



ANTECEDENTS AND OUTCOMES OF  
ETHICAL WORK CLIMATE AMONG  
PUBLIC SECTOR AUDITORS IN MALAYSIA

BY

LOKE CHEW HAR

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## ABSTRACT

Ethics is important in any profession, including the accounting profession. Due to the accountability of the public sector, ethics of public sector auditors (PSAs) is paramount. Thus, this research firstly explores the level of ethical work climate (EWC) in the National Audit Department (NAD) in Malaysia. This is followed by an investigation on ethical culture as an antecedent of EWC. Furthermore, outcomes of EWC, specifically code commitment, organizational commitment, and work-related ethical behaviour, are determined. The data on all variables (i.e. EWC, ethical culture, code commitment, organizational commitment, work-related ethical behaviour) were collected using a questionnaire instrument based on a seven-point Likert scale. The questionnaires were distributed to the population of PSAs in all the NAD offices throughout the whole of Malaysia. The response rates were 66% and 78% for individual auditors and audit teams, respectively. A total of 61% and 70% of the questionnaires were useable for individuals and teams, respectively. Mean values, Ordinary Least Square (OLS) regressions and Hierarchical Linear Modelling (HLM) were the main statistical tests used in hypotheses testing. The findings revealed that EWC at the NAD is ethical. Next, the univariate regressions' results indicated that ethical culture and its virtues are the antecedents of overall EWC and its components. However, based on the findings of multiple regressions, virtues of ethical culture: feasibility and transparency do not show significant influence on overall EWC and each of its components. Finally, findings from HLM provided evidence that overall EWC was significantly and positively associated with each of the outcomes: code commitment, organizational commitment, and work-related ethical behaviour. However, there were mixed results on the effect of individual components of EWC on each of the outcomes. The findings of this study, that the PSAs at the NAD are ethical, should be reassuring to the public and the government. Nevertheless, this study may also be useful to the NAD as the results reveal the components of EWC that could be further improved, as well as the virtues of ethical culture that could enhance EWC. Finally, this study highlights to the NAD, the component of EWC that should be promoted to consistently produce positive outcomes of code commitment, organizational commitment and work-related ethical behaviour of the PSAs.

## مُلخَصُ البَحْثِ

الأخلاق مهمة في أيِّ مهنة بما في ذلك مهنة المحاسبة، ونظرًا إلى أن القطاع العام محلُّ للمساءلة المالية، فإن لأخلاق مدققي حساباته أهمية كبيرة، وعليه؛ يتحرى هذا البحث بدايةً مستوى بيئة العمل الأخلاقي في الإدارة الوطنية لتدقيق الحسابات في ماليزيا، ثم يُحقق في موضوع الثقافة الأخلاقية لازمةً سابقةً توفرُّ بيئة العمل الأخلاقي، إضافة إلى ذلك؛ يُحدِّد البحث مخرجات بيئة العمل الأخلاقي؛ أي: الالتزام بالقوانين، والالتزام التنظيمي، والسلوك الأخلاقي المرتبط بالعمل، وقد جُمعت البيانات لجميع المتغيرات (بيئة العمل الأخلاقي، والثقافة الأخلاقية، والالتزام بالقوانين، والالتزام التنظيمي، والسلوك الأخلاقي المرتبط بالعمل) باستخدام استبانة تستند إلى مقياس ليكرت ذي النقاط السبع، ووُزعت الاستبانات على مُدققي حسابات القطاع العام في الإدارة الوطنية لتدقيق الحسابات في ماليزيا جميعًا، وبلغت معدلات الاستجابة ٦٦٪ للمدققين الأفراد و٧٨٪ لفرق التدقيق، أما الاستبانات المقبولة فبلغت معدلاتها 61٪ للأفراد و70٪ للفرق، وتوسَّل البحث: حساب القيم المتوسطة، وطريقة المربعات الصغرى، والنمذجة الخطية الهرمية؛ في اختبار فرضياته، وكشفت النتائج أن بيئة العمل الأخلاقي في الإدارة الوطنية لتدقيق الحسابات بيئة أخلاقية، وأشارت معادلات الانحدار أحادية المتغيرات إلى أن الثقافة الأخلاقية وفضائلها هي المحدد العام لبيئة العمل الأخلاقي ومكوناتها، إلا أن معادلات الانحدار كثيرة المتغيرات أشارت إلى أن الثقافة الأخلاقية بمكوَّنيها الجدوى والشفافية؛ لا تُؤثِّر معنويًا في بيئة العمل الأخلاقي ومكوناتها، وأظهرت نتائج النمذجة الخطية الهرمية أن بيئة العمل الأخلاقي بعامة ترتبط ارتباطًا معنويًا وإيجابيًا بمخرجات بيئة العمل الأخلاقي؛ أي: الالتزام بالقوانين، والالتزام التنظيمي، والسلوك الأخلاقي المرتبط بالعمل، بينما تباينت النتائج المتعلقة بتأثير العناصر الفردية لبيئة العمل الأخلاقي في هذه المخرجات، وتبيَّن النتائج أيضًا أن بيئة العمل الأخلاقي في الإدارة الوطنية لتدقيق الحسابات بيئة أخلاقية، وحرَّيُّ بهذه النتائج أن تبعث الاطمئنان لدى الشعب والحكومة، وربما تكون مفيدة للإدارة الوطنية لتدقيق الحسابات؛ إذ تكشف نتائجها عن مكونات مناخ العمل الأخلاقي الذي يمكن تحسينه، فضلًا عن فضائل الثقافة الأخلاقية التي يمكن أن تُعزز بيئة العمل الأخلاقي، وأخيرًا؛ يوضح البحث العنصر المتعلق بمناخ العمل الأخلاقي الذي يلزم تعزيزه؛ لضمان تحقيق نتائج إيجابية مستمرة على صعيد الالتزام بالقوانين، والالتزام التنظيمي، والسلوك الأخلاقي المرتبط بالعمل لدى مدققي حسابات القطاع العام.

