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Earnings Management and Employee Selection

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Earnings Management and Employee Selection

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Earnings Management and Employee Selection

Abstract

This study examines whether the employee selection process perpetuates earnings management. In the context of a firm that faces pressure to manage earnings, we find that financial executives and executive recruiters judge a job candidate who has personality characteristics that indicate a predisposition to manage earnings as a better fit than a similarly-qualified job candidate who lacks those characteristics. In turn, we find that (1) financial executives judge the job candidate who has personality characteristics that indicate a predisposition to manage earnings as being more likely to be hired and (2) executive recruiters judge the job candidate who lacks those personality characteristics as being likely to be screened out before being referred to a potential employer. We also find that the personality characteristics that indicate a predisposition to manage earnings do not signal better managerial capabilities in other areas. Our results help illuminate why earnings management stubbornly persists despite decades of regulatory efforts designed to curtail that behavior.



1. Introduction

Accounting earnings is generally considered to be the premier summary measure of firm performance (Dechow 1994), and business professionals widely understand the importance that investors (and many others) ascribe to it (Graham et al. 2005). A large amount of anecdotal and empirical evidence indicates that many professionals find it tempting, if not essential, to manage earnings to meet common earnings-related objectives, such as reporting smooth earnings and avoiding negative earnings surprises (Brown and Caylor 2005; Dichev et al. 2013; Graham et al. 2005; Healy and Wahlen 1999; Levitt 1998). Evidence also indicates that earnings management is prevalent despite decades of regulatory efforts aimed at eliminating that behavior (Dichev et al. 2013; Graham et al. 2005). The purpose of this study is to expand our understanding of why the practice of earnings management flourishes.

The concept of economic Darwinism suggests that business practices that survive over time tend to yield benefits in excess of their costs or those practices would cease (Alchian 1950; Brickley et al. 2009). The practice of earnings management has survived for decades (Cohen et al. 2008; Dechow and Skinner 2000; Dichev et al. 2013; Healy and Wahlen 1999; Levitt 1998), which suggests that, on average, the benefits of earnings management exceed the related costs. At the same time, earnings management is an action that is undertaken by individuals, not by firms. For earnings management to arise, flourish, and survive over time, some individuals who assume positions of power and authority in the accounting function of firms must be willing and able to engage in that behavior. We contend that one plausible reason why earnings management is prevalent is because the employee selection process present in many firms may favor certain types of accounting managers over others.

Research in organizational behavior emphasizes the importance of assessing person-organization (PO) fit during the employee selection process to help distinguish between similarly qualified job candidates (Cable and Judge 1997; Chatman 1989; Edwards 2008; Rynes and Gerhart 1990; Schneider 1987). PO fit assessments reflect the perceived congruence between the organization's culture, values, goals, and norms and the job candidate's personality, values, goals, and attitudes (Kristof 1996). Research also suggests that personality characteristics provide insights into individuals' accounting-related behaviors and predispositions (Elias 2002; Greenfield et al. 2008; Hales et al. 2012; Johnson et al. 2013; Murphy 2012; Seybert 2010). Identifying and selecting job candidates who best fit an organization helps to ensure that key organizational objectives are internalized by employees and efficiently met. Accordingly, in firms that face pressure to manage earnings, we expect that job candidates who have personality characteristics indicating a predisposition to manage earnings will be judged to be a better fit than otherwise similarly-qualified job candidates who lack those characteristics. In turn, we predict that job candidates who are judged to be a better fit are more likely to be hired for high-level accounting positions.

To date, no empirical evidence about the relation between earnings management and employee selection has been brought to bear. One possible reason for the absence of empirical evidence is that necessary employment files and documentation are either confidential or completely unavailable. We circumvent this data availability problem by conducting surveys and experiments in which two hypothetical job candidates—one has personality characteristics indicating a predisposition to manage earnings and the other has personality characteristics indicating no such predisposition—compete for a senior-level accounting manager position in a firm that faces pressure to manage earnings. We create pressure to manage earnings by stating

the firm's earnings-related objectives, which include meeting profit goals, reporting smooth earnings, avoiding negative earnings surprises, and displaying financial strength and stability. These objectives are not only common in many firms (Dichev et al. 2013; Graham et al. 2005; Healy and Wahlen 1999), but they appear to stimulate earnings management (Bartov et al. 2002; Brown and Caylor 2005; Burgstahler and Dichev 1997; Graham et al. 2005).

We designed the descriptions of the two job candidates so that one candidate (referred to as "Candidate A") has personality characteristics indicating a predisposition to manage earnings, while the other candidate (referred to as "Candidate B") has personality characteristics indicating the opposite predisposition. Specifically, we imbued the personality profile of Candidate A with characteristics such as a propensity to morally disengage, a high degree of Machiavellianism and narcissism, and an ethical orientation characterized by low idealism and high relativism, each of which indicates a predisposition to manage earnings. We imbued the profile of Candidate B with the opposite characteristics. Appendix A shows the personality profiles of the job candidates, and Appendix B provides a summary of the development of the profiles.¹

In order to draw valid inferences about our primary research question, it is important that the job candidate personality profiles convey two messages simultaneously—(1) Candidate A is predisposed to manage earnings while Candidate B is not and (2) Candidate B is considered to be an equally capable (or more capable) manager as Candidate A. We empirically evaluate the first matter and find that the job candidate profiles convey the intended message (Study 1). We also empirically evaluate the second matter and find that that Candidate B is judged to be a better overall manager than Candidate A (Study 2). Beyond these perceived differences between the

¹ Our instruments vary whether the job candidates are referred to as Candidate A or Candidate B (see Section 3). For expositional simplicity, we refer to the job candidate who is predisposed to manage earnings as Candidate A and the job candidate who is not as Candidate B.

two candidates, we find that Candidate A, relative to Candidate B, is (1) much *less* likable, (2) perceived to be *more* likely to engage in fraud and other disreputable acts, and (3) perceived to be *less* likely to maintain high ethical standards in the face of adversity. Thus, to hire Candidate A, participants must be willing to accept a constellation of generally negative personality traits and predispositions.

In our two main studies, participants evaluate the two job candidates for the purpose of making a hiring decision (Study 3) or a referral decision (Study 4).² In both studies, participants learn that a firm is seeking to hire a senior accounting manager whose role will include, among other things, overseeing accounting operations and making important judgments and decisions related to financial reporting. Participants also learn about the firm's earnings-related objectives, which create pressure to manage earnings. Before making their hiring or referral decision, we have participants evaluate PO fit. We incorporate PO fit into our research design because many organizations routinely assess fit, either formally or informally, to help maintain a workforce that is committed to achieving important organizational objectives (Kristof 1996). By design, there are no differences between the job candidates in terms of their education or experience, and our participants view the candidates as being equal on these two dimensions. Thus, participants' fit assessments reflect their perceptions about the compatibility between the firm and the candidate.

The results of our survey of financial executives (Study 3) indicate that participants believe that Candidate A (the candidate whose personality profile indicates a predisposition to manage earnings) is a better fit than Candidate B (the candidate whose personality profile indicates no predisposition to manage earnings). In turn, participants believe that Candidate A

² We focus is on hiring and referral decisions rather than promotion decisions because those decisions determine the types of individuals who join an organization and later determine the pool from which employees are promoted.

will be hired over Candidate B to fill the senior accounting manager position. Specifically, participants expect Candidate A to be hired over Candidate B by a margin of 88 percent to 12 percent. This finding arises despite the fact that Candidate A, relative to Candidate B, is characterized by a constellation of negative personality characteristics which participants are apparently willing to accept in order to hire the job candidate who is predisposed to manage earnings.

We then conduct an experiment using executive recruitment professionals (Study 4) to explore an additional dimension of the employee selection process—whether certain types of individuals tend to be screened out before ever being considered by prospective employers. Participants evaluate one of the two candidates, assess PO fit, and then indicate their beliefs about whether the candidate they evaluated will be referred to a client who is seeking to fill a senior accounting manager position. The description of the senior accounting manager’s role and the financial objectives of the client firm are identical to those in Study 3. Our results reveal that participants believe Candidate A to be a better fit than Candidate B. In turn, participants believe that Candidate A is significantly more likely to be referred to the client to interview for the accounting manager position than Candidate B. Thus, for firms that face pressure to manage earnings, accounting job candidates who are not perceived to be predisposed to manage earnings may be screened out before they are ever considered by prospective employers.

Finally, it is possible that the reason participants preferred to hire (refer) Candidate A in Study 3 (Study 4) is not because of Candidate A’s predisposition to manage earnings. Instead, participants may always prefer to hire/refer Candidate A over Candidate B for other reasons that we do not fully appreciate. To help address this concern, we administer another survey (Study 5) in which the hiring entity is a non-profit foundation. In this context, there is no stimulus to hire

Candidate A because non-profit foundations neither measure nor report earnings. And because Candidate B is considered to be a better overall manager, we expect the observed preference to hire Candidate A over Candidate B to dramatically reverse. Consistent with this expectation, we find that Candidate B is strongly favored over Candidate A to fill the accounting position in this alternate context that does not involve earnings-related pressure.

Our research makes three interrelated contributions to the accounting literature. First, we provide evidence relevant to answering a very provocative question—are the individuals who are most likely to engage in earnings management also the individuals who are most likely to ascend to positions of power and authority in the accounting function of firms? This question has been bantered about for decades, but has not been investigated. For example, Rosenzweig and Fischer (1994, p. 33) state that accountants “who have loose standards regarding earnings management may be more likely to be promoted” and that lower-level employees “will learn quickly that the route to success in the organization is not facilitated by truthful reporting.” Related to this claim, Parfet (2000, p. 485-486) contends that earnings management “is expected and demanded, both inside and outside of business, by all stakeholders in the capital market.” We provide the first evidence relevant to addressing the descriptive validity of these claims.

Second, our evidence complements a large stream of earnings management research, which often focuses on testing whether managers manipulate earnings in response to various stimuli (e.g., avoiding regulation, avoiding a negative earnings surprise, avoiding debt covenant violations, maximizing compensation, etc.). We seek to answer a more fundamental question—*why* are managers of many firms so responsive to earnings management stimuli? We conclude that part of the answer lies in the types of people who are selected by, and retained in, firms.

