

AUDITOR PERCEPTIONS OF CLIENT NARCISSISM AS A FRAUD ATTITUDE RISK FACTOR

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SUMMARY

Auditing standards prescribe that the auditor should consider client management's attitude toward fraud when making fraud risk assessments. However, little guidance is provided in the auditing standards or the existing fraud literature on observable indicators of fraud attitude. We test whether observable indicators of narcissism, a personality trait linked to unethical and fraudulent behavior, is viewed by auditors as an indicator of increased fraud attitude risk. We administered an experiment to 101 practicing auditors from one international public accounting firm who assessed fraud risk based on a scenario in which client manager narcissism (attitude) and fraud motivation were each manipulated at two levels (low and high). Our results show that narcissistic client behavior and fraud motivation are significantly and positively related to auditors' overall fraud risk assessments. Implications of these findings for further research and the auditing profession are discussed.

Keywords: fraudulent financial reporting; attitude/rationalization; risk assessment; narcissism.

Data Availability: contact the authors.

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INTRODUCTION

Fraudulent financial reporting continues to be a serious concern, despite the increased emphasis on fraud detection in the auditing standards since the passage of the Sarbanes-Oxley Act of 2002 (Hogan et al. 2008).¹ Auditing standards related to fraud incorporate the *fraud triangle*, a conceptual framework that links the three elements believed to give rise to fraud: (1) motivation, pressure, or incentive; (2) opportunity; and (3) attitudes, set of values, or personal characteristics.² Auditing standards include specific examples of fraud risk factors (red flags) for each of the fraud triangle elements, but note the inherent difficulty of identifying fraud attitude risk factors.

Behavioral traits consistent with *narcissism* exhibited by client managers may provide observable indications to auditors of increased fraud risk related to attitude.³ Narcissism is a personality construct that defines an individual's self-concept in terms of an exaggerated sense of self-importance, fantasies of unlimited success or power, need for admiration, and lack of empathy. Although moderate levels of narcissism can be beneficial (Maccoby 2003), more extreme narcissism has been linked to unethical or fraudulent behavior (Blickle et al. 2006; Williams et al. 2010). Recent research in accounting suggests that narcissism is consistent with observed attitudes and behaviors in recent major frauds (Cohen et al. 2010). Other research has found associations between observed indicators of Chief Executive Officer (CEO) narcissism

¹ In this paper the term "fraud" refers exclusively to fraudulent financial reporting.

² Current professional standards on the assessment of fraud risk include: (1) International Auditing and Assurance Standards Board (IAASB) International Standard on Auditing 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (IAASB 2009); (2) Public Company Accounting Oversight Board (PCAOB) AU Section 316, *Consideration of Fraud in a Financial Statement Audit* (PCAOB 2012); and (3) American Institute of Certified Public Accountants (AICPA) AU-C Section 240, *Consideration of Fraud in a Financial Statement Audit* (AICPA 2011).

³ Emmons (1984) reports on three studies that tested the construct validity of the Narcissistic Personality Inventory (NPI) and finds that peer observations of narcissistic traits are strongly positively correlated to the NPI score.

and risky or fraudulent actions undertaken by the CEO's firm (Chatterjee and Hambrick 2007, 2011; Aktas et al. 2012; Schrand and Zechman 2012). Indicators of narcissism among executives and those charged with governance also has been linked to a lax or dysfunctional "tone at the top" of the organization (Salter 2008; Amernic and Craig 2010; Craig and Amernic 2011; Zona et al. 2012). If observed narcissistic traits by client managers are reliable indicators of fraud attitude risk, auditors should identify these traits as fraud attitude red flags and incorporate this information into their fraud risk judgments (Hammersley 2011).

Despite the potential significance of observable fraud attitude traits, comparatively little audit research into attitude-related elements of fraud risk has been conducted to date (Hogan et al. 2008). One reason advanced to explain the lack of research into fraud attitude in audit risk judgments is the difficulty in both observing and operationalizing attitude in a research setting (Wilks and Zimbelman 2004; Allen et al. 2006; Hernández and Groot 2006; Carcello and Hermanson 2008; Carpenter et al. 2011; Murphy and Dacin 2011; Murphy 2012). The primary objective of this exploratory study, therefore, is to evaluate whether auditors at various experience levels are able to 1) recognize characteristics indicative of narcissism exhibited by client personnel and 2) link observed client narcissism to increased fraud attitude risk. If so, these results would provide evidence that auditors are able to recognize a specific attitudinal characteristic, potentially associated with unethical and fraudulent management behavior, as an indication of increased fraud risk.

