



The Dilemma of Morality in Financial Accounting

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Abstract

In an effort to better understand how ethics and moral judgment in financial behavior are influenced in financial reporting, it is proposed that self-awareness influences honesty. This study proposed that test subjects who sign their name before reporting financial information will be more honest and moral in their accounting practices as opposed to those who sign after these activities, or not at all. The sample included 197 different participants from twelve different universities in the United States. There was a broad spread of genders, although there were more males, and races as well, with age ranges being limited to just nineteen or twenty years old. The time period for the tests that these participants completed was one hour. The literature review itself spanned a time period of around twenty years, making it retrospective. The experiment revealed whether differing perspectives influenced the ethical nature of university students. It was found that the most honest individuals were those that were in the pre-signature group, while the post-signature and the non-signature groups had very little difference between results. Requiring a signature before a task had a major influence on self-efficacy, self-identity, and self-awareness, and encouraged ethical behavior. The results reveal that this “signature effect” in signing a document may influence honest accounting and be a way to encourage moral financial reporting. Recommendations will emphasize the ways requiring that these sorts of altruistic actions, namely, signing one's signature, will be applied, as well as implications for future research to ensure constant development on the subject.

Keywords: self-awareness, self-identity, morality, signature-effect, ethics

1. Introduction

While many advancements in auditing, investigation, and detection of fraudulent behavior are on the rise, financial scandals continue to be numerous. Several issues with corporate governance are causing financial professionals to find loopholes and hidden avenues for additional income. Adding to this, many types of fraudulent behavior and scandals have become an institutionalized practice. Tax avoidance is the most popular crime among popular corporations, influential politicians, and the average individual. It is even common for wealthy individuals to funnel their wealth into hidden bank accounts, untouchable by the government (or so believed). A variety of new regulations have been passed to counter these issues, which include the ones proposed by the Securities and Exchange Commission (SEC), in addition to the introduction of the Sarbanes-Oxley Act. Not to mention, stock market trade has also seen its fair share of new policies required by the government. Due to the vast number of frauds that have been exploding over the past decades, reform has taken hold of the financial system, as well as new research initiatives which may help stem some of the more popular fraudulent activities. Financial losses are the most conventional result of such scandals, in addition to the reputations of major accounting firms being entirely ruined. Auditing is a major tool for preventing scandals. However, the lack of ethics and moral judgment are an influential factor in accounting performance. The underlying factors concerning ethics and how to better improve the use of moral judgment in financial behavior, are not entirely understood and requires further research.

It is proposed in this study, utilizing Duval and Wicklund's (1972) theory of objective self-awareness, that an individual who is more aware of their intentions will react differently based upon this awareness. This study proposes that test subjects who sign their name before reporting financial information, as opposed to after, will be more honest and moral in their accounting practices. Individuals who sign their name at the beginning of a report will be more aware of their intentions, while individuals who sign at the end won't be as self-reflective. The experiment will reveal whether differing perspectives and objective self-awareness will influence the ethical and moral behavior of these individuals. Implications include the development of future tactics and solutions for encouraging morality in financial activities such as auditing and reporting.



2. Objective

The overall objective of this study is to quantify the ways that signing one's signature before reporting their financial information reflected the overall levels of honesty. These will then be compared to those of either signed their signature later or did not sign at all. The overarching objective here is to understand and quantify the ways that self-efficacy, self-identity, and self-awareness play a role in each of these concepts. It will then lead to the objective of elucidating the aforementioned "signature effect," which will help to provide an insight into some of the key components of honesty as they relate to the concept of accounting as a whole. Furthermore, the research here will attempt to elucidate some of the more in-depth and intricate of psychological factors involved in the decision-making process as a whole here, being indirectly answered by the research. Through this attempt, the research will ideally be able to examine the concepts of self-awareness, and how their intentions will impact this, both positively and negatively. In the longer term, this research will hopefully be able to positively impact the development of measures that can be taken to improve and encourage morality, although the specific impact and implications here remain elusive. There will also be an in-depth review of some of the most prominent of literature on the subject, and this will enable the layman to better understand the future direction of research on this subject, as well as the groundwork that has already been laid, and the research here will attempt to draw in-depth conclusions from this literature.

