addressed the influence of the perceived importance of corporate ethics and social responsibility on accountants' ethical decision making processes. That study investigated the relations among Machiavellianism, PRESOR attitudes and ethical decisions (ethical judgments, social responsibility judgments and behavioral intentions) for a sample of Hong Kong tax professionals working in public accounting firms. The study found highly significant correlations between both Machiavellianism and PRESOR attitudes and all the measures of ethical decision making. Using mediated regression analysis, the authors found that the stockholder view (but not the stakeholder view) fully mediated the relationship between Machiavellianism and ethical decision making. They suggested that this finding indicates that tax practitioners use arguments based on the traditional stockholder view to rationalize engaging in overly aggressive tax minimization strategies.

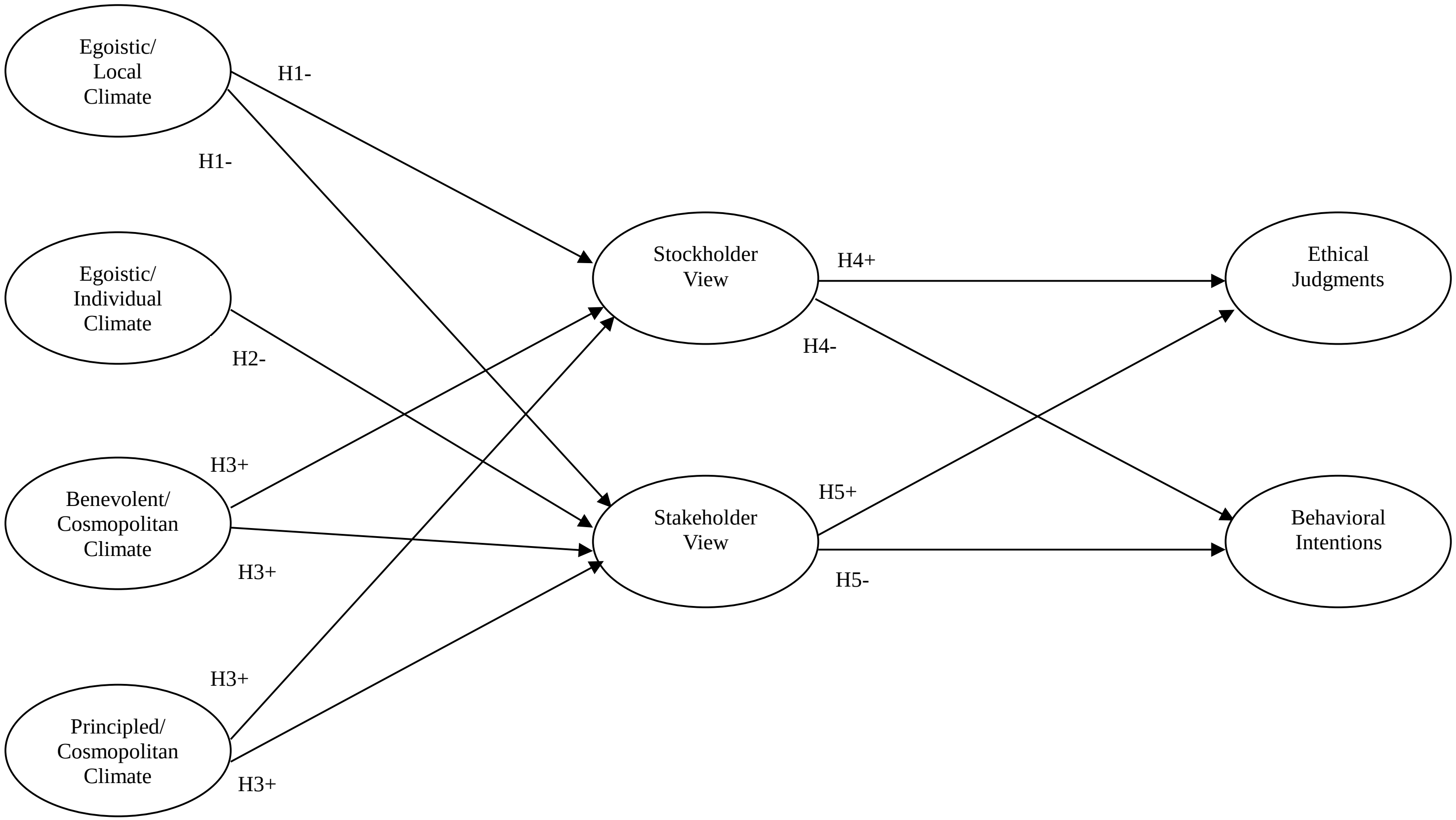
Chapter 3: Hypothesis Development

Though no prior accounting studies have addressed the issue, a sound argument can be made for the existence of a relationship between the perceived ethical climate in one's organization and attitudes toward the importance of ethical and socially responsible behavior. It has traditionally been argued that employee perceptions of ethical climate/culture influence ethical decisions by establishing organizational expectations for what is considered acceptable or unacceptable behavior (Treviño, Butterfield and McCabe, 1998; Victor and Cullen, 1988, 1987). Thus, the organizational expectations (explicit or implicit) embodied in the ethical climate set standards that employees are encouraged to follow.

As shown in Figure 2 overleaf, I propose an integrated model in which the ethical climate in organizations influences attitudes toward the importance of corporate ethics and social responsibility, which will in turn affect ethical decision making processes (ethical judgments and behavioral intentions) relating to accounting and operating earnings management.

Figure 2

Hypothesized Relationships



If perceived organizational expectations dictate aggressive or unethical behavior, employees should seek a mechanism for rationalizing their participation in such behavior. The adjustment of one's attitudes toward the importance of corporate ethics and social responsibility seems to be a likely rationalization mechanism in this context. For instance, if the organizational climate emphasizes achieving short-term profitability (an egoistic/local climate), professional accountants may rationalize aggressive reporting methods as being in line with the traditional stockholder view and minimize the importance of the stakeholder view of corporate ethics and social responsibility. This reasoning leads to the following hypothesis.

> *Hypothesis 1:* A stronger perceived emphasis on corporate profitability (egoistic/local climate) will lead employees to believe more strongly in the stockholder view and less strongly in the stakeholder view of corporate ethics and social responsibility.[5]

A climate that normalizes the aggressive pursuit of self-interest (an egoistic/individual climate) may also create tensions and conflict for professional accountants, leading them to rationalize the behaviors they observe in their work environment by minimizing the importance of corporate ethics and social responsibility. Attitudes toward the stakeholder view of corporate ethics and social responsibility appear to be most relevant to the justification of the pursuit of self-interest. Minimization of the importance of obligations to external stakeholder groups and the importance of ethical behavior to long-term corporate success can clearly be used to rationalize the aggressive pursuit of self-interest. Because the stockholder view focuses on the tension between corporate profitability and ethical/socially responsible behavior, it seems less relevant to the issue of pursuing self-interest. For instance, increasing one's support for the primacy of short-term corporate profitability does not justify self-interested behaviors that enrich individuals at the expense of the company. Although personal interests and corporate profitability may be aligned through incentive pay structures, this is not likely to be the case for the majority of accounting department employees. Accordingly, I feel that the primary means of justifying the pursuit of self-interest among accounting employees will be the minimization of the importance of the stakeholder view of corporate ethics and social responsibility, as reflected in the following hypothesis.