Third, we provide evidence relevant to assessing the efficacy of regulators' current approach to curtailing earnings management (i.e., increased amounts of regulation). Our results suggest that regulatory efforts to curtail earnings management may achieve greater success if those efforts simultaneously target the cultural dimension of earnings management that is played out through the employee selection process. Indeed, the former chairman of the SEC, Arthur Levitt, hinted at doing more than enacting additional regulations when he called for "nothing less than a fundamental cultural change on the part of corporate management as well as the whole financial community" to eliminate earnings management (Levitt 1998, p. 18). However, it is hard to solve a problem when a major underlying cause is not well illuminated. Our research helps to illuminate why earnings management stubbornly persists despite regulatory efforts designed to curtail that behavior.

The remainder of this paper proceeds as follows. Section 2 develops our main research hypothesis. Section 3 provides evidence about the message that is conveyed to participants by the job candidate personality profiles (Studies 1 and 2). Section 4 provides our main empirical tests and results (Studies 3 and 4). Section 5 provides additional evidence relevant to addressing an alternative explanation for our main empirical results (Study 5). Section 6 provides some concluding comments.

2. Theory and hypothesis

Competition is a powerful force—it favors firms that use efficient operating procedures and contracting techniques and weeds out firms that do not (Alchian 1950; Brickley et al. 2009; Zimmerman 2003). In competitive economic systems, business practices that survive over time tend to yield benefits in excess of their costs or those practices would eventually cease (Alchian 1950; Brickley et al. 2009; Watts and Zimmerman 1986; Zimmerman 2003). Many firms face

considerable pressure to achieve various earnings-related objectives, and some professionals may engage in earnings management to achieve those objectives (Dichev et al. 2013; Graham et al. 2005).³ The practice of earnings management has survived for many decades (Cohen et al. 2008; Dechow and Skinner 2000; Healy and Wahlen 1999) and continues to occur to this date (Dichev et al. 2013), indicating that the benefits of earnings management exceed the associated costs, on average. There is also indirect evidence that the market rewards (or fails to penalize) earnings management. For example, Bartov et al. (2002) find that the market reward for meeting or beating analysts' earnings forecasts is only marginally affected by whether firms manage earnings to meet that threshold. Similarly, Das et al. (2011) find that although there is a market penalty for managing earnings to meet an earnings threshold, the market reward exceeds the market penalty.

Professionals in the accounting labor market who are able and willing to manage earnings compete against other members of the labor market who may be unable or unwilling to manage earnings. Professionals who possess the abilities demanded by prospective employers are likely to successfully compete for higher level positions, while professionals who lack those abilities are likely to languish in lower level positions. The survey results of Graham et al. (2005) suggest that failure to meet an earnings target is viewed by the labor market as a managerial failure, and repeatedly missing an earnings target inhibits a manager's labor market mobility. Professionals seem to understand the importance that investors and many others ascribe to earnings (Bhojraj and Libby 2005; Dichev et al. 2013; Graham et al. 2005), and a considerable amount of evidence indicates that managers find it tempting, and sometimes essential, to manage

³ Examples of earnings-related objectives include, but are not limited to, avoiding negative earnings surprises (Brown and Caylor 2005), avoiding losses (Burgstahler and Dichev 1997), avoiding earnings decreases (Burgstahler and Dichev 1997), and reporting smooth earnings (Graham et al. 2005).

earnings (Dichev et al. 2013; Graham et al. 2005). A survey of CFOs by Dichev et al. (2013) provides a glimpse into the prevalence of earnings management. They report that the CFOs they surveyed believe that approximately 20 percent of public firms manage earnings in a given year, and that the misrepresentation is approximately 10 percent of earnings.

Scholars have speculated that incentives present in many firms may result in a striking outcome—individuals who are most likely to manage earnings are also the ones who are most likely to ascend to positions of power and authority in the accounting function of firms (Bruns and Merchant 1990; Fuller and Jensen 2002; Merchant and Rockness 1994; Rosenzweig and Fischer 1994). This speculation is broadly compatible with a rational labor market matching process whereby certain types of people are attracted to, selected by, and continue employment with certain types of organizations (Schneider 1987). The concept of person-organization (PO) fit underlies this rational matching process.⁴ The management literature indicates that it is desirable for organizations to hire individuals who fit their work environment (Edwards 2008), which helps to maintain a workforce that is committed to achieving important organizational objectives (Kristof 1996). Many organizations identify what a particular job requires in terms of employee knowledge, skills, abilities, and other attributes (e.g., personality characteristics) and hire an individual who possesses those desired attributes (Schneider 2001).

Research suggests that personality traits provide a glimpse into the accounting-related behaviors of managers. For example, Murphy (2012) finds that high Machiavellian individuals are more likely to misreport performance than low Machiavellian individuals and they feel less guilt about doing so. Hales et al. (2012) find that narcissistic individuals inflate reported task performance. Johnson et al. (2013) indicate that auditors view client manager narcissism as a

⁴ PO fit refers to a job candidate's organization-specific employability as opposed to general employability (Rynes and Gerhart 1990).

fraud attitude risk indicator. Greenfield et al. (2008) find that high relativists are more likely to manage earnings than high idealists. Consistent with this finding, Elias (2002) indicates that accountants who are high on relativism and low on idealism view earnings management as more ethically acceptable than accountants who have other ethical orientations. Lastly, Seybert (2010) finds that high self-monitors are more likely to engage in real earnings management than low self-monitors.

For accounting managers who are predisposed to manage earnings to propagate in the labor market, employers must have the capability to identify those individuals. Many firms formally assess PO fit prior to making hiring decisions (Cable and Judge 1997; Chatman 1989; Edwards 2008; Kristof 1996; Rynes and Gerhart 1990; Schneider 1987) by evaluating job candidate personality profiles (Baez 2013; Krell 2005; Stabile 2002). In addition, executive recruitment firms claim to assess job candidate personality characteristics before referring a candidate to a client.⁵ Even in the absence of a formal process for evaluating a job candidate's personality, hiring decisions for management positions likely involve an informal assessment of the candidate's personality to help ensure proper PO fit. Figure 1 provides a conceptual model of the antecedents to hiring/referral decisions.

This discussion highlights several interrelated factors leading to our hypothesis. First, many firms face considerable pressure to manage earnings. Second, earnings management is, at minimum, tacitly approved by some firms as an efficient means to achieve earnings-related objectives. Third, the ability and willingness to manage earnings is part of the overall skillset

⁵ See, for example, the websites of two large executive recruitment firms—Lucas Group and Korn Ferry International. Lucas Group states that “Our detailed interviewing process enables Lucas Group to precisely match qualifications, cultural fit, and long-term compatibility, and it ensures lasting and successful placements.” Korn Ferry states that “...behavior-based approaches to interviewing consistently lead to better results in identifying the right talent for the job.”

provided by certain accounting professionals. Fourth, personality characteristics are informative about an individual's accounting-related behaviors and predispositions, which are manifest in on-the-job performance. Fifth, firms seek to match the demands of the positions they fill with the skills, capabilities, and personalities of the individuals whom they hire to fill those positions.

The entirety of this discussion leads to our main research hypothesis, stated in alternative form:

Hypothesis: Firms that face pressure to manage earnings tend to hire accounting job candidates whose personality characteristics indicate a predisposition to manage earnings over similarly-qualified accounting job candidates whose personality characteristics indicate the opposite predisposition.

3. Studies 1 and 2

3.1. Purpose of studies

We develop two job candidate personality profiles, with one personality profile intended to convey the message that the job candidate is predisposed to manage earnings and the other intended to convey the opposite message. We do not overtly state that either job candidate does or does not manage earnings (participants must infer such a predisposition from the personality profiles).⁶ Appendix A provides personality descriptors for the job candidates who have a high predisposition to manage earnings (Candidate A) and a low predisposition to manage earnings (Candidate B). Appendix B summarizes our development of the candidate personality profiles.⁷

It is possible that by varying the job candidates' predispositions to manage earnings we simultaneously convey the message that Candidate A, relative to Candidate B, is predisposed to manage earnings *and* is a better manager in general. Our intent when creating the job candidate

⁶ An alternative approach would be to overtly state that the job candidate does or does not manage earnings. This approach seems problematic because there is no evidence that job candidates and employers talk about earnings management in such an overt way.

⁷ When constructing the two personality profiles, we wanted to make them sufficiently different to yield strong effects, yet be within the relevant range of personality attributes (see related discussion in Libby et al. 2002). Testing reveals that the two job candidates are perceived to be very different in terms of their predispositions to manage earnings (see Appendix B).

personality profiles was to convey the former message, but *not* the latter. The two studies in this section evaluate whether the job candidate personality profiles shown in Appendix A (and used to test our hypothesis in Studies 3 and 4) convey the intended message (and not some alternative message). Specifically, we want to show that Candidate A, relative to Candidate B, is perceived to be predisposed to manage earnings (Study 1), but *not* perceived to be a better overall manager (Study 2).

3.2. Study 1

3.2.1. Participant recruitment

We randomly selected 2,500 professionals from U.S. firms on the LexisNexis Academic Executive List.⁸ Each of the professionals had a title indicating involvement in the accounting and/or finance function. The study was administered via Qualtrics. We contacted business professionals in two ways—(1) an initial email and a follow-up email approximately one week later and (2) a letter to the street address of each individual who had a valid email address. Of the 2,500 business professionals we contacted, 344 had an invalid email/street address. A total of 59 experienced business professionals participated in this study, resulting in a response rate of 2.74 percent.⁹

3.2.2. Instrument

Participants are provided with background information about a public company that is trying to fill a senior accounting manager position. Participants learn that company personnel have evaluated a large pool of candidates and that two finalists have been chosen. For each candidate, the instrument provides information about (1) education and certification, (2) work

⁸ We use this same database in Studies 1, 3, and 5, each time randomly selecting a new, non-overlapping sample of 2,500 business professionals.