One of the most important objectives of this research, though, is that of the elucidation of what goes into some of the most prominent acts of dishonesty, such as fraud. Questions such as what, specifically, is involved in these processes from a psychological perspective will be answered. Therefore, another of these objectives is to ensure that the reader is made aware of each of these intricate psychological processes and the ways that they can positively or negatively impact those that experience them, one way or another. The overarching objective of this research is to educate the reader about a number of these components of self-awareness and honesty, as well as some of the most prominent of ways that these are undermined. Lastly, paving the way for future research is another of the key objectives of this research. This will be done through examinations of trends and generalized projections on the future of these sorts of issues. Of course, as with all issues relating to psychology in some way, it is difficult to predict these sorts of trends with any sort of concrete certainty, but even so, it is possible to at least extrapolate data and make basic predictions that will likely see at least some level of validation.

3. Literature Review

Current auditing practices may not be enough to help assuage the needs of the financial sector regarding the high level of fraudulent accounting that has exploded over recent years. Not enough research encompasses methodologies and intervention strategies to resolve this issue. Advancements in experimental studies may require the improvement of research paradigms dealing with corporate governance, new forms of research, and the expansion of existing research studies (Carcello, Hermanson, & Ye, 2011). Financial fraud is described as a deliberate fraud executed by leaders within the corporation which directly harm creditors and investors through the creation of materially misleading financial statements (Agarwal & Medury, 2014). A majority of auditing practices mainly focus on the statistical analysis of market activity data found in financial statements and organized financial ratios (Goel & Uzuner, 2016). Financial statements are often well planned, and easily concealed, where financial conditions are warped or manipulated for the benefit of those choosing to commit wrongdoing. An individual who is influential within the firm will be more likely to be knowledgeable of the financial system and will have the capability to thwart auditing mechanisms on an entirely undetectable level.

One newly introduced solution applied the use of language processing as an approach thought to help in the accurate analysis of annual reports regarding financial data. This solution utilizes natural language processing methods to identify whether any sentiment is displayed in the text, which is a form of fraud detection (Goel & Uzuner, 2016). In one study on whether this approach works on the Management and Discussion Analysis (MDA) section of analysis reports, it was revealed that it is effective. Items reviewed in the text included levels of subjectivity, intensity, and polarity, which differed across the text of fraudulent and honest MDA sections of accounting reports. Results indicated that untruthful MDAs had quadruple as many negative sentiments and thrice as much positive sentiment as compared to truthful MDAs. Researchers believed that fraudulent MDAs contained a more vivid positive and negative



sentiment. Too many adjectives and other forms of subjectivity were thought to be a major indicator of fraud due to a higher level of sentiment, based on the adverb-modifying-adjective pattern.

The extraction of linguistic items from textual information could help reveal fraudulent financial activity. However, there are still some flaws with this approach. This technique requires much time and effort, and some of these decisions regarding cues could be on a whim (Dong et al., 2014). Additionally, all of the extracted text indications were based on a predefined arrangement of cues, which could make identification useless if these somehow limited potential cues tied to fraudulent activity. Such oversight could render this technique inaccurate for fraud detection.