> Hypothesis 2: A stronger perceived emphasis on the pursuit of self-interest (egoistic/individual climate) will lead employees to believe less strongly in the stakeholder view of corporate ethics and social responsibility.

If the organizational climate emphasizes protection of the public interest (benevolent/cosmopolitan climate) and compliance with professional codes of conduct (principled/cosmopolitan climate), this should reinforce accountants' commitment to professional values, increasing support for the stakeholder view and reducing support for the stockholder view of corporate ethics and social responsibility. Serving the public interest, or doing what is best for the collective welfare of society, is consistent with the stakeholder view, which explicitly acknowledges that corporations have obligations to broader collectives external to the organization. In contrast, the stockholder view explicitly denies the importance of serving interests other than those of the company and its stockholders. Similarly, a focus on following professional codes of conduct, which emphasize serving the public interest and behaving in an ethical fashion, is clearly consistent (inconsistent) with the stakeholder (stockholder) view of corporate ethics and social responsibility. Accordingly, I propose the following hypothesis.

> *Hypothesis 3:* A stronger perceived emphasis on serving the public interest (benevolent/cosmopolitan climate) and following professional codes of conduct (principled/cosmopolitan climate) will lead employees to believe less strongly in the stockholder view and more strongly in the stakeholder view of corporate ethics and social responsibility.

There is also support for the argument that attitudes toward the perceived importance of corporate ethics and social responsibility will influence professional accountants' ethical decisions and behavioral intentions regarding earnings management. Elias (2002) found that attitudes toward the stakeholder view, but not the stockholder view, influenced ethical judgments regarding earnings management. These findings provide general support for a relationship between PRESOR attitudes and decisions regarding earnings management, although Elias (2002) only examined ethical judgments and did not address behavioral intentions. In fact, most prior studies (Rosenzweig and Fischer, 1994; Elias, 2002) adopting the Merchant (1989) earnings management scenarios have examined only ethical judgments. In the current paper I argue that the perceived importance of corporate ethics and social responsibility will have significant effects on both ethical judgments and behavioral intentions.

In this respect, it is important to recognize that the practical focus of attitudes toward corporate ethics and social responsibility, as reflected in the PRESOR instrument (see Appendix 2), suggests that their greatest impact will be on teleological (pragmatic) ethical judgments and behavioral intentions. If one considers the attitudes that comprise the stockholder view, this practical focus is evident. The statements give *priority* to corporate profitability, efficiency, competitiveness and survival over considerations of ethics and social responsibility. Essentially, this view holds that unethical or irresponsible actions may be necessary to serve the best interests of the stockholders. It does not deny that the actions are immoral or unethical from a deontological or principled point of view; it simply maintains that they may be required in a competitive business environment. A practical focus is also evident in the stakeholder view. These items describe ethical and socially responsible behavior as “important”, “essential to long-term profitability”, central to organizational “effectiveness”, critical to “the survival of a business enterprise”, “compatible” with profitability, and “good business”. Thus, it appears that the stakeholder view condemns unethical and socially irresponsible behavior primarily on the basis of its practical import rather than the violation of deontological ethical principles.

In light of the above discussion, I can surmise that support for the stockholder view of corporate ethics and social responsibility will result in more lenient ethical judgments of aggressive actions and a higher estimated likelihood of engaging in such actions. Individuals who feel that unethical and socially irresponsible behaviors are sometimes necessary and in the best interests of a company should make relatively favorable teleological evaluations of such issues, resulting in such actions being viewed as more ethical or moral. It follows that such individuals will be more likely to establish intentions to engage in similar actions. On the other hand, individuals who support the stakeholder view feel that unethical/socially irresponsible actions are antithetical to the long-term success of business enterprises; consequently, their teleological evaluations of such issues should be relatively harsh, leading them to judge such actions as unethical or immoral. This should result in a lower likelihood of developing intentions to engage in such actions. These arguments are consistent with the findings of Shafer and Simmons (2008) in their study of Hong Kong tax practitioners. Accordingly, I propose the following hypotheses.

> *Hypothesis 4:* Support for the stockholder view of corporate ethics and social responsibility will lead employees to judge aggressive actions as more ethical and increase the likelihood that they will engage in similar actions.

> *Hypothesis 5:* Support for the stakeholder view of corporate ethics and social responsibility will lead employees to judge aggressive actions as less ethical and decrease the likelihood that they will engage in similar actions.

Chapter 4: Research Method

4.1 Instrument

For the purposes of this study, participants completed: (1) four earnings management scenarios adapted from Merchant (1989); (2) sixteen items from the Ethical Climate Questionnaire (ECQ) (Cullen et al., 1993) designed to measure egoistic/individual, egoistic/local, benevolent/cosmopolitan and principled/cosmopolitan climates; (3) the Perceived Importance of Ethics and Social Responsibility (PRESOR) scale (Singhapakdi et al., 1996); (4) a demographic questionnaire. All of these scales have been used extensively in prior studies and found to possess acceptable levels of reliability and validity.

The four scenarios taken from the Merchant instrument (illustrated in Appendix 1) included two cases dealing with operating manipulations and two cases dealing with accounting manipulations. For each scenario, participants provided overall ethical judgments, judgments on five dimensions of the Multidimensional Ethics Scale (MES) (Henderson and Kaplan, 2005; Shafer, 2008), judgments of the likelihood that their peers would engage in similar actions, and self-reported behavioral intentions. The instrument was administered in English, which was considered appropriate given the common use of English in the Hong Kong business community.

Responses to the ethical judgment and behavioral intention measures were provided on seven-point scales, with higher numbers indicating that the action was considered less moral or ethical and higher estimated likelihoods of engaging in similar actions. Following common practice, (e.g., Shafer, 2008), to provide alternative measures of behavioral intentions and to encourage more honest responses, in addition to self-reported intentions, participants were also asked to estimate the likelihood that their professional peers would commit similar actions. Responses to the Ethical Climate Questionnaire were provided on the original six-point scale, anchored on "completely false" (1) and "completely true" (6). PRESOR responses were provided on a seven-point scale anchored on "disagree strongly" (1) and "agree strongly" (7). For the PRESOR scale, higher numbers are indicative of stronger support for the Stakeholder View and weaker support for the Stockholder View (due to the fact that the Stockholder View items are all reverse-scored). More generally, higher scores on the PRESOR scale indicate stronger belief in the importance of corporate ethics and social responsibility.[6]

4.2 Participants

Access to participants was obtained through personal contacts. A cover letter that explained the nature of the study and assured the confidentiality of the information collected was attached to every instrument distributed. The letter also reminded respondents to complete the instrument in person without assistance and return it in a sealed envelope. In order to increase the response rate, two weeks after distributing the instrument, participants who had not responded received emails or phone calls to remind them to complete and return the instrument. The sample was comprised of accountants working in private industry. Questionnaires were either distributed in hard copy or by email.