One hundred and one practicing auditors from one international public accounting firm, representing all experience levels from staff to partner, participated in the study. In a quasi-experimental setting, client narcissism and fraud motivation were manipulated between subjects at two levels (high and low). Our results indicate that auditor assessments of fraud risk are significantly higher when auditors observe client manager behavior and attitudes that are

consistent with narcissism. Higher motivation to commit fraud also was related to higher auditor assessments of fraud risk. A post-experimental questionnaire administered to managers and partners from the participating public accounting firm confirmed that experienced auditors do interpret high levels of client manager narcissism as a significant fraud attitude risk indicator.

This study contributes to the auditor fraud judgment literature by incorporating an observable measure of fraud attitude into auditor fraud risk assessments. Further, these results suggest that auditors respond to client narcissism as a significant fraud risk factor, consistent with research in psychology, business, and accounting that has linked manager narcissism with dysfunctional or fraudulent corporate conduct. Finally, auditor awareness of narcissism as a fraud attitude indicator should translate into greater understanding of the potential impact of narcissistic client leadership on the organization's control environment, ethical climate, and "tone at the top."

The remainder of this paper is organized as follows. In the following section, we discuss the psychological characteristics of narcissism, how narcissism is linked to fraud attitude, and the development of a research hypothesis and research question. Next, we describe the research design and development of our experimental materials. We then present our statistical model and experimental results. The paper concludes with a discussion of the results and limitations of the study, along with implications for current auditing practice and future research.

THEORY AND HYPOTHESIS DEVELOPMENT

Narcissism as a Personality Characteristic

In a comprehensive analysis of narcissism, Morf and Rhodewalt (2001, 177) describe the narcissistic personality as follows:

[A] pervasive pattern of grandiosity, self-focus, and self-importance... narcissists are preoccupied with dreams of success, power, beauty, and brilliance. They live on an interpersonal stage with exhibitionistic behavior and demands for attention

and admiration but respond to threats to self-esteem with feelings of rage, defiance, shame, and humiliation. In addition, they display a sense of entitlement and the expectation of special treatment. They are unwilling to reciprocate the favors of others and are unempathetic and interpersonally exploitative.

Researchers in psychology distinguish between *clinical* narcissism (a personality disorder) and *trait* narcissism. Trait narcissism is viewed as a relatively stable personality characteristic that is normally distributed in the adult population (Foster and Campbell 2007; Miller and Campbell 2010). In interpersonal contexts, trait narcissism serves as both a personality trait and as a self-regulatory mechanism, wherein the narcissist's motivations, relationships with others, and self-regulatory strategies interact to drive behavior (Campbell et al. 2011). In contrast with clinical narcissism, there is no recognized cutoff point for trait narcissism between "normal" and "excessive" levels (Miller and Campbell 2010).⁴

Elevated levels of narcissism are associated with an inflated sense of one's importance and capabilities (grandiosity), and the need to have these beliefs constantly reinforced (Campbell et al. 2004b). A narcissist with strong grandiose tendencies is obsessed with obtaining, or creating if necessary, positive feedback from others (Morf and Rhodewalt 2001). However, if such feedback is withheld, such as in the face of failure, the narcissist responds with extreme displays of negative emotion (Horowitz and Arthur 1988; Bushman and Baumeister 1998; Rhodewalt and Morf 1998) and deflection of blame to others (Kernis and Sun 1994; Stucke and Sporer 2002). Narcissistic grandiosity includes a strong self-enhancement dimension (Paulhus and Williams 2002), making it a highly observable trait by others.

Another key element of elevated narcissism is entitlement, which is manifested interpersonally as a sense of superiority compared to others (Brown et al. 2009). Campbell et al. (2004a) conceptualize entitlement as a pervasive sense that the entitled individual deserves more,

⁴ For ease of exposition, the term "narcissism" refers to trait narcissism in the remainder of the paper.

in both rewards and recognition, compared to others. In a series of experiments across multiple settings, Campbell et al. (2004a) found significant associations between entitlement and a variety of self-serving behaviors. Entitlement has also been linked to *interpersonal exploitativeness* of others for personal gain or to reinforce the power relationship between the narcissist and others whom the narcissist believes are less worthy (Corry et al. 2008; Reidy et al. 2008).