Over the past 20 years, many firms were apprehended due to their failure to comply with financial law, and the trend is spreading. For example, in 2001 the insurance company HIH was the second largest in Australia. However, their reinsurance did not transfer risk, losses had been transferred to goodwill accounts, and the corporation under-provided for future expected claims (Jones, 2011). These caused the company to collapse completely, where all of the executives were punished for the failure of the organization's inability to properly audit their consultant work. In 2003, the European Enron, who had many fictitious sales, were not recording debts or recorded debt as equity and overstated their assets. They had also double billed, and often falsely created subsidiaries' sales. A Bank of America forged check had been issued with € 3.95 billion as well. Issues detected included one family being too influential in corporate direction, and the board of stability auditors being found ineffective while the audit committee lacked independence. Additionally, external auditors had not properly monitored corporate activities. In another case, a flourishing corporation called ENRON had misreported cash flow and established fictitious income in their off-balance financial sheets. It became the seventh largest company in the US to go bankrupt. In another recent fraud, the ExtUK European company had been taken over by GEC through a contested bid. However, while the AEI forecasted £10 million in profits, the GEC had released results of a £4.5 million loss. This caused a controversy, which prompted the creation of the UK Accounting Standards Steering Committee. In another scenario, Chinese companies that listed themselves overseas to obtain investor capital had gone public in the North American Market and were called the China Concept Stock (Dong et al., 2014). However, several companies had been implicated in fraudulent activities. These included CCME, DGW, RINO, ONP, and more, which caused the stock to fail. These companies were later permanently barred from the stock exchange. As could be seen in the previous examples, accounting fraud is found around the world no matter how great the institution or company. Other high-profile examples of fraudulent accounting include WorldCom and the Lehman Brothers.

It is believed that fraud can't occur without the right kind of personality and the right tools. These individuals are thought to be intelligent, even creative, well-seasoned individuals who understand internal flaws within an organization (Free & Murphy, 2015). Researchers believe that the potential opportunity is what allows fraud to occur, due to the rationalization and incentive which can be the result of dishonesty (Free & Murphy, 2015). An individual's influence within the institution allows him or her an opportunity which may not be open to others. Other qualities of one who might commit a fraudulent activity include being an individual who utilizes their position to gain access to a system only to exploit weaknesses within the system internally. This includes an individual with confidence, and a strong ego, who may be capable of touting charisma to stay out of sticky situations. Additionally, this individual can go to great lengths to conceal or coerce others to perform the deed for them (Wolfe & Hermanson, 2004). This individual would have the ability to lie consistently to avoid detection and also be both convincing and persuasive. Those interacting may not detect anything wrong, may turn a blind eye, or may play a part in the activity. Lastly, this individual would be able to handle a high level of stress but still have the ability to avoid detection despite the associated heightened risks.

Auditors who are successful at detecting fraud are expected to have a specific skill-set. Some data suggested that professional skepticism is required for auditors to be successful at fraud detection (He, Kothari, Xiao, & Zuo, 2018). However, this can be developed differently based upon the economic tide occurring on hire. The research revealed that there are higher degrees of professional skepticism for individuals who work during economic downturns. This may be due to the high level of instability during economic downturns which increases the difficulty of an organization's financial success. Executives may be more likely to exaggerate or understate finances during these times, where auditors have to be more skeptical of potential misstatements throughout these economic slumps (He et al., 2018). Other data



revealed that many audit firms during economic downturns will incorporate additional auditing requirements, increase monitoring, create new tools, obligate additional training, and enhance their quality control. For this reason, a skeptical mindset is sharper during economic struggles, and less-so during financial blooms.

Tax avoidance, one of the most active fraudulent activities, has become a common business practice. Many big accounting firms encourage tax avoidance, where it has become institutionalized, several of which mask their activities as simply “tax planning” (Sikka & Willmott, 2013). Some researchers believed that weak internal controls were directly connected to the level of financial fraud reported by leaders in the organization (Donelson, Ege, & McInnis, 2016). Currently, it is unknown if whether strengthening control directly affects fraud risk, due to the lack of research literature. In a study which investigated this matter, it was found that the unveiling of fraud and material weakness were highly connected, where weaker controls allowed corporate leaders to commit more fraud (Donelson et al., 2016). In another study, it was revealed that the level of board director independence had a negative relationship with earnings management (Lin & Hwang, 2010). In addition to this, an audit committee’s size, independence, skill level, and meeting number also had a negative relationship with earnings management. Results seem to suggest that corporate circumstances influence the level of fraud which may occur, rather than it being a natural or spontaneous personal attribute of individuals.

