

ADVANCES IN ACCOUNTING BEHAVIORAL RESEARCH

Edited by Khondkar E. Karim

ADVANCES IN ACCOUNTING
BEHAVIORAL RESEARCH

VOLUME 24

**ADVANCES IN ACCOUNTING
BEHAVIORAL RESEARCH**

ADVANCES IN ACCOUNTING BEHAVIORAL RESEARCH

Series Editor: Khondkar E. Karim

Recent Volumes:

Volumes 5–14: Edited by Vicky Arnold

Volumes 15–20: Edited by Donna Bobek Schmitt

Volumes 21–23: Edited by Khondkar E. Karim

ADVANCES IN ACCOUNTING BEHAVIORAL RESEARCH
VOLUME 24

ADVANCES IN ACCOUNTING BEHAVIORAL RESEARCH

EDITED BY

KHONDKAR E. KARIM

*The Robert J. Manning School of Business
University of Massachusetts, Lowell, USA*

ASSOCIATE EDITORS

TIMOTHY FOGARTY

Case Western Reserve University, USA

ROBERT RUTLEDGE

Texas State University, USA

ROBERT PINSKER

Florida Atlantic University, USA

JOHN HASSELDINE

University of New Hampshire, USA

CHARLES BAILEY

University of Memphis, USA

TERENCE PITRE

Saint Mary's College of California, USA



emerald
PUBLISHING

United Kingdom – North America – Japan
India – Malaysia – China

Emerald Publishing Limited
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2021

Copyright © 2021 Emerald Publishing Limited

Reprints and permissions service

Contact: permissions@emeraldinsight.com

No part of this book may be reproduced, stored in a retrieval system, transmitted in any form or by any means electronic, mechanical, photocopying, recording or otherwise without either the prior written permission of the publisher or a licence permitting restricted copying issued in the UK by The Copyright Licensing Agency and in the USA by The Copyright Clearance Center. Any opinions expressed in the chapters are those of the authors. Whilst Emerald makes every effort to ensure the quality and accuracy of its content, Emerald makes no representation implied or otherwise, as to the chapters' suitability and application and disclaims any warranties, express or implied, to their use.

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN: 978-1-80071-013-9 (Print)

ISBN: 978-1-80071-012-2 (Online)

ISBN: 978-1-80071-014-6 (Epub)

ISBN: 1475-1488 (Series)



ISOQAR certified
Management System,
awarded to Emerald
for adherence to
Environmental
standard
ISO 14001:2004.

Certificate Number 1985
ISO 14001



INVESTOR IN PEOPLE

CONTENTS

<i>List of Contributors</i>	vii
The Effect of Accountability Pressure and Perceived Levels of Honesty on Budgetary Slack Creation	1
<i>Vincent K. Chong, Michele K. C. Leong and David R. Woodliff</i>	
The Effects of Machiavellianism and Ethical Environment on Whistle-blowing across Low and High Moral Intensity Settings	29
<i>Derek W. Dalton</i>	
Limited Attention, Analyst Forecasts, and Price Discovery	51
<i>Rajib Hasan and Abdullah Shahid</i>	
The Impact of Requiring Audit Documentation on Judgments of Audit Quality and Auditor Responsibility	87
<i>Casey J. McNellis, John T. Sweeney and Kenneth C. Dalton</i>	
Psychological Contract Research in Accounting Literature	117
<i>Kristie M. Young, William W. Stammerjohan, Rebecca J. Bennett and Andrea R. Drake</i>	
<i>Index</i>	139