⁹ The demographics for participants in this study are very similar to those for Study 3 (see Table 2 for Study 3 demographics). For brevity, we do not tabulate the demographic information for Study 1.

experience, and (3) the job candidate personality profile.¹⁰ By design, the candidate summaries are extremely similar in terms of the information conveyed by items (1) and (2), but they differ in terms of the information conveyed by item (3).¹¹ The instrument defines the phrase “earnings management” to give participants a common understanding of what this phrase generally means. Our definition is a composite definition from the academic literature (Dechow and Skinner 2000; Healy and Wahlen 1999; Schipper 1989), which is as follows:

Senior accounting managers frequently make accounting estimates and accounting-related professional judgments. These estimates and judgments can have a large influence on the amounts reported in a firm’s financial statements, including net income. Ideally, senior accounting managers make estimates and judgments in ways that produce accurate and transparent financial statements. In some cases, senior accounting managers desire to achieve a particular level of earnings, and they may alter their estimates and judgments to get that outcome. This is called “earnings management.” When senior accounting managers manage earnings, the main consequence is that the firm’s financial statements do not accurately reflect the firm’s true economic performance.

Participants then respond to questions to elicit their views about each job candidate (see Table 1 for questions). Participants respond on a 100-point sliding scale, with the left endpoint labeled “Definitely Candidate A” and the right endpoint labeled “Definitely Candidate B.”

3.2.3. Results

Table 1 provides participant responses to the 14 questions about earnings management and moral/ethical pliability. Participants have strongly polarized views, as indicated by the fact

¹⁰ The instrument informs participants that as part of the company’s employment application process, each candidate was required to complete a personality assessment questionnaire designed to elicit the behaviors, beliefs, and values that the job candidate is most likely to exhibit on the job.

¹¹ In this study and in all other studies except Study 4, participants view the job candidate personality profiles side-by-side. When presenting the profiles, we vary the order in which they are presented. For half of the participants, the candidate who is predisposed to manage earnings is presented in the first column and the candidate who is not predisposed to manage earnings is presented in the second column (and vice-versa). The first candidate is always *labeled* Candidate A and the second candidate is always *labeled* Candidate B. There are no order effects in any study (p -values > 0.20). In Study 4, participants only view one of the two job candidates so there is no issue related to order. And in Study 4, the candidate is always *labeled* as Candidate A. For expositional simplicity, we refer to the job candidate who is predisposed to manage earnings as Candidate A and the job candidate who is not as Candidate B.

that all responses are significantly different from the midpoint of the scale (t-statistics ≥ 7.82 , p-values < 0.001). Participants believe that Candidate A is most likely to initiate efforts to manage earnings (Question 1), most likely to encourage others to manage earnings (Question 4), most susceptible to pressure from others to manage earnings (Question 5), most likely to believe that the positive consequences of earnings management justify engaging in that behavior (Question 7), most likely to participate in types of earnings management that would be considered fraud (Question 8), most likely to engage in a series of seemingly harmless accounting decisions that lead to serious accounting infractions, including fraud (Question 11), and most likely to relax their standards of ethical behavior in the face of professional gain (Question 13). Thus, we find that Candidate A, relative to Candidate B, is perceived to be more likely to engage in earnings management and related accounting behaviors.

In contrast, participants believe that Candidate B is least likely to go along with existing efforts to manage earnings (Question 2), most uncomfortable managing earnings (Question 3), most likely to steer others away from managing earnings (Question 6), most likely to follow a company code of ethics that prohibits earnings management (Question 9), most likely to set an exemplary standard of ethical behavior (Question 10), most likely to hold himself/herself to the highest ethical standards (Question 12), and least likely to relax their own standards of ethical behavior in the face of professional hardship (Question 14). Thus, we find that Candidate B, relative to Candidate A, is perceived to be less likely to engage in earnings management and related accounting behaviors.

3.2.4. Discussion

Our participants appear to interpret the job candidate personality profiles in the manner we intend. Candidate A, relative to Candidate B, is perceived as being predisposed to manage

earnings. At the same time, Candidate A, relative to Candidate B, is also perceived to be more likely to fall prey to accounting-related ethical infractions (and more likely to ensnare others in those same ethical infractions), which, even if initially small, could lead to serious infractions later, including outright fraud. Concurrently, Candidate B, relative to candidate A, is perceived to be largely immune to such temptations and is perceived to be unlikely to allow accounting-related ethical infractions to propagate in firms. Given that the predispositions of the two job candidates are fairly obvious to participants, it appears that we have created a meaningful hurdle that Candidate A must surmount in order to be hired over Candidate B—individuals deciding to hire Candidate A must implicitly accept that Candidate A is significantly more likely to engage in earnings management and certain other undesirable (and potentially harmful) behaviors than Candidate B.

3.3. Study 2

3.3.1. Participant recruitment

We conduct an experiment using participants from Amazon's Mechanical Turk platform (see Rennekamp 2012). There are 99 participants who average approximately 33 years of age and 13 years of work experience.¹² In order to obtain participants, we compensate them \$2.00 to complete a study that takes approximately 5 to 15 minutes. The age and experience profiles of these participants suggest that they are suitable for the task that we have them perform.

3.3.2. Instrument

Participants are informed that the company's senior accounting manager recently retired and that the company has hired a new senior accounting manager to fill the position. Participants

¹² The concept of a response rate is not relevant in this study. We sought 100 participants and once that threshold number of participants was met, the study was closed. There was one individual who requested payment but did not complete the study, which is why the study has 99 participants rather than 100.

then learn about the company's financial objectives, which the accounting manager is expected to help achieve. These objectives include achieving profit goals, avoiding negative earnings surprises, reporting smooth earnings, and displaying financial strength and stability. These are common financial objectives, which may create pressure to manage earnings. Participants are informed that employees of the company are committed to achieving the financial objectives. Participants also learn about the senior accounting manager's role within the company, which includes overseeing accounting operations and making important judgments/decisions related to financial reporting.

Next, participants learn that two qualified job candidates were selected as finalists for the position. Participants then receive job candidate summaries, which provide information about each candidate's (1) education and certification, (2) work experience, and (3) personality. By design, the candidate summaries are extremely similar in terms of the information conveyed by items (1) and (2), but they differ substantially in terms of the information conveyed by item (3). Participants learn that Candidate A or Candidate B was hired (this is our between-subjects manipulation). Participants then respond to 27 statements that elicit their attributions about why the particular candidate was hired. The statements are clustered around six managerial/personal skills—managing people, managing the work environment, managing activities, work habits, interpersonal traits, and managing earnings to achieve accounting outcomes. We have participants respond on a 100-point scale (the left endpoint labeled “Definitely disagree” and the right endpoint labeled “Definitely agree”). Representative statements, one for each of the managerial/personal skills, are provided below (these statements are for the condition in which participants learn that Candidate A was hired over Candidate B):

1. Candidate A will provide more constructive feedback to staff than Candidate B (managing people dimension)

2. Candidate A will maintain staff morale better than Candidate B (managing the work environment dimension)
3. Candidate A will plan activities of the accounting department better than Candidate B (managing activities dimension)
4. Candidate A will work more efficiently than Candidate B (work habits dimension)
5. Candidate A is more pleasant than Candidate B (interpersonal traits dimension)
6. Candidate A will more likely remove any roadblocks to achieving profit goals than Candidate B (managing earnings to achieve accounting outcomes dimension)

3.3.3. Results

Figure 2 graphs mean responses by condition. We find that the mean responses for each managerial/personal skill type are significantly different between conditions (p -values ≤ 0.01) except for the mean responses related to managing activities (p -value = 0.78). A difference in the means implies that participants attribute the hiring decision to differential candidate abilities in a given managerial/personal skill. For example, participant responses to the statements about managing people have a mean of 54.04 when participants learn that Candidate A was hired and a mean of 70.79 when participants learn that Candidate B was hired. The significant difference between conditions suggests that participants attribute the hiring of Candidate B to relatively strong capabilities at managing people. The same inference can be drawn about Candidate B relative to Candidate A with respect to managing the work environment, work habits, and interpersonal traits.

There is a dramatic reversal with respect to statements related to managing earnings to achieve accounting outcomes. The mean is 76.68 when participants learn that Candidate A was hired and only 54.27 when participants learn that Candidate B was hired. This suggests that participants attribute the hiring of Candidate A to his/her comparatively strong capabilities at managing earnings to achieve accounting outcomes. In summary, Candidate B is perceived to be a better manager than Candidate A on four of six managerial/personal skills, and Candidate A is perceived to be a better manager than Candidate B on one of six managerial/personal skills—

managing earnings to achieve accounting outcomes. Thus, we conclude that the personality traits that signal a predisposition to manage earnings do not simultaneously signal superior managerial/personal skills in other areas.

3.3.4. Discussion

The results of this experiment help to confirm that the personality profiles convey the intended message, but do not simultaneously convey an unintended message. Our intention was for Candidate A's personality profile to convey the message that he/she is predisposed to manage earnings without simultaneously conveying the message that Candidate A is a better manager in general than Candidate B. The results of this study suggest that Candidate B is unambiguously considered to be a better manager than Candidate A, so it is reasonable to expect that Candidate B will experience greater accounting labor market success than Candidate A. As a consequence, it appears that we have created a substantial hurdle that Candidate A must overcome in order to be hired over Candidate B for a high-level accounting position—firms must be willing to forego hiring the job candidate who is judged to be the better manager in general in order to hire the job candidate who is most able (and willing) to manage earnings. To the extent that Candidate A is favored over Candidate B in our employee selection studies (discussed below), the labor market for high-level accounting personnel would seem to value a specific managerial capability above many others—the ability and willingness to manage earnings—especially in firms that face pressure to manage earnings.

4. Studies 3 and 4

4.1. Purpose of studies

The purpose of the two studies reported in this section is to empirically test our research hypothesis. To do this, we use two relevant participant groups. Our participants in Study 3 are

highly experienced company executives who have large amounts of experience making hiring decisions. However, company officials are not the only individuals involved in employee selection decisions. In Study 4, our participants are highly experienced executive recruitment professionals. The purpose of using this participant group is threefold. First, we want to test our research hypothesis using participants who evaluate job candidates before they interview with company officials.¹³ It is possible that executive recruitment professionals also favor Candidate A over Candidate B (or, stated alternatively, they screen out Candidate B), which would increase the likelihood of job market success for job candidates who are perceived to be predisposed to manage earnings. Second, we want to use alternative PO fit measures. Study 3 assesses PO fit using generic fit measures, but Study 4 uses PO fit measures tailored to accounting. Finally, we want participants to comparatively evaluate the job candidates and independently evaluate them. Study 3 has participants comparatively evaluate job candidates, while Study 4 has participants evaluate one of the two job candidates only.

