

## **MACHIAVELLIANISM AND SHORT-TERM EARNINGS MANAGEMENT PRACTICES**

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*ABSTRACT: Despite the growing interest, the empirical results found in the literature concerning Machiavellianism and its impact on ethical judgments document both inconsistent and contradictory results. On the other hand, the acceptance of short-term earnings management practices raises the most important and controversial ethical issues in the accounting profession. To help resolve these issues, this particular experimental study explores whether ethical acceptability of short-term earnings management varies with Machiavellian behaviour predisposition. The results of the study find that “high Mach” exhibit less strict ethical judgments than “low Mach” counterparts. Implications for future research are discussed.*

*Keywords: earnings management, Machiavellianism, ethical judgments*

*JEL Codes: I23, M40, M41*

### **Introduction**

Earnings management assessment occupies extensive empirical and theoretical examination in accounting literature. Despite its level of development, earnings management area seems to lack clarity in some aspects. One of the aspects in discussion is the one related to its assessment related to ethicality of such practices. Previous empirical research frequently appears to be inconsistent and occasionally contradictory of other empirical research in terms of predisposition of acceptance of earnings management (e.g. Schepens, 2003; Shafer and Simmons, 2008).

This particular study is timely in light of these conditions. The novelty of this study consist in approaching this demarche under the aegis of Machiavellian behaviour assessment, and tested empirically whether the predisposition for high Machiavellian behaviour is translated in higher acceptance of short-term earnings management practices, mostly considered as being unethical. According to earlier studies conducted by Ren and Guo (2011), economic conditions have also the potential to explain manipulative managerial decisions. This study did not approach this latter path.

The subject is relevant at least for two reasons. First, short-term earnings management practices have the potential to affect the company image, so its assessment is desirable. Second, by trying to assess potential explanatory factors for observed differences in individuals' ethical judgments, both unethical behaviour and behavioural intentions are explained. Since the latter are important aspects in decision making processes with economic consequences, the reliability of such demarche is understood easily.

Developed primarily in psychology literature, Machiavellian behaviour is interested to be examined in accounting and business environment. Therefore, this particular study is an interdisciplinary study that is focusing on two areas.

The remainder of this paper is organized as follows. The first segment comprises the research problem and purpose of the study. The next section provides a review of the relevant literature, followed by the methodology and research design. The discussion segment includes the

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analysis of experiment conducted. The conclusion, limitation and scope for future research segment are the last ones approached.

### **The research problem and purpose of the study**

Since High Machiavellian individuals are willing to do what is necessary in order to achieve their goals, morality is usually not part of their demarches (Bass et al., 1999). Previous literature associates Machiavellianism characteristics with unethical behaviours such as manipulation and fraud (Pan and Sparks, 2012). On the other side, short-term earnings management practices are considered either ethical or unethical, the degree of acceptance vary in time and space. That is the main reason why earnings management acceptability under ethical aegis deserves a continuous examination.

The purpose of this study is to investigate empirically previous theoretical relationships (Pan and Sparks, 2012) and test if the ethical acceptability of short-term earnings management varies with Machiavellian behaviour predisposition.

### **State of the art and hypothesis development**

Short-term earnings management practices in terms of ethical acceptance is opening the road to a strong and challenging spring of research. The main question is related to whether is the right thing to do. Even if individuals moral code should prevent practices like earnings management (e.g. considered by most of the people as being unethical), various results documented in the literature prove the contrary (Wesley and Ndofor, 2013).

According to Wilson et al., (1998) respondents who score high on Machiavellian scale tend to be more manipulative than individuals who score low. They tend to leave an implicit alliance when it is in their advantage (Christie and Geis, 1970) compared with low Machs and also to take advantage on every situation (Murphy, 2012; Wilson et al., 1996).

As such individuals scoring high on Machiavellianism can judge the loss of ethicality more leniently (Pan and Sparks, 2012). According the previous studies conducted in the literature, individuals scoring high on Machiavellianism exhibit less strict ethical judgments compared with individuals scoring low on Machiavellianism (Shafer and Simmons, 2008). On the opposite side there are studies contradicting previous results, where the authors did not found any connection between the scoring of Machiavellianism and participants decisions regarding ethicality. In this respect the study conducted by Schepers (2003) is representative.

In the present study one of the predictors of ethical judgments (e.g. Machiavellianism) is tested, using an adapted research hypothesis after Pan and Sparks (2012) conceits. The hypothesis that matches the purpose of this study is as follows:

*H: As Machiavellianism increases, ethical judgments related to short-term earnings management acceptance become less strict.*

### **Methodology**

Data was collected by means of two questionnaires, administrated to the respondents. The first questionnaire comprised the assessment of the Machiavellian behaviour predisposition, while the second one examines the ethical acceptance of short-term earnings management practices. Our goal was to assess if the Machiavellian behaviour can explain their choices in terms of acceptance as ethical short-term earnings management practices.