During this age, ethical responsibility is not always upheld. Reform will require greater transparency, and accuracy of financial reports, in addition to timely and concise reports that follow a moral code. Researchers have revealed interdependence between the role of accounting and professional morality, where the accountant’s role is highly dependent upon the accounting profession ethics (Jaijairam, 2017). In a meta-analysis of the association between the audit committee independence and financial reporting quality, it was found that there were inconsistencies in these supposed correlations (Pomeroy & Thornton, 2008). This was partially due to audit committees being more adept at improving audit quality as opposed to financial statement quality. Some data shows that many inexperienced professionals are introduced into their role without a comprehensive understanding of where ethics sit within the responsibilities of a professional accountant (Michaluk, 2011). Overall data suggested that financial professionals may require additional training and coaching on morality, and in the management of difficult moral dilemmas.

4. Research Methods

In a study on the signature effect and how signing a document may influence honest reporting, several university students are separated into three groups in a study utilizing self-reported financial data. Quite typically, governments and corporations will require proof of honest intent through the use of a signature. It is thought that signing a report can prime self-identity and influence consumption-related behavior (Kettle, 2011). Students are separated into three groups, those that sign at the beginning of the self-report, those that sign at the end of self-report, and those that don’t sign at all. The end result is predicted to be that students who signed at the beginning of the self-report are more likely to be honest about their finances. The following table briefly outlines the different types of signatures and their basic requirements and applications, showing that these groups have different requirements for when, specifically, to provide a signature in relation to the completion of the report.

Table 1 Definition of signature types

| Group | Definition |
|----------------|--|
| Pre-signature | Required to provide signature <i>before</i> beginning report |
| Post-signature | Required to provide signature <i>after</i> completing report |
| Non-signature | Not required to provide signature before beginning nor after completing report |

4.1 Methods

This study was split up into two separate experiments. Both of the experiments are tested within a laboratory. All of the respondents came from 12 universities, spoke fluent English, were located in the United States, and were aged 19 to 20 years of age. Announcements were posted within science,



technology, engineering, and mathematics colleges within the university, where students with demanding levels of mathematical and intellectual academic work were invited. Staff also made announcements and mentioned incentives for students. There may be selection bias due to the specific students being targeted, mainly for their ability to perform mathematical calculations.

All participants were provided with an informed consent form, where students had to read and sign the document before being interviewed. In each interview, every student was introduced the same way and was informed of their confidentiality as well as the length of the study. Whether or not students were allowed to be part of the study was based upon whether they were dependable enough to show up, could perform basic math with little issue, and were able to speak and read English fluently. Students would receive \$5 on entry but be required to bring their own lunch on their scheduled day of participation.

Next, the students were provided a questionnaire with 12 items in the form of a semi-structured interview that lasted 60 minutes and were conducted inside private rooms. During this time, responses were written down, although each question was based on a scale from one to seven (See Appendix A). The survey results consisted of three categories: individual-serving functions, organization-serving functions, and affective functions. The questions revolved around financial, asset misappropriation, tax fraud, and other moral dilemmas based upon material wealth. The students who scored higher on affective functions were considered more ethical while those who scored more on individual-serving functions were seen as less ethical. Those who scored higher on organization-serving functions were considered in the middle ground. High morality and low morality were highly dependent on the average of the student scores in each category. This is loosely based on the "Moral Foundations Questionnaire," created by Jesse Graham and Jonathan Haidt (Graham et al., 2013). The results would reveal the level of morality each individual had as a pre-test. The second test was provided in private consisting of 25 problem-solving tasks, and their grades were recorded.