Dysfunctional Aspects of Narcissism

Moderate levels of narcissism are associated with such positive personal characteristics as confidence and decisiveness (Kets de Vries and Miller 1985; Maccoby 2003). Elevated levels of narcissism, however, lead to dysfunctional or destructive interpersonal relations and outcomes (Lubit 2002; Maccoby 2003; Kets de Vries 2004). For example, the constant need for admiration rooted in narcissism may drive the narcissist to take excessive risks (Wallace and Baumeister 2002; Vazire and Funder 2006; Foster et al. 2009; Williams et al. 2010). Similarly, narcissism can lead to unethical behaviors when the narcissist believes that (s)he is deserving of greater rewards than can be obtained ethically (Brown et al. 2009; Brunell et al. 2011), or when the narcissist's ego is threatened by real or perceived competition (Campbell et al. 2004a; Davis et al. 2008).

High levels of narcissism are also associated with low personal integrity (Schlenker 2008). Elevated narcissism has been empirically linked to academic cheating (Brown et al. 2009; Williams et al. 2010; Brunell et al. 2011) and research misconduct (Mumford and Helton 2002; Davis et al. 2008). Blickle et al. (2006) reported that a sample of white-collar criminals scored significantly higher on a standard narcissism scale compared to a group of non-criminals with similar professional backgrounds.

Manager Narcissism and Corporate Performance

Recent research in organizational psychology and business has linked observable measures of CEO narcissism (e.g., higher compensation levels, size and placement of the CEO's photograph in annual reports, and frequency of self-references in shareholder letters) with risky and negative consequences to the organization. Chatterjee and Hambrick (2007, 2011) demonstrated that higher levels of CEO narcissism are associated with extreme and volatile corporate financial performance, and that narcissistic CEOs are less responsive to objective measures of negative corporate performance. Other research has linked executive- and board-level narcissism with less effective corporate governance, including a lax or unduly aggressive "tone at the top" that may facilitate organizational misconduct (Salter 2008; Amernic et al. 2010).

Evaluation of the effects of manager narcissism is a recent area of focus in accounting research as well. In an experimental economics context, Hales et al. (2011) found a positive association between manager narcissism and aggressive financial reporting. Aktas et al. (2012) examined CEO narcissism effects in merger and acquisition activity and found less favorable shareholder reaction to takeover announcements and lower probability of deal completion when the acquiring and/or target organization CEOs were more narcissistic. In two studies that focused on financial reporting fraud as documented in SEC Audit and Accounting Enforcement Releases (AAERs), Rijsenbilt (2011) found a significant association between reported fraud and a multidimensional measure of CEO narcissism, while Schrand and Zechman (2012) observed significantly higher levels of CEO compensation (as a proxy for higher CEO narcissism) in fraud versus non-fraud AAERs. Olsen et al. (2012) reported that the prominence and placement of the CEO's photograph in annual reports (a measure of narcissism used by Chatterjee and Hambrick

2007) was positively related to earnings per share, share price, and audit fees in a sample of Fortune 500 companies from 1992-2009.

Fraud Attitude and Auditor Fraud Risk Assessments

Fraud attitude is defined in the auditing standards as a mindset, set of ethical standards, or rationalization that justifies the commission of fraud. Although auditing standards emphasize the critical importance of attitude in assessing fraud risk, existing standards acknowledge the inherent difficulty of observing red flags associated with increased fraud attitude risk, and consequently provide few specific examples of management attitudes, values, or personal characteristics that would assist the auditor in assessing the risk of fraud based on these factors.

In an early study of audit fraud indicators (red flags), Albrecht and Romney (1986) found that such attitude-related elements as dishonesty, lack of ethics, and low moral character among top managers were considered to be significant fraud risk factors by auditors. Loebbecke et al. (1989, 19) identified two factors related to personal integrity, *moral fiber* and *personality anomalies*, as audit fraud indicators. Turner et al. (2003) concluded that management integrity is a key element of fraud attitude in the auditor's fraud risk assessment.

Empirical research on fraud attitude indicates that auditors are cognizant of the potential for increased fraud risk when management's attitude suggests a lack of integrity. Bell and Carcello (2000) proposed a predictive model of fraud in which dishonest or evasive management was a significant fraud risk indicator. Beaulieu (2001) found evidence of a negative relationship between perceived client integrity and audit effort. Kizirian et al. (2005) found that management integrity impacts risk assessments and corresponding audit scope. In a scenario-based study, Gillett and Uddin (2005) surveyed 139 chief financial officers (CFOs) regarding the likelihood of committing fraud. They found that CFOs' fraud intentions were linked to their attitudes toward fraudulent financial reporting and concluded that auditors' assessments of management

attitudes based on personal contact could serve as fraud indicators. In a study of over 5,600 audit engagements by one Big 4 firm in the Netherlands, Hernández and Groot (2006) provide evidence that audit partners respond to lower assessments of client integrity with increased fraud risk assessments during audit planning.