## APPROVAL PAGE

The thesis of Student's Name has been approved by the following:

---

Suhaiza Ismail  
Supervisor

---

Fatima Abdul Hamid  
Co-Supervisor

---

Hafiz Majdi Ab Rashid  
Internal Examiner

---

Normah bt Omar  
External Examiner

---

Zakiah bt Salleh  
External Examiner

---

Akram Zeki Khedher  
Chairman

## DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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## LIST OF ABBREVIATIONS

AG	Auditor General
CEV	Corporate Ethical Virtues
CM	Collective Moral
CMV	Common Method Variance
CPAs	Certified Public Accountants
CEVMS	Corporate Ethical Virtues Model Scale
ECI	Ethical Climate Index
EDMP	Ethical Decision-Making Process
et al.	<i>(et alia)</i> : and others
EWC	Ethical Work Climate
H	Research Hypothesis
HLM	Hierarchical Linear Modelling
i.e.	that is
IUM	International Islamic University Malaysia
INTEGRITY	The Malaysian Institution of Integrity
INTOSAI	International Organization Supreme Audit Institutions
ISSAI	International Standards of Supreme Audit Institutions
IFAC	International Federation of Accountants
KFC	Kentucky Fried Chicken
KPMG	Klynveld Peat Marwick Goerdeler
MACC	Malaysian Anti-Corruption Commission
MAMPU	Malaysian Administrative Modernisation and Management Planning Unit
MIA	Malaysian Institute of Accountants
MMHB	Megan Media Holdings Berhad
NAD	National Audit Department
NIP	National Integrity Plan
OLS	Ordinary Least Square
PCA	Principal Component Analysis
PPM	Psychological Process Model
RO	Research Objective
RQ	Research Question
PSAs	Public Sector Auditors
PwC	PricewaterhouseCoopers
SPSS	Statistical Package for the Social Sciences
SOP	Standard Operating Procedure
U.S.	United States

# CHAPTER ONE

## INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

Ethics is the “moral principles that control or influence a person’s behaviour” (*Oxford*, 2010, p. 500). Being ethical is about principles, values, beliefs or attitudes that eventually influence an individual’s or a team of members’ judgement and behaviour, which goes beyond obeying laws, rules, and regulations (Malaysian Institute of Accountants (MIA), 2013). Unfortunately, human beings may act unethically for self-benefit; corporations also tend to achieve self-desired objectives which run “foul of their own greed and desire to maximize their opportunities” (Svensson & Wood, 2004, p. 56). Consequently, the current global community is losing traditional values of being ethical in the face of materialistic tendencies and that money is valued over ethical conduct. Unfortunately, this trade-off of morality for money has led to increasing diverse challenges and repeated ethical failures in society, including in organizations.

