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The Impact of Social Influence Pressure on CFO Judgments

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**THE IMPACT OF SOCIAL INFLUENCE PRESSURE ON
CFO JUDGMENTS**

by
Carol C. Bishop

A Dissertation

Presented in Partial Fulfillment of Requirements for the
Degree of
Doctor of Business Administration
in the
Coles College of Business
Kennesaw State University

Kennesaw, GA
2013

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Carol C. Bishop
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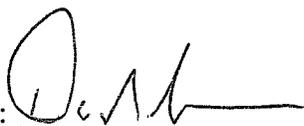
Coles College of Business
Doctor of Business Administration

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The content and format of the dissertation are appropriate and acceptable for the awarding of the degree of Doctor of Business Administration.

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DEDICATION

For my parents

Thank you for instilling confidence and prioritizing learning.

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I am deeply grateful to the family and friends who have supported, inspired, and sustained me during this exciting adventure.

My husband Joe never complained about the disruptions to his daily life. On the contrary, he cheered me on; bragged about my progress to all within earshot; cooked, cleaned, and toted; and most importantly, he always understood when I dropped all other activities in favor of writing. My pride and joy - Matthew, Mary, Philip and Sarah - have believed in me, grounded me, and grown before my eyes into amazing young people.

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ABSTRACT

THE IMPACT OF SOCIAL INFLUENCE PRESSURE ON CFO JUDGMENTS

by
Carol C. Bishop

Through an experiment, this study examines the influence of social influence pressure on the Chief Financial Officer's (CFO's) financial reporting decisions. Specifically, I evaluate the impact of inappropriate obedience and compliance pressure from the Chief Executive Officer (CEO) on the CFO's propensity to make revisions to financial results in order to meet an earnings target. This study also examines how followership propensities and core self-evaluations (CSE) influence the pressure effects. This study complements and expands archival research examining why CFOs appear to participate in material accounting manipulations (Feng, Ge, Luo, & Shevlin, 2011; Ge, Matsumoto, & Zhang, 2011).

The results of a between-subject experiment with 66 public company CFOs indicate that obedience and compliance pressure significantly increase CFOs' willingness to revise their initial inventory adjustments in the direction preferred by the CEO. Although compliance pressure did not create perceived pressure in the CFOs, it generated an actual response (similar revision of the initial adjustment) similar to that under obedience pressure. Compliance pressure's strength reveals that CEO power is effective even when soft tactics (i.e., requests) are utilized. The findings confirm the importance of

the “tone at the top” in financial statement judgments. In addition, the findings reveal that effective followers, who independently evaluate leadership’s requests, were less likely to revise their initial adjustment. Finally, CFOs with more accounting experience were less likely to revise their initial adjustment. This study has implications for corporate governance mechanisms, including improving the effectiveness of CFOs as financial statement monitors and improving CFO independence to alleviate pressure from the CEO.

Keywords: *financial statement fraud, material accounting misstatement, obedience pressure, compliance pressure, followership theory, core self-evaluations, CFO, CEO.*

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CHAPTER 1

INTRODUCTION

Instead of viewing followers as the 'good soldiers' who carry out commands dutifully, we need to view followers as the primary defenders against toxic leaders or dysfunctional organizations. The buck stops more with followers than leaders (Kelley, 2008, 14).

This study examines the effect of social influence pressure on the Chief Financial Officer's (CFO's) financial reporting decisions. Specifically, I evaluate the impact of inappropriate obedience and compliance pressure from the Chief Executive Officer (CEO) on the CFO's propensity to revise financial results. Beasley, Carcello, Hermanson, and Neal (2010) call for research examining the behavioral factors motivating CFOs to engage in fraudulent misreporting using leadership and organizational behavior research. This study complements and expands archival research by examining why CFOs appear to participate in material accounting manipulations (Feng et al., 2011; Ge, Matsumoto, & Zhang, 2011).

This study also examines how followership propensities and core self-evaluations (CSE) influence the pressure effects. Followership theory (Kelley, 1992) classifies followers based on their degree of independence and activity, and offers a framework for understanding CFO follower behavior (Amernic & Craig, 2010). CSE is composed of self-esteem, locus of control, self-efficacy, and emotional stability (Judge, Locke, & Durham, 1997). CSE influences behavior in reaction to organizational social stressors (Bono & Judge, 2003; Harris, Harvey, & Kacmar, 2009).

Financial statement misreporting is a form of aggressive accounting, which, in the extreme, reaches the level of financial statement fraud. Fraud schemes involve the intentional misstatement or omission of material information in the organization's financial reports, including recording fictitious revenues, concealing liabilities or expenses, and artificially inflating assets (ACFE, 2010). Motivations for manipulating the financial reports of publicly owned companies are numerous, including financial rewards, company survival, excessive executive egos, and meeting growth strategies. As a result, prior literature has investigated the likelihood of committing financial statement fraud from diverse perspectives, including criminology (Bucy, Formby, Raspanti, & Rooney, 2008), sociology/psychology (Ramamoorti, 2008), moral reasoning (Maroney & McDevitt, 2008), and ethics (Shafer, 2002).

Academic accounting literature has focused considerable attention on the "fraud triangle" as a tool for investigating the root causes of fraud from a psychological perspective. The fraud triangle posits that three conditions are generally present when fraud occurs: (1) an incentive or pressure, (2) an opportunity, and (3) rationalization or attitude (Hogan, Rezaee, Riley, & Velury, 2008; Loebbecke, Eining, & Willingham, 1989). Likewise, accounting professionals feature the fraud triangle in their efforts to detect fraud in Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, 2002). By separately evaluating each element of the fraud triangle, auditors increase their effectiveness in making an overall fraud risk assessment as a result of being more sensitive to opportunity and incentive clues (Wilks & Zimbelman, 2004).

Financial statement fraud is carried out by individuals who are either morally inclined to commit fraud or individuals who set aside their moral convictions as a result of pressure or incentives and then rationalize their decision. Thus, financial statement fraud is at its core an individual decision. Due to its nature, financial statement fraud is primarily planned and carried out by members of the top management team. In fact, the SEC named the CEO and/or CFO for some level of involvement in 89 percent of accounting fraud cases brought by the Securities and Exchange Commission from 1998-2007 (Beasley et al., 2010), with the CEO named in 72 percent of the cases and the CFO in 65 percent. As head of the top management team (TMT), most corporate reporting fraud schemes necessarily originate from the CEO's actions or attitudes (Anderson & Tirrell, 2004) because CEOs are responsible for the organization's "tone at the top." CEOs can provide incentives and pressure to induce fraudulent behavior by other TMT members.

CEOs have significant influence over fraudulent financial reporting, including all three areas of the fraud triangle. However, their opportunity to directly commit fraud is partially constrained since they do not have hands-on access to financial records. As a result, CEOs typically need assistance from CFOs to carry out their intentions. Entrusted with primary responsibility over financial statement preparation, CFOs play a pivotal role in determining the quality of financial reporting (Aier, Comprix, Gunlock, & Lee, 2005). CFOs also maintain internal controls and implement accounting principles and procedures. The importance of the CFO's fiduciary duties is evidenced by the requirement in Section 302 of the Sarbanes-Oxley Act of 2002 that CFOs (along with CEOs) certify and approve the integrity of their company's financial statements.

Archival evidence (Beasley et al., 2010) indicates that both CEOs and CFOs are the primary individuals implicated in financial statement fraud. Research also suggests that CEO and CFO equity incentives significantly influence earnings management activities and the likelihood of beating analysts' forecasts (Jiang, Petroni, & Wang, 2010). CEOs occupy higher positions of power in the organization in comparison to CFOs and, as a result, have the ability to influence the compensation, job security, and future career opportunities of the CFO. In contrast, CFOs have primary responsibility and influence over financial reporting. Thus, differences in CEO and CFO power and job responsibilities suggest differences in motivations, rationales, and decision making in the area of financial statement misreporting. In fact, Feng et al. (2011) find archival evidence suggesting that CFOs are more likely to commit financial statement fraud in response to perceived pressure from CEOs rather than for their own personal financial benefit. They find higher CEO equity incentives and power in firms with material accounting manipulations as compared to matched non-manipulation firms, but no difference in CFO equity incentives across the two types of firms.

I use two types of social influence pressure to examine, in an experimental setting, the extent to which CEO pressure is a motivating factor for CFOs to revise the financial statements, which may be a first step toward committing financial statement fraud (Beasley et al., 2010, finds that many frauds start small and become larger over time). Obedience pressure and compliance pressure involve pressure from superiors. Under these pressures, the supervisor's influence comes in the form of either a directive (obedience pressure) or a request (compliance pressure) to engage in an act.

According to obedience theory, individuals who succumb to pressure (i.e., direct orders) from a superior rationalize their fraudulent behavior by placing full responsibility for the fraud on the authority figure (Davis, DeZoort, & Kopp, 2006). By rationalizing that they had no choice but to follow a superior's orders, they are able to reduce the stress they might otherwise feel from engaging in unethical, immoral, or illegal behavior conflicting with their individual values. Under obedience pressure, subordinate individuals break from an autonomous state, become an agent for the authoritative source, and deny responsibility (Milgram, 1963). Thus, obedience pressure links two areas of the fraud triangle: pressure and rationalization.

Compliance pressure refers to an individual's *acquiescence* in response to an explicit or implicit *request* (Cialdini & Trost, 1998) from either a peer or superior (DeZoort & Lord, 1997). Target individuals may have various underlying reasons for accepting or adopting the influence of others, including gaining rewards or approval and avoiding punishment or disapproval.

I explore the judgments of practicing CFOs in an experimental setting and measure behavioral factors motivating their decisions. The experimental setting is advantageous because motivations influencing the decisions of participants can be evaluated *directly* using unobservable personality characteristics rather than *indirectly* using observable proxies such as demographic characteristics (as is commonly done in previous archival research). The use of practicing CFOs is advantageous because an actual management manipulation decision can be evaluated *directly* in a case study rather than *indirectly* using observable proxies such as accounting financial statement variables typically used in archival research. Further, the use of practicing CFOs responds to the

call for incorporating management, given its significant influence, into governance studies (Carcello, Hermanson, & Ye, 2011; Cohen, Krishnamoorthy, & Wright, 2004). The use of behavioral factors is advantageous because it is an attempt to *directly* look at the psychological factors driving executive manipulation behavior and determining managers' style differences (Ge et al., 2011) rather than *indirectly* examining the inputs and outputs of the "black box" (Hambrick, 2007). Thus, this paper attempts to expand the theories (psychology) and research methods (experimental) typically used to understand the important problem of financial statement manipulation, as suggested by Carcello, Hermanson, and Ye (2011).

In this study, current CFOs participated in an experiment involving a hypothetical CFO's earnings manipulation decision. Using a between-subjects manipulation, I used three levels of CEO pressure (obedience pressure from a CEO who *tells* the CFO to revise an estimate, compliance pressure from a CEO who *asks* the CFO to revise an estimate, and a control group where the CEO does not pressure the CFO). Additionally, I measured personality variables (followership and core self-evaluations) for potential moderating effects. The dependent variable was the participant's propensity to revise an inventory adjustment decision.

The results indicate that obedience and compliance pressure significantly increase CFOs' willingness to revise their inventory adjustments. Additionally, obedience and compliance pressure produce similar CFO responses (i.e., revisions to meet the earnings target) despite differences in the CFOs' perception of the degree of pressure inherent in the demand or request. The findings confirm the importance of "tone at the top" and of corporate culture surrounding earnings targets in financial statement judgments. The

predictions for responsibility assessments, that CFOs who succumbed to CEO pressure would assign responsibility for their decision to the CEO, were not supported. Instead, CFOs under pressure assigned primary responsibility for their decision to themselves and provided qualitative evidence of their sense of responsibility for financial statement decisions. Overall, CFOs found a revision of the estimate to be legal and neither ethical or unethical. However, the CFOs who did not revise their estimate judged such a change to be significantly more illegal and unethical than CFOs who did revise.

The hypothesized effect for followership (moderating the effect of pressure) was not found. However, I did find that effective followers, who independently evaluate leadership's requests, were less likely to revise their adjustment. The findings did not support the prediction for CSE; the participants' levels of CSE did not influence their resistance to pressure or their propensity to revise their adjustment. Finally, CPAs with more accounting experience were less likely to revise their initial adjustments. This study has implications for corporate governance mechanisms, including improving the effectiveness of CFOs as financial statement monitors and improving CFO independence to alleviate pressure from the CEO.

This paper enhances the study of social influence effects by using followership theory to investigate how CFO behavior is influenced by individual factors such as personality and passive/proactive followership schema. Additionally, followership may enrich our understanding of how CFOs as followers can fulfill an ethical watchdog role (Kelley, 1998) and contribute to corporate governance. By encouraging thoughtful dissent, organizations are more likely to achieve better decisions (Bennis, 2010) and potentially reduce fraud. A review of the accounting literature indicates that the construct

of followership has not yet been empirically tested in an accounting context. This paper's investigation of followership propensities will lay the groundwork for future research into accounting practitioner followership propensities.

Additionally, this paper extends the study of psychological characteristics influencing CFO decision-making by examining the influence of core self-evaluations (CSE) on an earnings manipulation decision. CSE is a higher-order personality construct composed of at least four specific traits: self-esteem, locus of control, self-efficacy, and emotional stability (Judge, Locke, & Durham, 1997). This dispositional trait subconsciously influences individual perceptions and behavior (Bono & Judge, 2003) and moderates individual reactions to organizational social stressors (Harris, Harvey, & Kacmar, 2009).

In summary, this research is expected to improve our understanding of the factors ultimately contributing to an individual's decision to set aside personal beliefs and engage in fraud (although the current study examines a softer setting than outright fraud), including the attitudes and rationalizations that result in the decision to engage in fraudulent misreporting, and the psyche of individuals involved in fraudulent reporting (Beasley et al., 2010). Additionally, this research has implications for potential improvements in the effectiveness of CFOs as financial statement monitors by exploring thoughtful dissent. Lastly, this research extends corporate governance research on CFOs and provides support for the need to improve CFO independence to alleviate inappropriate pressure from the CEO.

The next sections provide background information and develop the hypotheses. Subsequent sections describe the methodology, results, and conclusions.

CHAPTER TWO

LITERATURE REVIEW AND HYPOTHESES

As noted above, SEC fraud-related enforcement cases typically cite the CEO and/or CFO for some level of involvement in the misreporting (Beasley et al., 2010). Considerable research has investigated top management team fraud resulting from financial incentives from bonuses or equity-based compensation (Armstrong, Jagolinzer, & Larcker, 2010; Burns & Kedia, 2006; Efendi, Srivastava, & Swanson, 2007). However, the motives, pressures, and incentives of top management team members vary across titles. For example, research has found that CEOs are primary instigators (31.9 percent) and primary financial beneficiaries (42.5 percent) of accounting manipulations (Feng et al., 2011). But, CFOs are not primary instigators (17.5 percent) or primary financial beneficiaries (7.5 percent) of accounting manipulations (Feng et al., 2011). Indirect archival evidence leads Feng et al. (2011) to conclude that CFO involvement in accounting manipulations is more likely to be due to CEO pressure rather than personal financial benefits to the CFO.