Fraud Attitude Hypothesis

Prior research in psychology and accounting suggests that characteristics consistent with narcissism likely increase fraud risk. Further, Hammersley's (2011) model of auditor fraud risk assessment identifies motivation, opportunity, and attitude factors as general fraud risk indicators which, when combined with client- or engagement-specific red flags, suggest an elevated risk of fraud. Auditors then generate specific fraud hypotheses, assess fraud risk based on these hypotheses, and modify the nature, timing, and extent of audit procedures to reflect the assessed level of fraud risk.

Based on Hammersley's (2011) auditor fraud risk assessment model, auditors *should* 1) identify narcissistic personality cues and behaviors by a client manager as fraud attitude red flags, 2) consider how these observed cues and behaviors could result in specific fraudulent actions by the manager, and 3) incorporate both the manager's elevated fraud attitude and the increased potential for fraudulent actions into higher fraud risk assessments. Accordingly, we predict that auditors will associate higher perceived client manager narcissism with higher assessments of fraud risk. This prediction is formally stated as our research hypothesis:

Hypothesis: An auditor will assess the risk of fraud to be higher when a client manager exhibits behavior and attitudes consistent with high levels of narcissism.

Interaction of Narcissism with Motivation and Opportunity to Commit Fraud

Recent research suggests that the three elements of the fraud triangle interact in determining fraud risk. Desai et al. (2010) examined management's propensity to make

opportunistic accounting choices under varying combinations of high and low pressure (motivation) and opportunity, controlling for individual differences in managers' predispositions to rationalize their choices (i.e., a measure of fraud attitude). Desai et al. (2010) found a significant interaction between rationalization and opportunity in management's accounting choices. Other research has examined interactions among fraud triangle elements in auditor fraud risk assessments. In an evidential modeling study, Turner et al. (2003) demonstrated significant interactions between auditors' evaluations of management integrity (fraud attitude) and both opportunity and motivation, concluding that low management integrity (high attitude risk) not only increased assessments of fraud risk directly, but could motivate management to create additional opportunities and incentives for fraud, further increasing assessed levels of fraud risk. Hernández and Groot (2006) reported that fraud motivation factors (i.e., incentive pay schemes) significantly influenced auditor fraud risk assessments only when management integrity was high (i.e., fraud attitude risk was low). Conversely, Wilks and Zimelman (2004) and Favere-Marchesi (2009) demonstrated that auditor sensitivity to fraud motivation cues was unaffected by the level of fraud attitude risk.

Based on our primary focus on narcissism and the mixed results of prior research, we do not advance specific hypotheses for fraud motivation or its interaction with narcissism on fraud risk assessments.⁵ Rather, we propose the following research question (RQ) with respect to fraud motivation and its relationship with narcissism:

RQ: Does level of fraud motivation influence auditors' fraud risk assessments interactively across low and high levels of client manager narcissism?

⁵ We initially planned to examine the effects of both motivation and opportunity on fraud risk assessments in addition to narcissism. However, our initial analysis of the data indicated that fraud opportunity was not significantly associated with auditor fraud risk assessments. Accordingly, opportunity was eliminated from further analysis, and all subsequent tests examined narcissism and fraud motivation effects only.

RESEARCH DESIGN

Experimental Materials, Participants, and Data Collection

We developed an audit judgment case scenario that included specific indications of client fraud attitude (narcissistic traits) and fraud motivation. Narcissism and motivation were each manipulated at two levels (high or low) in a 2 x 2 design. The client manager in the case scenario is the general manager of a significant business unit within a commercial construction company.⁶

Data were collected in a quasi-experimental setting, where participants were randomly assigned to one of the four possible experimental conditions and individually completed the experimental materials. Participants were 101 practicing auditors from several U.S. offices of a large international public accounting firm. Responses were gathered through a combination of (1) “live” administration at firm training events attended by the researchers and (2) mail responses, where the managing partners of four firm offices agreed to distribute the questionnaires and coordinate their completion and return. All mail responses were returned on a timely basis, with the majority received from one large office in a single mailing three weeks after delivery. Approximately 80 percent of the responses were collected during the live sessions.⁷ Participants represented all levels of experience (staff, senior, manager, senior manager, and partner). Demographic information for participants is shown in Table 1.⁸ Because prior research and our participating audit firm include auditors with all experience levels in the

⁶ We selected the commercial construction industry for the case scenario setting because it is an industry generally familiar to external auditors. This setting allowed the inclusion of several common industry operating risk factors (e.g., complex contract accounting, project delays, construction lending) in addition to the seeded fraud risk factors

⁷ Responses from live administration were compared to those returned by mail. No differences were noted in any experimental responses or demographic variables between the two administration methods.