Participants were then randomly selected and divided into three groups: students who would sign a signature at the beginning of a report (pre-signature group), students who signed at the end of a report (post-signature group), and students who didn't sign at all (non-signature group). Those that were assigned to the pre and post-signature group would be expected to read and sign a statement that requires students to examine their information and fill it out to the best of their knowledge, stating that the information is accurate. Before filling out the report, all students are given instructions on how to fill it out.

On a scheduled day, students participated in experiment 1, where each student was given a mathematical puzzle with problem-solving tasks within one room. Students had only 1 hour to complete 50 questions on the task, which required creativity and analysis. The questions were randomly chosen from old IQ exams from MENSA. For each correct answer, a student would receive \$1. If all questions were correct, a student would receive \$50. Answers were not revealed until students were relocated into a separate room.

In experiment 2, these students are required to perform tax reporting on their earnings. The earnings of these students are taxed at 15%. Students were taken to another room with separate private cubicles, where they would fill out a tax return similar to the IRS's standard tax return form. Answer sheets to the 50-question problem-solving task were provided in each cubicle. This is where participants were asked to sign the form if they were in the pre or post-signature group.

Table 2 Results of two different experiments

| Experiment | Requirements |
|--------------|---|
| Experiment 1 | Mathematical puzzle with problem-solving tasks 50 questions randomly chosen from MENSA Time was 1 hour \$1 per correct answer, for total of \$50 |
| Experiment 2 | Perform tax reporting on respective incomes; complete "tax returns" with expenses Respective earnings taxed at 15% 50 questions randomly chosen from MENSA Total of \$7.50 |

The above table outlines the results of two experiments performed, representing accounting testing and results. These students had to self-report their income based on their performance. Additionally,



expenses were credited. The expenses included “number of hours for study time missed”, “commute time to and from dorm”, and “dining costs”. Dining costs went to a maximum of \$3 and commute time was charged \$0.05 per minute for a total of 15 minutes if the student lived on-campus and 30 minutes if off-campus. The number of hours missed cost \$0.50 per hour and only went up to 4 hours. These expenses would then be credited back to students for their final payment as a form of reimbursement (i.e. tax return) and could not exceed \$7.5.

All students had the opportunity to cheat on the tax return form and the problem-solving task. The students could incorrectly state the number of answers they had correct to inflate their income, as well as overstate their expenses to avoid being taxed too much. Each of the student’s form had a triple-digit identifier for confidentiality.

The results of the interview questionnaires were calculated and placed in a hierarchy scale developed for morality for each individual student. The grades of the pre-test 25 question problem-solving task were compared to the grades of the experimental task of 50 questions to observe the likelihood that an individual was cheating. The level of cheating was compared to the morality grade. Additionally, the level of cheating was compared across all groups, and the level of credits of each of the three groups was compared to their morality grade.

All data was analyzed by a hired professional analyst who was not associated with the school on a password-secured laptop. All paperwork from the students was locked in a safe box and stored in the psychology department in a secure cupboard.

4.2 Samples

197 participants were picked from 12 different universities in the United States. Male students made up 72% of the population while females were 28%. 50% were Caucasian, 18% African American, 16% Hispanic, and 12% Asian. All individuals were between 19 to 20 years of age. For the pre-signature group, n=65, for the post-signature group, n=65, and for the non-signature group, n=67. The below chart shows the ratio of males to females within the participants of this study with the majority, 72 percent, being male. The chart following that also describes demographics, in this case, the races of the participants with Caucasians comprising around half of the participants and the rest is fairly evenly distributed between Hispanics, Asians, and African-Americans. Figure 1-5 defines the n values for each of these signature groups.