This page intentionally left blank

LIST OF CONTRIBUTORS

<i>Rebecca J. Bennett</i>	University of Central Florida, USA
<i>Vincent K. Chong</i>	The University of Western Australia, Australia
<i>Derek W. Dalton</i>	Clemson University, USA
<i>Kenneth C. Dalton (deceased)</i>	University of Nevada, Las Vegas, USA
<i>Andrea R. Drake</i>	Louisiana Tech University, USA
<i>Rajib Hasan</i>	University of Houston – Clear Lake, USA
<i>Michele K. C. Leong</i>	The University of Western Australia, Australia
<i>Casey J. McNellis</i>	Gonzaga University, USA
<i>Abdullah Shahid</i>	Cornell University, USA
<i>William W. Stammerjohan</i>	Louisiana Tech University, USA
<i>John T. Sweeney (retired)</i>	University of Kansas, USA
<i>David R. Woodliff</i>	The University of Western Australia, Australia
<i>Kristie M. Young</i>	Illinois State University, USA

This page intentionally left blank

THE EFFECT OF ACCOUNTABILITY PRESSURE AND PERCEIVED LEVELS OF HONESTY ON BUDGETARY SLACK CREATION

Vincent K. Chong, Michele K. C. Leong
and David R. Woodliff

ABSTRACT

This paper uses a laboratory experiment to examine the effect of accountability pressure as a monitoring control tool to mitigate subordinates' propensity to create budgetary slack. The results suggest that budgetary slack is (lowest) highest when accountability pressure is (present) absent under a private information situation. The results further reveal that accountability pressure is positively associated with subordinates' perceived levels of honesty, which in turn is negatively associated with budgetary slack creation. The findings of this paper have important theoretical and practical implications for budgetary control systems design.

Keywords: Accountability pressure; budgetary control system; impression management theory; perceived levels of honesty; private and public information; budgetary slack

INTRODUCTION

Budgeting studies suggest that subordinates may attempt to “play games” during the budget-setting process (Bart, 1988; Collins, Munter, & Finn, 1987; Libby & Lindsay, 2010). Indeed, Libby and Lindsay (2010, p. 161) note that “... the use of the budget as a fixed performance contract leads to unreliable performance-evaluation and promotes budget gaming”. Research has found that subordinates

(i.e. budgeting managers) are motivated by self-interest to bias their budget estimates to ensure that their targets are more easily achieved (Kren, 1993; Onsi, 1973). Such intentional biasing of performance targets below expected levels is known as budgetary slack creation (Chow, Cooper, & Haddad, 1991).¹ Budgeting managers who misrepresent private information regarding their resource needs or production capacities may receive excess resources.² This opportunistic use of private information can be considered an ethical issue because budgetary slack creation violates social norms (see Merchant & Van der Stede, 2000), such as personal integrity (see Chow, Cooper, & Waller, 1988, p. 120) or aversion to lying (see Chow et al., 1991, p. 59).

Although it is common for firms to set budgets through a negotiation process (see Anthony & Govindarajan, 1998, pp. 381–387; Howell & Sakurai, 1992, p. 32), research has tended to focus on situations where subordinates unilaterally set budgets (Webb, 2002; Young, 1985). Fisher, Frederickson, and Peffer (2000, 2002a) were among the first scholars to examine budgets set through a negotiation process. Fisher, Frederickson, and Peffer (2002a) found that budgets contained more slack when there was negotiation agreement under an information asymmetry condition but slack did not differ across negotiation agreements under an information symmetry condition. Fisher et al. (2002a), however, did not consider the means by which budgetary slack may be controlled. Numerous budgeting studies (Chong & Ferdiansah, 2011; Chow et al., 1988; Hobson, Mellon, & Stevens, 2011; Stevens, 2002; Webb, 2002) have examined the factors which can mitigate budgetary slack creation.³ Webb (2002), for example, examined the influence of accountability pressure on budgetary slack in an experimental setting when his participants set their budget *unilaterally* rather than through a *negotiation* process. A unilateral budgeting process involves only “one-way” communication between subordinates and supervisors.