4.2. Study 3

4.2.1. Participant recruitment

We randomly selected 2,500 professionals from U.S. firms on the LexisNexis Academic Executive List. Each of the professionals has a job title indicating involvement in the accounting and/or finance function at their firm. The study was administered via Qualtrics. We contacted professionals in two ways—(1) an initial email and a follow-up email approximately one week later and (2) a letter to the street address of each individual who had a valid email address. Of the 2,500 business professionals we contacted, 368 had an invalid email/street address. A total

¹³ Executive recruitment professionals seek to recruit individuals who they believe can deliver required financial, operational, and managerial results for their clients (and screen out those individuals who cannot). Many executive recruitment organizations express such statements, including Korn Ferry International, Lucas Group, and Spencer Stuart.

of 56 experienced business professionals participated in this study, resulting in a response rate of 2.63 percent.

4.2.2. Demographics

Table 2 provides demographic information. Participants' mean age is 51.18 years and their mean work experience is 28.50 years. Participants indicate that they are familiar with the duties of accounting managers (mean 9.02 on a 10-point scale with higher responses indicating greater familiarity) and with evaluating job candidates for purposes of making hiring decisions or hiring recommendations (mean 9.13 on a 10-point scale with higher responses indicating greater familiarity). The mean employee headcount at participants' firms is 5,810.21. Approximately 72 percent of participants have experience working for a public company.¹⁴ The mean number of accounting and finance courses taken is 10.64 and 6.01, respectively.¹⁵ Approximately 55 percent of participants are male. Participants generally hold titles indicating a high level of professional achievement (i.e., chief financial officer, chief accounting officer, controller, etc.).

4.2.3. Instrument

Participants take the role of an executive at a public company. They are informed that the company's senior accounting manager recently retired and that the company is now in the process of finding a successor. Participants then learn about the company's financial objectives, which the accounting manager is expected to help achieve. These financial objectives include meeting profit goals, reporting smooth earnings, avoiding negative earnings surprises, and displaying financial strength and stability. These are common earnings-related objectives that stimulate earnings management. Participants are informed that employees are committed to

¹⁴ The inferences and conclusions of the study are unaffected by excluding participants who have no public company work experience.

¹⁵ These questions did not specify whether "courses" refers to college courses or continuing professional education courses. These means would likely be lower if the questions specified formal college courses.

achieving the objectives and that there is a belief that failure to achieve them will adversely affect the company. Finally, participants then learn about the senior accounting manager's particular role within the company, including overseeing accounting operations and making important judgments/decisions related to financial reporting.

Participants are informed that company personnel have evaluated a large pool of job candidates and that two finalists have been chosen (referred to as "Candidate A" and "Candidate B"). The task of participants is to indicate which candidate they believe the company will hire. The materials explain that both candidates are highly qualified for the position, performed very well in their interviews, were liked by the interviewers, displayed strong communication skills, and received excellent recommendations from previous employers. Participants also receive job candidate summaries which provide information about (1) education and certification, (2) work experience, and (3) the job candidate personality profile. By design, the candidate summaries are extremely similar in terms of the information conveyed by items (1) and (2), but they differ substantially in terms of the information conveyed by item (3).¹⁶

Fit assessments often occur early in the applicant evaluation process when organizations are seeking to fill high-level positions (Bretz et al. 1993; Cable and Judge 1997; Chatman 1991; Judge et al. 2000; Rynes and Gerhart 1990). There is an important temporal order between fit assessments and the hiring decisions—PO fit assessments precede hiring decisions (Arthur et al. 2006; Cable and Judge 1997; Judge et al. 2000). This temporal order of events not only reflects

¹⁶ Efforts to equalize education and experience between the job candidates were extensive. Both candidates (1) worked at a Big 4 accounting firm, (2) achieved the rank of manager, and (3) have undergraduate and graduate degrees in accounting from respected public universities. Participants also respond to a series of salience checks which take the form of true/false questions. For example, one true/false question states that "Both candidates received excellent recommendations from previous employers" while another question states that "Both candidates possess similar qualifications for the senior accounting manager position." Participants correctly respond to the salience check questions between 85 percent and 100 percent of the time. The inferences and conclusions of this study are unaffected by removing participants who missed salience checks.

actual practice, but it also reflects theoretical models of hiring decisions (Cable and Judge 1997; Kristof 1996) and design choices made in other studies (Cable and Judge 1997; Chatman 1991; Edwards 2008; Judge et al. 2000; Rynes and Gerhart 1990). Thus, we have participants evaluate fit before making their hiring decision. Figure 1 provides a conceptual model of the antecedents to hiring decisions which reflects the real-world temporal order of events.

Participants respond to nine PO fit questions (referred to as “fit questions” below) that we develop from prior literature (see Appendix C). The information that participants receive about the company making the hiring decision is limited to general company information and selected financial objectives. There are no real differences between the job candidates other than their personality profiles. Therefore, participants’ fit assessments reflect their perceptions about the compatibility between the company’s financial objectives and candidates’ personality profile. Participants respond to the fit questions on a 100-point sliding scale, with the left endpoint labeled “Definitely Candidate A” and the right endpoint labeled “Definitely Candidate B.”¹⁷

Participants then respond to the job candidate selection question, which states “Based on your assessment of the candidates and the information about the Company, which candidate do you believe the Company will most likely hire to fill the senior accounting manager position?”¹⁸ Participants respond on the same 100-point sliding scale as the fit questions. We analyze both a continuous response and a dichotomous response. The dichotomous response is coded as 0 if the

¹⁷ For all of the questions using the 100-point sliding scale, the slider starts at the mid-point of the scale. Participants must move the slider in either direction to continue. Once the slider is moved in either direction, the mid-point of the scale cannot be selected. Participants do not see numerical values on the scale, but we translate their scale position to a numerical value between 1 and 100, inclusive. In the instructions, participants are informed that moving the slider closer to one end of the scale or the other indicates the strength of their response.

¹⁸ An alternative to having the instrument reflect this temporal order of events in the real-world is to counterbalance the fit assessment and the job candidate selection question. To learn whether our inferences and conclusions are sensitive to the order in which information is elicited from participants, we repeated Study 3 using 60 MBA students from two large public universities, but counterbalance the order in which we elicit responses from participants. We find no order effects (p-values > 0.20).

response is below the mid-point of the scale (a preference for Candidate A) and 1 if the response is above the mid-point of the scale (a preference for Candidate B).¹⁹ Finally, participants answer salience checks and demographic questions.

4.2.4. Results

The results of the study are provided in Figure 3. Panel A provides both the continuous fit assessment and the dichotomous fit assessment. The mean fit assessment is 31.53, which is significantly below the midpoint of the 100-point response scale (t-statistic = 6.04, p-value < 0.001).²⁰ This indicates that Candidate A is considered to be the better fit. Likewise, when the fit assessment is dichotomized at the scale's midpoint, 85.71 percent of the study participants believe that Candidate A is the better fit, while only 14.29 percent believe that Candidate B is the better fit. The percentages are significantly different from the midpoint (χ^2 -statistic = 28.57, p-value < 0.001), indicating a strong belief that Candidate A is the better fit.

Panel B provides both the continuous choice and dichotomous choice between the two job candidates. The mean of the continuous choice is 23.93, which is significantly below the midpoint of the response scale (t-statistic = 7.09, p-value < 0.001). This indicates that Candidate A is considered most likely to be hired. Likewise, when the continuous choice is dichotomized at the scale's midpoint, 87.50 percent of the study participants believe that Candidate A is most likely to be hired, while only 12.50 percent believe that Candidate B is most likely to be hired.

¹⁹ Participants may respond to questions in ways that they believe are “correct” or socially acceptable (referred to as “social desirability bias”) (Fisher 1993). Social desirability bias may influence variable means and relationships among variables (Zerbe and Paulhus 1987). However, indirect questioning may reduce the effect of social desirability bias (Fisher 1993). Thus, we phrase the candidate selection question using indirect questioning.

²⁰ We form a composite measure of fit by averaging the responses to all of the fit items. An averaging approach is appropriate because the fit questions collectively measure one unidimensional construct, as evidenced by Cronbach's (1951) alpha of approximately 0.94 and a single eigenvalue in excess of one (its value is 6.51). Our inference and conclusions do not change if we use factor scores to derive our composite measure of fit. In Studies 4 and 5, which also measure fit using multiple items, we also come to the conclusion that the fit questions collectively measure one unidimensional construct.

The percentages are significantly different from the midpoint (χ^2 -statistic = 31.50, p-value < 0.001), indicating a strong belief that Candidate A will be hired. Thus, we find support for our research hypothesis that firms facing pressure to manage earnings tend to hire job candidates who appear predisposed to manage earnings over equally-qualified job candidates who appear to lack that predisposition.

4.3. Study 4

4.3.1. Participant recruitment

We sought participation from executive recruitment professionals who have experience placing job candidates in accounting and/or finance positions. To identify such participants, we examined the online biographical sketches of executive recruitment professionals.²¹ We invited 561 executive recruitment professionals to participate in our study via email (39 emails were returned as undeliverable) and sent a follow-up email about one week later. The experiment was administered via Qualtrics. To increase the response rate, we offered respondents a \$10 gift card for their participation. There are 41 professionals who participated in the experiment, resulting in a response rate of 7.85 percent.

4.3.2 Demographics

Table 3 provides demographic information. Participants' mean age is 45.03 years and their mean work experience is 23.21 years. Participants indicate that they are familiar with the duties of accounting managers (mean 7.47 on a 10-point scale with higher responses indicating greater familiarity). The mean number of executive searches and accounting/finance searches in which our participants have been involved is 518.99 and 400.57, respectively. The mean number

²¹ It is not always possible to know whether an executive recruitment professional has experience in accounting and/or finance, but our demographic information suggests that we successfully identified participants who have the desired experience.

of accounting and finance courses taken by participants is 5.91 and 4.13, respectively. About 64 percent of participants are male.

4.3.3. Instrument

Participants consider a situation facing a hypothetical executive recruitment consultant who works for an executive recruitment firm. Participants are informed that a public-company client is seeking to fill a vacant senior accounting manager position. Participants then learn about the client's financial objectives, which the senior accounting manager is expected to help achieve (see Study 3 for the financial objectives). Participants are informed that the consultant is now making a decision about whether to refer a particular candidate, whose background has already been vetted, to the client to interview for the senior accounting manager position. The candidate being considered is *either* Candidate A or Candidate B but not both (see Appendix A). Thus, we manipulate the personality profile of the job candidate between subjects at two levels, but hold all other aspects of the job candidate summary constant.²² Participants are randomly assigned to experimental conditions.