### **Research design**

Given the fact that the present research is investigating a causal relationship, an experiment was conducted in order to test earlier stated hypothesis. In this respect 54 last year university students were used as respondents. Each student had to fill up an informational set comprising two

questionnaires and ask to make a decision. All participants received the same information, in the same time and location. There were no differences in terms of: age (e.g. average age was 23 years), history, instrumentation, maturation, selection or testing. Also in order to reduce other internal validity threats like attrition, retention strategies were adopted.

The experiment was developed in two stages as following:

- First stage consisted in testing all participants in terms of Machiavellian behaviour. For this reason the questionnaire developed by Christie and Geis (1970) was used. Considered one of the most suitable instruments to measure it, the Mach IV scale was preferred to conduct this particular study too. Used in more than 500 psychological studies, both experimental and demographic, the scale validates its predictive power in assessing and explaining how the behaviour of high and low Machs differs (Gunnthorsdottir et al., 2002).
- Based on the results obtained in the first stage, two groups were formed in the second stage (low Mach group and high Mach group) and tested them in terms of short-term earnings management practices acceptance. All the results are presented and discussed in the segments below.

The students were chosen as participants of this study since they will be the future managers and practitioners of tomorrow. Accounting students were chosen based on the technical nature of the scenarios comprised in the second stage of the experiment (e.g. the questionnaire developed by Bruns and Mercant, 1990).

### **Sample**

A single group was surveyed, comprising under-graduating last year accounting students from one of the largest public university in Spain. Participation at the experiment was voluntary and the respondents were announced that their responses were anonymous. Six students did not answer all questions, resulting in 54 usable responses. From the students participating, 25 were female. Compared to previous students used as respondents in earnings management acceptance tests, there is no difference between the participants of this research and those ones in terms of accounting course or ethics course hours.

### **The questionnaires**

Two questionnaires were used for achieving the purposes of this research. A first questionnaire assessed the Machiavellianism predisposition. As it was stated above, it was the first questionnaire applied. The questionnaire used (e.g. Mach IV scale) was the one developed by Christie and Geis (1970). Since the questionnaire can be used in three substantive areas (e.g. Machiavellian views, tactics and morality) it was the one that served better our purposes. Similar to Gunnthorsdottir et al., (2002) this research used the scores rank from 20 to 140, having the same explanations and rationality. A constant of 20 is added to all raw scores conducting to a scale ranges from 40 to 160, with a theoretical midpoint of 100. The higher value or score will document the stronger Machiavellian orientation for the respondent.

The second questionnaire applied was the one developed by Bruns and Merchant (1990). It was used to assess the degree of acceptance of short-term earnings management practices. This questionnaire was preferred based on its large applicability in similar previous studies. Similar like in Bruns and Merchant (1990), this research followed the research path approached and informed the respondents about the company description, about the variety of actions undertaken by individuals and also that some of the actions are ethical while others are considered by the most of the people as being unethical. High scores correspond with higher degrees of ethical unacceptability. The same five-point Likert scale was used like in Bruns and Merchant (1990) for the purposes of assessing short-term earnings management practices acceptance.

The language of the questionnaires was English, which is also the language of the line of study for the respondents.

**Findings and discussion**

The results of the experiment conducted indicate some success towards meeting the objective of the study stated earlier. Pan and Sparks (2012) indicated that Machiavellianism predisposition has the potential to influence ethical judgments, since their results supported the generally consisted relationship between ethical judgments and Machiavellianism. Since previous studies examined established empirical relationships but with contradictory results, it is understood the interest for the Machiavellian and short-term earnings management impact assessment.

Table no. 1 reports the mean values for the Mach IV scores in the sample of the present study compared with values obtained in previous research.

Table no. 1

**Mach IV scores in our sample compared to previous results**

	<b>Mean</b>	<b>Previous results (Gunnthorsdottir et al., 2002)</b>
N	54	1593
Median age	23	18
% Female	46,29	61.20
Average score for females	91,40	90.77
Average score for males	92,86	96.69
Average score whole sample	92,17	93.00

Source: Author's projection

Once the first stage was completed, the results of the Mach IV scale comprised the distribution of individuals based on their answers. At a first look, the individuals from this particular study score lower than the respondents examined in Gunnthorsdottir et al. (2002) study. Males, on average score higher on the Mach test compared with females, proportion that is documented also in the present study. Male also are present in a higher proportion than females among the ones scoring High in the present study. However, it is not the purpose of this study to examine Machiavellian behaviour under gender analysis.