The data were gathered from October 2011 to February 2012. As convenience sampling is particularly prone to the possibility of obtaining a non-representative sample, I adopted several measures to reduce the effect of possible sampling bias. Approximately the same number of questionnaires was sent to both male and female accountants. I included a wide variety of company sizes in the sample, including companies ranging in total employees from 10 to over 1000. Different types of companies were also included in the survey, such as local listed and non-listed, and multinational companies.

Approximately 700 instruments were distributed, and a total of 211 respondents returned their instrument, giving a response rate of approximately 30 percent. Five instruments were discarded because of incomplete information given, resulting in a usable sample of 206 responses.

As indicated in Table 1 on page 31, the mean age of participants was approximately 35. They had an average of ten years' of professional accounting experience. This is a relatively high level of accounting experience for studies of this type. Fifty one percent of the respondents were male. Ninety percent had bachelors degrees or above. About 30 percent of the respondents were general staff, 20 percent seniors, 20 percent supervisors and 23 percent managers. Approximately 56 percent worked in local non-listed companies, 10 percent in local listed companies, and 34 percent in multinational companies. All respondents were ethnic Chinese, although a small number held British passports. Finally, over half the sample held CPA or Chartered Accountant certifications, and 24 participants held management accounting certifications.

Table 1

Demographic Summary

Sample size by position:		
	General Staff	66
	Senior Staff	42
	Supervisor	45
	Manager	49
Type of current employment:		
	Local company (non-listed)	113
	Local listed company	20
	Multinational company	68
Mean age		35.1
		(8.0)
Mean experience (years)		10.0
		(7.2)
Gender:	Male	101
	Female	99
Nationality:	Chinese	178
	British	13
Degree:	Non-degree holders	7
	Associate degree holders	5
	Bachelors	120
	Masters	61
	Others	5
Certification:	LCC/AAT Accountant	12
	CPA/Chartered Accountant	94
	Management Accountant	24
	Others	25

Notes:

1. Numbers do not total 206 due to missing values.
2. Numbers in parentheses are standard deviations.

Chapter 5: Findings

5.1 Scale Construction

Exploratory principal components factor analyses with varimax rotation were performed for the ethical judgment, behavioral intention, ethical climate and PRESOR measures. A minimum cutoff for factor loadings was set at .4. Before conducting the factor analyses for participants' ethical judgments, I averaged responses to the individual scale items for the two operating scenarios and the two accounting scenarios to develop combined measures for operating and accounting manipulations.

The factor analyses for ethical judgments indicated that, for both operating and accounting manipulations, overall ethical judgments and the five MES items all loaded on a single dimension, which I will refer to simply as ethical judgments. The factor analysis for behavioral intentions indicated that both self-reported intentions and estimated peer intentions also loaded on a single factor referred to herein as behavioral intentions. I constructed the operating and accounting ethical judgment scales by computing the mean responses to the six items comprising each scale. Similarly, I constructed the behavioral intentions scale as the mean of the two measures of intentions.

Three interpretable factors with eigenvalues in excess of one were indentified for the ethical climate instrument: a benevolent/cosmopolitan factor that included all four of the original items and had a coefficient alpha of .834; a principled/ cosmopolitan factor that included all four original items and had a strong coefficient alpha of .875; and an instrumental factor that included seven of the eight egoistic/individual and egoistic/local climate items and had a coefficient alpha of .728.[7]

The factor analysis for the PRESOR items revealed two factors with eigenvalues in excess of one representing the stockholder view and stakeholder view components. The stockholder view factor included all five of the original items and had a coefficient alpha of .800. The stakeholder view factor included all eight of the original items and had a coefficient alpha of .857. Thus, the PRESOR scale factors were found to possess high internal reliability in the current study.

Scales for the ethical climate and PRESOR factors were also computed as the mean of the individual items comprising each measure.

5.2 Mean responses

The mean responses by position are shown in Table 2 on page 36. No significant differences in ethical climate perceptions by position were found. However, significant differences in PRESOR attitudes were documented. Specifically, managers and supervisors believed less strongly in the stakeholder view than did the lower-level employees, a difference that was significant at the .05 level.

Highly significant differences by position were found for behavioral intentions with respect to operating manipulations. In the case of peer intentions, senior staff, managers and supervisors all estimated a significantly greater likelihood of earnings management occurring than did lower-level general staff. For self-reported intentions, supervisors and managers estimated a significantly greater likelihood that they would personally commit operating manipulations than did general or senior staff. These findings suggest that the propensity to engage in operating earnings management increases with experience. This could be the case, for example, if such manipulations are common in practice, so that more experienced managers have witnessed more similar occurrences and consequently rationalize such behavior as acceptable on practical grounds. Supervisors and managers also judged operating manipulations to be more ethically acceptable than lower-level employees, though these differences were not significant at conventional levels.

However, no clear pattern of differences emerged for the accounting manipulations. In the case of estimated peer intentions, general staff estimated a lower likelihood of accounting manipulations than the other three groups (p=.05), but no other differences were significant. Due to the fact that accounting manipulations are generally viewed as more unethical than operating manipulations (cf. ethical judgments for operating and accounting manipulations in Table 2 overleaf), it may be the case that fewer instances of accounting manipulations are observed in practice, lowering the likelihood of them being rationalized as common and thus acceptable.

Table 2

Mean Responses by Position

	General Staff	Senior Staff	Supervisor	Manager	Pooled
INST	3.96 (0.52)	4.15 (0.49)	3.97 (0.90)	4.15 (0.73)	4.05 (0.67)
BCC	3.95 (0.75)	3.76 (0.79)	3.52 (1.04)	3.62 (1.05)	3.73 (0.91)
PCC	4.42 (0.90)	4.33 (1.05)	4.02 (1.12)	4.24 (1.05)	4.27 (1.02)
Stock	4.52 (1.12)	4.50 (1.21)	4.32 (1.33)	4.31 (1.3)	4.42 (1.22)
Stake	5.09 (0.74)	5.02 (1.14)	4.65 (1.08)	4.65 (1.22)	4.87* (1.05)
JudgeOM	4.47 (1.15)	4.10 (1.32)	3.97 (1.49)	3.87 (1.21)	4.14 (1.29)
PeersOM	3.54 (1.36)	4.46 (1.49)	4.74 (1.80)	4.60 (1.60)	4.26** (1.62)
SelfOM	3.40 (1.32)	3.88 (1.63)	4.48 (1.86)	4.37 (1.6)	3.98** (1.64)
JudgeAM	5.15 (0.90)	4.88 (0.78)	4.95 (1.00)	4.80 (0.88)	4.96 (0.90)
PeersAM	3.42 (1.31)	4.04 (1.27)	3.88 (1.53)	4.03 (1.35)	3.80* (1.38)
SelfAM	3.40 (1.43)	3.39 (1.32)	3.67 (1.51)	3.58 (1.41)	3.50 (1.42)

Notes:

1. Top numbers are means; bottom numbers are standard deviations.
2. Responses to the Ethical Climate scale were provided on six-point scales, where six represents stronger perceptions of climate types.
3. The remaining responses were provided on seven-point scales, where seven represents more harsh ethical judgments and higher likelihoods of committing the act in question, and stronger belief in the perceived importance of corporate ethics and social responsibility.
   *(*) Difference in means is significant at the .05 (.01) level or smaller.