The materials explain that the candidate has the technical competence and qualifications for the senior accounting manager position, but that the client relies on the consultant to ensure that job candidates who are referred for an interview are a good fit for the position. We develop five fit questions tailored to our accounting context (see Appendix D). Participants respond to these fit questions on a 100-point sliding scale, with the left endpoint labeled "Definitely not" and the right endpoint labeled "Definitely yes." After responding to the accounting fit questions,

²² The job candidate profiles are amalgamations of different personality characteristics. On the surface, one might speculate that a single characteristic could be a dominant consideration when making an employee selection or referral decisions. To address this issue, we ask participants whether they considered the candidate's overall personality profile or they considered only a specific personality attribute. Only four of the 41 participants indicated that they focused on a specific personality attribute.

participants respond to the client referral question, which states “Based on your evaluation of the candidate and the information about the client, how likely is the consultant to refer the candidate to the client to interview for the senior accounting manager position?” Participants respond on the same 100-point sliding scale as the accounting fit questions. Participants then answer a series of salience checks and demographic questions.²³

4.3.4. Results

Descriptive information for the experiment is provided in Figure 4. Panel A reveals that the mean accounting fit assessment is 81.23 for Candidate A and only 34.71 for Candidate B. Likewise, Panel B reveals that the mean referral decision is 49.74 for Candidate A and 31.89 for Candidate B. To formally examine the relationships between job candidate characteristics, accounting fit, and the client referral decision, we estimate the following regressions:²⁴

$$AFIT = \beta_0 + \beta_1CAND + \varepsilon \quad (1)$$

$$REF = \beta_0 + \beta_1AFIT + \beta_2LIKE + \varepsilon \quad (2)$$

where AFIT is the mean response to the five accounting fit questions shown in Appendix D (responses are provided on a 100-point sliding scale, with the left endpoint labeled “Definitely not” and the right endpoint labeled “Definitely yes”); CAND is the job candidate profile, coded as 1 for Candidate A and 0 for Candidate B; REF is participants’ response to the client referral question; LIKE is the response to a likability question, which states “Based on the information

²³ The two job candidates are perceived to be very different in terms of their predispositions to manage earnings (see Section 3). At the same time, both of the candidates are reasonable representations of job candidates who might pursue a senior accounting manager position. One of the post-experimental questions asks participants to indicate whether someone like the job candidate would apply for a senior accounting manager position. Participants respond on a 10-point scale with the left endpoint labeled “Definitely not” and the right endpoint labeled “Definitely yes.” The mean response for the job candidate who is predisposed to manage earnings is 8.29 and the mean response for the job candidate who is not is 8.81. Thus, while we have created job candidates whose personality profiles seem very different, they are not extreme in terms of the types of individuals who might pursue a senior accounting manager position.

²⁴ We model PO fit as an intervening variable (i.e., the attributes of the job candidate influence the referral decision through PO fit). This is consistent with our discussion of Figure 1.

presented in the job candidate profile summary report for Candidate A, how much did you like Candidate A” (or Candidate B depending on the condition)? Responses are provided on a 10-point scale with the left endpoint labeled “Definitely disliked” and the right endpoint labeled “Definitely liked.”²⁵

Panel A of Table 4 reveals that AFIT is significantly influenced by CAND (t-statistic = 8.41, p-value < 0.001), indicating that perceived accounting fit is influenced by the personality characteristics of the job candidate. At the same time, Panel B of Table 3 reveals that REF is significantly influenced by AFIT (t-statistic = 3.78, p-value < 0.001), indicating that executive recruitment professionals’ referral decision is strongly influenced by accounting fit. We also include participants’ likeability rating in the regression to control for the differential likeability of the two job candidates. We find that likeability is positively associated with the job candidate referral decision (t-statistic = 4.13, p-value < 0.001), as one would expect.

An implication of our findings is that, in firms facing pressure to manage earnings, job candidates who are perceived to be unwilling to manage earnings may be screened out by executive recruitment firms before such individuals can even be considered by corporate personnel for senior accounting manager positions. This screening process leaves firm officials with a homogenous set of applicants from which to select senior accounting managers (in terms of perceived predisposition to manage earnings).

²⁵ Cable and Judge (1997) examine factors that influence employee selection decisions, finding that fit, likeability, and other factors (e.g., gender and physical appearance) influence hiring decisions. In the experimental materials, we are silent about gender and physical appearance. However, we know that the two candidates may be differentially likeable. Candidate A has traits that some might consider to be unattractive (for example, Candidate A is narcissistic), while Candidate B has traits that some might consider to be commendable (for example, Candidate B is an idealist). To address the issue of likeability, a post-experimental question asks “Based on the information presented in the job candidate profile summary report for Candidate A, how much did you like Candidate A?” (Candidate B in the other condition). Participants respond on a 10-point scale with the left endpoint labeled “Definitely disliked” and the right endpoint labeled “Definitely liked.” We find that participants like Candidate B (mean = 5.44) significantly more than Candidate A (mean = 4.62) (t-statistic = 2.16, p-value = 0.04), which suggests that we should control for likeability when examining participants’ candidate referral decisions.

5. Study 5

5.1. Purpose of study

The purpose of Study 5 is to help rule out a potential alternative explanation for the results of Study 3. This potential alternative explanation is that executives will always prefer to hire Candidate A over Candidate B for high-level accounting positions. In Study 5, participants learn that the hiring entity is a non-profit foundation rather than a for-profit firm. Accordingly, the stimulus to hire Candidate A is removed because non-profit foundations neither measure nor report earnings. Therefore, we expect that the preference to hire Candidate A over Candidate B in Study 5 will be reversed relative to the preference exhibited in Study 3.

5.2. Participant recruitment

We randomly selected 2,500 professionals from U.S. firms on the LexisNexis Academic Executive List. Each of the professionals has a job title indicating involvement in the accounting and/or finance function at their firm. The study was administered via Qualtrics. We contacted professionals in two ways—(1) an initial email and a follow-up email approximately one week later and (2) a letter to the street address of each individual who had a valid email address. Of the 2,500 business professionals we contacted, 381 had an invalid email/street address. A total of 57 experienced business professionals participated in this study, resulting in a response rate of 2.69 percent.²⁶ Because the demographics for participants in this study are very similar to the demographics for Study 3, they are not tabulated.

5.3. Instrument

²⁶ The demographic questions ask participants to indicate if they have experience working in a non-profit organization. Approximately 62 percent of our participants have such experience. Our inferences and conclusions do not change when we limit our sample to participants who have work experience in a non-profit organization.

The instrument used in the present study is very similar to the instrument used in Study 3 except that we modify the financial objectives. Specifically, we describe the organization as a non-profit foundation whose financial objectives include maintaining proper stewardship of donations, fulfilling donor directives, controlling operating costs, and transparency related to reporting the activities and financial position. If Candidate A was favored over Candidate B for some reason that we do not fully appreciate, then Candidate A should again be favored over Candidate B in this alternative organizational context.

5.4. Results

The results of this study are provided in Figure 5. Panel A provides both the continuous fit assessment and the dichotomous fit assessment. The mean fit assessment is 69.63, which is significantly above the midpoint of the 100-point response scale (t-statistic = 6.64, p-value < 0.001). This indicates that Candidate B is considered to be the better fit. Similarly, when the fit assessment is dichotomized at the scale's midpoint, 87.72 percent of participants believe that Candidate B is the better fit, while only 12.28 percent believe that Candidate A is the better fit. The percentages are significantly different from the midpoint (χ^2 -statistic = 32.44, p-value < 0.001), indicating a strong belief that Candidate B is the better fit.

Panel B provides both the continuous choice and dichotomous choice between the two job candidates. The mean of the continuous choice is 75.91, which is significantly above the midpoint of the response scale (t-statistic = 7.01, p-value < 0.001). This finding indicates that Candidate B is considered most likely to be hired. Likewise, when the continuous choice is dichotomized at the scale's midpoint, 85.96 percent believe that Candidate B is the most likely to be hired, while only 14.04 percent believe that Candidate A is the most likely to be hired. The percentages are significantly different from the midpoint (χ^2 -statistic = 31.50, p-value < 0.001),

indicating a strong belief that Candidate B will be hired. These results, when considered along with the fit results, indicate participants' belief that Candidate B will be hired over Candidate A because Candidate B is considered to be a better fit for the senior accounting manager position in the non-profit context.

Like the results for Study 3, these results here are decisive. Participants overwhelmingly believe that Candidate B is the best fit for the position and that he/she will ultimately be hired. However, notice the reversal between Study 3 and this study. In Study 3, there was a strong belief Candidate A will be hired, but in this study there is a strong belief Candidate B will be hired. The only thing that differs between the two studies is the type of organization and its financial objectives. Our results run counter to the view that Candidate A will always be hired over Candidate B. Instead, they suggest that the hiring decision is a function of the perceived fit between the personality characteristics of the candidate and the financial objectives that the senior accounting manager is expected to help achieve.

6. Conclusions

This study provides the first direct evidence about the types of individuals who are hired into positions of power and authority in the accounting function of firms. Specifically, we find that, in the context of a firm facing pressure to manage earnings, financial executives indicate that an accounting job candidate whose personality characteristics indicate a predisposition to manage earnings is likely to be hired over an equally-qualified accounting job candidate who appears to lack that predisposition. Further, we find that executive recruitment professionals indicate that an accounting job candidate whose personality characteristics signal an aversion to earnings management is likely to be screened out before even being considered by prospective employers.

This study raises questions about the efficacy of increased accounting regulations as a means to reign in earnings management. The SEC has a long history of enacting regulations to combat earnings management and perceived accounting abuses (e.g., Staff Accounting Bulletins No. 99, 100, and 101), but the selection process in firms that face pressure to manage earnings may result in those firms populating many of their accounting positions with individuals who are predisposed to manage earnings. Under such circumstances, regulation may only have a modest effect on earnings management.