Ethical failure means failing to do the right thing (MIA, 2013; Ravendran, 2006). However, in an ethical organization, “the right thing to do is the only thing to do” (Verbos, Gerard, Forshey, Harding, & Miller, 2007, p.17). Ethical failure leads to ethical scandal. The Enron case is an example of an ethical scandal in accounting, publicized in 2001, in which Arthur Andersen, one of the big accountancy firms, failed to discover that Enron had overstated its earnings (Thomas, 2002). For many years, Andersen was not only both the external and internal auditor but also consultant to Enron, which called its audit independence into question. This was significant

because independence is one of the elements of ethics in auditing standards (INTOSAI, 2010; IFAC, 2017).

There are cases of financial failures in the Malaysian private sector, such as Megan Media Holdings Berhad (MMHB) which were related to irregularities of financial reporting (Omar, Koya, Sanusi, & Shafie, 2014). Ethical scandals occurred not only in the private sector but also in the public sector. In particular, the case of Youth and Sport Ministry concerned an embezzlement scandal involving a huge sum of public funds (*The Malay Mail*, 2016). The embezzlement was caused by an abuse of procurement's standard operating procedure (SOP) (*The Straits Times*, 2016). The Securities Commission's subsequent investigation of the group found that revenue figures in the past were falsified (Zakimi & Hamid, 2013). This evidence raised the issue of why the external auditor (in this case Klynveld Peat Marwick Goerdele (KPMG), another big accountancy firm) overseeing the problem of the SOP on procurement failed to detect embezzlement cases. Since KPMG was the auditor appointed to certify the truth and fairness of financial reports, it should have discovered any irregularities during audit process. Clearly, such ethical scandals are of concern to the accounting profession<sup>1</sup>.

Practitioners in the audit profession are facing challenges in light of these ethical scandals. Should ethical failure occur in the public sector, it would be even more detrimental, ultimately having a huge impact not only on the entire country but also globally. This is because ethical scandals involving the public sector eventually lead to public distrust and slower economic development, and they cause disharmony

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<sup>1</sup> A comment in prior literature is that there was vague distinction between accounting and auditing profession in research (Bampton & Cowton, 2013). This may be because auditing is a subset of accounting. Thus, the present study uses 'accounting' to represent both accounting profession (accountants) and audit profession (auditors). On the other hand, the term 'auditing' purely refers to the audit profession (auditors).

in the country and even between nations (Cameron, 2004; Abdullah, Sulong, & Mohd Said, 2014). Therefore, public sector auditors (PSAs) should uphold their responsibility even more stringently and be more rigorous in performing their audit duties.

Public sector organizations are accountable for public resources. The National Audit Department (NAD) is a public sector organization in Malaysia entrusted with performing audit on all other public sector organizations of the country to ensure that they properly discharge their accountability to the public. Hence, the NAD holds a vital responsibility in auditing and reporting on the performance of public sector organizations from different aspects. The former Auditor General (AG) of Malaysia, H.E. Tan Sri Dato' Setia Haji Ambrin Bin Buang (Buang, 2010), confirmed that "auditor and the audit work are significant elements in reducing fraud and misconduct". Thus, the EWC of the NAD is important as PSAs are accountable to the public. Accordingly, this study is focused on assessing the EWC in the NAD, based on the PSAs' perception.

Since ethical scandals are committed by human beings who fail to behave ethically, ethics research on human behaviour has gained prominence. In ethics research, moral development became a topic of interest in the mid-1950s (Kohlberg, 1968), and this interest continues. The early ethical decision-making process (EDMP) models were gradually developed and built on, and they were well received among researchers, who recognised that these models could promote better human behaviour (Thomas, 2002; Ferrell & Gresham, 1985; Hunt & Vitell, 1986; Trevino, 1986; Dubinsky & Loken, 1989; Jones, 1991; Rest & Narvaez, 1994).