Various types of pressures create stress within accountants and affect their attitudes and performance (see DeZoort & Lord, 1997 for a review). Drawing from the social psychology literature, the behavioral accounting literature has examined the organizational-related pressures faced by individuals in firms, including three types of social influence pressure (obedience, compliance, and conformity). Two types of social

influence pressure involve pressure from superiors: obedience pressure and compliance pressure. Under these pressures, the supervisor's influence comes in the form of either a directive (obedience pressure) or a request (compliance pressure) to engage in an act. Conformity pressure results from pressure to act in accordance with one's peers in order to avoid appearing different.

The present study seeks to better understand accounting manipulation through the scenario of CEOs as leaders and CFOs as followers through a leadership and organizational behavior research lens. Some individuals are predisposed to intentional dishonesty as a result of attitude, character, or ethics, while other individuals are able to rationalize committing a fraudulent act. Organizational corruption is often explained by a combination of rationalization tactics used by individuals to justify their actions and socialization tactics used to induce newcomers into accepting the unethical practices as normal (Anand, Ashforth, & Joshi, 2004).

Obedience Pressure

In an environment in which there is perceived opportunity to commit fraud, obedience theory may enrich our understanding of the potential pressures and rationalizations that motivate individuals to commit fraudulent acts. Obedience pressure is a form of social influence pressure where individuals are compelled to submit to an order from an authority figure. Of the three social pressures, obedience pressure typically is most potent because of the power a hierarchical supervisor holds over an employee. Thus, CEO pressure can result in a great deal of stress, particularly regarding the potential negative impact on job and career (DeZoort & Lord, 1994; DeZoort & Lord, 1997).

The significant influence of legitimate authorities can override individual predispositions (Blass, 1991; Milgram, 1963). Legitimate power arises from one's hierarchical position in the organization and depends on the willingness of subordinates to defer to demands (French & Raven, 1959). While obeying the directives of authorities such as parents and teachers is beneficial for children because of the authority figures' greater knowledge and their control over rewards and punishments, adults also reap the practical advantages of obedience to authority.

The origins of obedience theory can be traced to Stanley Milgram's (1963) experiments, which measured participants' willingness to obey an authority figure directing them to apparently administer electric shocks to others, in conflict with their personal conscience. Milgram's study found that participants obeyed more often than expected, despite the apparent pain caused by the treatments, leading to the theory that obedience may be a deeply ingrained behavior that may override ethics or morality (Milgram, 2009).

In a partial replication of Milgram's experiment, Burger's (2009) obedience rates were only slightly lower than Milgram's rates 45 years earlier. Several reasons have been advanced for the high rates of obedience (Burger, 2009). First, Milgram's experiments suggested that ordinary people were willing to justify atrocities by claiming that they were merely following orders, thus abdicating individual moral responsibility. Second, the legitimacy of the authority figure is important, along with the cultural forces that compel individuals to obey authority figures. Third, when the intensity of the demands is gradually increased, attitudinal and behavioral changes are stronger. Milgram's

experiments also demonstrated the difficulty of translating intentions into actions when someone is influenced by pressure (Blass, 1991).

After decades of broad psychological research, more recent studies have extended the obedience concept to the business organization. For example, managers were more likely to act unethically or illegally in the workplace when ordered to do so by a supervisor than when acting under their own volition (Smith, Simpson, & Huang, 2007). Many participants in recent high profile corporate frauds appeared to be ethical employees who quietly went along with activities that were obviously unethical, and then neutralized their negative feelings or regrets by denying responsibility for their behaviors (Anand, Ashforth, & Joshi, 2004). Additionally, obedience pressure significantly increased auditors' willingness to sign off on an account balance that was materially misstated (Lord & DeZoort, 2001).

In terms of the fraud triangle, CEO instigators, lacking *opportunity* or direct access to the financial statements, may pressure CFOs to commit fraud. Obedience pressure from the CEO authority figure may be viewed as a potential *motivation* for CFOs under pressure from CEO instigators. At the same time, obedience theory provides a potential *rationalization* for CFOs who act in conflict with their personal beliefs and shift responsibility for their actions to the CEO authority figure. In an examination of managers' unethical behavior in 39 high-profile fraud cases, Cohen et al. (2010) suggested that managers' dominant influence or tyrannical/autocratic personalities represent significant fraud-risk factors.

Compliance Pressure

This study also investigates the influence of another social influence pressure, compliance pressure, on CFO financial reporting behavior. Compliance pressure refers to an individual's *acquiescence* in response to an explicit or implicit *request* (Cialdini & Trost, 1998) from either a peer or superior (DeZoort & Lord, 1997). Thus, the primary distinction between the two types of social influence pressures lies in how the influence attempt is framed – as a request (compliance) or a demand (obedience). In organizations, compliance pressure includes both overt requests, as well as requests from unspoken pressure inferred from organizational circumstances or the incentive structure (Prentice, 2007).

Target individuals may have various underlying reasons for accepting or adopting the influence of others, including gaining rewards or approval and avoiding punishment or disapproval. Frequently, individuals who acquiesce to compliance pressure publicly agree while privately dissenting. Thus, compliance can occur even when the requested behavior is incongruent with the target's value system, and even when the target does not believe in, accept, or internalize the content (Kelman, 1958; Nail, MacDonald, & Levy, 2000). For example, in situations involving initial disagreement between the source and the target, Nail (1986) distinguishes between two types of conformity behavior: conversion (publicly and privately agreeing with the source's position) and compliance (publicly agreeing but privately continuing to disagree).

Accountants who are asked to inappropriately change their actions face stress-inducing compliance pressure. Pressure from a superior is particularly stressful for a subordinate, particularly regarding the potential negative impact on job and career

(DeZoort & Lord, 1994; DeZoort & Lord, 1997). For example, supervisor requests to underreport time were found to have significant explanatory power regarding subordinate auditors' underreporting behavior (Lightner, Adams, & Lightner, 1982; Sweeney, Arnold, & Pierce, 2010).

Followership Theory

Interviews with prosecutors and defense attorneys led Bucy et al. (2008) to conclude that participants in fraudulent schemes are classified as either leaders or followers, with different personality profiles and motives attributed to each group. Additionally, followers can be separated into ineffective followers (whose actions clearly have negative implications for their organization) and effective followers (independent, critical thinkers whose creativity, innovation, and courage result in positive implications for their organizations) (Kelley, 1992). The role of ineffective followers is important in understanding financial statement fraud because collusion among top management team (TMT) members is frequently a component of fraud schemes. Furthermore, Feng et al.'s (2011) research supports the scenario of CEO instigators pressuring CFO followers. On the other hand, practitioner literature offers examples of effective follower behavior, noting that heroic followers effectively check the power of toxic leadership (Bennis, 2010) by thinking independently (Kelley, 1992) and acting courageously (Chaleff, 2003).

In an early attempt to classify followers, Zaleznik (1965) differentiated followers based on their level of dominance vs. submissiveness and activity vs. passivity. The four resulting groups were labeled impulsive, compulsive, masochistic, and withdrawn. Later, Kelley (1988, 1992) identified five types of followers (effective, alienated, yes-people, sheep, and survivors) according to their levels of critical independent thinking and

activity level. In a related typology, Chaleff (2003) classified followers based on the level of support given to the leader and the willingness to challenge the leader on critical issues. The four resulting typologies are partner, implementer, individualist, and resource followers. Chaleff highlights the importance of “the courageous follower” in strongly supporting leaders, but challenging them if necessary. A review of the foregoing typologies indicates that the activity level criterion is an important classification factor in the practitioner literature, particularly in Zaleznik (1965) and Kelley (1988, 1992).

Kelley’s (1992) five types of followers are classified based on their degree of independence and activity. Four of the five types of followers are deemed to be ineffective or less than advantageous. The least effective, sheep, wander in herds waiting for the leader’s instructions. Yes-people are also considered ineffective. Although they are more active than sheep, they still depend on the leader and tell the leader what they believe the leader wants to hear. Alienated followers are ineffective due to passivity. They may think critically, but because they remain passive, they do not act on their opinions. Pragmatic followers act based on political expediency or on the system’s bureaucrats, and keep their ideas to themselves.

Kelley’s exemplary followers exercise independent critical thinking, evaluate leadership’s requests, and balance their own ideas as well as those of the leader with the organization’s goals and objectives. Kelley developed seven steps for acting as an exemplary follower: (1) be proactive, (2) gather the facts, (3) seek wise counsel, (4) play by the rules, (5) persuade by speaking the organization’s language, (6) have the courage to go over heads when necessary, and (7) take collective action or be prepared to stand

alone (Kelley, 1998). Kelley's seven steps give common sense recommendations for courageously offering dissenting opinions to a leader (Corrothers, 2009).

Chaleff's (2003) four-quadrant model for followership mirrors Kelley's model on many points; however, it recognizes positive attributes in each category. For example, in place of Kelley's "sheep," Chaleff's "resource followers" work honestly, but not beyond the minimum. Chaleff's "partners" correspond with Kelley's "exemplary" followers. Partners support the leader vigorously, but are willing to question the leader's behavior if necessary.

Follower-Centered Approach

The discussion above provides a historical account of the underpinnings of followership. This section describes how the focus of research on followers has developed over time. Until recently, the leadership literature has primarily been leader-focused, emphasizing the perspectives of the leader and largely ignoring the follower's perspectives (Kellerman, 2007). Beginning in the 1990s with Meindl's (1995) propositions, a follower-centered approach to leadership has explored how follower traits influence the leadership process (Avolio, Walumbwa, & Weber, 2009) and contribute to a richer understanding of leadership (Sy, 2010). The growing interest in followership recognizes that the complexity of organizational dynamics (a) demands an exploration of the role of followers (Marion & Uhl-Bien, 2001), (b) examines follower-based approaches to leadership (Shamir, 2007), and (c) considers the follower to be the primary focus (Graen & Uhl-Bien, 1995). The "romance of leadership" notion highlights the potential bias toward the importance of leaders in organizations (Meindl, Ehrlich, &

Dukerich, 1985) and urges an emphasis on followers and their interaction with leaders (Meindl, 1995).

The Social Construction of Followership

After reviewing the evolution of the construct of followership from a historical perspective, it is important to explore the interactions of followers with others in an organizational setting. The roles of leaders and followers in an organization, by definition, involve an imbalance of authority or a difference in status. Followers appear to develop cognitive schemas over time regarding appropriate or inappropriate behavioral norms or role behaviors to guide their actions in followership roles. Followership behavior involves some degree of deference to the leader (Uhl-Bien & Pillai, 2007), varying from passive to proactive followership (Carsten, Uhl-Bien, West, Patera, & McGregor, 2010). Thus, followers appear to have schemas of followership ranging from subordination and obedience to partnership and co-leadership (Graen & Uhl-Bien, 1995; Shamir, 2007). Individuals employ context-specific schemas depending on their position in the organization and leadership contexts in the social construction process. Implicit leadership theories (ILTs) and implicit followership theories (IFTs) represent dynamic classifications of prototypical leadership and followership behavior that both leaders and followers use as a basis for their organizational interaction with each other (Shondrick & Lord, 2010). The identities of leaders and followers mutually impact each other, with characters that shift within contexts (Collinson, 2006).

Core Self-Evaluations

For several decades researchers have investigated how executives' demographic and psychological characteristics are manifested in their behaviors, especially when they

have a high degree of discretion (Hambrick & Mason, 1984). The premise of this “upper-echelons” research stream is that the personal demographic and psychological characteristics of senior executives influence their choices in various organizational settings. Previously, researchers have evaluated various measures of executive’s self-concepts, including narcissism, hubris, and overconfidence. Recent psychological research has focused on the more comprehensive concept of core self-evaluations (CSE) to concisely measure an individual’s self-assessment. Hiller and Hamrick (2005) proposed applying CSE to executive settings.

Judge, Locke, and Durham (1997) developed and validated CSE, a stable personality trait that describes the “fundamental, bottom-line evaluations that individuals hold about themselves, the world, and others” and subconsciously influences their perceptions and behavior (Bono & Judge, 2003). CSE, a broad latent concept that assesses an individual’s perceptions of self-worth, is composed of at least four specific traits: self-esteem, locus of control, self-efficacy, and emotional stability (neuroticism). It has been found to be a significant dispositional predictor of job satisfaction and job performance (Judge & Bono, 2001). Research suggests that high CSE individuals work more effectively in teams (Zhang & Peterson, 2011) and are more likely to achieve economic success (Judge & Hurst, 2007). Additionally, CSE has been shown to have a moderating effect on individual reactions to organizational social stressors (Harris, Harvey, & Kacmar, 2009). Three of CSE’s four component traits have been investigated at the executive level (Hiller & Hambrick, 2005).

Hypotheses

This study investigates how CFOs' followership propensity and core self-evaluations influence decision-making in conditions of CEO social influence pressure to misstate financial statements. I predict that social influence pressure will increase CFOs' propensity to revise an estimate and will lead CFOs to assign responsibility for their actions to the CEO. I also expect the CFO's level of followership to influence behavior, such that the positive relationship between social influence pressure and CFO revision is stronger when follower effectiveness is lower. Similarly, I expect CSEs to influence CFOs' behavior, such that the positive relationship between social influence pressure and CFO revision is stronger when CSE is lower. Below, I formally develop these expectations.

Several recent financial statement frauds involve pressure from CEOs on subordinates to manipulate financial statements in conflict with GAAP in order to support stock prices (Donegan & Ganon, 2008). For instance, Betty Vinson, a midlevel accountant, reported enormous guilt and fear throughout the unrelenting pressure from her bosses to make false accounting entries at WorldCom (Pulliam, 2003). Similarly, Qwest's CEO, Joseph Nacchio, exerted extreme pressure on subordinates to achieve targets, paying bonuses if targets were met and threatening consequences if they were not (SEC, 2005).

A common motivation in many recent high-profile frauds was management's desire to meet earnings forecasts (Beasley et al., 2010). For instance, the SEC alleged that HealthSouth CEO Richard Scrushy instructed senior officers to match analysts' expectations in order to maintain the stock's market price, and to "fix it" by recording

false earnings to make up any shortfall (SEC, 2003). Likewise, when Enron's top executives realized they were going to miss the number they had promised Wall Street, they desperately scrambled to "fill the holes" in the company's earnings (McLean & Elkind, 2004). Clearly, top management pressure to meet earnings targets by adjusting earnings has relevance in the accounting literature, as well as in actual fraud cases. Considerable research investigates the influence of CEO equity incentives on firm performance and accounting irregularities. For example, stock-option based compensation is positively associated with CEO self-interested behavior, including the likelihood of managing corporate earnings upward (Bergstresser & Philippon, 2005; Burns & Kedia, 2006; Efendi, Srivastava, & Swanson, 2007), meeting or beating earnings targets (Cheng & Warfield, 2005), and committing accounting fraud (Johnson, Ryan, & Tian, 2009).