By focusing on employee selection, we have identified one of the potential root causes of earnings management. Although prior research assumes that earnings management is caused by some type of stimuli, we note that managers make a choice to manage (or not manage) earnings. So a more fundamental question is why do so many professionals manage earnings in response to stimuli? In our view, part of the answer to this question resides in the types of people who are selected by, and retained in, firms.

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APPENDIX A
Job Candidate Personality Profiles

High predisposition to manage earnings (Candidate A)	Low predisposition to manage earnings (Candidate B)
<i>High moral disengagement</i>	<i>Low moral disengagement</i>
1. Is results-oriented and believes that the end results are more important than the process by which one pursues those results.	1. Is process-oriented and believes that the process by which one pursues results is more important than the results themselves.
2. Believes that rules must be flexible enough to be adapted to different situations and will rewrite the rules if necessary to achieve goals.	2. Believes that rules are established purposefully, should not be circumvented to achieve goals, and should be changed only after significant deliberation.
3. Quickly assesses the norms of the organization and looks to those norms to determine what behavior is acceptable.	3. Has rigid beliefs about what constitutes acceptable behavior and rarely deviates from those beliefs.
<i>High Machiavellianism</i>	<i>Low Machiavellianism</i>
4. Believes that subordinates should only be privy to the specific information needed to do their jobs effectively.	4. Believes that subordinates should be privy to available information.
<i>High narcissism</i>	<i>Low narcissism</i>
5. Responds well to flattery and compliments.	5. Is embarrassed by flattery and compliments.
6. Likes to be the center of attention when in the presence of important people.	6. Is uncomfortable being in the spotlight when in the presence of important people.
<i>Ethical orientation – low idealist, high relativist</i>	<i>Ethical orientation – high idealist, low relativist</i>
7. Makes decisions by comparing the benefits and costs of each decision, and accepts that some decisions might negatively impact others in some way.	7. Avoids decisions that might negatively impact others, even if that harm is insignificant.
8. Believes that ideas about what constitutes moral or immoral behavior vary from person to person and from situation to situation.	8. Believes that ideas about what constitutes moral or immoral behavior should not vary from person to person and from situation to situation.
<i>High self-monitor</i>	<i>Low self-monitor</i>
9. Can change behaviors and opinions to suit different people and different situations.	9. Does not change behaviors or opinions to suit different people and different situations.
<i>Locus of control – powerful others</i>	<i>Locus of control – chance</i>
10. Believes that leadership achievements require the ability to please those in positions of power.	10. Believes that leadership achievements are chiefly due to being in the right place at the right time.
<i>High ability to rationalize behavior</i>	<i>Low ability to rationalize behavior</i>
11. Will take actions that feel right at the moment even if those actions seem inconsistent with values.	11. Will take actions only after deliberation to avoid actions that are inconsistent with values.
12. Can find justifications for actions after the fact.	12. Prefers to avoid having to justify actions after the fact.

Headings are not included in the actual instrument completed by participants (they are shown here for informational purposes only). See Section 3 and Appendix B for a discussion of the job candidate personality profiles and their development.

APPENDIX B

Summary of the Development of the Job Candidate Personality Profiles

The starting point in the development of the job candidate personality profiles in Appendix A was to identify validated personality scales that plausibly signal an individual's predisposition to manage earnings. Although there are numerous personality scales, six particular scales stood out as being suitable for our purpose. In addition, we develop one scale ourselves (a scale designed to measure an individual's ability to rationalize questionable behavior). To determine whether the items comprising the scales signal information about an individual's predisposition to manage earnings, we conduct a survey using 102 participants from Amazon's Mechanical Turk (AMT) platform (results not tabulated).

The survey defines "earnings management" using a composite, non-technical definition from the accounting literature (see Study 1 for our definition of earnings management). The survey then expresses the items comprising the scales as a series of independent statements about the beliefs of an individual. After each statement, participants rate how likely an individual who holds a particular belief is to manage earnings. Participants respond on an 11-point scale ranging from -5 to +5, with the left endpoint labeled "Unlikely to manage earnings," the right endpoint labeled "Likely to manage earnings," and the midpoint labeled "Neutral." Each of the personality scales is discussed below.

Moral disengagement (Shu et al. 2011). Moral disengagement occurs when individuals try to persuade themselves that their own questionable behavior is morally permissible. The mean of the moral disengagement items are significantly above zero (mean = 1.61, t-statistic = 5.56, p-value < 0.001), which indicates that individuals who morally disengage are perceived to be predisposed to manage earnings.

Machiavellianism and narcissism (Paulhus and Jones 2011). Machiavellianism is characterized by manipulation and exploitation of others, and narcissism is characterized by self-focus and an undue sense of self importance. The means of Machiavellianism items (mean = 1.19, t-statistic = 5.22, p-value < 0.001) and the narcissism items (mean = 1.04, t-statistic = 6.29, p-value < 0.001) are both significantly above zero, which indicates that individuals who measure high on these personality traits are perceived to be predisposed to manage earnings.

Ethical orientation (Forsyth 1980). Ethical orientation describes an individual's moral philosophies. Idealism and relativism are two dimensions of ethical orientation. The mean of the idealist items are significantly below zero (mean = -0.75, t-statistic = -2.71, p-value = 0.008), indicating that idealists are not perceived to be predisposed to manage earnings. The mean of the relativist items are significantly above zero (mean = 1.25, t-statistic = 5.44, p-value < 0.001), indicating that relativists are perceived to be predisposed to manage earnings.

Self-monitoring (Snyder and Gangestad 1986). Self-monitoring is a personality trait characterized by concern about managing one's behavior to accommodate social situations. The mean of the self-monitoring items is significantly above zero (mean = 0.99, t-statistic = 5.18, p-value < 0.001), indicating that high self-monitors are perceived to be predisposed to manage earnings.

Locus of control (Levenson 1973). Locus of control refers to the extent to which an individual believes he/she can control events in their lives. The means of the internal locus of control items (mean = 1.72, t-statistic = 9.02, p-value < 0.001) and the powerful others locus of control items (mean = 0.82, t-statistic = 3.71, p-value < 0.001) are both significantly above zero, which indicates that individuals who score high on these dimensions are perceived to be predisposed to manage earnings. The mean of the chance locus of control items is significantly below zero (mean = -0.73, t-statistic = -3.59, p-value < 0.001), which indicates that individuals who score high on this dimension are not perceived to be predisposed to manage earnings.

Ability to rationalize behavior. Earnings management is often considered to be questionable behavior, and some individuals can readily rationalize such behavior. The mean of the ability to rationalize behavior items is significantly above zero (mean = 1.27, t-statistic = 4.39, p-value < 0.001), indicating that those individuals who can readily rationalize questionable behavior are perceived to be predisposed to manage earnings.

Note: The personality profiles shown in Appendix A do not use the actual items from the original personality scales because the number of items is too voluminous and the items are not always suitably worded. We rephrased and combined items from the original personality scales to make them appropriate for inclusion in our job candidate personality profiles.

APPENDIX C

Person-Organization Fit Questions

1. Which candidate's attitude is most compatible with the culture of the Company?
2. Which candidate's value system is most compatible with the culture of the Company?
3. Which candidate's belief system is most compatible with the culture of the Company?
4. Which candidate's personality is most compatible with the culture of the Company?
5. Which candidate has priorities that are most similar to the priorities of the Company?
6. Which candidate is most likely to clash with the culture of the Company?
7. Which candidate's behaviors, beliefs, and values will be valued most by the Company?
8. Which candidate will find the senior accounting manager position most personally and professionally rewarding?
9. Which candidate is most likely to have to do something they do not like in order to meet the Company's expectations?

See Section 4 for a discussion of the person-organization fit questions. Participants respond on a 100-point sliding scale, with the left endpoint labeled "Definitely Candidate A" and the right endpoint labeled "Definitely Candidate B." Questions 6 and 9 are reverse coded.

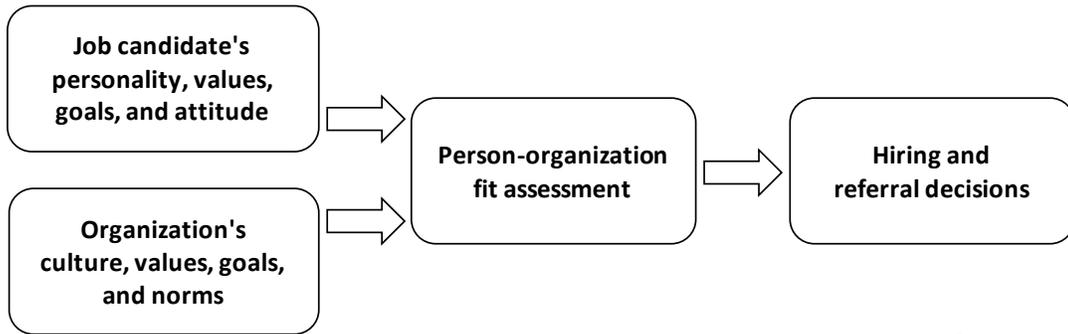
APPENDIX D

Accounting-Related Person-Organization Fit Questions

1. Candidate A will make accounting decisions to bolster reported profits.
2. Candidate A will make accounting decisions to achieve desired profit goals.
3. Candidate A will find a way to report the smoothest possible earnings to keep borrowing costs low.
4. Candidate A will push boundaries to meet analysts' earnings forecasts for the company.
5. Candidate A will portray financial performance in the most favorable light possible.