Table no. 2 presents the results of the present experiment. Since the interest of this study is on low and high scoring individuals, the following table (e.g. Table no. 3) comprised only the groups of individuals scoring low respectively high. From the latter stage of the experiment, average to low and average scoring was eliminated. Even if there are no significant differences in behaviour between low, average-to-low and average, for the purposes of this study only low and high scoring individuals where examined.

Table no. 2

**Mach IV scores in our sample (without gender separation)**

	<b>Mach IV Scale</b>	<b>Number of individuals</b>
Low	≤ 80	15
Average-to-low	81–90	9
Average	91–95	12
High	≥107	18
Total	----	54

Source: Author's projection

From the present tested population, 15 individuals scored low (below 80) on the Mach IV scale, 9 individuals scored average-to-low (81–90), 12 individuals scored average (91–95) and 18 individuals scored high (more than 107). From whole sample, approximate 27% scored low on the Mach IV scale while approximate 33% scored high.

The results of the first stage of the experimental design conducted documented that there are no significant differences between the individuals examined.

Further, two groups were formed by individuals scoring low and high on Mach IV scale and formed a control group respectively a treatment group in the present experiment. The details and results of the second stage of the experiment are presented in Table no. 3.

Table no. 3

**Results on experimental design – control/treatment group**

<b>(1) Control group – 15 last year students (Low Mach individuals)</b>	<b>(2) Treatment group – 18 last year students (High Mach individuals)</b>
63% scored serious infraction (3.5 to 4.5) Only 5% scored ethical (below 1.5)	61% scored Ethical (below 1.5). Those students scored ethical earnings management scenarios (scenarios 1, 2, 3, 5, 6 and 7) 27% scored questionable (1.5 to 2.5) Only 3% scored totally unethical (4.5 to 5).
<p><i>Students were asked to assess the acceptance of short-term earnings management practices how it is presented in the questionnaire developed by Bruns and Merchant (1990).</i></p> <p><i>Observation: No persuasive language was used in none of the groups examined. Students received the same information, explained in the same manner.</i></p>	

Source: Author’s projection

In the second stage of the experiment students were asked to assess based on the questionnaire developed by Bruns and Merchant (1990) the acceptability of the short-term earnings management practices described. As can be noticed from above table, low individuals ethical acceptance of short-term earnings management is stricter. 63% of the students scored the short-term earnings management practices as being serious infraction while only 5% of them considered them as being ethical. In the treatment group, 61% of the students scored as ethical the short-term earnings management practices presented. The practices scored as ethical by the individuals from the treatment group where among short-term earnings management scenarios with the highest disagreement in terms of ethicality (e.g. scenarios 1, 2, 3, 5, 6 or 7). Among the high Machs group, 27% scored the practices presented as being questionable and only 3% of them scored the practices as being totally unethical (4.5 to 5). In both groups, the rest of the individuals scored either minor practice or serious infraction.

Based on the results presented it can be documented that high Mach scoring individuals have less stricter views regarding short-term earnings management practices acceptance while low Machs have stricter views.

**Conclusion, limitations and scope for future research**

The present study documents that ethical acceptability of short-term earnings management practices depends also on the predisposition to “high” or “low” Machiavellian behaviour. The results of the present study show that individuals that score high on Machiavellian scale are having less strict views concerning the ethicality of short-term earnings management practices. While high Machs consider most of the short-term earnings management as being ethical acceptable, low Machs consider most of the practices of short-term earnings management as being unethical. Since Machiavellian predisposition play a central role in theories of ethical decision making, combined with earnings management acceptance this construct will remain an important part of research on unethical behaviour.

As important observation, personal traits of the participants did not differ across the groups. Following this, the results obtained cannot be explained based on those items. Meanwhile, the results documented should be treated with caution since the sample used comprised only students. One can argue that students are aware of the fact that the scientific demarche they were part of did not suppose any risk for them. Also it can be argued that students can be more vulnerable to effects of short-term earnings management compared with more sophisticated practitioners. Based on the latter assumption it is possible that students can judge the scenarios presented differently compared with managers or accounting practitioners. Also, there is a small probability that the students comprised in the sample do not fully understand the scenarios presented. On the other hand since the research design comprised accounting students, the latter limit can have a very small impact on our results.

This study can open a new wave of research by focusing on the cumulative effects of factors influencing decisional processes. Future research may wish to focus on testing not only well-established relationships tested in previous studies, but to focus in testing empirically theoretically sound relationships like: gender, religiosity or deontological evaluations all in connection with both long and short-term earnings management practices. Once tested, future springs of research has the potential to identify potential boundary conditions that circumscribe the effects of such variables on earnings management acceptance, durability or magnitude. Also, future research can comprise more sophisticated users of the accounting information assessment.

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