Our study aims to extend this line of research by investigating the *means* and the *process* by which budgetary slack creation may be controlled. First, we partially replicate the work of Fisher et al. (2002a). Specifically, we predict how accountability pressure can be used as the *means* to mitigate budgetary slack creation when subordinates set their budgets through a negotiation process under a private information condition.⁴ Second, we examine the *process* by which budgetary slack creation may be controlled by investigating the influence of subordinates’ perceived levels of honesty during the budget negotiation process. Previous negotiation studies have shown the importance of “honesty” during negotiation (Ferris, Blass, Douglas, Kolodinsky, & Treadway, 2003; Lewicki, Saunders, & Barry, 2006; Tinsley, O’Connor, & Sullivan, 2002). These studies suggest that a concern for reputation such as honesty is one of the elements that becomes more critical and pronounced when it occurs with a negotiation. The accounting literature has also noted the importance of promoting honesty during the budgeting process (Bruggen & Luft, 2011; Chong & Ferdiansah, 2011; Church, Hannan, & Kuang, 2012; Douthit & Stevens, 2015; Evan, Hannan, Krishnan & Moser, 2001; Hannan, Rankin, & Towry, 2006, 2010; Rankin, Schwartz, & Young, 2008; Zhang, 2008). These studies have called for more research to explore the promotion of honest behavior. To date, no studies have examined specifically the propensity to create

budgetary slack as a behavioral consequence of the attitudes of managers in honestly revealing their private information. In light of this gap in the accounting literature, the aim of our study is to address this issue by examining the mediating role of the level of honesty of subordinates on the relationship between accountability pressure and budgetary slack.

We conducted a laboratory experiment to investigate the above issues. In the experiment, participants assumed the role of a financial analyst for a hypothetical company. The experimental procedures consisted of three sessions. Session one was a trial-run and training session where participants were shown two types of simple tasks and trained to perform them. The aim of the first session was to establish participants' performance capabilities. Session two involved a budget negotiation process. Prior to commencing negotiation, the administrator explained the pay scheme and the steps in the budget negotiation process. The aim of the second session was for participants to set their final budget target decision by negotiating with their supervisor. The final budget target decision could be either a "negotiated budget" or a "superior-imposed budget."⁵ The third session involved the participants completing a work session. The aim of the third session was to measure participants' actual task performance. At the end of the experiment, all participants completed post-experiment questionnaires relating to demographic information, factors that influenced their budget negotiation process, and the manipulation of the independent variables. The experiment results support our hypotheses. First, we found that the subordinates in the private information condition created less budgetary slack when accountability pressure was present. Second, our experimental findings suggest that accountability pressure lead to higher perceived levels of honesty, which in turn result in lower budgetary slack creation.

Our findings have several implications for management accounting research and practice. First, we extend prior studies by providing further empirical evidence of the *means* and *process* by which budgetary slack creation may be controlled (e.g. Stevens, 2002; Webb, 2002). Our study finds that accountability pressure can be used as an effective control device to prevent subordinate budgetary slack creation when budget-setting is based on a negotiation process. Specifically, it is noted that a subordinate's perceived level of honesty mediates the relationship between accountability pressure and budgetary slack creation. The results of our study support impression management theory which suggests that subordinates with higher perceived honesty levels will be motivated to engage in lower budgetary slack creation than those with lower perceived honesty levels. The findings therefore suggest that it is important to consider the perceived levels of honesty of subordinates when designing a budgeting system. Organizations should attempt to promote and cultivate an organizational culture which will enhance and motivate subordinates to not only work to the best of their abilities, but also to report more honestly during any budget negotiation process.

The remainder of the study is structured as follows. The theoretical framework underlying the study is developed in the next section. This leads to the statements of hypotheses. Subsequent sections address research method, results, significant contribution to the literature and limitations of the study.

