HUMANISE CORPORATE GOVERNORS – ERADICATING ACCOUNTING FRAUD BY AUGMENTING ETHICAL SENSITIVITY AND RELIGIOSITY IN ACCOUNTING EDUCATION

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ABSTRACT – The purpose of this paper is to review behavioural accounting and the relationship between ethical sensitivity and religiosity to influence the behaviour of accountants when faced with ethical dilemmas. The research problem is that accounting fraud is on the rise and alternative measures must be looked into to restrain this issue. Rather than focusing only on greater transparency and more stringent control through improving and introducing new rules and regulations, ethical reasoning should also be addressed seriously, with emphasis on ethical sensitivity and religiosity to assist individuals to justify their actions. As a conceptual paper, the design of this study is an effort in depth literature review of the supporting areas of concern in behavioural accounting to discuss the relationship between ethical sensitivity and religiosity. This study finds that accounting ethics education intervention at tertiary level may possibly be the solution to eliminate or reduce accounting fraud by educating the future accounting practitioners, so that they are prepared when faced by ethical dilemma and to be more exposed to ethical dilemma as part of the curriculum to tackle ethical issues appropriately. The implication of this study is that by establishing the link between ethical sensitivity and religiosity and applying effective accounting ethics teaching methods at tertiary level to inculcate ethical sensitivity via religiosity will solve unethical accounting practices. A collaboration between the institutes of higher learning and the Ministry of Education can devise a plan to induce the appreciation of relevant religious tenets related to ethical behaviour to be embedded with accounting ethics for accounting students.

INTRODUCTION

With accounting fraud on the rise, alternative measures must be looked into to restrain this issue because accounting fraud will have adverse effects on the society and economy such as loss of investment, employment, and savings that will affect the fundamentals of society. Rather than focusing only on greater transparency and more stringent control through improving and introducing new rules and regulations, ethical reasoning ability should also be addressed seriously to justify individuals’ actions. Most ethical reasoning studies have been conducted predominantly on ethical judgement, which is to judge ethically right or wrong actions.

Another equally important element of ethical reasoning ability is ethical sensitivity that is the ability to interpret an ethical dilemma situation. In other words, being ethically sensitive is an ability to recognize an ethical issue in a given scenario. Looking at the literature on this research area in detail, one is able to point out that there is a gap whereby the focus given on ethical sensitivity is limited. This study also upholds that religiosity can be inculcated to strengthen the syllabus of the ethics course which can produce the most desired results, which is to produce accounting students who are ethically sensitive. Therefore, the ethical sensitivity of accounting students has to be studied on to add to the body of knowledge and help the academicians to come up with a syllabus that includes accounting ethics as it is vital to develop the necessary skills to handle ethical dilemma appropriately.

This study will be significant for a number of stakeholders, as there will be implications that each of these stakeholders need to appreciate and incorporate religiosity and ethical sensitivity ability into tertiary education, where ever relevant and justified to improve the main agenda of the Malaysian Economic Transformation Programme (ETP). As education is one of the twelve National Key Economic Areas (NKEA) and ties with the ‘Human Capital Development’ that is one of the eight Strategic Reform Initiatives (SRI), this initiative to effectively educate the new breed of accountants in Malaysia is just so vital. The ETP has also established the Corporate Integrity Pledge where organisations commit to uphold ethical principles in conducting businesses in Malaysia without corruption.

This justifies the need to establish a good ethical behaviour to curb accounting fraud as these initiatives relates to the significance of this study and its implications to stakeholders such as, the Institutions of Higher Learning in Malaysia, the Ministry of Education in Malaysia, accounting profession and its regulatory body and finally implication on research in...
accounting ethics. This study applies an in-depth review of literature combining content analysis and meta-analysis of prior research undertaken in the domain area of behavioural accounting, human governance, ethical development theories, ethical sensitivity, education system, fraud and religiosity.

LITERATURE REVIEW

Behavioural Accounting

Siegel and Marconi (1989) stated that, the objective of behavioural science is to understand, explain and predict human behaviour, therefore, behavioural accounting being part of behavioural science focuses on the relationship between human behaviour and the accounting system. Understanding human behaviour is vital to gauge the receptiveness of humans to ethical behaviour. Arfah and Aziuddin (2008) stated that, the tenet of human behaviour is central to the notion of human governance and should be inculcated through good behavioural accounting.