However, more recent research has demonstrated that it is important to study not only ethics of individuals but also the EWC in an organization, which is as worthy

of consideration, if not more so. This is because an ethical person may face extreme challenges in trying to behave ethically in a corrupt and unethical organization and may ultimately have to leave the organization if they intend to hold on to their principles. Similarly, an unethical person may be deterred by numerous barriers when surrounded by a strong EWC. Recognising the importance of an organization's EWC, Victor and Cullen (1988) developed the Ethical Work Climate (EWC)<sup>2</sup> model, which was later improved upon by Arnaud (2010). In fact, Arnaud's (2010) EWC model encompasses elements of both moral development and EDMP, and is thus considered a better model for addressing human ethical behaviours.

According to Arnaud (2010), EWC is represented by "the shared, aggregate perceptions of employees with respect to the content and strength of the prevalent values, norms, attitudes, and behaviours of the members of the social system" (p.348). Basically, EWC is shared perception among the organizational members of what they think the organization's practices are from an ethical perspective. Thus, it is important for an entity to sustain an EWC, which subsequently is expected to promote ethical work behaviour of employees.

Research on EWC is still developing and is particularly limited in the public sector context. In response to this gap, the present study examines the level of EWC in the NAD; since EWC is crucial to the NAD as it is an independent and professional entity, factors that promote EWC should be investigated. This study tests ethical culture as possible antecedents of EWC. Ethical culture is the shared belief among the employees with regard to the ethics of an organization (Key, 1999).

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<sup>2</sup> The term EWC/ethical climate is used interchangeably throughout the writing. There is no distinguish to ethical or unethical working climate, unless stated otherwise, for instance: positive/strong EWC or negative/weak EWC.

After determining the current level and antecedents of EWC in the NAD, this study continues by exploring the outcomes of EWC. EWC could result in many possible positive behavioural outcomes. However, in this study, the expected outcomes of EWC are code commitment, organizational commitment, and work-related ethical behaviour of the PSAs in the NAD. These outcomes are selected as they are particularly relevant and desirable outcomes in the context of PSAs.

In summary, the present study explores the EWC, its antecedents, and outcomes. The next section highlights the problem statements of the present study.

## **1.2 PROBLEM STATEMENTS**

This section describes problem statements that are related to the present study. Firstly, ethical misconduct is not limited to the private sector but also occurs in the public sector. For example, in the public sector of the United States (U.S.), an integrity survey report (New York-based KPMG Forensic, 2007) showed that 81% of the public sector respondents in New York reported that they observed misconduct on the job. Such results are worrying as they jeopardise the public's trust in the public sector. Unfortunately, the Malaysian public sector is facing similar concerns in discharging their accountability to the public. In fact, statistical evidence reveals that a large percentage of the Malaysian population believe public sector employees behave unethically, particularly in terms of corruption (Transparency International, 2013). Specifically, according to the 2013 Global Corruption Barometer, "46% of respondents in Malaysia were of the opinion that public officials and civil servants were corrupt or extremely corrupt" (Transparency International, 2013). However, these statistics are purely based on a survey, hence should be interpreted with caution as further research is needed to properly examine this issue. Although the present

study is not focused on corruption, it examines whether the work climate at NAD is ethical, in which the practice of corruption is relevant in reflecting the ethicality issue of civil servants in Malaysia.

In Malaysia, a study conducted by Majid, Mohamed, & Mahmud (2010) to examine whether existence of good internal control system in a Malaysian Local Authority can reduce misappropriation of assets in a public organization. The study concluded that a good internal control system may not hinder misappropriation of assets. 63% to 80% of the finance department employees of a selected Malaysian Local Authority perceived that misappropriation of assets was a common practice, 53% to 87% perceived that they have seen their colleagues misappropriate assets, and 10% to 13% perceived that their superior was aware of the misappropriation of assets. This study indicates towards the existence of unethical practices in the public sector.