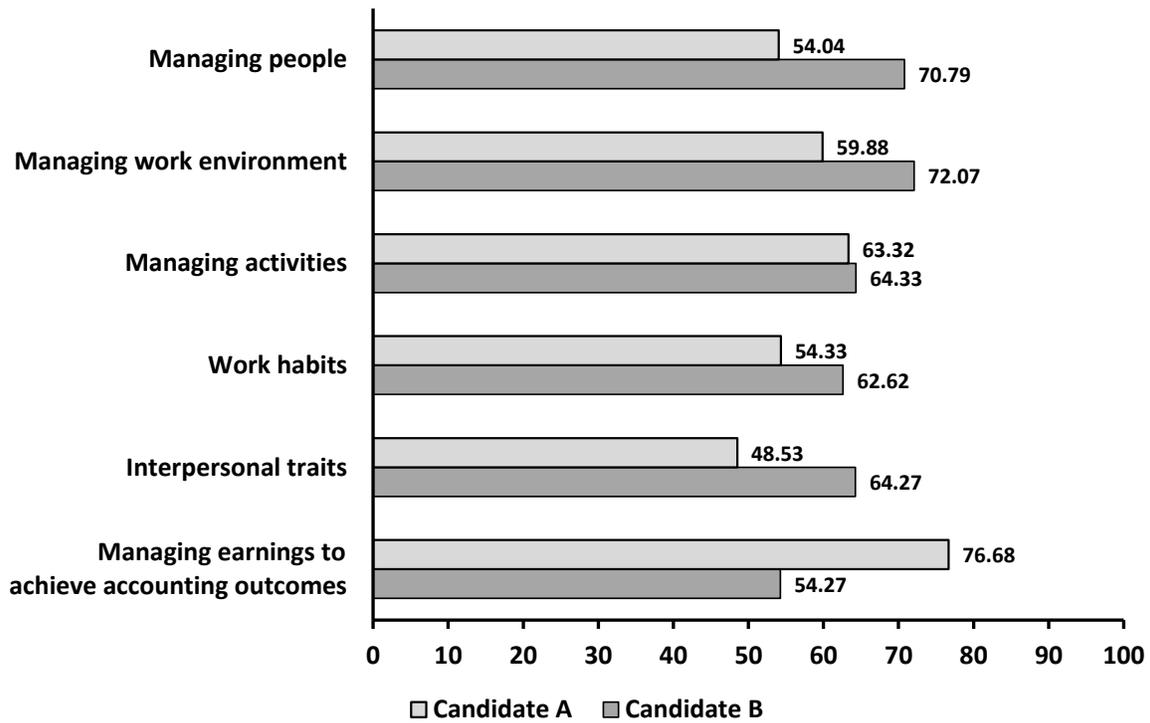
See Section 4 for a discussion of the accounting-related person-organization fit questions. Participants respond on a 100-point sliding scale, with the left endpoint labeled "Definitely not" and the right endpoint labeled "Definitely yes." The fit questions shown here are for the condition involving Candidate A.

FIGURE 1
Conceptual Model of Antecedents to Hiring and Referral Decisions



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Accounting
Association

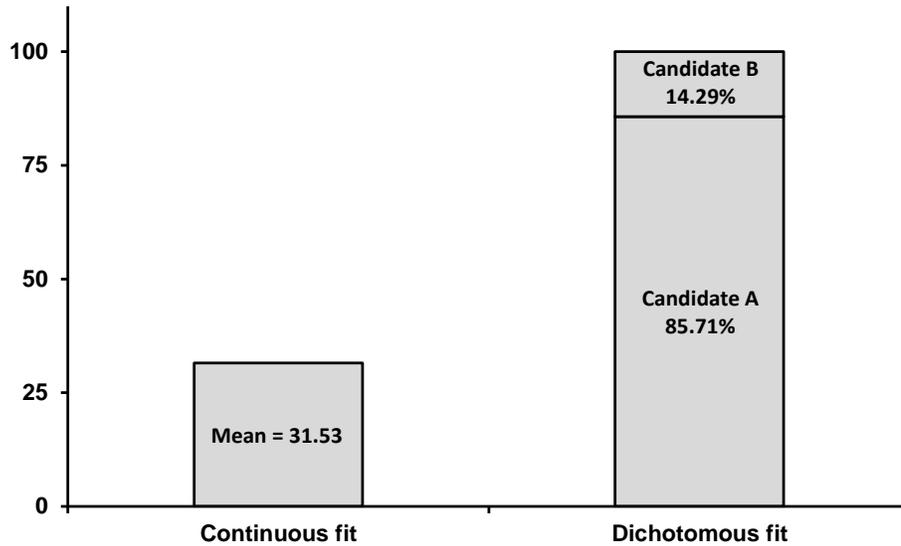
FIGURE 2
Graph of Results from Study 2 (n=99)



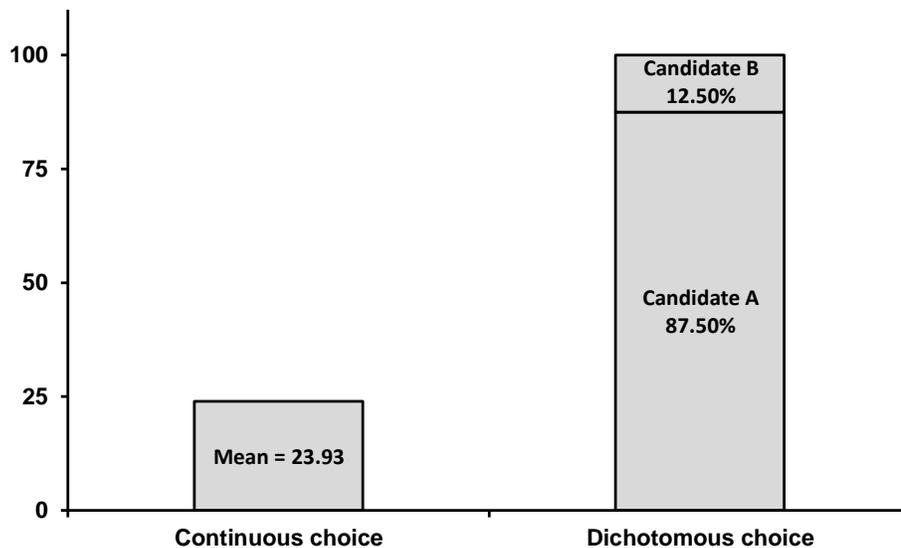
See Section 3 for a discussion of the Study 2. The experiment manipulates whether participants are informed that Candidate A or Candidate B was hired. Participants then respond to a series of 27 statements that elicit their attributions about why one candidate was hired over the other candidate. The statements are clustered around six managerial/personal skills—managing people, managing the work environment, managing activities, work habits, interpersonal traits, and managing earnings to achieve accounting outcomes. Participants respond on a 100-point scale with the left endpoint labeled “Definitely disagree” and the right endpoint labeled “Definitely agree.”

FIGURE 3
Graph of Results from Study 3 (n=56)

Panel A: Fit assessment of job candidates



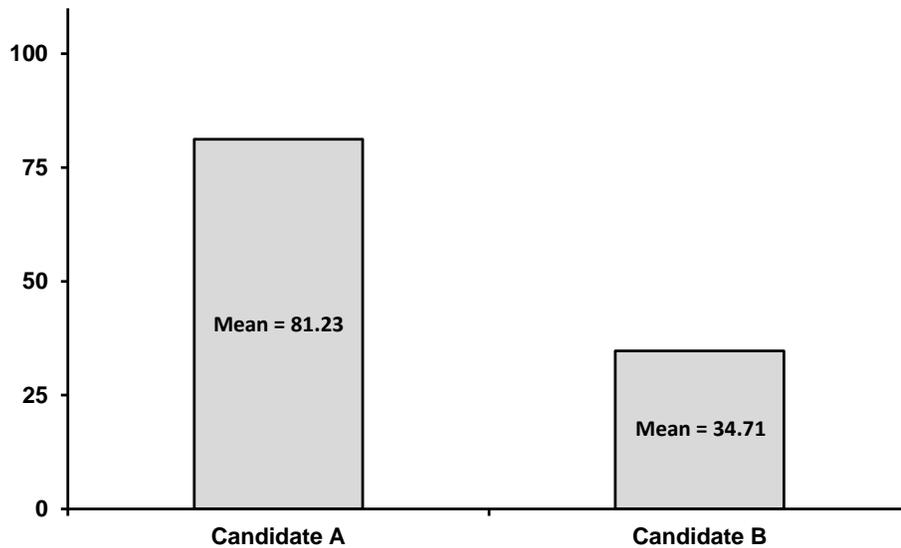
Panel B: Choice between job candidates



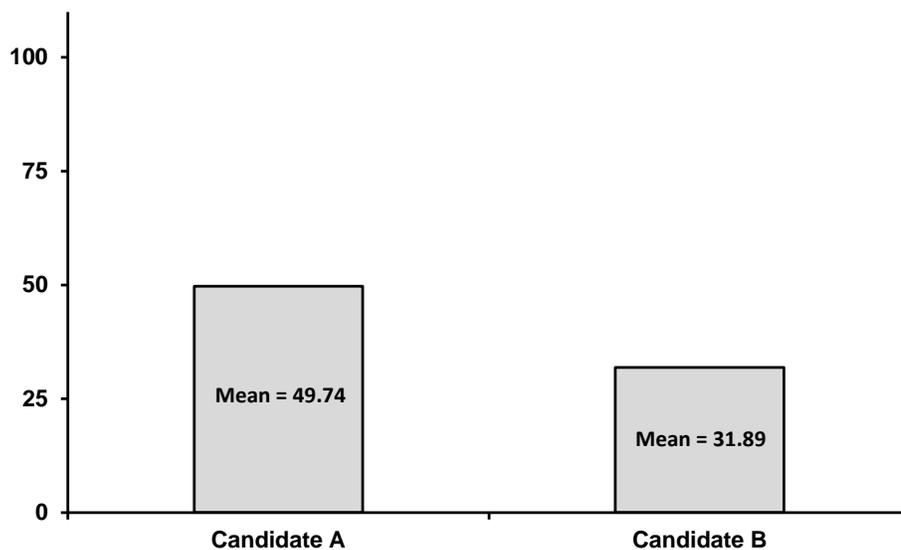
See Section 4 for a discussion of Study 3. Appendix A contains the personality descriptors for the job candidates. In Panel A, the fit assessment is the mean of the nine person-organization fit questions shown in Appendix C. In Panel B, the choice between job candidate question states “Based on your assessment of the candidates and the information about the Company, which candidate do you believe the Company will most likely hire to fill the senior accounting manager position?” In both panels, participants respond on a 100-point sliding scale, with the left endpoint is labeled “Definitely Candidate A” and the right endpoint labeled “Definitely Candidate B.” The dichotomous response is coded as 0 if the response is below the mid-point of the scale (a preference for Candidate A) and 1 if the response is above the mid-point of the scale (a preference for Candidate B).