Siegel and Marconi (1989) stated that behavioural accounting is the third major branch of accounting, concerned with the relationship between human behaviour (social science) and the accounting system, covering both domains of financial accounting and management accounting. Behavioural accounting discusses about how human behaviour influences accounting data and business decisions and how accounting information affects business decisions and human behaviour (Siegel & Marconi 1989; Birnberg, 2011). This relationship between human, behaviour and accounting is vital in maintaining an organisations sustainability through good human governance practices.

Birnberg (2011) posited that, behavioural accounting research can be identified by four categories, namely, individuals, small groups, organisations and environmental conditions. For the individuals’ domain, it focuses on the characteristics of a single actor (respondent) and/or that actor’s response to a particular accounting data set, accounting-related stimulus, or accounting-related setting. For groups domain, includes those studies where the relevant unit of analysis consists of a small number of individuals. For the organisations domain, the focus of research is on the characteristics of the unit, where the entity studied may be described by the legal boundaries of a firm or a division within a larger entity and the research question often is the role played by structural characteristics such as task complexity or the organization’s accounting system design. The final domain is the environmental conditions domain, where it examines the role of accounting in society that reflects the interaction between accounting and society. The interaction in the environmental conditions domain can take the form of the external forces that shape accounting and the role accounting has played in shaping the world in which we live (Birnberg, 2011). Arfah and Aziuddin (2009) argued that in order for an organisation to be sustainable it needs to accept the forces that affect it, for example, humans that are governing the organisation. The interception of notions by Birnberg (2011) with regards to environmental conditions domain explains well the need for good human governance as explained by Arfah and Aziuddin (2009).

Behavioural accounting explores how the attitudes and philosophies of management affect the nature of accounting controls and the functioning of the organisation. Siegel and Marconi (1989) attempts to intricate what sort of attitude a worker will have towards the control system of a firm, and their behaviour in operating the system and the consistency of enforcement, which will ultimately affect an organisation’s efficiency and effectiveness (Williams et al. 2006; Birnberg, 2011).

Siegel and Marconi (1989); Dyckman (1998); Birnberg (2011) stated that society and its beliefs can influence or dictate the action of an individual and make an important influence on behaviour. Attitude is not behaviour, rather attitude guides and drives behaviour that is acquired from personal experiences, parents, peers, social groups and social forces that can affect attitude formation such as school, religiosity, reference groups and mass media. Therefore, an attitude can become habitual and that behaviour will lead to values in an individual’s life that results in opinions for organisations. So, we will be able to discuss from the ethical lance and see how religiosity affect attitudes of individuals and behave in a manner which is ethically sensitive.

Human Governance

George Kohlrieser in his foreword on the book titled ‘Human Governance: A Shift in Governing Corporations’ by Arfah and Aziuddin (2008) stated that human governance is a powerful and important paradigm shift compared to corporate governance, as human governance points out that the rule-based governance system has limitations. Rule-based, ticking of box mentality has also proved to be problematic in the American’s rules-based accounting system that caused some bankruptcies in America like Enron in 2001 and WorldCom in 2002. Arfah & Aziuddin (2008) explained that human governance is a shift in paradigm that inculcates good behaviour in humans to maintain good quality of financial reporting and ethical behaviour to achieve good human governance. Arfah and Aziuddin (2008) identify the characteristics of human governance as viewing human as the focus and being the embodiment of corporation. The origin of law that governs human should be through revelation or the natural law, not sourced through acts of parliament and the spirit of the law is emphasised rather than letter of the law and also human governance is values-based not rules-based. The schema for human governance is ‘inner-out’, and is used to develop principles-based governance, to rectify the root cause of human’s misdeeds.