Despite the numerous examples of accountants succumbing to pressure from CEOs, a review of accounting research uncovers only a small body of literature concerning the susceptibility of accountants to social influence pressure. In a public accounting firm setting, auditors were found to be susceptible to obedience pressure when receiving inappropriate instructions from a superior (DeZoort & Lord, 1994; Lord & DeZoort, 2001). Additionally, in experiments with management accountants, the likelihood of violating explicit policy and creating budgetary slack increased when subjects were faced with obedience pressure from an immediate superior (Davis, DeZoort, & Kopp, 2006; Hartmann & Maas, 2010).

Compliance pressure from superiors influences auditors' intention to engage in dysfunctional behaviors. For example, supervisors' requests to underreport time were

found to have significant explanatory power regarding subordinate auditors' underreporting behavior (Lightner, Adams, & Lightner, 1982; Sweeney, Arnold, & Pierce, 2010).

Two studies examine the behavior of accountants under pressure leading to financial statement manipulation. First, using student subjects, Baird and Zelin (2009) found that pressure to obey supervisors overpowers an individual's tendency to act ethically, increasing an individual's likelihood of participating in financial statement fraud. Second, in a firm-level examination into causes of accounting manipulations, Feng et al. (2011) provided indirect archival evidence on the effect of pressures from superiors by suggesting that CFOs manipulate financial statements as a result of pressure from CEOs rather than from an attempt to acquire immediate personal gain. I extend this research, by examining specific types of pressure, using CFO subjects and the following hypotheses, which draw on the limited accounting literature and the more extensive social psychology literature:

H1a: CFOs under *obedience* pressure from the CEO to meet an earnings target will report higher earnings (by recording a smaller final inventory adjustment) than will CFOs under no obedience pressure.

H1b: CFOs under *compliance* pressure from the CEO to meet an earnings target will report higher earnings (by recording a smaller final inventory adjustment) than will CFOs under no compliance pressure.

Obedience theory, developed from Milgram's series of studies, states that under obedience pressure, target subordinates break from an autonomous state, become agents for the authoritative source, and tend to deny responsibility (Milgram, 1963). The concept of individuals shifting responsibility for their actions is a central tenet of obedience theory (Burger, 2009). Milgram's (1963) experiments suggested that ordinary people

were willing to justify unethical behavior by claiming that they were merely following orders, thus abdicating individual moral responsibility. Thus, obedience pressure links two areas of the fraud triangle, pressure and rationalization. Additionally, obedience pressure offers an explanation for a perplexing question in the arena of white-collar crime: why seemingly “good” people, with moral convictions and a clean record, would commit “bad” acts (Baird & Zelin, 2009). In accordance with obedience theory’s responsibility shifting prediction, accountants who violated corporate policy found themselves less responsible for their actions than did participants who refused to follow inappropriate directives from the authority figure (Davis, DeZoort, & Kopp, 2006). However, recent SOX 302 certification requirements were designed and implemented to strengthen CFOs’ sense of responsibility for the financial statements. Such policy enhancements introduce tension into the question of whether CFOs would be similarly motivated to abdicate responsibility to their CEO and offer an opportunity to incorporate such policy-related effects into the obedience theory literature. Thus, the current study uses obedience theory to motivate the responsibility-shifting hypothesis in a scenario of significant interest to policy makers.

I am not aware of any research investigating the degree to which individuals under compliance pressure hold themselves less responsible for their actions. However, in a setting in which the superior (as opposed to a peer) makes the request for compliance, I expect the presence of an authority figure to result in a similar responsibility shifting effect due to the power the supervisor holds over the subordinate. Therefore, in accordance with obedience theory’s key component of responsibility shifting, suggesting that individuals who succumb to obedience pressure will feel less

responsible for their decision and will be more likely to assign responsibility for their actions to their superior in comparison to individuals who resist pressure, I hypothesize the following:

- H2a:** CFOs who revise their initial inventory judgments under *obedience* pressure will find themselves less responsible for the decision than CFOs who do not revise their inventory judgments under obedience pressure.
- H2b:** CFOs who revise their initial inventory judgments under *compliance* pressure will find themselves less responsible for the decision than CFOs who do not revise their inventory judgments under compliance pressure.

Social influence pressure literature posits that obedience pressure is the most potent type of social influence pressure because of the power a hierarchical supervisor holds over an employee. Pressure from a superior produces a great deal of stress in the subordinate, particularly regarding the potential negative impact on job and career (DeZoort & Lord, 1994, 1997). Obedience pressure is an *order* from a hierarchical superior to a subordinate target. In contrast, compliance pressure is a *request* from a colleague at any level. Thus, obedience pressure's strength lies in a combination factors, including the hierarchical nature of the relationship (superior to subordinate) and the way the influence attempt is framed (order rather than request).

In another line of research exploring management's power and influence in organizations, Raven and his colleagues have developed, refined, and expanded a social power taxonomy. French and Raven's (1959; Raven, 1965) typology of the bases of social power or tactics (e.g., legitimate, coercive, reward, referent, expert, and informational) describes the types of power found in supervisor-subordinate relationships. In their initial work (French & Raven, 1959; Raven, 1965), social influence was described as a target's change in attitude, belief, or behavior that results from the actions of an influencing agent. Individuals in positions of power can choose from a

variety of power tactics when attempting to influence others (e.g., reward power promises compensation in return for compliance, whereas coercive power threatens punishment in order to gain compliance). Raven (1992) expanded the taxonomy to include 14 bases of power and developed the power interaction model (see Elias, 2008 for a review) to provide a theoretical framework for examining the antecedents and outcomes associated with social power choice.

Subsequently, the soft-harsh classification (Koslowsky & Schwarzwald, 2001; Raven, Schwarzwald, & Koslowsky, 1998) has been used to explore the use of power. *Harsh* (or positional) tactics rely on the influencing agent's status and are threatening in that they are forceful and direct. In contrast, *soft* (or personal) tactics tend to be more subtle and positive by relying on the influencing agent's personal assets and using collaboration or socializing. Thus, when classifying pressure types based on the influencing strategy utilized, obedience pressure is a *harsh* tactic because it involves hierarchy-based legitimate power (Raven et al., 1998) and compliance pressure is a *soft* tactic.

The influencing agent's choice of power tactics utilized to influence and gain compliance is situationally contingent. For example, higher status individuals utilized a greater variety of power tactics in conflict situations (Koslowsky & Schwarzwald, 1993), harsh tactics usage was associated with environments where routine tasks predominated (Schwarzwald, Koslowsky, & Ochana-Levin, 2004), and harsh tactics met with greater resistance from subordinates who perceived their supervisor as possessing similar knowledge and experience (Koslowsky, Schwarzwald, & Ashuri, 2001). When choosing power tactics to influence CFO targets, the foregoing discussion suggests that CEO

influencing agents are likely to use a variety of tactics due to their higher status. Additionally, given the more complicated nature of the situations, CEOs may avoid harsh tactic usage. Finally, since CFOs are likely to perceive the CEO's experience and knowledge in financial matters as similar to their own or even less (less power distance), if harsh tactics were used, CFO subordinates may react with resistance. As discussed in the following pages, subordinates who resist inappropriate influences from superiors are not only reflecting their disagreement, but may also be initiating a constructive dialog toward a more positive outcome.

In conclusion, social influence pressure literature predicts that obedience pressure is generally the most potent form of social influence pressure. In comparison, Raven's harsh-soft line of research suggests that compliance pressure may be more effective in the CEO-CFO context due to the complex situation and the CEO's lack of superiority in financial reporting experience and knowledge in comparison to the CFO. Since the preceding arguments suggest alternative effects, I do not make a directional prediction in the following hypothesis:

H3: The amount of earnings adjustment for CFOs under *compliance* pressure will be different than that for CFOs under *obedience* pressure.

Followers and Leaders

White-collar criminals have been described as generally falling into two groups: leaders or followers, with different personality profiles and motives (Bucy et al., 2008). Top management team collusion in financial statement fraud schemes necessitates the consideration of why certain followers are unwilling or unable to resist the pressures exerted by their leaders.

Historically, leadership studies have focused on the effects of exceptional leaders on their followers (Bass, 1999; Conger & Kanungo, 1987; Shamir, House, & Arthur, 1993). Even though not all authority is just, we are taught from childhood to obey rather than to challenge or question authority (Zimbardo, 2009). A dominant authority figure who negatively influences subordinates increases the level of unethical behavior (Treviño et al., 1998) and is a primary risk factor for fraud (AICPA, 2002). Recent studies investigate “destructive leadership” and the toxic triangle: destructive leaders, susceptible followers, and conducive environments (Padilla, Hogan, & Kaiser, 2007; Thoroughgood, Hunter, & Sawyer, 2011).

Followers’ self-worth may become intertwined with the leader’s vision, and unethical charismatic leaders with unilateral power may select or mold obedient or dependent followers (Howell & Avolio, 1992). Charismatic leaders are frequently able to inspire trust and a “reflexive obedience” in subordinate followers (Zahra, Priem, & Rasheed, 2005). Researchers have divided followers into groups of conformers, who passively comply whether through fear or reverence, and colluders, who actively participate through greed or ego (Padilla et al., 2007). Accountants should create environments conducive to good followership (Arlinghaus, 2006).

Kelley’s (1992) model of follower behavior suggests that followers from the world of accounting “who are *conformist* (active and dependent, uncritical thinking) and *passive* (passive and dependent, uncritical thinking) would be most prone to be influenced by the policies, actions and language of their CEO” (Amernic & Craig, 2010). Similarly, in an exploratory qualitative study, Carsten et al. (2010) found that some followers are passive, obedient, and deferent, while others view their roles as

participative and proactive. Sy (2010) surveyed leaders' perceptions of follower characteristics and developed a followership prototype (industry, enthusiasm, and good citizen) and followership antiprototype (conformity, insubordination, and incompetence). Sy urged an extension of his research to an examination of followers' perceptions.

Chaleff (2003) urges followers to appropriately exercise resistance or "courageous followership" by challenging the leader or voicing constructive criticism and dissent. He indicates that courageous followers have the courage to assume responsibility, to serve, to challenge, to participate in the transformation, and to take moral action. Thus, Chaleff also values active participation among followers and asserts that some followers with high activity levels are more likely to voice dissent against inappropriate leader behavior.

Typologies provide a parsimonious framework for describing complex processes and consistent patterns among constructs "that should be subjected to quantitative modeling and rigorous empirical testing" (Doty & Glick, 1994). Typologies have been used to explain charismatic (Trice & Beyer, 1993) and transformational (Tichy & Devanna, 1986) leadership.

Of the primary practitioner typologies described above, only Kelley (1992) provides a published instrument by which followers can be assessed and categorized. Kelley's scale provides a grounded means of analysis for follower effectiveness (according to levels of critical independent thinking and activity level), and coupled with Kelley's typology provides a means to predict variance among constructs (Doty & Glick, 1994). I initiate the investigation of followership among accountants with the following hypothesis:

- H4:** Followership will moderate the relationship between social influence pressure and CFO financial statement revision, such that the positive relationship between social influence pressure and CFO financial statement revision is stronger when follower effectiveness is lower.

Core Self-Evaluations

Effective transformational leaders engage and mobilize followers by articulating a vision and incorporating followers into the vision. Shamir, House, and Arthur (1993) suggest that successful charismatic leaders match their vision with followers' existing goals and individual self-concepts. Thus, certain follower personality or behavioral characteristics may moderate the effect of leadership on outcomes. For instance, in a meta-analysis of 136 behavioral ethics studies, Kish-Gephart, Harrison, and Treviño (2010) investigated the antecedents of unethical decision making in organizations, including individual characteristics. Their results indicated that individuals who obey the authority figures are lower in cognitive moral development, are Machiavellian, and have an external locus of control.

The core self-evaluations (CSE) (Judge et al., 2003) construct is designed to measure the appraisals people make of their overall value; their capabilities in controlling their life; their competence in performing, coping, and succeeding; and their general belief that their life will turn out well. CSE is a relatively new construct indicated by the following traits: self-esteem, self-efficacy, locus of control, and neuroticism (i.e., emotional stability).

CSE's four component traits are among the most frequently studied in the psychology literature. For example, Hinrichs (2007) proposed that low self-efficacy followers (who believe they lack leadership capability or potential) are more likely to defer moral responsibility to the leader and to view leaders as having more responsibility

in decision-making. Additionally, prior research suggests follower self-esteem is related to both organizational citizenship behavior (OCB) and deviant workplace behavior (DWB) (Avey, Palanski, & Walumbwa, 2011).

In a setting in which a hierarchical superior exerts social influence pressure, I expect a target individual's level of resistance to be influenced by their self-esteem, self-efficacy, locus of control, and emotional stability. Specifically, individuals high in CSE feel confident, competent, and successful. Additionally, they feel capable of coping with problems, in control of their own success, and able to determine their own destiny. This discussion suggests the following hypothesis:

- H5:** CSE will moderate the relationship between social influence pressure and CFO revision, such that the positive relationship between social influence pressure and CFO financial statement revision is stronger when CSE is lower.

CHAPTER THREE

METHODOLOGY

Experimental Task

To evaluate pressure's effect on financial reporting decisions, the participants completed an experimental task (provided in the Appendix) involving social influence pressure from the CEO to engage in earnings manipulation. Participants were randomly assigned to one of the three pressure treatment groups: a control group receiving no pressure, an obedience pressure group (i.e., demand from a superior), and a compliance pressure group (i.e., request from a superior).

After completing the experimental task, the participants in each treatment group completed a brief followership questionnaire and a CSE instrument to assess whether their individual personality characteristics influenced their level of intention to revision their estimate (these are not included in the Appendix). Finally, participants completed a series of questions that will be used as a manipulation check and to collect demographic information about the participants.

Design

The study's three-level design involved an experiment with three types of social influence pressure manipulated randomly between subjects: a control group receiving no pressure, an obedience pressure group (i.e., demand from a superior), and a compliance pressure group (i.e., request from a superior). Participants in each of the three pressure

treatment groups were evaluated based upon their scores on Kelley's (1992) 20-item followership questionnaire and the 12-item Judge et al. (2003) Core Self-Evaluations Scale (CSE).

Research Instrument

The instrument provided the participants with a financial reporting case involving a CFO's earnings manipulation decision under three types of CEO pressure. The case materials and vignette are partially derived from previous research (DeZoort, Hermanson, & Houston, 2003a, 2003b; Libby & Kinney, 2000). The vignette described a "gray" or ambiguous earnings management scenario, and involved a CFO's decision regarding whether to meet an earnings target by manipulating the amount of an inventory adjustment.