Legend:

BCC – Benevolent/cosmopolitan climate
PCC – Principled/cosmopolitan climate
INST – Instrument climate
Stock – Stockholder View
Stake –Stakeholder View
JudgeOM – Ethical Judgment on Operating Manipulation
JudgeAM – Ethical Judgment on Accounting Manipulation
PeersOM –Peers Intention on Operating Manipulation
PeersAM –Peers Intention on Accounting Manipulation
SelfOM –Self Intention on Operating Manipulation
SelfAM –Self Intention on Accounting Manipulation

5.3 Correlation Analysis

Correlation results for the continuous measures are presented in Table 3 on page 39. The correlations are generally consistent with the research hypotheses. Due to the fact that all the egoistic items loaded on a single instrumental factor, I could not test Hypotheses 1 and 2 directly. However, the strong negative correlations between the instrumental climate factor and both the stockholder and stakeholder view scales provides general support for the proposition that egoistic/individual and egoistic/local climates encourage a relatively low level of concern for corporate ethics and social responsibility.[8] Consistent with Hypothesis 3, I found that the benevolent/cosmopolitan and principled/cosmopolitan climates were positively and significantly correlated with both the stockholder view and stakeholder view, indicating that organizational concerns with serving the public interest and following laws and professional codes of conduct lead employees to believe more strongly in the importance of corporate ethics and social responsibility. The effects of the stakeholder view and stockholder view on ethical judgments and behavioral intentions (peer and self) were also consistent with Hypotheses 4 and 5. As proposed in Hypothesis 4, support for the stockholder view was associated with more lenient ethical judgments and a greater estimated likelihood that participants and their peers would engage in similar actions. Similarly, consistent with Hypothesis 5, endorsement of the stakeholder view led participants to judge unethical actions more harshly and estimate lower likelihoods that they or their peers would engage in similar actions.

Table 3

Correlation Analysis

	EthJudgOM	PeersOM	SelfOM	EthJudgAM	PeersAM	SelfAM	INST	BCC	PCC	Stock
PeersOM	-.624 .000									
SelfOM	-.611 .000	.827 .000								
EthJudgAM	.433 .000	-.245 .000	-.264 .000							
PeersAM	-.290 .000	.577 .000	.543 .000	-.428 .000						
SelfAM	-.227 .001	.436 .000	.622 .000	-.437 .000	.798 .000					
INST	-.403 .000	.359 .000	.333 .000	-.270 .000	.251 .000	.230 .001				
BCC	.265 .000	-.226 .001	-.232 .001	.225 .001	-.184 .008	-.159 .023	-.147 .036			
PCC	.244 .000	-.245 .000	-.234 .001	.123 .079	-.206 .003	-.138 .049	-.103 .142	.551 .000		
Stock	.242 .001	-.198 .004	-.324 .000	.287 .000	-.214 .002	-.319 .000	-.321 .000	.170 .015	.267 .000	
Stake	.488 .000	-.344 .000	-.431 .000	.298 .000	-.235 .001	-.241 .001	-.311 .000	.428 .000	.365 .000	.477 .000

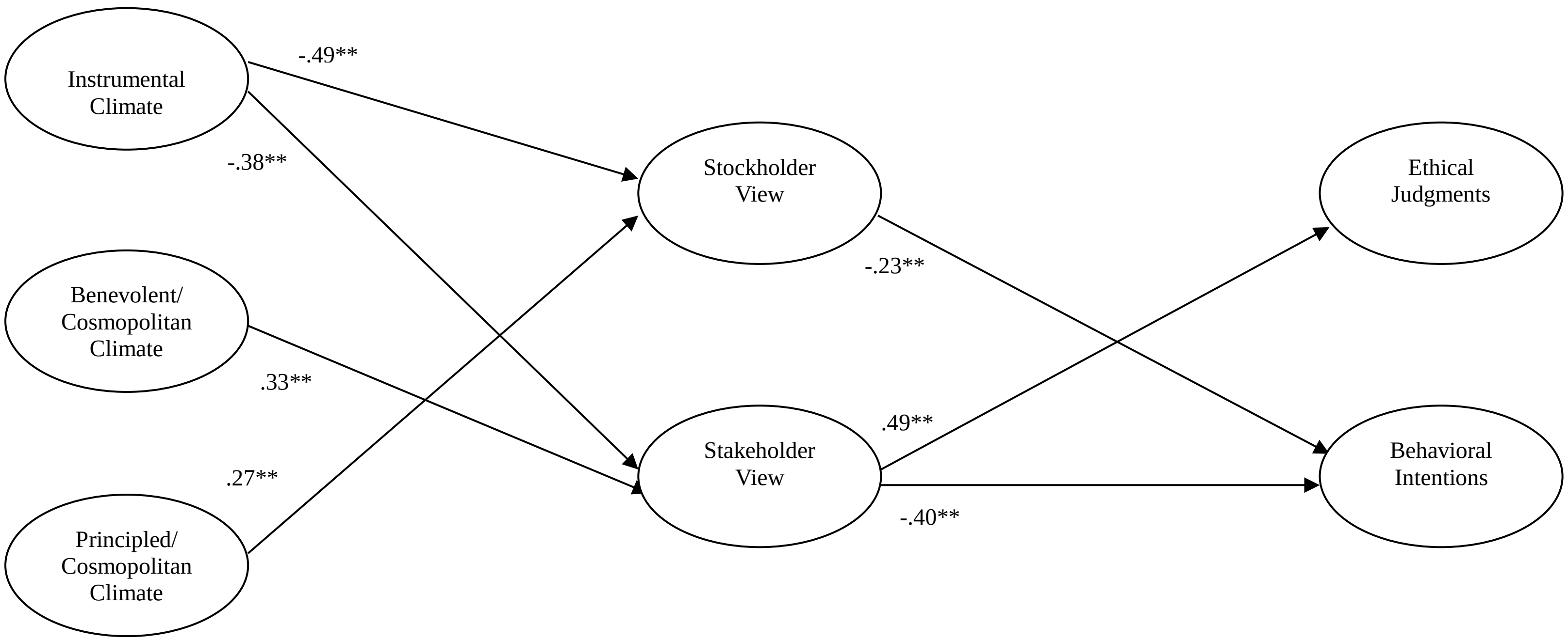
Note: Bottom numbers are significance levels based on two tailed tests. For legend, see Table 2.