Intervention through education to inculcate ethics in students can be done by understanding the concept of human governance and its ability to assist the understanding of unethical behaviour and find a solution to improve the ethics of humans that form societies. Arfah and Aziuddin (2008) also established that the human factor has led to corporations being deficient of spirit and consciousness, attributes that only humans possesses as natural persons. When good human governance is implemented, the individual will be able to address ethical issue and act on it appropriately without any
prescribed written directions, therefore enhancing the sustainability of corporations. The inclusion of religiously based elements and qualities into the teaching of accounting ethics to accounting students can promote and enhance good human governance amongst accounting students.

Arfah and Aziuddin (2009) argued that the core of ethical behaviour are humans, therefore it is important to address the issue of unethical behaviour at the root level, which are the students. Arfah and Aziuddin (2009) postulated that the core of human governance is attained through religion and spirituality as these are the fundamentals of human governance, on which corporate governance should be revised and built upon. Corporations that cannot move beyond the lower state of consciousness of self-interest, as explained in agency theory, will find themselves struggling to sustain (Arfah and Aziuddin, 2008).

Arfah and Aziuddin (2008) reiterated that they are proposing human governance as a complement to corporate governance and is to be supplemented with the existing framework of corporate governance, with human governance taking the central position. Having a good human governance will assist the decision-making process in an organisation as well by individuals. Arfah and Aziuddin (2008) explained that there is a link between governance and decision-making architecture of risk in life. Generally, life is seen to be as a series of dilemmas and actions need to be taken to solve these dilemmas and decision-making process is dependent upon the attitude towards risk. This decision-making process involves choices of risk treatment, for example the avoidance of risk, transfer of risk, mitigation of risk, deferring of risk, toleration of risk or acceptance of risk. These risks need to be governed and best done by principle-based governance, therefore human governance governs individuals to increase their preparedness to solve ethical dilemmas.

The domain of human governance involves ethics, behaviour, corporate governance and frauds. Arfah and Aziuddin (2009); Arfah et al., (2009) argued that the corporate governance’s mechanistic structure is already broken and it cannot be mended with more regulations, legislations or new policies. Arfah and Aziuddin (2009); Arfah et al., (2009) stated that compliance-based rules do not work as well as value-based methodology that inspires humans to work more honestly and behave more ethically, therefore a new governance structure need to be implemented and this goes beyond sense perception and experience. Gravel (2003), Arfah and Aziuddin (2009) argued that human integrity is the paramount to good ethical behaviour as corporations are not able to and are ill-equipped to mimic human being’s feelings and behaviour. The pinnacle of Arfah and Aziuddin (2009)’s contestation is that individual governance is a primary matter of spiritual development and that governance begins with the individual which is also why this paper suggest to uses religiosity as one of its predictors of ethical sensitivity.

Ethical Development and Theories

Luper (2001); Northouse (2004) and Chan and Leung (2006) stated that ethics or ethos in Greek is interchangeably used as morals, which is also known as mores in Latin. Crane and Matten (2007) posited that ethics guides on how we should live a good life and also to direct individuals to be able to distinguish the good from the bad. Morality focuses on norms, values, and beliefs embedded in social processes that define right and wrong for an individual or a community. Ethics studies morality and the application of reasons to clarify specific rules and principles that determine the right and the wrong for a given situation. Generally, these rules and principles are called ethical theories.

In other words, all individuals and communities have morality as a basic sense of right or wrong. Ethics represents an attempt to systematise and rationalise morality, typically into generalised normative rules that supposedly offer a solution to situations of moral uncertainty. The outcomes of the codification of these rules are ethical theories (Crane and Matten, 2007), but moral and ethics, even though are revealed with different distinctions, are still almost synonymous.

Pearson (1995); Crane and Matten (2007) argued that the forms of analyses used in ethics are mainly those borrowed from moral philosophy and some adapted from psychology. To the philosopher every term in the area of ethics is crucial, but to accounting practitioners, the terms are not as important, since philosophy itself does not provide definite answers, only different ways of looking at questions, and furthermore accounting students are not expected to become philosophers of any substance. Therefore, these accountants in training, need to be exposed to accounting ethical dilemmas, to create awareness so that they will be more ethically sensitive to be able to act ethically.