FIGURE 4
Graph of Results from Study 4 (n=41)

Panel A: Accounting fit assessment



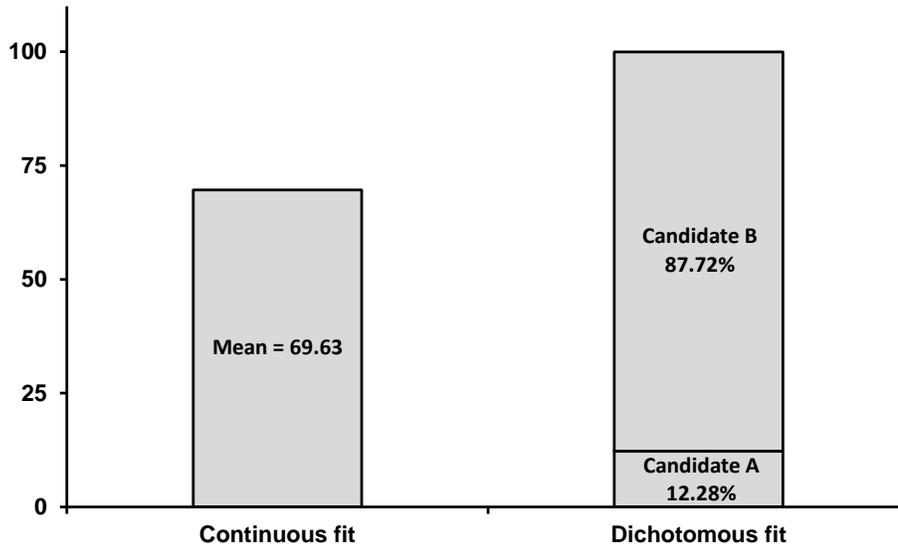
Panel B: Referral decision



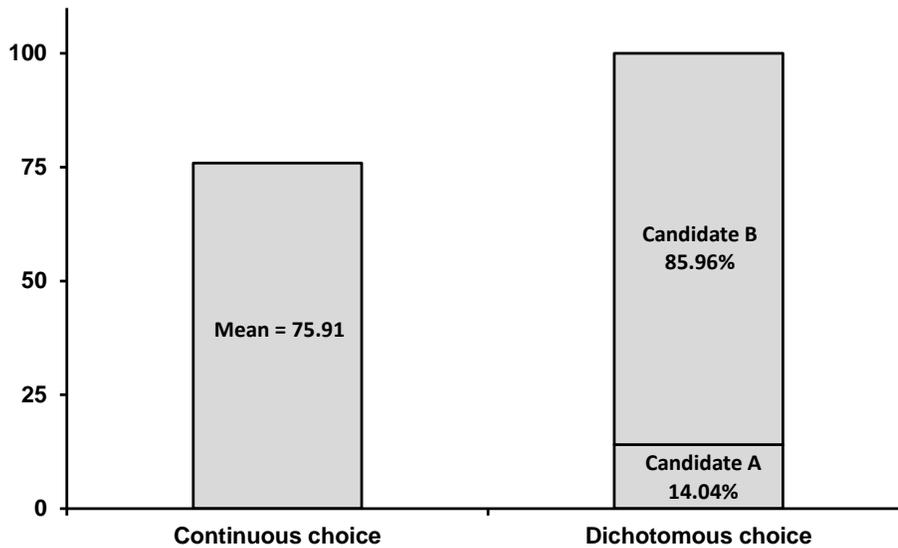
See Section 4 for a discussion of Study 4. Appendix A contains the personality descriptors for the job candidates. In Panel A, the fit assessment is the mean of the five accounting-related person-organization fit questions shown in Appendix D. In Panel B, the client referral question states “Based on your evaluation of the candidate and the information about the client, how likely is the consultant to refer the candidate to the client to interview for the senior accounting manager position?” In both panels, participants respond on a 100-point sliding scale, with the left endpoint is labeled “Definitely Not” and the right endpoint labeled “Definitely Yes.”

FIGURE 5
Graph of Results from Study 5 (n=57)

Panel A: Fit assessment of job candidates



Panel B: Choice between job candidates



See Section 5 for a discussion of Study 5. Appendix A contains the personality descriptors for the job candidates. In Panel A, the fit assessment is the mean of the nine person-organization questions shown in Appendix C. In Panel B, the choice between job candidate question states “Based on your assessment of the candidates and the information about the Company, which candidate do you believe the Company will most likely hire to fill the senior accounting manager position?” In both panels, participants respond on a 100-point sliding scale, with the left endpoint is labeled “Definitely Candidate A” and the right endpoint labeled “Definitely Candidate B.” The dichotomous response is coded as 0 if the response is below the mid-point of the scale (a preference for Candidate A) and 1 if the response is above the mid-point of the scale (a preference for Candidate B).

TABLE 1
Results from Study 1 (n=59)

Question	Mean	t-stat.	p-value
1. Which candidate is MOST likely to initiate efforts to manage earnings?	10.88	15.93	< 0.001
2. Which candidate is LEAST likely to go along with existing efforts to manage earnings?	81.76	9.38	< 0.001
3. Which candidate is MOST uncomfortable managing earnings?	80.93	7.82	< 0.001
4. Which candidate is MOST likely to encourage others to manage earnings?	15.83	13.49	< 0.001
5. Which candidate is MOST susceptible to pressure from others to manage earnings?	15.36	12.30	< 0.001
6. Which candidate is MOST likely to steer others away from managing earnings?	80.49	9.14	< 0.001
7. Which candidate MOST likely believes that the positive consequences of earnings management justify engaging in that behavior?	12.25	15.53	< 0.001
8. Which candidate is MOST likely to participate in types of earnings management that would be considered fraudulent?	14.53	13.87	< 0.001
9. Which candidate is MOST likely to follow a company code of ethics that prohibits earnings management?	92.05	23.07	< 0.001
10. Which candidate is MOST likely to set an exemplary standard of ethical behavior?	87.07	16.14	< 0.001
11. Which candidate is MOST likely to engage in a series of seemingly harmless accounting decisions that lead to serious accounting infractions, including fraud?	15.35	14.86	< 0.001
12. Which candidate holds them self to the HIGHEST ethical standards?	89.19	18.55	< 0.001
13. Which candidate is MOST likely to relax their standards of ethical behavior in the face of professional gain?	10.52	26.28	< 0.001
14. Which candidate is LEAST likely to relax their standards of ethical behavior in the face of professional hardship?	84.49	10.09	< 0.001

See Section 3 for a discussion of Study 1. Appendix A contains the personality descriptors for the job candidates. Participants respond to the questions on a 100-point sliding scale, with the left endpoint labeled “Definitely Candidate A” and the right endpoint labeled “Definitely Candidate B.” The t-statistics test whether the mean differs from the mid-point of the scale.

TABLE 2
Demographic Information for Participants in Study 3 (n=56)

Variables	Mean	Median	1st quartile	3rd quartile	Std. dev.
Age in years	51.18	52.00	44.00	58.00	10.22
Work experience in years	28.50	30.00	20.50	37.50	10.40
Familiarity with duties of accounting managers	9.02	9.00	9.00	10.00	1.33
Familiarity with evaluating job candidates	9.13	9.00	8.00	10.00	0.99
Employee headcount at current employer	5,810.21	310.00	40.00	3,100.00	12,763.35
Percent with experience in a public company	72.00	100.00	0.00	100.00	45.36
Number of accounting courses taken	10.64	10.00	5.00	12.00	7.98
Number of finance courses taken	6.01	4.50	3.00	10.00	6.95
Percent male	55.10	100.00	0.00	100.00	50.25

See Section 4 for a discussion of Study 3. Responses to the questions about familiarity with the duties of accounting managers and familiarity with evaluating job candidates are provided on 10-point scales with higher responses indicating greater familiarity. Some participants did not answer all demographic questions, so the number of observations for each demographic question varies.



TABLE 3
Demographic Information for Participants in Study 4 (n=41)

Variables	Mean	Median	1st quartile	3rd quartile	Std. dev.
Age in years	45.03	47.00	37.00	52.00	10.81
Work experience in years	23.21	23.00	16.00	30.00	10.22
Familiarity with duties of accounting managers	7.47	8.00	7.00	9.00	1.89
Number of executive searches completed	518.99	75.00	20.00	400.00	1,167.28
Number of Accounting/Finance searches	400.57	150.00	20.00	490.00	636.93
Number of accounting courses taken	5.91	3.00	2.00	10.00	5.55
Number of finance courses taken	4.13	3.00	1.50	6.00	3.75
Percent male	63.89	100.00	0.00	100.00	48.71

See Section 4 for a discussion of Study 4. Responses to the question about familiarity with the duties of accounting managers are provided on a 10-point scale with higher responses indicating greater familiarity. Some participants did not answer all demographic questions, so the number of observations for each demographic question varies.



TABLE 4
Regression Results for Study 4 (n=41)

Variables	Coefficient	t-statistic	p-value
Panel A: Regression of accounting fit on candidate ($AFIT = \beta_0 + \beta_1CAND + \varepsilon$)			
Intercept	34.71	4.14	< 0.001
CAND	46.51	8.41	< 0.001
Model F-statistic = 70.78			
Model p-value = < 0.001			
Adj. R ² (%) = 63.56			
Panel B: Regression of referral on accounting fit and likeability ($REF = \beta_0 + \beta_1AFIT + \beta_2LIKE + \varepsilon$)			
Intercept	-22.55	-1.58	0.122
AFIT	0.57	3.78	< 0.001
LIKE	6.89	4.13	< 0.001
Model F-statistic = 11.28			
Model p-value = < 0.001			
Adj. R ² (%) = 33.96			

See Section 4 for a discussion of Study 4. Variables are defined as follows: AFIT is the mean response to the five accounting fit questions shown in Appendix C (responses are provided on a 100-point sliding scale, with the left endpoint labeled “Definitely not” and the right endpoint labeled “Definitely yes”); CAND is the job candidate profile, coded as 1 for Candidate A and 0 for Candidate B; REF is participants’ response to the client referral question, which states “Based on your evaluation of the candidate and the information about the client, how likely is the consultant to refer the candidate to the client to interview for the senior accounting manager position?” (responses are provided on the same 100-point sliding scale as the accounting fit questions); LIKE is the response to the likability question, which states “Based on the information presented in the job candidate profile summary report for Candidate A, how much did you like Candidate A? (Candidate B in other condition) (responses are provided on a 10-point scale with the left endpoint labeled “Definitely disliked” and the right endpoint labeled “Definitely liked”).