THEORETICAL DEVELOPMENT AND HYPOTHESES

The Concept of Accountability

Accountability is defined broadly as the requirement for one to be answerable for performing up to prescribed standards that are relevant to fulfilling obligations, duties, expectations, and other charges (Schlenker, 1997). DeZoort and Lord (1997) describe it as the pressure for one to justify his/her judgments and decisions to others. In our study, accountability manifests as pressure to justify, be responsible for and to provide regular feedback on, chosen of budget targets (Lerner & Tetlock, 1999). In the context of our experimental study, a production (i.e. budgeting) manager is accountable to his/her superior manager for any budget deviation. We argue that this accountability exerts three different pressures on the production manager. These pressures include justification, responsibility, and feedback. We propose that these pressures occur at different stages of the budgeting-setting negotiation process. As depicted in Fig. 1, our production manager needs to *justify* the budget target he/she sets at the beginning of the budgeting period. Our production manager is then *responsible* for the budget target established during the budgeting period. Finally, our production manager needs to provide *feedback* regarding budget attainment at the end of the budgeting period.

Justification pressure requires the subordinate to provide an explicit justification for their budget target. It is suggested when individuals know that they have to justify a decision to another person, especially a superior, the accuracy and consistency of decision making tends to increase, and the impact of decision biases such as overconfidence, susceptibility to order effects, and insensitivity to new information, tends to decrease (Arkes, Christensen, Lai, & Blumer, 1987; Hagafors & Brehmer, 1983; McAllister, Mitchell, & Beach, 1979; Tetlock, 1983a, 1983b; Tetlock & Kim, 1987). Responsibility pressure makes an individual feel responsible for an event. It is suggested that an individual can only be held accountable for the outcome if he/she is responsible for the decision that leads to the outcome (see Simons, 2000). Feedback pressure, on the other hand, results from situations where individuals are expected to provide information about their performance decision tasks such as budget setting.

Based on this discussion, we expect accountability pressure can serve as an effective managerial control to mitigate subordinates' propensity to create budgetary slack. In the next section, the relationships between (1) information availability and budgetary slack and (2) accountability pressure and subordinates' budgetary slack are discussed.

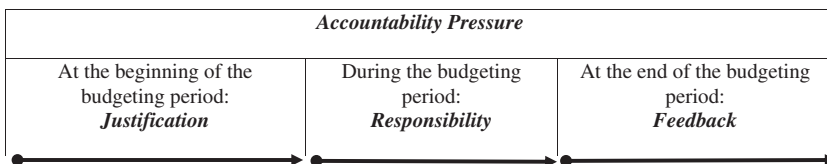


Fig. 1. Accountability Pressure.

*The Relationship between Information Availability
and Budgetary Slack Creation*

Most of the research examining budgetary slack is based on an agency theory framework. Agency theory suggests that agents' actions are likely to be driven by their self-interest (Baiman, 1982, 1990). When there is a conflict between agents' and principals' goals, the agents are likely to engage in dysfunctional behaviors such as *adverse selection* and *moral hazard* (Arrow, 1985; Baiman, 1982, 1990). Adverse selection is a pre-contractual problem where agents possess private information about their job capabilities and hide it from their future employer. This condition creates an opportunity for the agents to misrepresent their job capabilities to gain a higher paying position. The moral hazard problem, on the other hand, is a post-contractual problem where agents possess private information about their action which is not known by their current employer. The focus of this paper is on the moral hazard problem as budgetary slack creation is an action taken by the agents during employment.

Prior studies (Chow et al., 1988; Fisher et al., 2002a; Young, 1985) have suggested that the availability of information about subordinates' performance capabilities influences subordinates' intentions to create slack in their budgets. It has been suggested the ability to detect slack can deter subordinates' budgetary slack behavior (e.g. Lal, Dunk, & Smith, 1996; Onsi, 1973; Young, 1985). The rationale for such behavior is that when subordinates' performance capabilities are publicly available, they do not possess local (private) information which can be used to cheat by intentionally creating budgetary slack. This is because such dysfunctional behavior can be easily detected by the superior. Accordingly, it is in the best interest of subordinates not to bias their budget by building slack in it. In contrast, private information has an opposite consequence on subordinates' behavior. In the private information condition, superiors do not have information about subordinates' performance capabilities and therefore cannot fully monitor subordinate's behavior. As a result, there is a greater chance for subordinates to engage in opportunistic behavior such as creating budgetary slack (Fisher et al., 2002a; Young, 1985).