Additionally, the integrity unit from the NAD has disclosed two important statistics on disciplinary cases among PSAs in Malaysia. The first statistic (Appendix 1) regards data on the number of staff liable for disciplinary actions from 2006 to 2016<sup>3</sup>. The figures show that almost every year (except 2006), “do not report for work” was the key problem in the NAD; “misappropriation of NAD assets” was ranked second. The second statistic (Appendix 2) is the number of auditors who have been referred to counselling sessions. Consistent with the first set of statistics, “do not report for work” was the key reason for PSAs having to attend counselling. Both sets of statistics demonstrate ethical problems in the NAD. Furthermore, the former AG of Malaysia, H.E. Tan Sri Dato’ Setia Haji Ambrin Bin Buang, stated:

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<sup>3</sup> According to the management of integrity unit records of wrong doers based on types of wrongdoings and not concern of their position or grade; thus, the statistic attached in Appendix 1 lists the wrongdoings regardless of the position of the employees. Hence, the statistics include all positions of staff in the NAD, both administrative staff and auditors.

Fraud, misconduct and corruption have resulted in wastage of resources and reducing economic growth and the quality of life, undermines government credibility and reduces its effectiveness. The increasing fraudulent practices and corruption have also raised concerns regarding the credibility of the audit profession (Buang, 2010, p.2).

The concern of the former AG reflects the need to improve PSAs' behaviour. However, to attain positive behaviour, the determinant of such behaviour needs to be studied. One of the determinants is EWC.

The second problem statement is that a code of ethics does not only exist as a set of formal documents (Svensson & Wood, 2004); instead, it is one of the control mechanisms governing the behaviour of members of the profession (Gunz, Gunz & McCutcheon, 2002). Such a mechanism may not be sufficient to deter ethical scandals. Conventionally, when there are any ethical problems in a society or organization, the typical administrative solution is to add rules, more complex procedures and greater sanctions (Lynch, Lynch, & Cruise, 2002). The sixth and current Prime Minister of Malaysia, Dato' Sri Haji Mohammad Najib bin Tun Haji Abdul Razak, called for a reinforcement of ethical policies and applications in the Ninth Malaysia plan. These additional procedures resulted in members of organizations facing more and more surveillance and stringent punishment. Even with these added codes, regulations, and policies, individuals still find ways to behave unethically. In fact, empirical studies have found that human behaviour is not sufficiently controlled by underlying ethical codes (Trevino, Butterfield, & McCabe, 1998; Peterson, 2002; Svensson et al., 2004; Lere & Gaumnitz, 2007; Kaptein & Schwartz, 2008; DeConinck, 2010). Hence, other remedies must be considered to minimise unethical behaviour. These include creation of an ethical work environment to promote more ethical behaviour, that is, establishing a positive EWC.

The third issue concerns the limitation of Victor and Cullen's (1987, 1988) EWC model. According to (Rest & Narvaez, 1994), an individual pass through four psychological components in making ethical decisions. However, Victor and Cullen's (1988) EWC model failed to incorporate all these components, and was thus considered inadequate. In response to this criticism, Arnaud (2010) introduced another EWC model. However, there is scant research that verifies the value of this improved model in developed or developing countries, particularly in the public sector context. Consequently, more studies are called for to explore this refined model.

The fourth problem of this study is in relation to the EWC model. Although Arnaud's (2010) model improves on Victor and Cullen's (1988) model, they both focus only on EWC, specifically the EDMP. Antecedents and outcomes of EWC have not been tested in-depth simultaneously, specifically in relation to Arnaud's (2010) EWC, thus rendering previous studies incomplete. To remedy this shortcoming, the present study conducts a more comprehensive investigation of EWC in the NAD by addressing both, antecedents and outcomes.

The fifth and final problem is that prior EWC studies have failed to appropriately capture the fundamental concept of EWC, that is, "shared perception". The failure to capture the shared perception concept has created two problems: first, the inaccuracy of measurement and, second, the inadequacy of the analysis method. In other words, most prior studies measure shared perception only at individual level, which does not reflect shared perception. Shared perception refers to perception at the collective level, for example, the perspective of a team, a department or an organization. Focusing on individual perception is insufficient to accommodate the important concept of shared perception, but multilevel measurement can overcome this problem.