5.4 Structural Equations Models

To test the hypotheses, structural equations models (SEM) were used to simultaneously analyze the relationships among the variables of interest.[9] The models for operating and accounting manipulations are presented in Figures 3 and 4 respectively overleaf. In general, both models provided a good fit to the data and support the research hypotheses.

Figure 3

Structural Equations Results for Operating Manipulations

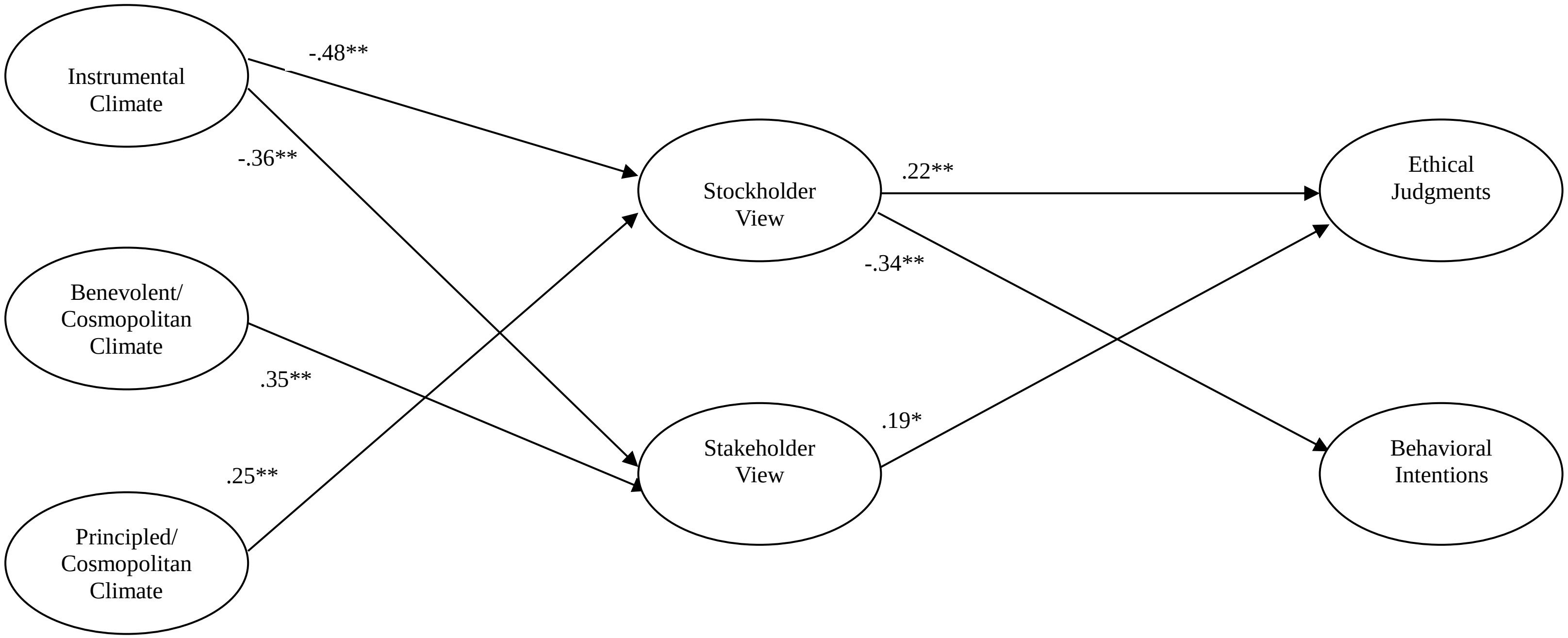


Note:

1. Only significant coefficients are included above
2. *: p<=.05, **: p<=.01

Figure 4

Structural Equations Results for Accounting Manipulations



Note:

1. Only significant coefficients are included above
2. *: p<=.05,   **: p<=.01

Overall model fit tests were first conducted by reference to several key indexes. For both models, the chi-square statistic divided by the degrees of freedom was below the commonly recommended cutoff of 2.0 (1.53 for the operating manipulation model; 1.54 for the accounting manipulation model). For the operating manipulation model, the root mean square error of approximation (RMSEA) was .051, a value well below the desired .08 cutoff. The Comparative Fit Index (CFI) for this model, at .97, was well above the .90 threshold. Similarly, the indices for the accounting manipulation model were well within the recommended guidelines, with an RMSEA of .051 and a CFI of .96. Collectively, these results indicate that the structural equations models provided an excellent fit to the data for both operating and accounting manipulations.

After verifying the overall fit of the models, I examined the parameter estimates to test the research hypotheses. In both models, the instrumental climate influenced the stockholder view and stakeholder view at the .01 significance level or smaller. These results are generally consistent with Hypotheses 1 and 2.

In both models, the benevolent/cosmopolitan climate was significantly associated with the stakeholder view, though it was not significantly associated with the stockholder view. In contrast, in both models, the principled/cosmopolitan climate was significantly associated with the stockholder view but not the stakeholder view. These results provide partial support for Hypothesis 3.

In the operating manipulation model, the stockholder view was significantly associated with behavioral intentions as hypothesized, but was not associated with ethical judgments. This result provides partial support for Hypothesis 4. In the accounting manipulation model, the stockholder view was significantly associated with both ethical judgments and behavioral intentions, which is fully consistent with Hypothesis 4. In the operating model, the stakeholder view was strongly and significantly associated with both ethical judgments and behavioral intentions consistent with Hypothesis 5. However, in the accounting model Hypothesis 5 was only partially supported, with the stakeholder view significantly affecting ethical judgments but not behavioral intentions. These findings provide partial support for Hypotheses 4 and 5.

Chapter 6: Discussion and Conclusions

This study proposes and tests an integrated model of the relationships among organizational ethical climate, the perceived importance of ethics and social responsibility (PRESOR), and accountants' ethical decisions regarding earnings management. The findings, based on a survey of practicing accountants in private industry in Hong Kong, provide general support for the research hypotheses.

I found that instrumental or egoistic climates had the greatest impact on PRESOR attitudes, with strong relationships documented between this climate type and both the stockholder and stakeholder views. For both the stockholder and stakeholder views, instrumental climates were associated with a lower perceived importance of corporate ethics and social responsibility. The benevolent/ cosmopolitan climate was significantly associated with the stakeholder view, while the principled/cosmopolitan climate was significantly associated with the stockholder view.[10] In both these cases perceptions of stronger climates were associated with greater belief in the importance of ethics and social responsibility, as anticipated. Taken together, these findings provide reasonable support for the general proposition that more negative (positive) organizational ethical climates will reduce (increase) the importance attached to corporate ethics and social responsibility by professional accountants in private industry. This is the first study to document these relationships.

These findings have important practical implications. For instance, the significant relationship between the benevolent/cosmopolitan climate and the stakeholder view indicates an emphasis on serving the public interest has the potential to influence a variety of ethical judgments among accountants in private industry. In the accounting profession, discussions of serving the public interest have traditionally been limited primarily to the independent auditor's role in certifying financial statements. However, the findings of the current study suggest that an emphasis on the public interest can also restrain unethical behavior among industry accountants (cf. Shafer and Wang, 2011). The significant relationship between the principled/cosmopolitan climate and the stockholder view indicates that an organizational emphasis on following professional accounting standards and codes of conduct can reduce the negative influence of the traditional stockholder view on industry accountants' ethical decisions.