⁸ None of the demographic variables were significantly related to the experimental factors or dependent measure responses in the primary data analysis.

fraud risk assessment process during audit planning, we believe the wide range of audit experience levels of participants is appropriate for our experimental task.⁹

Insert Table 1 here

This study is an initial examination of client narcissism as a fraud attitude risk factor in an audit context. Thus we believe that the experimental task and setting and the experience levels of the participants are appropriate given the exploratory nature of the research. Having participants assess fraud risk individually, rather than in an engagement team discussion setting, allows us to focus on the individual-level influences of our narcissism variable on audit fraud risk. Recent research on audit team fraud “brainstorming” (e.g., Carpenter 2007; Brazel et al. 2010) indicates that individual auditors’ fraud risk identification and responses are generally reflected in overall audit team fraud risk judgments.

Motivation Manipulations

The case manipulated fraud motivation in two ways. First, the future of the business unit was (was not) described as dependent on the client manager securing future profitable business in the high (low) fraud motivation condition. Second, the unit’s reported financial performance on a current project for a large customer was (was not) linked to the likelihood of obtaining lucrative additional business from the customer in the high (low) fraud motivation condition.¹⁰

Narcissism Manipulation

We based our narcissism manipulation on an analysis of selected items from the Narcissistic Personality Inventory (NPI) by Raskin and Hall (1979). The NPI is the most commonly used scale to measure narcissism in business research (Hales et al. 2011). We focused

⁹ Carpenter (2007) included manager-, senior-, and staff-level auditors from the Big 4 firms in her study of audit team fraud risk “brainstorming.” Discussions with partners and managers from the participating audit firm in our study confirmed that their firm’s current practice is to include audit team members from all experience levels (staff through partner) in the fraud risk assessment process during engagement planning.

¹⁰ The motivation manipulations are similar to those used in prior fraud risk assessment research (Webber et al. 2006).

on NPI items that best matched up with the narcissism constructs of *grandiosity* and *entitlement/exploitativeness*. In the case scenario, we included a dialogue between the auditor (the participant) and the client manager that included (in the high narcissism condition) or did not include (in the low narcissism condition) conversational cues by the manager that were consistent with these narcissism constructs. For example, in the high-narcissism condition, the manager's attitude and demeanor as part of the dialogue with the auditor reflected grandiosity ("I make sure things get done on time, and let me tell you, it's not always easy"), entitlement ("My staff is small, and I keep them plenty busy"), and exploitativeness ("I told my staff that they had better follow my procedures to the letter from now on or heads would roll").

In addition, the high narcissism treatment condition included numerous first-person references ("I," "me") by the manager in the dialogue with the auditor. First-person references are consistently associated with high narcissism (Chatterjee and Hambrick 2007, 2011; Raskin and Shaw 1988). We also included in the high narcissism dialogue a self-description of the manager's tendency to react with anger to an ego threat, which is another characteristic of high narcissism (Rhodewalt and Morf 1998; Stucke and Sporer 2002). The low narcissism condition dialogue did not include either first-person references or an emotional reaction by the manager.¹¹ Excerpts from the research instrument are shown in the Appendix.

Dependent Measure

The dependent measure to elicit the overall fraud risk assessment was worded as follows:

Overall, I believe the risk of fraud in [the business unit] is....

¹¹ The narcissism manipulations were pilot tested by approximately 120 senior undergraduate and master's-level accounting students as well as auditors from several large public accounting firms, resulting in minor modifications to the wording of our measures.

Responses to the fraud risk assessment question were measured on a seven-point scale, with endpoint labels of 1 = “very low” and 7 = “very high.” The scale midpoint of 4 was labeled “moderate.”

Narcissism Manipulation Checks

After reading the case and making their fraud risk assessments, participants responded to a number of statements pertaining to their perceptions of the general manager’s personal traits. Participants responded to each statement on a seven-point scale where 1 = “strongly agree,” 4 = “neutral,” and 7 = “strongly disagree.” Example statements included descriptions of the manager as “demands respect,” “has a high opinion of himself,” and “is even-tempered” (reverse-scored). Statements unrelated to narcissism also were included to disguise the nature of the manipulation check task. For the narcissism-related statements, t-tests of mean differences (not tabulated) indicated that responses of participants in the high-narcissism reflected significantly higher perceived narcissism compared to those of participants in the low-narcissism condition ($p < .001$).