Participants assumed the role of CPAs employed as CFOs for a mid-size publicly traded company that manufactures and distributes cellular telephone accessories to retailers. First, participants were presented with the financial information, including estimated year-end balances for the current year, pretax earnings per share (EPS) as currently stated of \$1.10 per share, and the consensus analysts' EPS forecast of \$1.08 per share. Next, the participants were presented with an inventory obsolescence issue for their consideration. A competitor's newly introduced product is expected to reduce demand and services for one of their products, necessitating an inventory write-down to net realizable value. Participants were told that their tentatively proposed adjustment would reduce pretax EPS from \$1.10 to \$1.06. Ultimately, the participants were given the opportunity to revise their inventory adjustment.

Independent Measures

Social influence pressure (PRESSURE) was manipulated at three types based on statements made by the CFO's immediate supervisor, the company's CEO, during a meeting to discuss the year-end financial results. Participants in the control group (no pressure condition) were assured "that ultimately the inventory write-down decision is yours to make". In the obedience pressure condition, the CFO received pressure to engage in earnings management from the CEO who emphasized the extreme importance of meeting short-term earnings estimates – and explicitly *tells* the CFO to change the tentative inventory adjustment so as to meet the earnings target. In the compliance pressure condition, the CFO again received pressure from the CEO, but rather than a directive, the pressure is in the form of a request – the CEO *asks* the CFO to change the tentative inventory adjustment so as to meet the earnings target.

Dependent Measures

Revision of an Inventory Adjustment Decision

The vignette involved professional judgment regarding a CFO's decision in response to CEO pressure to change an accounting estimate (i.e., to revise their initial inventory adjustment recommendation to meet an earnings target). After reading the background information regarding a financial reporting decision, the participants' propensity to revise was assessed using a three-item measure. First, participants were asked to indicate "the likely final inventory adjustment and pretax EPS you would record" with endpoints of "\$1.06, your initial adjustment" and "\$1.10, EPS before any adjustment" (REVISION). The decision to revise enough to meet an earnings target (move from \$1.06 to the analysts' forecast of \$1.08 of EPS) is less than 2% of pretax

EPS, but it is qualitatively material according to Staff Accounting Bulletin No. 99, Materiality (SEC, 1999) since it means the difference between meeting or missing an earnings target.

Next, participants were asked about actions of a typical or average CFO in an attempt to obtain more unbiased responses to questions regarding sensitive subjects such as potential accounting fraud (Cohen, Pant, & Sharp, 1996). In addition to asking the participants to indicate the “final inventory adjustment and pretax EPS you would record”, I also asked subjects to indicate the “final inventory adjustment and pretax EPS that a typical public company CFO would record in this situation”. This additional question was intended to control for the potential “social desirability” or “halo” effect in business ethics cases measuring behavioral intention (Cohen, Pant, & Sharp, 1993) and to eliminate potential bias induced by vanity (Milgram, 2009). Additionally, I avoided value-laden language in the case and questions by asking participants for an honest assessment of an adjustment, without labeling the adjustment as fraudulent, aggressive, or manipulative. I also included language in the case indicating that the adjustment involved considerable judgment and subjectivity.

Participants were asked to briefly explain their decision with the following open-ended questions: Please list at least two primary reasons in order of importance for your decision (and a typical public company CFO’s decision) in this situation. Participants’ responses provided a richer understanding and additional insight into the potential rationalizations and responsibility shifting associated with participants’ judgments. Finally, the participants were asked to estimate the percentage of typical CFOs who would “make a small enough final inventory adjustment to result in pretax EPS of \$1.08 or more”.

Responsibility Assessment

Participants were asked to “assign responsibility for your final inventory adjustment” using a 100-point allocation method between themselves (the CFO), their superior (the CEO), and others. This assessment indicated the degree to which participants accept responsibility themselves or assign responsibility for their decision to the authority figure. Participants were also asked the following open-ended question: “Please indicate the reasons for your decision above regarding allocating responsibility for the final inventory adjustment among the CFO (you), the CEO (Chris), or others”.

Other Measures

Manipulation Check

To determine whether the participants interpreted the study’s experimental manipulation in the intended way, the instrument included a multiple-choice question regarding the CEO’s communication regarding the final inventory adjustment. Specifically, participants were asked whether the CEO said that the inventory write-down decision was “*yours* to make” (no pressure), “*asked* you to please change your proposed inventory write-down” (compliance pressure) or “*told* you to change your proposed inventory write-down” (obedience pressure). (See discussion in the Results section regarding the wording of this question and its revision in the second mailing.)

Perceptions of the Case

Participants were asked a series of questions to assess the understandability and realism of the case. To obtain the participants’ perceptions of the degree of ethical conflict in the case and the ethicality of the proposed action, participants were asked, “If the situation described in this case were real, how much pressure would you feel to record

a smaller final inventory adjustment (smaller than the \$2 million tentative adjustment)?”; and “In this case, do you believe it is unethical for the CFO to record a smaller final inventory adjustment (smaller than the \$2 million tentative adjustment)?”. To assess participants’ views regarding the legality of the case scenario, participants were asked, “In this case, do you believe it is illegal for the CFO to record a smaller final inventory adjustment (smaller than the \$2 million initial adjustment)?”. In addition, participants were asked to indicate whether they have ever actually been pressured by anyone to improperly manipulate the financial statements.

Whistleblowing

To assess the likelihood of whistleblowing in the experimental situation, following Davis et al. (2006), the obedience [compliance] treatment groups were asked, “If you were faced with this situation in practice, how likely would you be to **report** the CEO’s order [request] telling [asking] you to ‘go back and fix this now so that we meet our target’”? Additionally, participants were asked to indicate the party to whom they would most likely report.

Demographic and Company Variables

Demographic control variables included age, gender, education, job title, professional experience, and professional certification. Company characteristics included the company’s industry and size in revenue.

Moderator Variables

Followership

Based on the followership questionnaire, participants were evaluated as to their level of followership (FOLLOWERSHIP) based on Kelley’s (1992) 20-question

followership questionnaire which includes two dimensions: activity level (10 items) and propensity for independent thinking (10 items). Kelley's instrument utilizes a seven-point Likert scale, ranging from 1-*Rarely*, 4-*Occasionally*, to 7-*Almost Always* (Kelley uses a 0-6 scale, while I coded the scale from 1 to 7). Similarly, the current study measures the CFOs' self-reported frequencies utilizing a seven-point Likert scale, ranging from 1-*Rarely*, 4-*Occasionally*, to 7-*Almost Always*. Kelly's effective followers score high on both activity level and independent thinking. Thus, follower effectiveness increases as both activity level (10 to 70 in the current study) and independent thinking (10 to 70 in the current study) increase, ultimately creating a continuous variable measuring followership (20 to 140 in the current study).

This instrument included 10 questions to assess activity level and 10 questions to assess level of independent thinking. Example items are, "Do you take the initiative to seek out and successfully complete assignments that go above and beyond your job?"; "Do you independently think up and champion new ideas that will contribute significantly to the leader's or the organization's goals?"; and "Do you assert your views on important issues even though it might mean conflict with your group or reprisals from the leader?"

Core Self-Evaluations

Core Self-Evaluations (CSE) were assessed with the 12-item Judge et al. (2003) core self-evaluations instrument. The instrument measured participants' responses utilizing a five-point Likert scale with endpoints of 1-*Strongly disagree* and 5-*Strongly agree*. Example items are, "When I try, I generally succeed."; "Overall, I am satisfied with myself."; and "I am capable of coping with most of my problems." Based on the

results of the instrument, participants were evaluated as to their level of CSE. This instrument has six reverse-coded items. CSE increases as scores increase, producing a continuous variable ranging from 12 to 60 (Tsaousis, Nikolaou, Serdaris, & Judge, 2007). A recent review of 15 years of CSE research found general support for CSE's internal consistency, reliability and validity (Chang, Ferris, Johnson, Rosen, & Tan, 2012).

The items for the 20-question followership questionnaire and 12-item core self-evaluations scale were included in the instrument. Cronbach's alpha is used to explore the internal consistency of the scales as applied to the CFO sample. The Cronbach's alpha coefficients of .835 for the followership scale and .828 for the CSE scale are well above the recommended level of .70 (Hair et al., 2010).

Because the study's data are collected using a self-report measure in a single instrument, the possibility of common methods bias must be addressed (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003). The research instrument was carefully designed in an attempt to minimize the potential sources of common method variance. Additionally, Harman's single-factor test is used to diagnose the extent of any potential threats to internal validity. The results of Harman's single-factor test do not indicate a problem resulting from common methods bias. An exploratory factor analysis with the study's variables reveals that no single factor accounts for more than 29% of the variance (well under the 50% level for concern).

Model

Based on the discussion above, an analysis of covariance (ANCOVA) model is used to examine the effects of pressure on the inventory adjustment decision and test hypotheses 1, 3, 4, and 5. The complete model is:

$$\text{REVISION} = f(\text{PRESSURE}, \text{FOLLOWERSHIP}, \text{CSE}, \text{PRESSURE} \times \text{FOLLOWERSHIP}, \text{PRESSURE} \times \text{CSE}, \text{ACCTEXP})$$

PRESSURE has three levels (1 = no pressure, 2 = compliance pressure, and 3 = obedience pressure). FOLLOWERSHIP and CSE are measured as continuous variables from 20 to 140 and 12 to 60, respectively. ACCTEXP (the natural log of each CFO's accounting experience) is a control variable.

Pretesting

The primary focus of the case materials was to evaluate professionals' propensity to revise their accounting estimate and their susceptibility to pressure. Given the sensitive nature of the research focus and the fact that respondents were drawn from the top management team, particular care was taken with the design and administration of the research instrument. The materials were developed with reference to previously published research (DeZoort et al., 2003a, 2003b; Libby and Kinney, 2000) and reviewed by a panel of experts active in the accounting behavioral ethics area for realism, relevance, accuracy, and internal consistency. Additionally, the questionnaire was pilot tested with a small group of graduate accounting students and with a few individuals with previous CFO experience. The instrument was revised based on this feedback.

Participants

A total of one hundred twenty one (121) U.S. public company CFOs participated in the study. Participants were drawn from an *Audit Analytics* pool of public company CFOs appointed or reappointed between 1/1/2005 to 6/30/2012 to serve companies with revenues greater than \$0 but less than \$2 billion. After eliminating 196 addresses in non-English speaking countries, the CFO sample was randomly selected from the *Audit*

Analytics pool of the 2,238 most recently appointed CFOs in companies matching the revenue and date criteria. The case materials were mailed via USPS priority mail to 635 CFOs. Each packet included a personalized letter on the university's color letterhead, a hand-stamped return envelope, a hand-written note encouraging participation, and the incentive of a charitable contribution to the charity of their choice (Dillman, 2009). Sixteen packages were returned due to insufficient addresses and resent after obtaining better addresses. Second requests were sent four weeks after the initial mailing. A total of 121 CFOs responded, for a response rate of 20% based on the adjusted sample size of 607 (there were 28 sets of undeliverable materials).

The 20% response rate is quite good when compared to other recent CFO studies, particularly unsponsored studies (studies without a sponsoring professional organization). For example, a study mailed to public company CFOs drawn from the Compact Disclosure database yielded a 7% response rate (Gillett & Uddin, 2005). The 15.1% response rate from CFOs in Gibbins, McCracken, & Salterio (2007) was described as the highest response rate to date for a Financial Executives Institute (FEI)-sponsored study. In a recent email study co-sponsored by CFO Magazine and Duke University, 5.4% of the CFOs responded (Dichev, Graham, Harvey, & Rajgopal, 2012). Audit committee studies sponsored by large accounting firms (e.g., DeZoort et al. 2003a, 2003b, 2008) have typically drawn response rates of approximately 20%, but similar studies without sponsors (e.g., Bierstaker et al. 2012) have response rates of 10% or less.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

Manipulation Check and Related Issues

A manipulation check question was used to evaluate the effectiveness of the manipulation in the case instrument. In the first mailing, participants were asked to, “Indicate your judgment as to the degree of pressure on the CFO to make a smaller final inventory adjustment to meet the earnings target”. The response choices were (1) The CEO, Chris, said that ultimately the inventory write-down decision is *yours* to make, (2) The CEO, Chris, *asked* you to please change your proposed inventory write-down, and (3) The CEO, Chris, *told* you to change your proposed inventory write-down.

This question was reworded for the second mailing after written comments from three respondents indicated confusion over the wording, and based on a lower than expected pass rate for the initial mailing (49%). In the second mailing, participants were asked, “Which of the following reflects the CEO’s communication to you regarding the final inventory adjustment?” The response choices remained the same in the second mailing. The participants’ pass rate improved to 78.3% on the second mailing, for an overall manipulation check pass rate of 54.5%.¹ After eliminating 55 CFOs who failed the manipulation check, 66 participants remained for subsequent hypothesis testing.

¹ The overall manipulation check results are reasonably comparable with prior studies with executive-level subjects. For example, in studies of audit committee members, DeZoort et al. (2003a) and DeZoort et al. (2003b) report manipulation check failure rates of 38% and 36%, respectively, versus 45.5% in the present study.

The ANCOVA results for the full sample ($n = 117$ after excluding those with incomplete responses) are not consistent with the results presented in Table 5. For example, if participants who failed the manipulation check are included, Model 2 in Table 5 is not significant ($p = 0.52$)². Thus, the study's findings hold only when CFOs who fail the manipulation check are excluded.

The only significant demographic or expertise difference between respondents failing the manipulation check question and respondents passing the manipulation check question was age. Respondents who failed the manipulation check were significantly ($p < 0.01$) older ($M = 53.11$; $SD = 7.39$) than those who passed ($M = 49.24$; $SD = 6.46$).

The power of the manipulation (for those passing the manipulation check question) also was evaluated with an alternative measure designed to assess the participants' perception of pressure in the case. Specifically, participants were asked, "If the situation described in this case were real, how much pressure would you feel to record a smaller final inventory adjustment (smaller than the \$2 million initial adjustment)?" on a 100-point³ scale with endpoints⁴ of 0 = "None" and 100 = "A Great Deal".

As presented in Table 1, obedience group participants perceived significantly more pressure ($M = 64.48$, $SD = 25.75$) than members of the control group ($M = 39.39$,

² All p -values are two-tailed, unless otherwise indicated.

³ Such 100-point scales are common in similar studies in accounting literature (e.g., DeZoort et al., 2003a, 2003b, 2008; Bierstaker et al., 2012).

⁴ For the instrument's 100-point graphic rating scales, participants were asked to indicate their responses by placing a slash on a ruled line with labeled anchors. Their slash-mark responses were then converted to the 0-100 scale based on where the slash crossed the line (DeZoort et al., 2003a, 2003b, 2008; Bierstaker et al., 2012). However, some respondents indicated their answers with a circle. The circled responses were converted to a 0-100 scale based on the center of the circle on the line or based on the value corresponding to the circled anchor values if the words were circled.

$SD = 29.06$) and the compliance group ($M = 45.00$, $SD = 30.58$) ($p = 0.004$ and $p = 0.030$, respectively). In contrast, the difference in the perceived pressure of the compliance group and the control group was not significant. Thus, the choice of power tactics employed by the CEO affected the perception of pressure in participant CFOs. This points to the effectiveness of the experimental setting.