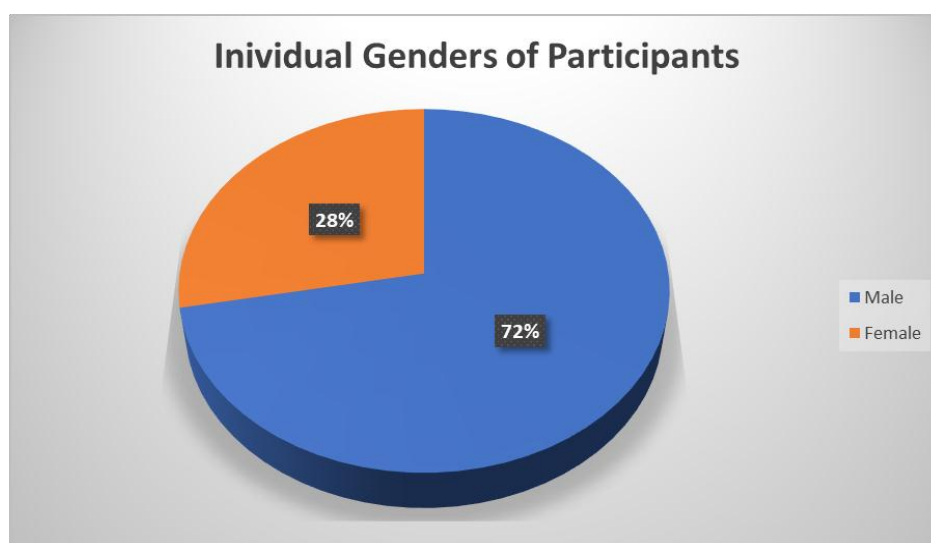


Figure 1 A pie chart representing the genders of those participating in the study

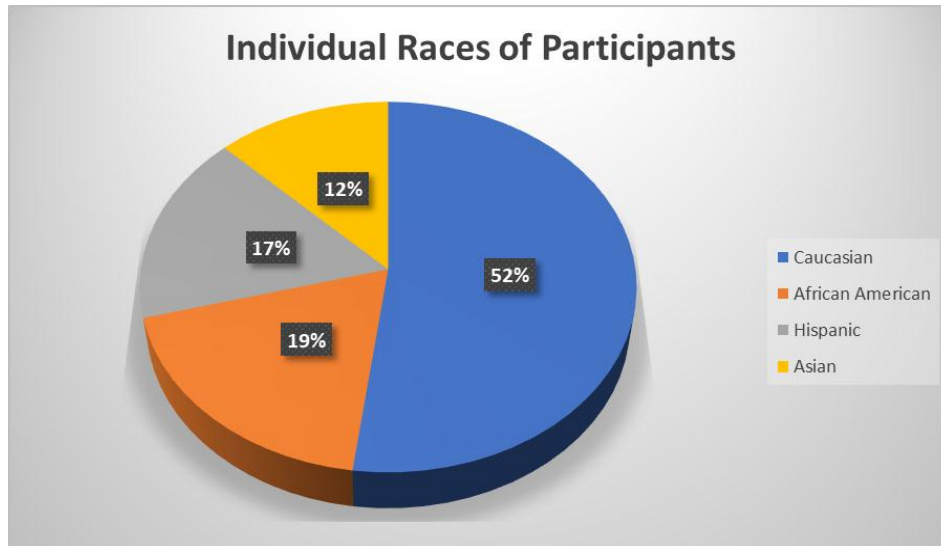


Figure 2 a pie chart that shows the races of the participants

Table 2 N correlations within each signature group

| Groups | WHAT "n" STANDS FOR |
|-----------------|---------------------|
| Pre-signature | n=65 |
| Post- signature | n=65 |
| Non- signature | n=67 |

4.3 Designed Questionnaire

Loosely based on the "Moral Foundations Questionnaire" created by Jesse Graham and Jonathan Haidt (Graham et al., 2013), the questionnaire would reveal the level of morality each individual had. It was on a scale from 1 to 7 with 1 being least important and 7 being very important, in terms of how the question relates to the individual's decision making. The scores were based on three functions: individual-serving functions, organization-serving functions, and affective functions. Those that scored highest on the individual-serving functions were least moral, those that scored highest on the organization-serving functions were more in the middle ground, and those that scored high on affective functions were considered most moral. All scores were ranked against each other, where a scale was developed and based entirely on the responses of students.