*The Relationship between Accountability Pressure
and Budgetary Slack Creation*

Our study proposes that accountability exerts the following pressures on subordinates who negotiate budget targets with their superiors: (1) justification, (2) responsibility, and (3) feedback pressures on their decision choice (Lerner & Tetlock, 1999). Justification pressure requires the subordinate to provide an explicit validation for their budget target. Accountability pressure signals to individuals that their decision outcomes will be monitored and need to be justified regardless of procedures. If subordinates are held accountable the presence of a mandatory control system should enable superiors to better detect attempts to build budgetary slack. Such concern is therefore expected to discourage and prevent subordinates from creating budgetary slack (Kren,

1993; Lal et al., 1996; Merchant, 1985a, 1985b; Onsi, 1973). Responsibility pressure makes an individual feel responsible for an event. It is suggested that an individual can be held accountable for the outcome only if he or she is responsible for the decision leading to the outcome (Simons, 2000). Thus, it is expected that subordinates held personally responsible for the final budget target will tend to be more cautious (Merchant, 1989; Prendergast, 1997). Feedback pressure results from situations where individuals are expected to provide information about their decision tasks (such as budget setting) and their task performance. It is expected that if the subordinates are made accountable to provide feedback for any deviations from their budget target they will tend to be careful in setting such budget targets (Lal et al., 1996). Furthermore, Simonson and Staw (1992, p. 421) suggested that “when one is accountable for outcome, the need for justification may be heightened.” In a budget negotiation context, we expect such pressure requires the subordinate to provide an explicit justification for their final budget target. It is expected that when individuals know that they have to justify a decision to another person, especially a superior, the accuracy and consistency of decision making tends to increase, and the impact of decision biases such as overconfidence, susceptibility to order effects, and insensitivity to new information, tend to decrease (Arkes et al., 1987; Ashton, 1992; Hagafors & Brehmer, 1983; McAllister et al., 1979; Tetlock & Kim, 1987). Indeed, Ashton (1992) found that justification pressure improved judgment accuracy and consistency.

When a subordinate is held personally responsible for a budget target, he/she is held responsible for subsequent deviations between *budgeted* target and *actual* results (see Simons, 2000). The subordinate should be prepared to take the initiative to correct any unfavorable budget variances, and most importantly, should be prepared to *explain* to top management the reasons for any significant variances and their causes. Therefore, the subordinates may experience responsibility pressure and respond with caution in negotiations with their superior on an appropriate final budget target to ensure that future potential budget variances will not be large enough to warrant a management investigation.⁶

Finally, individuals who are expected to provide information about their final budget will also experience feedback pressure. Such pressure will deter individuals from setting budget proposals below their task performance capability levels or creating budgetary slack due to concern of being *detected* by their superior or being perceived as incompetent. It has been suggested the ability to detect slack can deter subordinates' budgetary slack behavior (e.g. Lal et al., 1996; Merchant, 1985a; Onsi, 1973; Young, 1985). We expect that subordinates confronted with feedback pressure would “appear” to cheat less on their budget submission as they are aware of the possibility of having to explain the variation of actual task performance from the final budget target.

Based on the above discussion, it is expected that accountability pressure would cause subordinates to be more cautious about their decision choices thus serving as an effective monitoring tool to mitigate the propensity to create budgetary slack.

The Impact of Availability of Information and Accountability Pressure on Budgetary Slack

The literature discussed earlier suggests that private information can enable budgetary slack to be built into participatively set budgets through the negotiation process. In contrast, in a public information situation, subordinates are less likely to create budgetary slack because any act intended to shirk in such situations cannot be exercised without being detected by the supervisor.