Table 1. Descriptive statistics: Perceived pressure ($n = 66$ CFOs)

<i>Overall</i>	<i>n</i>	<i>Mean</i>	<i>SD</i>	<i>t</i>	<i>Sig.</i>	<i>t</i>	<i>Sig.</i>
No pressure (control)	23	39.39	29.06				
Compliance pressure	22	45.00	30.58	-.631 ^a	.532		
Obedience pressure	21	64.48	25.75	-3.019 ^a	.004	-2.253 ^b	.030
Total	66	49.24	30.12				

^a Independent-samples *t*-test comparing group mean with mean of no pressure group.

^b Independent-samples *t*-test comparing group mean with mean of compliance pressure group.

All *p*-values are two-tailed.

Pressure Treatment Groups:

No pressure: Control group with no obedience or compliance pressure from the CEO.

Compliance pressure group: Group received pressure from the CEO in the form of a request – the CEO asks the CFO to change the tentative inventory adjustment so as to meet the earnings target.

Obedience pressure group: Group received pressure from the CEO in the form of a demand – the CEO tells the CFO to change the tentative inventory adjustment so as to meet the earnings target.

Participants' Perceptions of the Case

Overall, the participants found the case to be realistic and understandable. Using a 100-point scale (anchored 0 = “*Not at all Realistic*” and 100 = “*Very Realistic*”), the participants agreed that the case was realistic ($M = 64.64$, $SD = 26.22$). The participants also indicated that the case was understandable ($M = 88.20$, $SD = 14.54$) on a scale anchored 0 = “*Not at all Understandable*” and 100 = “*Very Understandable*”). Both means are significantly greater than the scale midpoint of 50 ($p < 0.001$).

Participants' views as to the ethicality and legality of the experimental setting showed more variation (perhaps due to the purposeful selection of a "gray" fact situation). The participants had diverse views about whether changing their inventory adjustment would be unethical. When asked, "In this case, do you believe it is unethical for the CFO to record a smaller final inventory adjustment?", the mean response of 46.71 ($SD = 32.02$) was not significantly different than the midpoint of 50 on a scale anchored 0 = "Completely Unethical" and 100 = "Completely Ethical". However, 20 respondents' responses were ≤ 25 and 17 respondents' responses were ≥ 75 . The CFO participants indicated that recording the inventory adjustment would not be illegal when asked, "In this case, do you believe it is illegal for the CFO to record a smaller final inventory adjustment?" The participants' mean response of 63.92 ($SD = 33.14$) on a 100-point scale anchored 0 = "Completely Illegal" and 100 = "Completely Legal" was significantly greater than the scale midpoint of 50 ($p = 0.001$).

There were no significant differences in responses to the ethicality and legality questions between pressure groups ($p > 0.050$ in all cases). However, the 40 CFOs who did not change their initial adjustment felt such a change was significantly ($p = 0.001$) more unethical ($M = 36.85$; $SD = 27.67$) than the 26 CFOs who ultimately changed their recommended adjustment in the case ($M = 61.88$; $SD = 32.81$). Participants showed similar differences in their judgment as to the legality of the situation. The CFOs who did not change their recommended adjustment in the case viewed the prospect of making such a change to be significantly ($p = 0.02$) more illegal ($M = 56.33$; $SD = 31.96$) than the CFOs who did not change their recommendation ($M = 75.62$; $SD = 32.07$).

Participants were also asked if they had “ever actually been pressured by anyone to improperly manipulate the financial statements”. Sixteen (24.2%) of the CFOs reported experiencing improper pressure. The CEO was identified as the source of the pressure in 62.5% of such cases. The prevalence of actual improper pressure from CEOs reinforces anecdotal evidence from high-profile fraud cases and confirms the importance of the topic.

Participants subjected to pressure in the hypothetical case expressed mixed feelings toward whistleblowing. When asked about the likelihood that they would report an improper request (or order) to “go back and fix this now so that we meet our target” (on a 100-point scale anchored 0 = “*Very Unlikely*” and 100 = “*Very Likely*”) the mean response of 45.47 ($SD = 34.14$) was not significantly different than the indifference midpoint of 50. Participants’ responses reflected strong feelings at both extremes. Almost half (41.8%) of the responses were less than 25, and nearly one-third of the responses were greater than 75 (30.2%). There were no significant differences in responses between pressure groups or between participants who revised their recommended adjustment and those who did not.

Respondent Demographics

Table 2 presents demographic information for the 66 CFOs (participants are collectively referred to as CFOs, although one participant is identified as a controller). A majority of the participants were CPAs (81.8%) with public accounting experience

(84.8%). Most of the participant CFOs (89.4%) were male and between the ages of 40 and 59 (86.3%). Thirty-nine percent of the participants have a graduate degree.

Participants possessed a mean of 5.7 years of experience in their current position and 20.6 years of accounting experience. In a majority of the cases, the CFO's current company operated in a non-regulated industry (74.2%) and reported total revenue less than \$250 million (59.1%). In summary, the participants' demographics indicate that they possess the ability and expertise required to complete the research materials and render a judgment in a complex accounting situation.

Additionally, when compared to the 5,055 CFOs in the subset of the Audit Analytics database from which they were drawn, the respondents were similar in age and size of company of employment (see Table 2), suggesting that the sample is representative of the *Audit Analytics* population of CFOs on certain dimensions.

TABLE 2. Participant demographics ($n = 66$ CFOs)

<i>Variable</i>	<i>Number</i>	<i>Percent</i>
Title		
CFO	65	98.5%
Controller	1	1.5%
CFO age ^a		
Under 40	5	7.6%
40-49	28	42.4%
50-59	29	43.9%
60 or over	4	6.1%
CFO gender		
Male	59	89.4%
Female	7	10.6%
CFO education		
Bachelors	40	60.6%
Masters	24	36.4%
JD	1	1.5%
PhD/DBA	1	1.5%
CFOs with CPA certification	54	81.8%
CFOs with public accounting experience	56	84.8%
Annual revenue of CFO's current company ^a		
Under \$250 million	39	59.1%
\$250 – \$499 million	10	15.2%
\$500 – \$999 million	10	15.2%
\$1 billion and over	7	10.6%
Industry of current company ^b		
Non-regulated industry	49	74.2%
Regulated industry	15	22.7%
No response	2	3.0%
	<i>Mean</i>	<i>SD</i>
Years of experience		
Current position	5.7	4.2
Accounting	20.6	10.2

^a Means for CFOs in the subset of the Audit Analytics database are as follows: CFO age (46.9) and annual company revenue (\$339 million).

^b Participants were dispersed across 20 industry categories with no more than 9 CFOs in any category.

Descriptive Results for REVISION

The descriptive results for the dependent variable, REVISION, by pressure treatment are presented in Table 3. The results in Panel A present the CFO's propensity to revise an estimate in response to CEO pressure to meet an earnings target (i.e., to revise the initial inventory adjustment recommendation to meet an earnings target). Specifically, the mean results reflect the degree to which CFOs are willing to change their initial estimate on a scale of 0 (*the CFO's initial adjustment of \$2 million or \$1.06 EPS*; i.e., no change to the CFO's initial estimate) to 100 (*an adjustment of \$0 or \$1.10 EPS*; i.e., CFO changes his/her estimate to \$0). Thus, higher values of REVISION indicate greater acquiescence to the CEO's pressure in the pressure conditions (and greater reductions of the CFO's initial inventory adjustment). The midpoint of 50 represents the CEO's desired adjustment (*an adjustment of \$1 million or \$1.08 EPS*; i.e., a change to meet the analysts' forecast). Panel B presents the results measured by the actual dollar amount of the CFO's inventory adjustment revision (i.e., a scale of \$0 of revision to \$2,000,000 of revision). Subsequent results are presented using the 0 to 100 scale only.

Table 3. Descriptive statistics: Pressure effects on inventory adjustment revisions (REVISION) ($n = 66$ CFOs)

<i>Pressure treatment group</i>	<i>n</i>	<i>Mean (0-100)</i>	<i>SD (0-100)</i>	<i>t</i>	<i>Sig.</i>	<i>t</i>	<i>Sig.</i>
Panel A: Means using 0-100 scale (0 = \$2 million final adjustment [no revision], 100 = \$0 final adjustment [complete revision])							
No pressure (control)	23	4.91	14.39				
Compliance pressure	22	21.05	31.89	-2.171 ^a	.038		
Obedience pressure	<u>21</u>	<u>18.67</u>	<u>27.35</u>	-2.059 ^a	.048	.262 ^b	.795
Total	66	14.67	26.10				
Panel B: Means using \$ size of downward revision							
<i>Pressure treatment group</i>	<i>n</i>	<i>Mean (\$)</i>	<i>SD (\$)</i>	<i>Final adjustment % Participants assigning</i>			
				<i>\$2M</i>	<i>\$2M<x<\$1M</i>	<i>≤\$1M</i>	
No pressure (control)	23	\$98,200	\$287,800	83%	9%	9%	
Compliance pressure	22	\$421,000	\$637,800	50%	23%	27%	
Obedience pressure	<u>21</u>	<u>\$373,400</u>	<u>\$547,000</u>	<u>48%</u>	<u>33%</u>	<u>19%</u>	
Total	66	\$293,400	\$522,000	61%	21%	18%	

^a Independent-samples t-test comparing group mean with mean of no pressure group.

^b Independent-samples t-test comparing group mean with mean of compliance pressure group.

All p -values are two-tailed.

Pressure Treatment Groups:

No pressure: Control group with no obedience or compliance pressure from the CEO.

Compliance pressure group: Group received pressure from the CEO in the form of a request – the CEO asks the CFO to change the tentative inventory adjustment so as to meet the earnings target.

Obedience pressure group: Group received pressure from the CEO in the form of a demand – the CEO tells the CFO to change the tentative inventory adjustment so as to meet the earnings target.

The pressure-related hypotheses predicted that CFOs under social influence pressure from the CEO would be more likely to make revisions to their estimates than CFOs under no pressure. Specifically, Hypotheses 1a and 1b predicted that obedience pressure and compliance pressure would influence CFOs' inventory adjustments (i.e., CFOs would report higher earnings by recording a smaller final inventory adjustment). Consistent with H1a and H1b, the results in Table 3 show that CFOs' mean inventory

revisions for the compliance and obedience pressure groups ($M = 21.05$ and 18.67 , respectively) are significantly higher than the mean inventory revision of 4.91 ($p < 0.038$ and $p < 0.048$, respectively) for the control group under no such pressure.

Hypothesis 3 predicted that CFO judgments under compliance pressure would be different than CFO judgments under obedience pressure, with no prediction as to the direction of the difference. However, there was not a significant difference in CFO response under compliance versus obedience pressure ($p = 0.795$), inconsistent with hypothesis 3. Thus, the revisions of CFOs subjected to compliance pressure were similar to the revisions of CFOs under obedience pressure. This result is interesting when considered in light of the participants' reported levels of *perceived* pressure (see Table 1 above). CFOs under compliance pressure indicated low levels of perceived pressure, similar to the control group and significantly less than the obedience group. Taken together, the perceived pressure and revision results suggest that although compliance pressure does not create perceived pressure, it generates an actual response (REVISION) similar to obedience pressure.

Responses by pressure treatment group (Panel B) reveal significant differences in the proportion of participants willing to revise their initial adjustment so as to meet the analysts' forecast (make an inventory adjustment of \$1 million or less). Only two participants (9%) in the control group made such an adjustment. In contrast, six (27%) of the compliance group participants and four (19%) of the obedience pressure group participants made inventory adjustment recommendations sufficient to meet the earnings target.

Table 4 provides descriptive results for the moderator and control variables (i.e., followership, CSE, and accounting experience). The results are categorized according to the degree to which CFOs ultimately revised their inventory adjustment in response to CEO pressure (i.e., no pressure, no acquiescence, zone of compromise, and total acquiescence). The means appear quite similar across groups, and t-tests reveal no significant differences ($p > 0.05$). These relations are further explored in the ANCOVA testing below.

Table 4. Descriptive statistics: Moderator and control variables ($n = 66$ CFOs)

<i>Pressure response group</i>		<i>FOLLOWERSHIP</i>	<i>CSE</i>	<i>ACCTEXP</i>
No pressure (control)	<i>Mean</i>	115.41	3.99	21.00
	<i>SD</i>	11.09	.47	10.24
	<i>n</i>	23	23	23
Pressure, but no acquiescence (\$2M)	<i>Mean</i>	119.43	3.95	21.81
	<i>SD</i>	8.88	.53	9.36
	<i>n</i>	21	21	21
Pressure and Zone of Compromise (\$2M < x < \$1M)	<i>Mean</i>	120.50	4.06	23.08
	<i>SD</i>	7.38	.51	8.73
	<i>n</i>	12	12	12
Pressure and total acquiescence (\leq \$1M)	<i>Mean</i>	115.10	3.88	14.40
	<i>SD</i>	11.23	.55	12.17
	<i>n</i>	10	10	10

Pressure Response Groups:

No pressure (control) group: participants were not subjected to pressure treatment.

No acquiescence group: participants refused to change their initial inventory adjustment recommendation of \$2 million despite a demand or request by the CEO.

Zone of compromise group: participants changed their initial inventory adjustment recommendation of \$2 million, but not to \$1 million as demanded or requested by the CEO.

Total acquiescence group: participants changed their initial inventory adjustment recommendation of \$2 million to \$1 million or less in response to a demand or request by the CEO.

Variable Definitions:

FOLLOWERSHIP = total score on the 20-item Followership questionnaire, with each item measured on 7-point scale (possible total score range 20 - 140);

CSE = total score on the 12-item Core Self Evaluations scale, with each item measured on a 5-point scale (possible total score range 12 - 60); and

ACCTEXP = years of accounting experience (raw years of experience are shown in this table).

ANCOVA Results

An analysis of covariance (ANCOVA) model is used to examine the effects of pressure on the inventory adjustment decision and test hypotheses 1, 3, 4, and 5 (see subsequent section for testing of H2). The complete model is shown below:

$$\text{REVISION} = f(\text{PRESSURE}, \text{FOLLOWERSHIP}, \text{CSE}, \text{PRESSURE X FOLLOWERSHIP}, \text{PRESSURE X CSE}, \text{ACCTEXP})$$

PRESSURE has three levels (1 = no pressure, 2 = compliance pressure, and 3 = obedience pressure).⁵ FOLLOWERSHIP and CSE are measured as continuous variables from 20 to 140 and 12 to 60, respectively. ACCTEXP (the natural log of each CFO's accounting experience) is a control variable.⁶ Previous research indicates that a CFO's number of years of experience is positively associated with earnings quality (Aier et al., 2005). Additional potential control variables were added to the model, one at a time – age, gender, education, professional certification, years in current position, years of public accounting experience, annual revenue of current company, and industry (regulated or not). None of these was significantly related to REVISION ($p > 0.05$).