4.4 Data Collection

The results of the pre-test interview were based on scores that reveal whether an individual is more self-serving functional bonds, organization-serving functional, or affective functional. This is compared to the level of cheating that was detected on their test. If a student deviated from their original score more than 10%, they were considered likely to have cheated. By more than 15%, they were labeled as a cheater. By more than 20%, a moderate cheater. By more than 25%, a high-level cheater. The level of expenses and tax credits were not tested for the level of cheating, only observed. However, the number of credits claimed was compared to their morality score, and whether they were flagged for cheating or not. A mediation analysis was performed for the mediated effect of the condition on the level and extent of cheating. The number of ethics-related responses was placed in a linear regression model which predicted the level of cheating on the exam. This was also compared and measured against the potential for over-reporting of tax credits. A p-test was performed in order to observe the distribution of morality scores against the exam cheating-level scores. A second one was performed to observe the distribution of morality against the number of taxes reimbursed between \$.05 to \$7. A z-test was performed to test whether the hypothesis had passed the significance level.



5. Results

The percentage of participants who cheated and over-claimed income for the problem-solving tasks had fewer that cheated in the pre-signature group (23%) as compared to the post-signature group (89%), $P = 0.003$, where there were no significant differences found in the non-signature group and the post-signature group (See Appendix B). The tax credits claimed were fewer for those in the pre-signature group ($M = \$4.24$, $SD = 2.03$) in comparison to the post-signature group ($M = \$6.5$, $SD = 5.3$; $P < 0.01$). The no-signature condition had no significant differences from the post-signature group ($M = \$6.45$, $SD = 5.52$; $P < 0.05$). The most honest individuals were found in the pre-signature group, while the least honest were found in the non-signature group with some in the post-signature group. Performances on the problem solving-task varied the most for the post-signature and the most signature groups, where most of the students had a 20% increase in their grade. There was no significant difference in the post-signature and non-signature groups regarding their test scores. The below two figures describe the percentage of tax credits claimed in one figure, as well as the over-claimed income as a percentage within the different signature groups in the other. Figure 1-6 showed that post-signature and non-signature groups maintained much higher percentages of over-claimed income than those in the pre-signature group. In figure 1-7, the figure showed that one hundred percent of all tax credits were claimed by all signature groups.

There are a number of recommendations that can be made as a result of the literature and actual research that has been conducted here. Perhaps, most importantly, forcing people to sign their signature before any sort of financial dealings or perhaps any intensive dealings at all will yield at least some tangible benefit. Another recommendation that can be made is to create other situations and mechanisms that force people in these situations to lay their credibility on the line, literally, in some cases. These pre-signature actions are so effective primarily because they force a degree of introspection and self-awareness on the part of the signee, and this is what at least partially contributes to these clearly observable benevolent thoughts and actions. It seems clear, then, that there must also be a greater amount of research that quantitatively analyzes the impact that these signatures and similar gestures have on overall attitudes and behaviors. After all, this research is but one dimension of what is clearly a much larger and more overarching concept. Future analyses will help researchers to better understand why people think this way in such a nearly universal fashion.