The observed relationships between PRESOR attitudes and ethical decisions (judgments and behavioral intentions) differed for the operating and accounting manipulations. In the case of operating manipulations, support for the stakeholder view had a particularly strong association with ethical decisions, leading participants to judge such manipulations more harshly and estimate lower likelihoods of engaging in similar actions. The stockholder view was not associated with ethical judgments for operating manipulations, though it was significantly associated with behavioral intentions. Specifically, participants who believed less strongly in the traditional stockholder view estimated a lower likelihood that they and their peers would engage in operating manipulations.

The pattern of results for accounting manipulations provides a clear contrast with those for operating manipulations, with the stockholder (stakeholder) view having a stronger (weaker) association with ethical decisions regarding earnings management. In this case, weaker support for the traditional stockholder view was associated with more negative ethical judgments and a significantly lower estimated likelihood of committing such actions. Stronger support for the stakeholder view was also associated with more negative ethical judgments, but not significantly associated with behavioral intentions.

Collectively, these findings provide at least moderate support for the anticipated relationships between PRESOR attitudes and ethical decisions regarding earnings management. Stronger belief in the importance of corporate ethics and social responsibility was associated with greater condemnation of earnings manipulations and a lower estimated probability of engaging in such actions, with three of four potential relationships significant for both ethical judgments and behavioral intentions.

The observed differences in the patterns of results for operating and accounting manipulations may be due to differences in the nature of the stakeholder and stockholder views and how they influence ethical decision processes. It is apparent that the stakeholder view to some extent reflects a long-term orientation. For example, the statement "the ethics and social responsibility of a firm are essential to its long-term profitability" (see Appendix 2) explicitly adopts a long-term focus. In addition, statements such as "business ethics and social responsibility are critical to the survival of a business enterprise", "social responsibility and profitability can be compatible", and "good ethics is often good business" reflect an implicit assumption that long-term benefits can be obtained by acting in an ethical and socially responsible fashion. A relatively long-term orientation toward ethical issues should clearly be associated with decisions regarding operating manipulations, because their effects primarily arise in the long-term. For example, actions such as aggressive promotions that accelerate sales into the current year (Case 1, Appendix 1) and deferring discretionary maintenance expenses (Case 3, Appendix 1) may not violate GAAP but they focus on enhancing short-term profitability at the likely expense of the longer term. Thus, individuals who place more emphasis on the implications of ethical/socially responsible behavior on the long-term success and survival of a business should judge operating manipulations to be less ethical and estimate a lower likelihood of committing similar actions, as the empirical results indicate.

On the other hand, the stockholder view is likely to be used as a means of rationalizing the more clearly unethical accounting manipulations. Indeed, Shafer and Simmons (2008) concluded that Hong Kong tax advisors utilize the traditional stockholder view, with its de-emphasis of the importance of corporate ethics and social responsibility, to justify acquiescence in aggressive tax avoidance schemes. Consequently, weaker support for the stockholder view seems likely to be associated with more critical judgments of accounting manipulations and a lower estimated likelihood of committing such actions, as the results indicate.

Overall, the findings of the current study provide strong support for the mediating role of attitudes toward corporate ethics and social responsibility on the relationship between ethical climate and ethical decisions regarding earnings management. This is the first study to investigate and document these relationships. The findings are broadly consistent with the results of Shafer and Simmons (2008), who documented that the stockholder view of corporate ethics and social responsibility mediates the relationship between the personality trait of Machiavellianism and ethical decision making in taxation. However, the finding that organizational ethical climate influences attitudes toward corporate ethics and social responsibility, which in turn affect ethical judgments, appears to have greater practical implications than findings relating to individual differences in personality traits such as Machiavellianism. In contrast to personality traits, the ethical climate is more subject to the control of the organization. Thus, the findings of the current study suggest that if corporations take proactive steps to enhance the ethical climate in the organization, this may enhance professional accountants' belief in the importance of corporate ethics and social responsibility, and in the long-term discourage earnings manipulations.

This study is subject to a number of limitations; consequently, the results should be interpreted with caution. For example, the data are based on correlations and thus do not establish causality. Future experimental studies should be designed to provide a firm basis for conclusions regarding the causal relationships among the variables.

Due to practical constraints on the length of the research instrument, impression management was not measured in this study, which can be regarded as a limitation. Shafer (2009) reported that impression management was significantly correlated with three of four ethical climate dimensions investigated, suggesting that Chinese auditors bias their reports of these variables in a socially desirable fashion; thus, ideally impression management should be controlled for in ethical studies of this type. Future studies should investigate whether impression management has similar effects in the context of private industry in China.

Another limitation of the current study is that it relied on a convenience sample obtained through a network of personal contacts. Further, since demographic information on the pool of potential respondents was not available, meaningful tests for possible non-response bias could not be conducted.

Appendix 1

Questionnaire

Part 1 Cases

Please respond to each of the following cases. We appreciate that normally you would require more information than is provided here before you make such decisions. However, for purposes of this study, we ask you to make your decisions based on the limited information provided. Assume that all amounts involved are material to the companies' financial statements.

Case 1: In September 2011, Mr. Chan, the General Manager of a large division of a multinational company, realized the division would need strong performance in the fourth quarter to reach its budget targets. He decided to implement a sales program offering liberal payment terms to pull some sales that would normally occur next year into the current year; customers accepting delivery in the fourth quarter would not have to pay the invoice for 120 days.

Action: Mr. Chan implemented the sales program, and as a result the division was able to meet its budget targets.

1. Please give your beliefs about Mr. Chan's action by placing a mark **(✓)** between each of the opposites that follow:

1 2 3 4 5 6 7

Ethical __ __ __ __ __ __ __ *Unethical*

Just __ __ __ __ __ __ __ *Unjust*

Fair __ __ __ __ __ __ __ *Unfair*

Morally Right __ __ __ __ __ __ __ *Not Morally Right*

Culturally Acceptable __ __ __ __ __ __ __ *Culturally Unacceptable*

Traditionally Acceptable __ __ __ __ __ __ __ *Traditionally Unacceptable*

2. What is the likelihood your professional colleagues would act as Mr. Chan did? Please place a mark **(✓)** between each of the opposites that follow:

1 2 3 4 5 6 7

Unlikely __ __ __ __ __ __ __ *Very Likely*

3. What is the likelihood you would act as Mr. Chan did? Please place a mark **(✓)** between each of the opposites that follow:

1 2 3 4 5 6 7

Unlikely __ __ __ __ __ __ __ *Very Likely*

Case 2: Mr. Zhou is the head of a division of a multinational company that was straining to meet its earnings forecasts during late 2011. Mr. Zhou decided to call the engagement partner of a consulting firm that was doing some work for the division and ask that the consulting firm not send an invoice until next year, although the consulting fees had already been incurred in 2011. The consulting partner agreed.