The ANCOVA results for H1, H3, H4 and H5 are presented in Table 5. Model 1 includes only the manipulated variable (PRESSURE), Model 2 adds the moderator variables (FOLLOWERSHIP and CSE) and control variable (ACCTEXP), and Model 3 adds the interactions (PRESSURE X FOLLOWERSHIP and PRESSURE X CSE) to

⁵ When PRESSURE is converted to a dummy variable (0 = no pressure, 1 = pressure), Model 2 results in Table 5 are similar and PRESSURE is significant at $p < 0.01$.

⁶ Substituting raw accounting experience for the natural log of each CFO's accounting experience in Model 2 in Table 5 produces similar results (ACCTEXP has $p = 0.001$).

allow for testing of H4 and H5. Results from Model 1 provide some support for the influence of PRESSURE on REVISION ($F = 2.64; p = 0.080$).

Model 2 is significant ($F = 3.34; p = 0.010$), and adjusted R^2 improves from 4.8% in Model 1 to 15.2% in Model 2. The results also indicate that PRESSURE ($F = 3.64; p = 0.032$), FOLLOWERSHIP ($F = 5.70; p = 0.020$), and ACCTEXP ($F = 6.38; p = 0.014$) are significantly related to REVISION.^{7, 8} Specifically, pressure from the CEO increases the CFOs' propensity to revise, as expected in H1 (see the contrast testing below for further analysis of this effect and specific insights into H1 and H3). Effective followers (who score higher on the followership scale) are less likely to revise their inventory adjustment. Thus, the Model 2 results indicate a direct effect for followership in resisting improper CEO pressure. Likewise, CFOs with more accounting experience make smaller revisions (i.e., provide lower inventory revisions) to their accounting estimates under pressure, highlighting the importance of accounting experience in resisting CEO pressure. The ANCOVA results indicate that CSE is not significant ($F = 1.35; p = 0.250$).^{9, 10}

⁷ In Model 2, the inventory adjustment recommendations for CFOs who had previously experienced inappropriate pressure were not significantly different ($p = 0.148$) than the recommendations of participants who had no such experience.

⁸ Including the participants' views regarding the ethicality and legality of the case as control variables (one at a time) in Model 2 yields similar results for PRESSURE and FOLLOWERSHIP (ethicality and legality have $p < 0.001$), but ACCEXP is then only marginally significant ($p = 0.078$ and $p = 0.063$, respectively).

⁹ The Breusch-Pagan/Cook-Weisberg test provides evidence of heteroskedasticity. As a result, the REVISION data was converted to ranks in order to perform a non-parametric sensitivity test (e.g., Conover, 1980). The ANCOVA on ranks provides similar results ($F = 3.11; p = 0.015$), but ACCTEXP is no longer significant ($F = 2.61; p = 0.111$).

¹⁰ There is a strong, positive correlation between CSE and FOLLOWERSHIP ($r = .52; p = 0.01$). To assess possible multicollinearity, I ran the model as a regression (replacing the three-level PRESSURE variable with two dummy variables, COMPLIANCE and OBEDIENCE). Both COMPLIANCE and OBEDIENCE are significant ($p \leq 0.03$), and the maximum variance inflation factor (VIF) is 1.47, well below the standard criterion of 10. Therefore, multicollinearity is not an issue.

Model 3 examines H4 and H5 by including the interaction effects for followership and CSE; each variable interacted with PRESSURE. Hypothesis 4 and 5 predicted that the positive relationship between social influence pressure and CFO revision would be stronger when follower effectiveness and CSE are lower, respectively. Model 3 is significant ($F = 2.41$; $p = 0.022$). However, PRESSURE ($F = 2.12$; $p = 0.130$) and FOLLOWERSHIP ($F = 1.65$; $p = 0.205$) are no longer significant (see comments below regarding the statistical power of this model). The model's interaction terms, PRESSURE X FOLLOWERSHIP ($F = 2.15$; $p = 0.126$) and PRESSURE X CSE ($F = 0.24$; $p = 0.784$), are not significant.¹¹ Therefore H4 and H5 are not supported. ACCTEXP is the only variable that remains significant ($F = 2.15$; $p = 0.012$).

Given the changes to the significance of variables with the addition of the interaction terms in Model 3, it is appropriate to assess the power of the models. Observed power for the overall model, which is adequate (Hair et al., 2010) in both models as shown in Table 5, increased from .872 in Model 2 to .880 in Model 3. However, observed power for the PRESSURE variable decreased from .650 in Model 2 to .416 in Model 3. The FOLLOWERSHIP variable had similar drop in power from .652 to .243. In summary, the addition of the interaction terms in Model 3 hurts the model's power and produces insignificant results.¹²

¹¹ The interaction terms in Model 3 also are insignificant if they are included in the model one at a time. CSE also is insignificant in Model 2 when each variable is included in the model one at a time.

¹² Supplemental analysis was conducted in order to assess whether the sample size affected the sensitivity (power) of the results. Sample doubling yields highly significant results for both Model 2 ($F = 7.01$; $p < 0.001$) and Model 3 ($F = 5.26$; $p < 0.001$). Additionally, PRESSURE X FOLLOWERSHIP becomes significant ($F = 4.68$; $p < 0.011$). This suggests that the insignificant findings for H4 reflect small sample size rather than small effect size. This sample size effect is present despite sample cell sizes of greater than the recommended 20 per cell (Hair, Black, Babin, & Anderson, 2010).

The effect size for each of the models is presented in Table 5. Specifically, Cohen's $f = .348$ for Model 2, indicating an effect size between medium (.25) and large (.40) (UCLA, 2013a).

Table 5. ANCOVA results for REVISION^a ($n = 66$ CFOs)

<i>Variable</i>	Model 1		Model 2		Model 3	
	<i>F</i>	<i>p</i>	<i>F</i>	<i>p</i>	<i>F</i>	<i>p</i>
PRESSURE (H1, H3)	2.64	0.080	3.64	0.032	2.12	0.130
FOLLOWERSHIP			5.70	0.020	1.65	0.204
CSE			1.35	0.250	0.77	0.384
PRESSURE X FOLLOWERSHIP (H4)					2.15	0.126
PRESSURE X CSE (H5)					0.25	0.784
ACCTEXP			6.38	0.014	6.76	0.012
Model	2.64	0.080	3.34	0.010	2.41	0.022
Adj. R2		4.8%		15.2%		16.4%
Effect size – Cohen's f^c		.289		.348		.275
Observed Power - Model ^b		.506		.872		.880
Observed Power - PRESSURE ^c		.506		.650		.416

^a The dependent variable measures the CFOs' willingness to revise their initial inventory recommendation on a scale of 0 = no change from CFO's initial recommendation of \$2 million to 100 = revise adjustment to \$0, with a midpoint of 50 = revise adjustment to \$1 million to meet earnings target.

^b Partial eta squared.

^c Computed using alpha = .05.

All p -values are two-tailed.

Variable Definitions:

PRESSURE = manipulated variable (1 = control 2 = compliance, or 3 = obedience);

FOLLOWERSHIP = total score on the 20-item Followership questionnaire, with each item measured on 7-point scale (possible total score range 20 - 140);

CSE = total score on the 12-item Core Self Evaluations scale, with each item measured on a 5-point scale (possible total score range 12 - 60); and

ACCTEXP = Natural log of years of accounting experience.

Contrast Testing

In order to directly test H1 and H3, planned contrast tests are run (UCLA, 2013b).

Table 6 presents the results for contrast testing based on Model 2 (using Model 3 yields

similar results). As predicted, the planned contrast test results in Table 6 reveal significant differences ($p < 0.05$) between the no pressure and obedience pressure groups (H1a) and no pressure and compliance pressure groups (H1b). Although not specifically hypothesized, the planned contrast test results also reveal a significant ($p = 0.014$) difference between the no pressure condition and the average of obedience and compliance pressure conditions. The planned contrasts reveal no significant difference ($p = 0.654$) between the obedience versus compliance pressure conditions (H3). Overall, the contrast testing results provide support for H1a and H1b, but not H3.

Table 6. Results of hypothesis testing: Pressure effects on REVISION^a
(Planned contrasts testing based on Model 2 above)

<i>Pressure effects</i>	<i>F</i>	<i>p-value</i>
<i>Tests of contrasts of individual treatments</i>		
No pressure versus obedience pressure (H1a)	3.06	0.043*
No pressure versus compliance pressure (H1b)	4.71	0.017*
Obedience versus compliance pressure (H3)	0.20	0.654
No pressure versus average of obedience and compliance	5.07	0.014*

^a “*” denotes a one-tailed p-value, reflecting the directional prediction in H1a and H1b. The other p-value is two-tailed to reflect the non-directional H3.

Inventory Adjustment Decision Justifications

Participants were asked to furnish primary justifications for their inventory adjustment decisions. Table 7 summarizes the CFOs’ explanations, grouped by their degree of acquiescence to social influence pressure. Panel A provides the primary justifications from CFOs who complied with the CEO’s directive/request and recommended an inventory adjustment of \$1 million or less in order to meet an earnings target. A review of the responses for the 10 participants who acquiesced totally indicates

that most ($n = 8$) considered the inventory adjustment issue to be subjective or immaterial. Additionally, several participants felt that it was either too early to tell ($n = 2$) or that the original recommendation should be reviewed or it was incomplete ($n = 2$). In summary, these CFOs argued that the materiality, subjectivity, or uncertainty of loss justified postponing an adjustment to inventory.

Panel B provides the primary justifications from the CFOs who recommended a compromise inventory adjustment amount less than their original recommendation but greater than the CEO's directive/request. Similar to the CFOs who acquiesced in Panel A, some CFOs who compromised felt the original recommendation was incomplete and should be reviewed ($n = 5$) or the issue was subjective or immaterial ($n = 3$). This similarity is because some CFOs only acquiesced a very small amount (i.e., $REVISE \leq 6$ in five cases). Other participants provided justifications more aligned with the views of CFOs who did not acquiesce at all (i.e., Panel C) by explaining that their initial recommendation was supported by the evidence ($n = 3$) and that it is not appropriate to manage earnings or make decisions based on analysts' forecasts ($n = 3$).

Approximately half ($n = 21$) of the CFOs refused to change their initial inventory adjustment recommendation at all despite pressure from the CEO (Panel C). The majority of these CFOs ($n = 12$) indicated that their original recommendations were supported by the evidence. Other respondents stated that it is not appropriate to manage earnings or make decisions based on analysts' forecasts ($n = 7$). Five CFOs explained that the CEO did not offer substantive evidence to support reconsideration, while four CFOs were guided by personal integrity or certification expectations. Thus, CFOs who held firm to

Table 7. Justification for revision decision ($n = 66$ CFOs)

#	Justification	n
Panel A: Total Acquiescence Under Pressure ($n = 10$ with change to inventory adjustment recommendation = \$1 million or more)		
1.	Original estimate is subjective or not material	8
2.	It is too early to tell. Give it another quarter and consider other factors	2
3.	Original recommendation was incomplete and should be reviewed	2
Panel B: Zone of Compromise Under Pressure ($n = 12$ with change to inventory adjustment recommendation = \$0 < x < \$1 million)		
1.	Original recommendation was incomplete and should be reviewed	5
2.	I am confident that my initial recommendation is supported by evidence	3
3.	It is not appropriate to manage earnings or make decisions based on analysts' forecast	3
4.	Original estimate is subjective or not material	3
Panel C: No Acquiescence Under Pressure ($n = 21$ with change to inventory adjustment recommendation = \$0)		
1.	I am confident that my initial recommendation is supported by evidence	12
2.	It is not appropriate to manage earnings or make decisions based on analysts' forecast	7
3.	CEO did not offer substantive evidence to support reconsideration	5
4.	Personal integrity or certification expectations	4
Panel D: No Pressure Group ($n = 23$ with mean change to inventory adjustment recommendation = \$98,000)		
1.	I am confident that my initial recommendation is supported by evidence	13
2.	Industry/product/or technology factors dictate treatment	8
3.	Adjustment is appropriate under GAAP/SOX 404/SEC/ required disclosure	5

Most of the 66 participants provided multiple reasons for their inventory adjustment decision.

Pressure Response Groups:

Total acquiescence group: participants changed their initial inventory adjustment recommendation of \$2 million to \$1 million or less in response to a demand or request by the CEO.

Zone of Compromise group: participants changed their initial inventory adjustment recommendation of \$2 million, but by an amount less than the \$1 million change demanded or requested by the CEO.

No acquiescence group: participants refused to change their initial inventory adjustment recommendation of \$2 million despite a demand or request by the CEO.

No pressure: Control group with no obedience or compliance pressure from the CEO.

their initial recommendation highlighted their confidence in their original evidence-based decision and their perception that the CEO's directive/request was not evidence-based. They were also influenced by their personal integrity and their views regarding earnings management.

Panel D summarizes the viewpoints of CFOs who were not pressured by the CEO. Many of the members of the control group also mentioned that they were confident that their initial recommendation was supported by the evidence ($n = 13$). Other CFOs felt that the issue should be guided by either industry or technology factors ($n = 8$) or by regulatory or standard-setting body requirements ($n = 5$). Clearly, without the influence of social pressure, these CFOs saw the issue as a technical or accounting issue rather than a subjective or multi-dimensional judgment.

Additional Analyses

Participants were asked two questions to assess their perceptions of how typical CFOs would respond in a similar situation. The results provide some evidence of a halo effect. First, participants' mean inventory adjustment amount for a typical CFO ($M = 33.00$; $SD = 29.86$) was greater than their self-assessed mean inventory adjustment ($M = 14.67$; $SD = 26.10$). Such difference ($M = 18.75$; $SD = 26.06$) was significantly greater than zero ($p < 0.001$). Additionally, participants indicated that almost half ($M = 44.05$; $SD = 30.17$) of typical public company CFOs would acquiesce completely and "make a small enough final inventory adjustment to result in pretax EPS of \$1.08 or more" (untabulated). In contrast, the participants' responses in Table 3 reveal that only 18% of the participants indicated that *they* would completely acquiesce. There were no significant differences between the pressure groups.

Table 8 presents the participants' perceptions of a typical CFO's mean inventory adjustment ($M = 33.00$; $SD = 29.86$) organized first by pressure treatment group and then by pressure response group. In the Panel A results by pressure treatment group, the means for the no pressure ($M = 26.17$; $SD = 23.82$), compliance ($M = 36.86$; $SD = 32.40$) and obedience group participants ($M = 36.79$; $SD = 33.31$) are all significantly higher than the CFOs' mean responses to the question calling for *their own* inventory adjustment recommendation ($p < 0.001$; $p < 0.01$; and $p < 0.05$, respectively).