DATA ANALYSIS

The effects of the experimental treatments for client manager narcissism and fraud motivation were evaluated in a 2 (high/low narcissism) \times 2 (high/low motivation) between-subjects factorial analysis of variance (ANOVA), the results of which are shown in Table 2.¹²

Insert Table 2 here

¹² We also considered several other variables as controls in the model, including total audit experience, number of frauds encountered as an auditor, and responses to the primary narcissism manipulation check (“the manager has a high opinion of himself”). None of the potential control variables were significant; thus only the two fraud risk factors (narcissism and motivation) were included in the final model.

Narcissism and Motivation Effects on Fraud Risk Assessments

Both client narcissism and fraud motivation were significantly related to audit fraud risk assessments. Participants in the high narcissism condition assessed mean fraud risk as significantly higher compared to those in the low narcissism condition (5.212 versus 4.410; $F = 16.689$; $p < .001$). The significant narcissism effect supports our research hypothesis.

The effect of fraud motivation also was significant, where participants in the high motivation condition indicated higher mean fraud risk compared to those in the low motivation condition (5.011 versus 4.612; $F = 4.130$; $p = .045$). However, the narcissism x motivation interaction was not significant, indicating that the motivation effect was consistent across both levels of narcissism (RQ1).

Supplemental Analysis

In order to confirm the intended fraud attitude effect of narcissism and obtain a more detailed understanding of how auditors interpret client narcissism, we administered a post-experimental questionnaire to eight highly experienced auditors (two managers, four senior managers, and two partners) from the participating public accounting firm.¹³ Audit experience among this group ranged from six to 25 years (mean = 12.75 years). All participants agreed in advance to respond to the questionnaire by e-mail.

In the post-experimental questionnaire, we asked participants to identify additional client personality traits suggestive of higher fraud attitude risk and provide open-ended explanations for their choices. Among the additional traits identified were *ostentatious*, *sensitive to criticism*, *arrogant*, and *dismissive*, all of which are consistent with trait narcissism. One session

¹³ Although some auditors who participated in the post-experimental sessions had also participated in either the pilot study or the final experiment, the post-experimental sessions took place several months after the experiment administration. Thus the risk of carryover effects from the experiment to the post-experimental session results was considered remote. Further, we observed no differences between post-experimental responses based on earlier study participation.

participant commented on two specific fraud risks posed by a narcissistic client manager as follows:

“A manager with little tolerance for error indicates a higher fraud risk given this may be an indication unreasonable deadlines are being made on client staff. If deadlines are unreasonable, staff may rationalize that it is better to fraudulently complete their work rather than being subject to the negative feedback of the manager.”

“A manager’s actions to take credit for success and blame others for failure cause undue pressure on his staff. Such pressure could cause staff to rationalize that fraudulent or unethical acts are appropriate if they help them to avoid unfair blame from the manager.”

These open-ended responses are consistent with auditors considering client narcissism as a specific fraud attitude risk factor. More importantly, they provide evidence that auditors link observed client fraud attitude characteristics (narcissism) and specific potentially fraudulent client actions triggered by these attitudes.

DISCUSSION, CONCLUSION, AND DIRECTIONS FOR FUTURE RESEARCH

Our study contributes to the auditor fraud risk assessment literature by demonstrating a link between indications of client narcissism and auditor fraud risk assessments. We are not aware of any published study that has examined auditor fraud risk judgments based on specific client attitude factors consistent with narcissism. Based on prior research in organizational psychology and management, we predicted that high levels of narcissism exhibited by a client manager would be interpreted by auditors as consistent with an attitude or set of ethical values that would allow the manager to rationalize fraud. The results indicate a narcissism effect, with significantly higher assessments of fraud risk when a client manager was described as exhibiting narcissistic characteristics. Results of post-experimental questionnaires administered to eight experienced auditors (managers, senior managers, and partners) from the participating public accounting firm reinforce these findings. In addition, auditors assessed fraud risk as significantly

higher in the presence of motivations for the client manager to commit fraud. However, narcissism did not interact with fraud motivation in influencing auditor fraud risk judgments. This suggests that, in our experimental setting, high levels of either fraud attitude risk or fraud motivation risk were sufficient to increase auditors' fraud risk assessments.