Regardless of accountability pressure, in a public information condition, budgetary slack is likely to be low because there is little information that the subordinate has that is not also known to the supervisor (Cells 1 and 2, Fig. 2). However, in a private information situation with the absence of accountability pressure, subordinates are likely to attempt to negotiate budget slack (Cell 3, Fig. 2). The rationale for this proposition is that under this condition, the subordinates possess valuable and unique “local” information conducive for them to engage in opportunistic behaviors, so moral hazard and information impactedness are more likely to occur. *Information impactedness* condition arises when subordinates possessing valuable and unique “local” information are reluctant to disclose or convey it truthfully (Chong & Eggleton, 2007; see also Kaplan & Atkinson, 1998). Thus, subordinates have both the opportunity and incentive to create budgetary slack. However, in the presence of accountability pressure (Cell 4, Fig. 2), subordinates, while having the desire (or incentive) to create budgetary slack, will not be in a position to do so, since accountability pressure serves as an effective monitoring control tool to mitigate the propensity to create budgetary slack.

Taken together, we predict that budgetary slack will be lower (higher) when accountability pressure is present (absent) under private information condition than public information condition. Stated formally, the following hypothesis is tested:

H1. Budgetary slack will be lower (higher) in the presence (absence) of accountability pressure under private rather than public information condition.

Information availability	Accountability pressure absent	Accountability pressure present
Public	Cell 1	Cell 2
Private	Cell 3	Cell 4

Fig. 2. The Four Experimental Treatment Conditions.

The Process by Which Budgetary Slack Creation May Be Controlled

It is argued that the presence of private information is a necessary condition to induce subordinates to create slack in their budget through the negotiation process. This study further argues that the presence of accountability pressure mitigates subordinates' budgetary slack creation behavior in a private information condition. However the *process* by which a subordinate's slack can be controlled is unclear, so the following hypotheses (*H2* and *H3*) focus on the *process* of the predicted interaction effect of accountability pressure and information availability on budgetary slack. It is proposed that the subordinate's perceived levels of honesty during the budget negotiation process mediate the relationship between accountability pressure and budgetary slack creation.⁷

The Relationship between Accountability Pressure and Subordinates' Perceived Levels of Honesty

Impression management theory suggests that accountability pressure can be used to control dishonest behaviors (such as propensity of subordinates to create budgetary slack). *Impression management* refers to the process by which individuals attempt to control the impressions others form of them (Leary & Kowalski, 1990). Agency theorists (Arrow, 1985; Baiman, 1990) proposed that opportunistic behaviors can be controlled in part by the agent's concerns for reputation. Prior literature has examined the behavioral consequences of reputation concerns. For example, in the escalation of commitment literature, it is concluded that concerns for reputation influenced subjects' decisions to continue or discontinue a failing or unprofitable project (Harrell & Harrison, 1994; Harrison & Harrell, 1993; Kano-dia, Bushman, & Dickhaut, 1989; Kirby & Davis, 1998). The accounting literature (see Hannan et al., 2006; Stevens, 2002; Webb, 2002) has proposed that reputation concerns represent the agents' desire to appear honest to their superior.⁸ Organizational researcher, Grover (2005), defined honesty as "a tendency not to lie, cheat or steal" (see Grover, 2005, p. 148). In the accounting context, Hannan et al. (2006, p. 889) defined honesty as "the degree to which a report accurately reflects the underlying private information" while Evans, Hannan, Krishnan, and Moser (2001) defined honesty as not telling lies.

We propose that if reputation is a concern for agents, then the use of accountability pressure will be the most *appropriate* control of the agent's opportunistic behavior. Thus, we propose a theory to suggest that accountability will exert pressure on subordinates who are concerned about their reputation to appear to be honest. According to Tedeschi and Riess (1981), impression management refers to the behavior which managers engage in with the objective to influence the impressions that others will form about them. It is argued that when managers perceive that there are benefits to appearing honest during their budget negotiation process, they will be more likely to do so. The primary motivation of these managers to engage in impression management is to obtain the desired outcome in the final budget, such as a budget target which is difficult but achievable. This implies that the budget negotiation process will influence the subordinates' trade-off between the benefits of appearing honest and the benefits