Panel B, Table 8 presents the results for the typical CFOs question organized by response group. The overall mean response ($M = 33.00$; $SD = 29.86$) reflects the CFOs' judgment as to a typical public company CFO's inventory revision decision. The typical CFO's mean inventory adjustment for CFOs who completely acquiesced to pressure from the CEO ($M = 69.22$) was significantly higher ($p < 0.001$ and $p < 0.003$, respectively) than the means for CFOs who did not acquiesce and who compromised ($M = 25.90$ and 31.18 , respectively). In contrast, the mean for the CFOs who compromised ($M = 31.18$) was not significantly different ($p = 0.627$) than the mean for CFOs who did not acquiesce ($M = 30.69$). Thus, the results indicate differences among both pressure treatment groups and pressure response groups in their perceptions of the actions of typical CFOs.¹³

¹³ Several prior ethics studies (e.g., Cohen et al., 1993; Lord & DeZoort, 2001) also provide evidence of self-presentation effects (participants view themselves as less likely to revise in comparison to their peers). In contrast, other studies do not find evidence of such effects (e.g., Davis et al., 2006).

Table 8. Descriptive statistics: Typical CFO's inventory revision ($n = 64$)

<i>Pressure treatment group</i>	<i>n</i>	<i>Mean</i> (0-100)	<i>SD</i> (0-100)	<i>t</i>	<i>Sig.</i>		
Panel A: Means of supplemental question regarding typical CFOs by treatment group.							
No pressure (control)	23	26.17	23.82	-4.281 ^b	.000		
Compliance pressure	22	36.86	32.40	-3.183 ^b	.004		
Obedience pressure	19	36.79	33.31	-2.594 ^b	.018		
Total	64 ^a	33.00	29.86	-5.796 ^b	.000		
<i>Pressure response group</i>	<i>n</i>	<i>Mean</i>	<i>SD</i>	<i>t</i>	<i>Sig</i>	<i>t</i>	<i>Sig</i>
Panel B: Means of supplemental question regarding typical CFOs by response group.							
No pressure	23	26.17	23.82				
No acquiescence	21	25.90	30.69				
Zone of Compromise	11	31.18	24.84	-.491 ^c	.627		
Total acquiescence	9	69.22	24.25	-3.750 ^c	.001	-3.444 ^d	.003
Total	64 ^a	33.00	29.86				

^a Two CFOs declined to comment on the actions of typical CFOs.

^b Paired-samples *t*-test comparing group mean of supplementary question regarding typical CFO's decision with primary question calling for their decision.

^c Independent-samples *t*-test comparing group mean with mean of no acquiescence group.

^d Independent-samples *t*-test comparing group mean with mean of zone of compromise group.

All *p*-values are two-tailed.

Pressure Treatment Groups:

No pressure: Control group with no obedience or compliance pressure from the CEO.

Compliance pressure group: Group received pressure from the CEO in the form of a request – the CEO asks the CFO to change the tentative inventory adjustment so as to meet the earnings target.

Obedience pressure group: Group received pressure from the CEO in the form of a demand – the CEO tells the CFO to change the tentative inventory adjustment so as to meet the earnings target.

Pressure Response Groups:

Total acquiescence group: participants changed their initial inventory adjustment recommendation of \$2 million to \$1 million or less in response to a demand or request by the CEO.

Zone of Compromise group: participants changed their initial inventory adjustment recommendation of \$2 million, but by an amount less than the \$1 million change demanded or requested by the CEO.

No acquiescence group: participants refused to change their initial inventory adjustment recommendation of \$2 million despite a demand or request by the CEO.

No pressure: Control group with no obedience or compliance pressure from the CEO.

Responsibility Assessment

Hypothesis 2 predicted that CFOs who revise their initial inventory estimate under pressure would find themselves less responsible for their decision than CFOs who do not revise. The responsibility results in Table 9 do not support H2.¹⁴ In fact, the 10 CFOs who acquiesced to the CEO's demand/request assigned directionally *more* responsibility to themselves in comparison to the other groups, rather than less as expected. Thus, although the results contradict obedience theory's responsibility shifting prediction, they provide support for Schlenker et al.'s (1994) responsibility theory, which suggests that perceived responsibility is a function of an individual's connection to and identification with a set of policies or standards. As discussed in the subsequent section, the CFOs' primary rationalization for assigning primary responsibility was their view of the CFO's duties and responsibilities as principal accounting officer and the SOX 302 certification requirements.

¹⁴ One respondent's allocation percentage was changed to reflect his/her clear intention based on the written response to the open-ended question regarding responsibility (see Table 10). Specifically, the responsibility allocation of one respondent who wrote, "ultimately, I am responsible" and "the number should be up to me" was changed from 10% CFO and 80% CEO to 80% CFO and 10% CEO in order to match the written remarks.

Table 9. Responsibility assessment: % of responsibility assigned to CFO, CEO, or others ($n = 66$)^a

<i>Pressure response group</i>		<i>CFO</i>	<i>CEO</i>	<i>Other</i> ^b
No pressure	<i>Mean</i>	69.3	18.9	11.7
	<i>SD</i>	23.8	16.0	14.9
	<i>N</i>	23	23	23
No acquiescence	<i>Mean</i>	83.3	9.5	7.1
	<i>SD</i>	25.2	18.2	16.1
	<i>N</i>	21	21	21
Zone of compromise	<i>Mean</i>	85.4	11.3	3.3
	<i>SD</i>	15.3	15.4	6.5
	<i>N</i>	12	12	12
Total acquiescence	<i>Mean</i>	86.5	8.0	5.5
	<i>SD</i>	18.6	11.1	9.6
	<i>N</i>	10	10	10

^a The percentages above reflect the CFOs' assessment of responsibility for the inventory revision decision when asked to allocate responsibility to the CFO, CEO, or other.

^b Most (78.9%) of the nineteen CFOs who allocated a portion of the responsibility to someone other than the CFO or CEO identified the controller, COO, or sales/marketing director.

Pressure Response Groups:

No pressure: Control group with no obedience or compliance pressure from the CEO.

No acquiescence group: participants refused to change their initial inventory adjustment recommendation of \$2 million despite a demand or request by the CEO.

Zone of Compromise group: participants changed their initial inventory adjustment recommendation of \$2 million, but by an amount less than the \$1 million change demanded or requested by the CEO.

Total acquiescence group: participants changed their initial inventory adjustment recommendation of \$2 million to \$1 million or less in response to a demand or request by the CEO.

The results in Table 10 summarize the CFOs' responses to an open-ended question asking the CFOs to, "Indicate the reason for your decision above regarding allocating responsibility for the final adjustment." The results indicate that the recent SOX certification requirements offer one potential explanation as to why CFOs who acquiesce to pressure might continue to hold themselves 100% responsible for the decision. Panel A provides the primary justifications from CFOs who assigned 100% of

the responsibility for the inventory adjustment decision to the CFO. A review of the CFOs who accepted all of the responsibility ($n = 28$) indicates that they were guided primarily by their view of their responsibility for the financial statements, including the SOX Section 302 certification requirements. They indicated that the primary reason for their allocation was the CFO's ultimate responsibility for the financials as the principal accounting officer ($n = 20$). Additionally, participants were guided by their analysis or the accounting standards ($n = 5$) or by their SOX certification responsibilities ($n = 4$).

Panel B provides the primary justifications from the CFOs who assigned at least 75%, but less than 100%, of the responsibility for the inventory adjustment decision to the CFO ($n = 18$). Like the CFOs who assigned 100% in Panel A, some CFOs in this group assigned ultimate responsibility for financial information to the CFO as principal accounting officer ($n = 13$). Others in this group also assigned responsibility to the CEO. For example, five CFOs felt that since the CEO and CFO both certify the financials under SOX, they should share responsibility. Five others indicated that the CEO should be consulted in such decisions based on his/her operating knowledge.

Panel C summarizes the views of the CFOs who assigned less than 75% of the responsibility to the CFO ($n = 20$). Again, many CFOs in this group mentioned that the CFO's role as principal accounting officer was an important factor in their responsibility assessment ($n = 6$). Many of the group also felt that the CEO and other company officers should also be assigned responsibility. Six CFOs in this group indicated that the primary officers of company should be assigned collective responsibility for the decision. Five others felt that the CFO should consult with the CEO due to his operating knowledge.

Table 10. Justification for responsibility assessment ($n = 66$ CFOs)

#	Justification	n
Panel A: CFO fully responsible group ($n = 28$ with responsibility to CFO = 100%)		
1.	CFO as principal accounting officer has ultimate responsibility for financials	20
2.	Information/numbers/analysis/accounting standards are basis for the decision	5
3.	CFO certifies under SOX / CFO and CEO both sign, but CFO has ultimate responsibility	4
Panel B: CFO median responsible group ($n = 18$ with responsibility to CFO = $75\% \leq x < 100\%$)		
1.	CFO as principal accounting officer has ultimate responsibility for financials	13
2.	CEO and CFO both sign under SOX so responsibility is shared	5
3.	CFO primarily responsible but should consult with CEO due to his operating knowledge	5
Panel C: CFO least responsible group ($n = 20$ with responsibility to CFO of less than 75%)		
1.	CFO as principal accounting officer has ultimate responsibility for financials	6
2.	Primary officers of company have collective responsibility for decision	6
3.	CFO primarily responsible but should consult with CEO due to his operating knowledge	5

Most of the 66 participants provided multiple reasons for their inventory adjustment decision.

Responsibility Assessment Groups:

CFO fully responsible group: participants assigned 100% of the responsibility for their ultimate inventory adjustment decision to the CFO.

CFO median responsible group: participants assigned less than 100%, but at least 75% of the responsibility for their ultimate inventory adjustment decision to the CFO.

CFO least responsible group: participants assigned less than 75% of the responsibility for their ultimate inventory adjustment decision to the CFO.

CHAPTER FIVE

CONCLUSIONS, LIMITATIONS, AND FUTURE RESEARCH

Through an experiment, this study examines the influence of social influence pressure on CFO judgments. Consistent with obedience and compliance theory, CEO pressure significantly increased the CFOs' willingness to revise an accounting estimate by revising their recommended inventory adjustment. The results also reveal two variables that influence the effect of pressure. CFOs with more years of accounting experience and CFOs who score high on the effective follower scale are less likely to revise their initial adjustment. In contrast, the results did not reveal a significant effect for CSE, or any moderating effects of followership or CSE. Interestingly, in contrast to the tenets of obedience theory, individuals who acquiesced to the CEO did not hold themselves less responsible for their actions than those individuals who did not acquiesce.

This study's findings have important implications for researchers, practitioners, and policymakers. From a research perspective, the study provides insight into the strength of social influence pressure on financial statement quality in a top management team setting. Specifically, the results highlight the susceptibility of public company CFOs to both obedience and compliance pressure. The results suggest that more subtle forms of pressure (i.e., compliance pressure) generate a response similar to obedience pressure despite a lack of perceived pressure on the part of the CFOs. This study responds to the

Committee of Sponsoring Organizations of the Treadway Commission's (COSO) call for a better understanding of the factors that cause an individual to set aside a personal set of beliefs to engage in fraud, including the attitudes and rationalizations that result in the decision to engage in fraudulent misreporting, and the psyche of individuals involved in fraudulent reporting (Beasley et al., 2010). Additionally, the study's exploration of followership suggests an area for future research.

From a practitioner standpoint, the study has implications for potential improvements to the effectiveness of CFOs as monitors of financial statements. As TMT members, CFOs may be in a unique position to "Just Say No" and contribute to the monitoring function from the inside by offering thoughtful dissent. Exemplary followers, when needed, fulfill an ethical watchdog role (Kelley, 1998; Uhl-Bien & Carsten, 2007).

From a policy viewpoint, the findings suggest that CFOs' vulnerability to pressure is an important detractor of financial statement quality (confirming Baird and Zelin's, 2009, results with a student sample). If CEOs exert undue influence on CFOs, then corporate governance policies and practices should be revised to improve CFO independence and alleviate the pressure. The study also provides evidence of the high level of perceived responsibility on the part of CFOs as a result of such initiatives as SOX Section 302 certification requirements. Further improvements to corporate governance practices should be adopted, including enhancing audit committee interaction with and/or supervision of the CFO position, and encouraging external auditors to proactively develop tools to recognize, respond, and potentially alleviate such pressure (by acting as an advisor or sounding board to CFOs under pressure).

This study is subject to several limitations. First, there are inherent differences in the realism and power found in artificial pressure treatments and a natural setting; real-world pressures would be more powerful and intense than the case's experimental setting (DeZoort and Lord, 1997). Thus, the case presents a conservative measure of the effect of social influence pressure – in this setting, it is costless for the CFOs to ignore pressure from the CEO. Second, CFOs are likely to have a wider range of options available when encountering pressure than the ones presented in the study. For instance, actual CFO decisions may be affected by conversations with colleagues and superiors or adjusted by persuading their superior to modify the requested action. Third, the study measures participants' intended behavior (rather than their actual behavior). Although intention may predict or infer action (Ajzen, 1991), there still remains a degree of uncertainty regarding whether participants would behave differently when faced with the actual pressures. Fourth, since this case involves ethical decision-making, it may be particularly susceptible to “social desirability” or “halo” effects to the extent that participants may respond so as to present themselves more favorably rather than in accordance with their true feelings. Although the research design attempted to reduce this bias, it may not have completely eliminated such effects. The limitations inherent in the experimental condition make the test very conservative and biased against the hypothesized findings. Thus, the strength of the results gives support to the importance of the topic.

Financial statement misreporting remains an important topic for regulators and researchers. Attempts to identify behavioral factors motivating dysfunctional CFO activity are in their infancy. I encourage additional research into social influence pressure and its effect on CFOs including identifying personality factors that influence reactions to

pressure, isolating effective governance measures to support CFO resistance to pressure, improving auditors' tools to assess managements' integrity and susceptibility to pressure.

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Appendix
(excluding Followership and CSE materials)



Coles College of Business
School of Accountancy

September 17, 2012

Dana R. Hermanson

Dinos Eminent Scholar Chair of Private Enterprise
Director of Research – Corporate Governance Center
Kennesaw State University
dhermans@kennesaw.edu
770.423.6077

<<Title>> <<First Name>> <<Middle Name>> <<Last Name>>
<<Position>>
<<Company>>
<<Bus Street 1>>
<<Bus Street 2>>
<<City>>, <<State>> <<Zip>>

Dear <<Title>> <<Last Name>>:

As you know, the role of Chief Financial Officer (CFO) is quite complex and often challenging. My doctoral student, Carol Bishop, is working on her dissertation, in which she is seeking to better understand CFOs' judgments. Dr. Todd DeZoort (The University of Alabama) and I are overseeing Carol's research, and we are both experienced accounting researchers who have performed numerous studies sponsored by leading accounting and corporate governance organizations.

You are among a select group of CFOs we are contacting to ask for assistance with Carol's dissertation research. Your participation is very important to the success of the project and to gain a better understanding of the issues and challenges that CFOs confront in practice. We certainly hope you will contribute a few minutes of your time to help us in this area.

We ask that you read the enclosed hypothetical case and respond to all of the questions that follow using the directions provided in the case. This is not a test, and there are no "right" or "wrong" answers. We are interested in your candid views. Your responses are guaranteed anonymity. No effort will be made to link you to your responses, and all data will be reported in the aggregate only. The project has been approved by our Institutional Review Board.