The results of this exploratory examination offer initial evidence that manager narcissism is an observable measure of elevated fraud attitude risk. More research regarding the specific aspects of narcissism and how these influence unethical or fraudulent conduct by managers and organizations is clearly warranted. In addition, research that examines in more detail the combined effects of narcissism, motivation, and opportunity will likely provide insights into how fraud attitude influences, or is influenced by, the motivation and opportunity to commit fraud. Further, narcissism is related to two other similar but distinct personality traits, psychopathy and Machiavellianism, which together are known as the "Dark Triad" of dysfunctional or destructive personal characteristics (Paulhus and Williams 2002; Lee and Ashton 2005). Research that examines the similarities and differences in fraud attitude effects based on observable traits from all three "Dark Triad" characteristics will increase our understanding of the role of client personality on fraud attitude risk.

This study is subject to certain limitations. First, the experimental materials reflect one scenario in one industry and one specific operationalization of high and low fraud attitude and motivation. Second, our experimental procedures did not involve any group interaction in recognizing and evaluating fraud risk indicators as required by professional standards. Third, because our respondents represented only one large international public accounting firm, we cannot address whether inter-firm differences in fraud risk assessment training or procedures might have influenced the results.

These findings have implications for audit practice. The results suggest that auditors are aware of the link between client narcissism and increased fraud attitude risk. Public accounting firms should emphasize the linkage between specific client manager personality traits (including narcissism) and the increased likelihood of fraud-related behaviors in fraud risk assessment training. In addition, these findings may be useful to standard setters and auditing firms as a means to improve professional guidance regarding how to assess fraud attitude and the resulting effect on auditors' fraud risk assessments.

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Table 1
Participant Demographic Information
(n = 101)

| Variable | |
|---|------------|
| Mean age (years) | 29.8 |
| Gender (percent male) | 57.4% |
| Mean audit experience (months) | 73.7 |
| Number (percent) of participants by professional rank | |
| Staff | 28 (27.7%) |
| Senior | 32 (31.7%) |
| Manager | 20 (19.8%) |
| Senior Manager | 10 (9.9%) |
| Partner | 11 (10.9%) |
| Number (percent) who had encountered fraud on an audit engagement | 26 (25.7%) |
| Mean number of frauds encountered | 1.85 |
| Number (percent) with audit experience on construction industry clients | 39 (38.6%) |

Table 2
Analysis of Variance: Effects of Client Narcissism and
Fraud Motivation on Auditor Fraud Risk Assessments

| Panel A: ANOVA Model | | | | | |
|-----------------------|-------------|----|--------|--------|--------------|
| Source | Type III SS | df | MS | F | Significance |
| Model | 20.119 | 3 | 6.706 | 6.919 | < .001 |
| Client Narcissism (N) | 16.176 | 1 | 16.176 | 16.689 | <.001 |
| Fraud Motivation (M) | 4.003 | 1 | 4.003 | 4.130 | .045 |
| N × M | .250 | 1 | .250 | .258 | .613 |
| Error | 94.019 | 97 | .969 | | |

Model adjusted R² = .151

| Panel B: Treatment Means (Cell Frequencies) | | | |
|---|----------------|-----------------|----------------|
| | Low Narcissism | High Narcissism | Overall |
| Low Motivation | 4.261 (23) | 4.963 (27) | 4.612 (50) |
| High Motivation | 4.560 (25) | 5.462 (26) | 5.011 (51) |
| Overall | 4.410 (48) | 5.212 (53) | 4.811 (101) |

Responses to the audit fraud risk assessment measure were recorded on a seven-point scale with endpoints labeled 1 = “Very Low” and 7 = “Very High”. The midpoint of 4 was labeled “Moderate”.

Narcissism and *Motivation* are client fraud risk factors, each manipulated between subjects at two levels (low and high).

APPENDIX: EXCERPTS FROM CASE INSTRUMENT
(Low narcissism and low motivation version)

Client Information

Beaumont Construction Company (Beaumont) is a general contractor specializing in commercial and governmental construction projects. Beaumont provides demolition, site development, construction, and site management services on projects ranging from shopping centers and manufacturing facilities to railroads, pipelines, and other infrastructure projects. Beaumont's government projects have historically been limited to smaller-scale contracts to install utility lines and build roads and bridges for counties and municipalities. However, the company has recently decided to pursue an aggressive growth strategy by bidding on large building and facility contracts for state, county, and municipal governments.

Beaumont is privately held and has been a client of your firm for the past seven years. The company has approximately 1,200 employees and has offices in three states. For the fiscal year ended September 30, 2009, Beaumont reported revenues of \$154.6 million and net income of \$6.7 million.

Assume that it is now March 31, 2010, the end of the second quarter for the fiscal year ended September 30, 2010. Further assume that you were recently assigned to the audit of Beaumont's 2010 financial statements and that you will be responsible for the audit fieldwork on Beaumont's Government Projects Group (GPG). Because this is your first year on the Beaumont engagement, you have spent some time researching the client, its operations, and its personnel. Some additional information about the Government Projects Group follows.