Action: Mr. Zhou did not record the consulting expenses until the following year; as a result, the division met its earnings forecasts for 2011.

1. Please give your beliefs about Mr. Zhou's action by placing a mark **(✓)** between each of the opposites that follow:

1 2 3 4 5 6 7

Ethical __ __ __ __ __ __ __ *Unethical*

Just __ __ __ __ __ __ __ *Unjust*

Fair __ __ __ __ __ __ __ *Unfair*

Morally Right __ __ __ __ __ __ __ *Not Morally Right*

Culturally Acceptable __ __ __ __ __ __ __ *Culturally Unacceptable*

Traditionally Acceptable __ __ __ __ __ __ __ *Traditionally Unacceptable*

2. What is the likelihood your professional colleagues would act as Mr. Zhou did? Please place a mark **(✓)** between each of the opposites that follow:

1 2 3 4 5 6 7

Unlikely __ __ __ __ __ __ __ *Very Likely*

3. What is the likelihood you would act as Mr. Zhou did? Please place a mark **(✓)** between each of the opposites that follow:

1 2 3 4 5 6 7

Unlikely __ __ __ __ __ __ __ *Very Likely*

Case 3: Mr. Zhu serves as the manager of a small manufacturing company that has recently been experiencing financial difficulties. In order to help the company meet its annual budget targets, he ordered the employees to defer all discretionary expenditures (e.g., maintenance, advertising, hiring) into the next accounting period.

Action: Mr. Zhu's plan was implemented, and as a result the company was able to meet its budget goals.

1. Please give your beliefs about Mr. Zhu's action by placing a mark (**✓**) between each of the opposites that follow:

1 2 3 4 5 6 7

Ethical __ __ __ __ __ __ __ *Unethical*

Just __ __ __ __ __ __ __ *Unjust*

Fair __ __ __ __ __ __ __ *Unfair*

Morally Right __ __ __ __ __ __ __ *Not Morally Right*

Culturally Acceptable __ __ __ __ __ __ __ *Culturally Unacceptable*

Traditionally Acceptable __ __ __ __ __ __ __ *Traditionally Unacceptable*

2. What is the likelihood your professional colleagues would act as Mr. Zhu did? Please place a mark (**✓**) between each of the opposites that follow:

1 2 3 4 5 6 7

Unlikely __ __ __ __ __ __ __ *Very Likely*

3. What is the likelihood you would act as Mr. Zhu did? Please place a mark (**✓**) between each of the opposites that follow:

1 2 3 4 5 6 7

Unlikely __ __ __ __ __ __ __ *Very Likely*

Case 4: Mr. Tsang, the manager of a large division of a retailing firm, realized near the end of 2011 that his division would significantly exceed its budgeted profit targets for the year. As a result, he ordered his controller to develop a rationale for increasing the reserve for inventory obsolescence. By taking an overly pessimistic view of future market prospects, the controller was able to identify a significant amount of finished goods to be fully reserved or written off; even though Mr.

Tsang was fairly confident the inventory in question would still be sold at a later date at close to full price.

Action: Mr. Tsang implemented his strategy of recording excess inventory reserves. The division still met its 2011 profit targets, and had some excess inventory reserves that could be used to increase reported profits in the future.

1. Please give your beliefs about Mr. Tsang's action by placing a mark **(✓)** between each of the opposites that follow:

   1 2 3 4 5 6 7

   Ethical __ __ __ __ __ __ __ *Unethical*

   Just __ __ __ __ __ __ __ *Unjust*

   Fair __ __ __ __ __ __ __ *Unfair*

   Morally Right __ __ __ __ __ __ __ *Not Morally Right*

   Culturally Acceptable __ __ __ __ __ __ __ *Culturally Unacceptable*

   Traditionally Acceptable __ __ __ __ __ __ __ *Traditionally Unacceptable*

2. What is the likelihood your professional colleagues would act as Mr. Tsang did? Please place a mark **(✓)** between each of the opposites that follow:

   1 2 3 4 5 6 7

   Unlikely __ __ __ __ __ __ __ *Very Likely*

3. What is the likelihood you would act as Mr. Tsang did? Please place a mark **(✓)** between each of the opposites that follow:

   1 2 3 4 5 6 7

   Unlikely __ __ __ __ __ __ __ *Very Likely*

Part 2

We would like to ask you some questions about the general climate in your organization. Please answer the following in terms of how it really is in your organization, *not* how you would prefer it to be.

Please be as candid as possible; remember, all responses will remain strictly anonymous. Using the scale below as a guide, please indicate the extent to which you feel each of the following statements is true about your organization.

1	2	3	4	5	6
Completely false	Mostly false	Somewhat false	Somewhat true	Mostly true	Completely true

____ 1. In this organization, people are mostly out for themselves.
____ 2. People are expected to do anything to further the organization's interests.
____ 3. There is no room for one's own personal morals or ethics in this organization.
____ 4. Work is considered sub-standard only when it hurts the organization's interests.
____ 5. In this organization, people protect their own interest above other considerations.
____ 6. The first consideration is whether a decision violates any law or professional standard.
____ 7. People are expected to comply with legal and professional standards over and above other considerations.
____ 8. People are concerned with the organization's interests--to the exclusion of all else.
____ 9. In this organization, people are expected to strictly follow legal or professional standards.
____ 10. In this organization, the law or ethical code of one's profession is the major consideration.
____ 11. It is expected that you will always do what is right for the public.
____ 12. People in this organization have a strong sense of responsibility to the outside community.
____ 13. Decisions here are primarily viewed in terms of contribution to profit.
____ 14. People in this organization are actively concerned about the public interest.
____ 15. People in this organization are very concerned about what is best for them.
____ 16. The effects of decisions on the public are a primary concern in this organization.

Part 3

Listed below are a number of statements. Each represents a commonly held opinion and there are no right or wrong answers. You will probably disagree with some items and agree with others. We are interested in the extent to which you agree or disagree with such matters of opinion.

Read each statement carefully. Then indicate the extent to which you agree or disagree by circling the appropriate number beside each statement. First impressions are usually best in such matters. Please give your opinion on every statement.