Completion of the case should take approximately 25 minutes, and we will be happy to recognize your participation with a contribution to the charity of your choice. If you have any questions or would like to receive a summary of the results, please either email Carol at bishop_carol@columbusstate.edu or me at dhermans@kennesaw.edu. Thank you very much for your support of this research.

Sincerely,

Dana R. Hermanson, Ph.D.
Enclosures: Case, Return Envelope



Coles College of Business
School of Accountancy

Dana R. Hermanson
Dinos Eminent Scholar Chair of Private Enterprise
Director of Research – Corporate Governance Center
Kennesaw State University
dhermans@kennesaw.edu
770.423.6077

SECOND REQUEST – October 19, 2012

<<Title>> <<First Name>> <<Middle Name>> <<Last Name>>
<<Position>>
<<Company>>
<<Bus Street 1>>
<<Bus Street 2>>
<<City>>, <<State>> <<Zip>>

Dear <<Title>> <<Last Name>>:

If you responded to our previous mailing in September 2012, thank you very much for your help, and please disregard this letter. If you did not respond, we ask that you please consider assisting us with this important research by taking approximately 25 minutes to complete the enclosed case. We will conclude the data collection by November 20, 2012.

As you know, the role of Chief Financial Officer (CFO) is quite complex and often challenging. My doctoral student, Carol Bishop, is working on her dissertation, in which she is seeking to better understand CFOs' judgments. Dr. Todd DeZoort (The University of Alabama) and I are overseeing Carol's research, and we are both experienced accounting researchers who have performed numerous studies sponsored by leading accounting and corporate governance organizations.

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We ask that you read the enclosed hypothetical case and respond to all of the questions that follow using the directions provided in the case. This is not a test, and there are no "right" or "wrong" answers. We are interested in your candid views. Your responses are guaranteed anonymity. No effort will be made to link you to your responses, and all data will be reported in the aggregate only. The project has been approved by our Institutional Review Board.

We will be happy to recognize your participation with a contribution to the charity of your choice. If you have any questions or would like to receive a summary of the results, please either email Carol at bishop_carol@columbusstate.edu or me at dhermans@kennesaw.edu. Thank you very much for your support of this research.

Sincerely,

Dana R. Hermanson, Ph.D.
Enclosures: Case, Return Envelope



Coles College of Business

RESEARCH STUDY: CFO Decision-Making

This study is part of my research requirement to earn my Doctorate in Business Administration (DBA) at Kennesaw State University. The purpose of the study is to gain insight into the decision-making processes used by Chief Financial Officers (or similarly titled position).

Your position and expertise make your opinions and evaluations very important to this study. We will be happy to make a contribution to the charity of your choice in appreciation for your participation. The study consists of a hypothetical case and follow-up questions. The estimated time for completion is approximately 25 minutes.

Your participation in the study is entirely voluntary, and you may withdraw your consent (or skip a question) at any time without penalty. Additionally, your individual results will be anonymous (all data will be reported in the aggregate only). There are no known risks involved due to participation in this study. You must be at least 18 years of age to participate in this study.

If you have any questions about the study you can contact me using the information below. Research at Kennesaw State University that involves human participants is carried out under the oversight of an Institutional Review Board. Questions or problems regarding these activities should be addressed to the Institutional Review Board, Kennesaw State University, 1000 Chastain Road, #0112, Kennesaw, GA 30144-5591, (678) 797-2268.

Thank you in advance for your time and assistance. Your response is greatly appreciated.

Carol C. Bishop, CPA

bishop_carol@columbusstate.edu

(229) 881-7693

INSTRUCTIONS

1. The pages that follow contain a hypothetical case that includes summary background information and questions for you to answer.
2. It is critical that you attempt to put yourself in the following situation as the company's CFO and answer all of the questions as candidly as possible without consulting anyone else.
3. Please complete the materials/pages in the order given without looking ahead through the pages. There are no right or wrong answers, so please answer the questions in a way that reflects your honest opinions and judgments. To ensure a usable response, please complete **all** of the questions if possible. You will have an opportunity at the end of the case to provide any clarifications or comments you would like to make.
4. Your responses are guaranteed anonymity. No effort will be made to link you to your responses on the following pages, and all data will be reported in the aggregate only.

RESEARCHER

Carol C. Bishop, CPA
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Dissertation Committee

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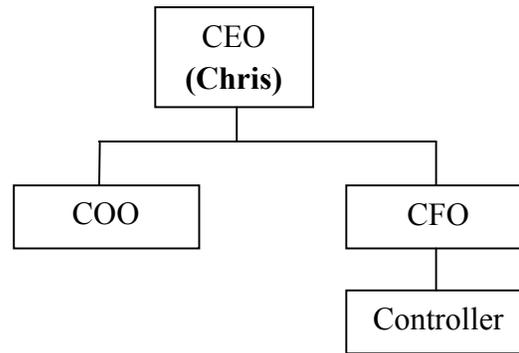
F. Todd DeZoort
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 Professional Advisory Board Fellow
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Please review the case information below and answer the questions that follow.

I. Background

Please assume you are a licensed CPA employed as the Chief Financial Officer (CFO) of Ace Cellular Telephone, Inc. (ACT) for the past three years. ACT is a mid-size publicly traded company that manufactures and distributes cellular telephone accessories to retailers throughout the eastern half of the United States. ACT's management recognizes that heavy competition in the industry and frequent technological advances make inventory obsolescence and inventory valuation key business and accounting issues.

ACT's relevant organizational structure is summarized below:



ACT's Chief Executive Officer (CEO), Chris Smith, has been with the company for the past five years. You report directly to Chris, who completes your performance evaluations and determines your annual raises. Since you joined the company, you have had a successful, effective working relationship with Chris, with no significant disagreements. As CFO, your current areas of responsibility include: financial reporting, investing, capital structure, long-term planning, and budget recommendations. In addition, you are responsible for enforcing company-wide fiscal policies.

II. Financial Information

ACT is in the fourth quarter of its fiscal year. Relevant estimated year-end balances are presented below:

Sales	\$650 million
Total assets	\$550 million
Inventories	\$188 million
Net earnings	\$55 million
Pretax earnings per share (EPS) as currently stated	\$1.10 per share
Consensus analysts' pretax EPS forecast	\$1.08 per share

ACT's pretax EPS has increased by approximately 6% in each of the last three years, similar to the industry average. Consistent with this trend, analysts' pretax EPS forecast of \$1.08 reflects an increase of 6% over the previous year's EPS. ACT's stock price typically reacts negatively when favorable trends in financial results are interrupted.

III. Issue before the CFO

During the fourth quarter of the current fiscal year, one of ACT's closest competitors introduced a product that is technologically superior to and less expensive than similar products currently in ACT's inventory. The competitor's newly introduced product is likely to reduce the demand and sales price for similar products currently in ACT's inventory.

Based on estimates of future customer demand and sales prices, you have decided to make an adjustment to the inventory valuation. You review the following factors to develop an estimate of the net realizable value of inventory: a slowdown in new orders, an increase in inventory levels in comparison to sales levels, the rapid rate of technological change in the industry, and an evaluation of the reliability and technical advantages of the competitor's new product.

Based on your initial assessment, you tentatively propose to write down inventory by \$2 million to a net realizable value of \$186 million (an adjustment of 1 percent of inventory value). Relative to preadjusted balances, your proposed adjustment of \$2 million is approximately 3.6 percent of pretax income, 0.3 percent of sales, and 0.36 percent of total assets. If your adjustment were made in full, **pretax EPS would be reduced from \$1.10 to \$1.06.**

After considering the foregoing information, you are comfortable with the reasonableness of this initial proposed adjustment (and the resulting revised EPS figure), but you recognize the considerable degree of judgment and subjectivity involved in developing the initial adjustment.

Now, you are considering the **final** adjustment to be recorded.

Control Group (No Pressure)

Chris, the company's CEO, meets with you to discuss the year-end financial reporting results. After you explain the effect of your proposed inventory write-down, which would reduce EPS from \$1.10 to \$1.06, Chris assures you that ultimately the inventory write-down decision is **yours** to make.

Compliance Pressure from CEO Condition

Chris, the company's CEO, meets with you to discuss the year-end financial reporting results. After you explain the effect of your proposed inventory write-down, which would reduce EPS from \$1.10 to \$1.06, Chris emphasizes the extreme importance of meeting the current year's earnings target of \$1.08 and **asks** you to change your proposed inventory write-down. Chris says, "If we make this entry, it will just kill our company. Will you **please** go back and fix this now so that we meet our target?"

Obedience Pressure from CEO Condition

Chris, the company's CEO, meets with you to discuss the year-end financial reporting results. After you explain the effect of your proposed inventory write-down, which would reduce EPS from \$1.10 to \$1.06, Chris emphasizes the extreme importance of meeting the current year's earnings target of \$1.08 and **tells** you to change your proposed inventory write-down. Chris says, "If we make this entry, it will just kill our company. I am **telling** you to go back and fix this now so that we meet our target."

Please answer the following questions based on the information in the case above. You may refer back to the case information when responding. Indicate your answer with a slash on the line.

1. Based on the information presented, indicate below the likely **final inventory adjustment and pretax EPS you would record.**

----- ----- ----- ----- -----	----- ----- ----- ----- -----	----- ----- ----- ----- -----
\$2 Million Adjustment	\$1 Million Adjustment	No Inventory Adjustment
\$1.06 EPS	\$1.08 EPS	\$1.10 EPS
Your Initial Adjustment	Analysts' Forecast	EPS Before Any Adjustment

2. Please list at least two primary reasons in order of importance for **your decision above.**

3. How would you assign responsibility for your **final** inventory adjustment above?

You (the CFO)	_____ % Responsible
CEO (Chris)	_____ % Responsible
Others (please describe) _____	_____ % Responsible
TOTAL	100 %

4. Please indicate the reasons for your **decision above** regarding allocating responsibility for the final adjustment among the CFO (you), the CEO (Chris), or others.

5. Based on the information presented, indicate below the likely **final inventory adjustment and pretax EPS that a typical public company CFO would record** in this situation.

----- ----- ----- ----- -----	----- ----- ----- ----- -----	----- ----- ----- ----- -----
\$2 Million Adjustment	\$1 Million Adjustment	No Inventory Adjustment
\$1.06 EPS	\$1.08 EPS	\$1.10 EPS
Your Initial Adjustment	Analysts' Forecast	EPS Before Any Adjustment

6. Please indicate at least two primary reasons in order of importance for a **typical public company CFO's decision above.**

7. Based on the information provided, what percentage of **typical public company CFOs** would make a small enough final inventory adjustment to result in pretax EPS of \$1.08 or more?

_____ %

Please answer the remaining questions without referring back to the case materials.

1. **In this case**, which of the following reflects the CEO's communication to you regarding the final inventory adjustment (*choose one*)?
 - The CEO, Chris, said that ultimately the inventory write-down decision is **yours** to make.
 - The CEO, Chris, **asked** you to please change your proposed inventory write-down.
 - The CEO, Chris, **told** you to change your proposed inventory write-down.

2. How **realistic** do you find this case? |---|---|---|---|---|---|---|---|---|
 (*Indicate with a slash on the line*) Not at all Very
Realistic Realistic

3. How **understandable** do you find this case? |---|---|---|---|---|---|---|---|---|
Not at all Very
Understandable Understandable

4. If the situation described in this case were real, how much **pressure** would you feel to record a smaller final inventory adjustment (smaller than the \$2 million initial adjustment)? |---|---|---|---|---|---|---|---|---|
None A Great
Deal

5. In this case, do you believe it is **unethical** for the CFO to record a smaller final inventory adjustment (smaller than the \$2 million initial adjustment)? |---|---|---|---|---|---|---|---|---|
Completely Completely
Unethical Ethical

6. In this case, do you believe it is **illegal** for the CFO to record a smaller final inventory adjustment (smaller than the \$2 million initial adjustment)? |---|---|---|---|---|---|---|---|---|
Completely Completely
Illegal Legal

7. Have you ever **actually** been pressured by anyone to improperly manipulate the financial statements?
 - Yes, if yes, by whom (person's title within the organization)? _____
 - No

Compliance (obedience) conditions only

8. If you were faced with this situation in practice how likely would you be to **report** the CEO's request (order) for you to "go back and fix this now so that we meet our target"? |---|---|---|---|---|---|---|---|---|
Very Very
Unlikely Likely

9. If you decided to report the CEO's request (directive), to whom would you most likely report (*check only one*)?

<input type="checkbox"/> Board of Directors (as a whole)	<input type="checkbox"/> Internal Auditor
<input type="checkbox"/> Chairman of the Board	<input type="checkbox"/> Whistleblower Hotline
<input type="checkbox"/> Audit Committee	<input type="checkbox"/> Others (<i>please indicate</i>) _____
<input type="checkbox"/> External Auditor	

Please respond to the following demographic questions. These will be used only to analyze the results, not to identify any participant.

1. What position or title do you hold in your organization (*check only one*)?

<input type="checkbox"/> CFO	<input type="checkbox"/> VP of Finance
<input type="checkbox"/> Controller	<input type="checkbox"/> Treasurer
<input type="checkbox"/> Chief Accounting Officer	<input type="checkbox"/> Other _____
2. How much experience do you have in your current position? _____ years
3. How much experience have you had in **public accounting**? _____ years
4. How much experience have you had as an **accountant**? _____ years
5. Please indicate below any professional certifications you have (*check all that apply*).

<input type="checkbox"/> Certified Financial Manager (CFM)	<input type="checkbox"/> Chartered Financial Analyst (CFA)
<input type="checkbox"/> Certified Public Accountant (CPA)	<input type="checkbox"/> Other _____
<input type="checkbox"/> Certified Management Accountant (CMA)	
6. What is your highest educational degree earned (*check only one*)?

<input type="checkbox"/> Bachelors	<input type="checkbox"/> PhD/DBA
<input type="checkbox"/> Masters	<input type="checkbox"/> Other _____
<input type="checkbox"/> JD	
7. What is your age? _____ years
8. What is your gender? _____

Finally, please provide the following information about the company where you are currently employed. This information will be used to analyze responses by company size and industry. Again, your responses will remain strictly confidential.

1. Please indicate the primary industry in which your company operates: _____
2. Please indicate your company's approximate annual revenue:

<input type="checkbox"/> Less than \$250 million	<input type="checkbox"/> \$500 million to \$999 million
<input type="checkbox"/> \$250 to \$499 million	<input type="checkbox"/> \$1 billion or more
3. Please provide any additional comments about the issues examined in this case.

Thank you for your participation. By taking time to share your thoughts and opinions about the challenges faced by CFOs, you have contributed to research in this important area. If you would like a summary copy of the study's results, please email the researcher at bishop_carol@columbusstate.edu. As a token of appreciation, we will make a contribution to the charity of your choice. Please indicate your preference below:

- | | |
|--|--------------------------------------|
| <input type="checkbox"/> American Cancer Society | <input type="checkbox"/> United Way |
| <input type="checkbox"/> American Red Cross | <input type="checkbox"/> Other _____ |
| <input type="checkbox"/> Habitat for Humanity | |