GPG Personnel and Operations

Michael Vance has been the General Manager of the GPG since January 2007. Michael, 34, is a CPA with eight years of experience prior to joining Beaumont, including three years at a Big 4 audit firm and five years in various financial and management roles for a small construction company. Other staff members include three contract accountants, Steven Archuleta, Rose Dawson, and Frank Choi; David Williams, the contract supervisor; and Celia McWhorter, the group's administrative assistant.

Many GPG subcontractors work on multiple projects. Site managers report all labor and material costs directly to Beaumont's corporate accounting department, which is responsible for recording the transaction details and updating the corporate general ledger.

As part of your client risk assessment procedures, you recently met with Michael to gain an understanding of business processes within the GPG. The following specific exchanges occurred during your meeting.

Because of the small size of the GPG staff, you inquired about its ability to meet deadlines. Michael replied: "The team has a history of stepping up when it counts to make sure things get done on time. I'll give you an example. Our first quarter close this year was on a tight deadline. We got a little behind on getting subcontractor change orders processed, and we hadn't

completed reconciling construction in progress [CIP] to the latest progress estimates. The team knew we had to get the change orders and CIP account detail in shape for closing, and everyone stayed late to get the job done. After things settled down, we had a meeting to go over our quarter-end procedures. The team came up with great suggestions to streamline the process and make it easier to meet deadlines in the future.”

When you inquired about the best way for your staff auditors to obtain information from the GPG staff, Michael replied: “Feel free to ask anyone for whatever you need. We have a small staff, but it’s a good team that is familiar with the kinds of information auditors typically need. It will be a lot more efficient for you to talk to the individuals directly without having to clear it with me first.”

GPG Contract and Financial Information

A key strategy for Beaumont’s growth is to actively pursue large-scale government construction projects in the region. Historically, the GPG has worked on contracts with revenues of \$5 million or less. During 2007 and 2008, the GPG bid on several large-dollar municipal contracts, but these bids were not accepted. Since then, Michael has intensified his efforts to secure large projects and has been aggressive in contract pricing and promoting Beaumont’s capabilities to complete projects on time and within budget.

As the result of Michael’s increased efforts, the GPG secured its first large-scale construction contract in January 2009. The contract is with Beale County for its new Department of Transportation facility. The facility includes a three-story office complex, a large garage capable of housing 20 large trucks, and a maintenance facility with space for five vehicles. This project, with a contract price of \$57 million and a budgeted profit of \$9.69 million, represents a substantial percentage of Beaumont’s projected revenue and income for fiscal 2010.

The Beale County contract called for the work to be completed in 18 months, with the county scheduled to take possession by October 1, 2010. The county will pay for unexpected costs due to increases in material, labor, or to changes in specifications.

At present (March 31, 2010), the GPG had six projects active, including the Beale County project. A summary of the current contracts is shown in the following table.

| Beaumont Construction Company Government Projects Group Schedule of Current Contracts As of March 31, 2010 | | | |
|---|---------------------|----------------|------------------|
| Project Number | Client | Contract Price | Estimated Profit |
| 1 | Able County | \$5 million | Cost plus at 18% |
| 2 | Able County | \$3 million | Cost plus at 18% |
| 3 | City of Charlestown | \$4 million | 16% |
| 4 | Town of Perryville | \$2.5 million | 18% |
| 5 | Town of Springfield | \$0.9 million | 20% |
| 6 | Beale County | \$57 million | 17% |

Without looking back at the case, please respond to each statement a through h below by writing in the space provided the number from the following scale (1 through 7) that most closely matches your belief for each statement. Use your best judgment based on your memory of the information in the case.

Scale for Statements a through h

- 1: Strongly Agree
- 2: Agree
- 3: Slightly Agree
- 4: Neutral
- 5: Slightly Disagree
- 6: Disagree
- 7: Strongly Disagree

- a. Michael Vance is competent.
Your Response (1 through 7): _____
- b. Michael Vance demands respect.
Your Response (1 through 7): _____
- c. Michael Vance is a team builder.
Your Response (1 through 7): _____
- d. Michael Vance has been successful in his career.
Your Response (1 through 7): _____
- e. Michael Vance has a high opinion of himself.
Your Response (1 through 7): _____
- f. Michael Vance is even-tempered.
Your Response (1 through 7): _____
- g. Michael Vance is assertive.
Your Response (1 through 7): _____
- h. Michael Vance is likable.
Your Response (1 through 7): _____