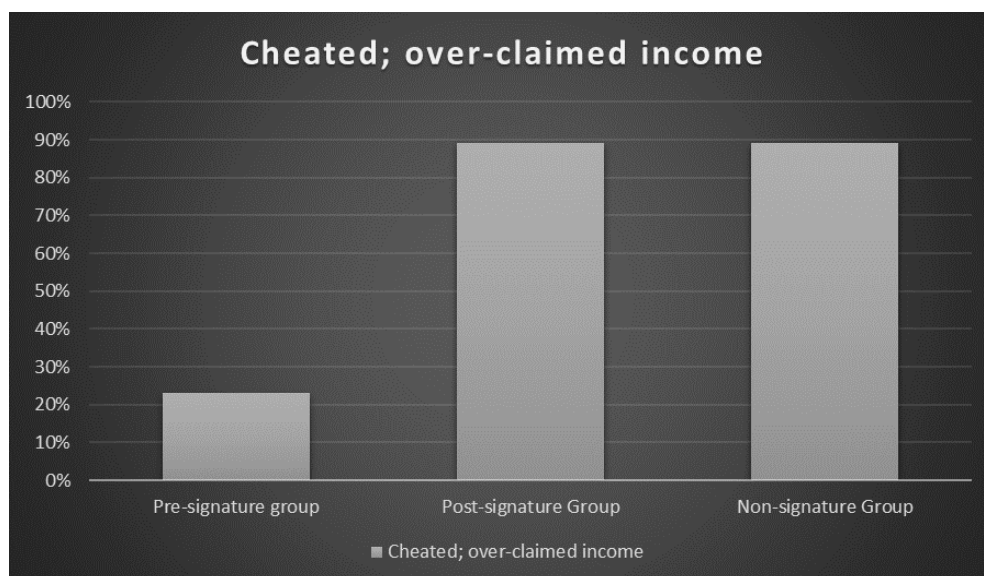


Figure 3 Comparison of signature groups relating to over-claimed income and cheating

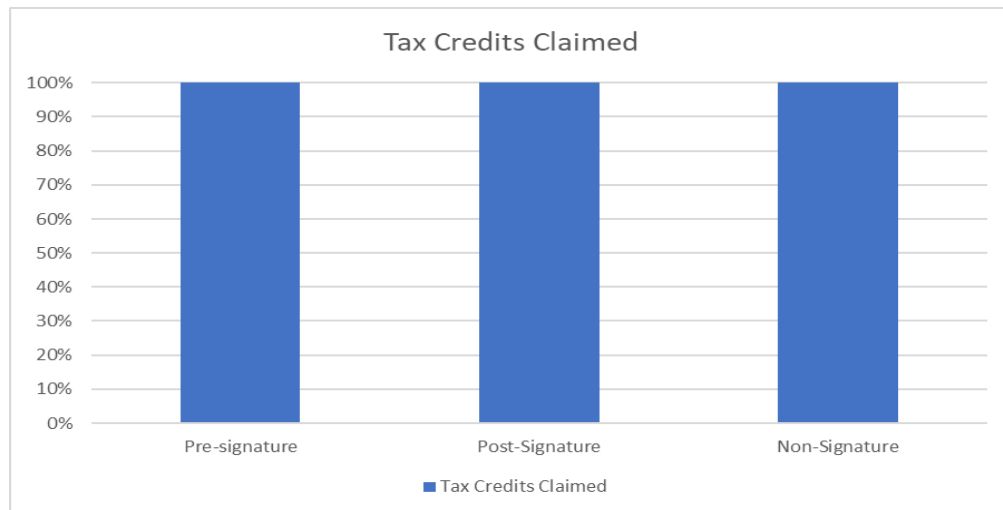


Figure 4 Another comparison of signature groups relating to the percentage of tax credits claimed for each

6. Conclusion

Participants who were more honest claimed fewer expenses, and thus, fewer tax credits, and were more likely to belong to the pre-signature group. However, it did not relate to their level of morality which varied. Those who claimed more tax credits were found mostly in the non-signature group, although they were also dense in the post-signature group. Morality was also varied in these groups. Individuals who tested high for morality were less likely to cheat, regardless of the group they were in. Additionally, individuals who tested low for morality were more likely to cheat. However, this was slightly mitigated in the pre-signature group. The post-signature and non-signature groups had very little difference between results. This seems to suggest that the signature had a major influence on self-efficacy, self-identity, and self-awareness. Data revealed that signing before the grading and reporting of income encouraged honesty while signing after these activities had little to no influence. Additionally, not signing at all was almost on par with signing afterward. The results reveal that individuals who are more aware of their intentions, and state and sign that they will have good intentions are more aware of their behavior and may act morally.

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