	Disagree Strongly	Disagree Somewhat	Disagree Slightly	Unsure	Agree Slightly	Agree Somewhat	Agree Strongly
1. If survival of a business enterprise is at stake, then you must forget about ethics and social responsibility.	-3	-2	-1	0	+1	+2	+3
2. Good ethics is often good business.	-3	-2	-1	0	+1	+2	+3
3. If the stockholders are unhappy, nothing else matters.	-3	-2	-1	0	+1	+2	+3
4. Business has a social responsibility beyond making a profit.	-3	-2	-1	0	+1	+2	+3
5. The most important concern for a firm is making a profit, even if it means bending or breaking the rules.	-3	-2	-1	0	+1	+2	+3
6. Social responsibility and profitability can be compatible.	-3	-2	-1	0	+1	+2	+3
7. To remain competitive in a global environment, business firms will have to disregard ethics and social responsibility.	-3	-2	-1	0	+1	+2	+3

	Disagree Strongly	Disagree Somewhat	Disagree Slightly	Unsure	Agree Slightly	Agree Somewhat	Agree Strongly
8. A firm's first priority should be employee morale.	-3	-2	-1	0	+1	+2	+3
9. Efficiency is much more important to a firm than whether or not the firm is seen as ethical or socially responsible.	-3	-2	-1	0	+1	+2	+3
10. Being ethical and socially responsible is the most important thing a firm can do.	-3	-2	-1	0	+1	+2	+3
11. The overall effectiveness of a business can be determined to a great extent by the degree to which it is ethical and socially responsible.	-3	-2	-1	0	+1	+2	+3
12. The ethics and social responsibility of a firm are essential to its long-term profitability.	-3	-2	-1	0	+1	+2	+3
13. Business ethics and social responsibility are critical to the survival of a business enterprise.	-3	-2	-1	0	+1	+2	+3

Supplemental Information

Please provide the following information regarding yourself. Your careful participation is greatly appreciated.

1. Year of birth_______________ 2. Gender ____ Male ____Female

3. Nationality ___________________

4. Years of professional accounting experience: Total _____ With current organization _____

5. Type of current employment:
   ____Local company (non-listed)
   ____Local listed company
   ____Multinational company

6. Position in the firm:
   ____General Staff
   ____Senior Staff
   ____Supervisor
   ____Manager
   ____Other

7. Educational background: Degrees held (check):
   ____Bachelors
   ____Masters
   ____Others (please specify) _______________________

8. Professional certifications held: Qualification_
   _____CPA/Chartered Accountant
   ____Management Accountant
   ____Others (please specify) _______________________

Appendix 2

Scale Items and Reliabilities

Instrumental Climate: (α=.728)

1. In this organization, people are mostly out for themselves.
2. In this organization, people protect their own interest above other considerations.
3. People in this organization are very concerned about what is best for themselves.
4. People are expected to do anything to further the organization's interests.
5. Work is considered sub-standard only when it hurts the organization's interests.
6. People are concerned with the organization's interests – to the exclusion of all else.
7. Decisions here are primarily viewed in terms of contribution to profit.

Benevolent/Cosmopolitan Climate: (α=.834)

1. It is expected that you will always do what is right for the public.
2. People in this organization have a strong sense of responsibility to the outside community.
3. People in this organization are actively concerned about the public interest.
4. The effects of decisions on the public are a primary concern in this organization.

Principled/Cosmopolitan Climate: (α=.875)

1. The first consideration is whether a decision violates any law or professional standard.
2. People are expected to comply with legal and professional standards over and above other considerations.
3. In this organization, people are expected to strictly follow legal or professional standards.
4. In this organization, the law or ethical code of one's profession is the major consideration.

PRESOR Scale:

Stockholder view: (α=.800)

1. The most important concern for a firm is making a profit, even if it means bending or breaking the rules.[1]
2. To remain competitive in a global environment, business firms will have to disregard ethics and social responsibility.[1]
3. If survival of a business enterprise is at stake, then you must forget about ethics and social responsibility.[1]
4. Efficiency is much more important to a firm than whether or not the firm is seen as ethical or socially responsible.[1]
5. If the stockholders are unhappy, nothing else matters.[1]

Stakeholder view: (α=.857)

6. Being ethical and socially responsible is the most important thing a firm can do.
7. The ethics and social responsibility of a firm are essential to its long-term profitability.
8. The overall effectiveness of a business can be determined to a great extent by the degree to which it is ethical and socially responsible.
9. Business ethics and social responsibility are critical to the survival of a business enterprise.
10. A firm's first priority should be employee morale.
11. Business has a social responsibility beyond making a profit.
12. Social responsibility and profitability can be compatible.
13. Good ethics is often good business.

1 = Reverse scored.

Endnotes

[1] Some studies argue that earnings management is not necessarily unethical (e.g., Schipper, 1989; Dye, 1988). However, this view is easily dispelled from the perspective of business ethics. Earnings management that involves intentional manipulation of reported accounting numbers is a clear violation of professional accounting standards and thus is obviously unethical from a deontological perspective (cf. Hunt and Vitell 1991, 1986). Even if the manipulative actions involved in earnings management do not involve direct violations of professional standards, they clearly have the potential to harm actual and potential users of financial statements (including company shareholders); thus, such actions are clearly unethical from a teleological perspective as well.

[2] Because my study was limited to a single jurisdiction and its focus was on the effects of organizational influences on ethical decisions, broader cultural factors such as power distance are not included in this research.

[3] Due to the prevalence of these four climate types in recent studies of ethical climate among accountants in Asia, they are the primary focus of the current study.

[4] Healy (1985) reported that incentive and compensation can be important determinants of accounting and operating manipulations. The lack of explicit consideration of these factors is acknowledged as a limitation of this study. However, it should also be noted that, because the form of a company's incentive and compensation schemes is likely to influence the organizational ethical climate, the effects of these factors are implicitly included within the conceptual framework adopted herein. For example, an incentive compensation scheme based solely on sales performance or short-term earnings would likely promote egoistic/individual and egoistic/local ethical climates. The resulting incentive to increase personal compensation and/or organizational earnings may lead to aggressive earnings management strategies.

[5] Note that, because all items comprising the Stockholder View in the PRESOR instrument are reverse-scored, the numerical signs for the hypothesized relationships involving the Stockholder View in Figure 1 are the opposite of those expressed in the Hypotheses.

[6] There is very little empirical evidence suggesting that ethical climates vary by company size; consequently, company size is not included in my research as an independent variable.

[7] As previously discussed, some prior studies have found that the egoistic/individual and egoistic/local items load on a single "instrumental" factor; thus, the results are not particularly surprising.

[8] Recall that the Stockholder View items are reverse-scored; consequently, higher scores on the Stockholder View scale represent greater support for the importance of corporate ethics and social responsibility.

[9] Structural equations modeling provides a number of distinct advantages in this context over more traditional approaches such as regression analyses. It provides a direct test of the potential mediating effects of variables. It also explicitly controls for measurement error for the latent constructs.

[10] It is unclear why both the benevolent/cosmopolitan and principled/cosmopolitan climates were each significantly associated with only one of the two components of the PRESOR scale. However, with the benefit of hindsight, there does appear to be some conceptual support for the observed significant relationships for these climate types. It appears intuitive that the benevolent/cosmopolitan climate would have a stronger relationship with the stakeholder view than with the stockholder view. This is due to the fact that the benevolent/cosmopolitan climate emphasizes the service of the public interest, while the stakeholder view encompasses support for the interests of all stakeholders including the public. In contrast, the principled/cosmopolitan climate is also most clearly related to the stockholder view, because the stockholder view essentially endorses the use of any legal means to increase shareholder value, even if such actions violate the professional ethical standards included in the principled/cosmopolitan climate. Future research should further address the relationships between these two climate types and the components of the PRESOR instrument, to test the robustness of the findings of the current study.

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