Pearson (1995); O’Fallon and Butterfield (2005) also stated that the need of business ethics or professional ethics, which is to change the values of people, is mainly concerned with the application of normative ethics, which is mostly focused on practical issues, which is about the right and the wrong. Descriptive ethics shuns away from the judging matters of right and wrong and meta-ethics is more skewed towards the analysis of the meanings of crucial ethical terms, the logic of moral reasoning and the nature of moral justification. Even though all these are important but what matters most is the execution of good ethical behaviour that starts with being ethically sensitive.

Generally, ethics theories can be divided into five categories. The first is eternal law, which is related very closely to religion. The golden rule, which is derived from the Christian theology that is ‘do unto others as you would have others do unto you’ is the main idea of the functionality of this theory. The next theory on ethics is classical teleological ethical theory, which is also known as utilitarianism. Utilitarianism is concerned with the consequences of actions, with the emphasis on the actions, rather than the intent of an individual’s actions. The gist of utilitarianism holds on the notion that, an action is right if it produces the greatest amount of good for the greatest number of people (Crane and Matten, 2007). The third theory on ethics is the classical deontological ethical theory, which is also known as universalism, a Greek word referring to duties or obligations of individuals. This approach is based on the idea that the moral worth of an action is dependent on the intentions of the person taking the action. The fourth and fifth theories are categorised as modern ethical systems and are based on values rather than principles. Distributive justice theory is based on the primacy of a single value, which is justice. The belief in the primacy of justice will lead us to make decisions and take actions that
are expected to result in compensating benefits for all, especially to the least advantaged members of our society. Personal Liberty is also based on the primacy of a single value, which is liberty, and the belief in the primacy of liberty will lead us to make decisions and take actions that will result in greater happiness and increased benefits for all.

Agency Theory

An agency agreement is an explicit or implicit contractual relationship between a principal and an agent that exerts effort on behalf of the principal (Jensen and Meckling, 1976; Sullivan 1994). Agency theory is explained that in an employment contract, an employee who is an agent agrees to exert for the benefit of the employer, who is the principal, in exchange for extrinsic rewards (Sullivan, 1994). Sullivan (1994) explains further, that if the agent is not able to work in tandem with principal and they are facing information asymmetry problem, then the agent might be involved in unethical decision making.

Kulik (2005) argued that corporate governance has its roots deeply established in agency theory, a notion developed primarily by Jensen and Meckling (1976). Jensen and Meckling (1976); Kulik (2005) described agency theory as an explanation on how the public corporation should exist, given the assumption that managers are self-interested and in public corporations, the top management does not always act to maximize shareholders return on investment. When interest of the agent and principal differs, it will result in a divergence of managerial attention to self-interest and not to the interest of the shareholders, therefore agency theory looks into ways to solve this agency problem by aligning the behaviour of managers with actions that will benefit the shareholders and minimising the agency cost (Simga-Mugan et al., 2005; Kulik, 2005; Faizah and Azlinda, 2011).

Agency theory has two main players, namely the principal who is the owner of the organisation and the agent who is the person who manages the organisation. Faizah and Azlinda, (2011) stated that agency theory has been widely used in empirical research in the areas of board of directors and firm performance and according to the findings of Muth and Donaldson (1998), the board of directors (agents) have to be independent of the influence of the management to achieve maximum performance of a firm. The principal’s interest can be compromised if the agents act in their own self-interest at the expense of the organisation’s profitability and sustainability (Faizah and Azlinda, 2011).

Agency theory argues that the managers of an organisation should act in the best interest of the owners, which is by maximising the shareholders’ wealth and it is central to this paper that focuses on behaviour, corporate governance and human governance. Agency theory rests on the same platform that influences the way individuals behave ethically, whereby greater monetary returns negatively expose the decision maker to greater risk of fraud. The behavior of the decision maker (agent) can be affected by the expectation that are being set on the decision maker, therefore aligning the behavior of the decision maker with actions that will benefit the owners to minimize the agency cost is crucial. This behavioral stance is justifiable as human governance is attained through religion and spirituality and consciousness of self-interest in agency theory.

Positive Accounting Theory

Positive Accounting Theory (PAT) about self-interest by Watts and Zimmerman (1978) argues that every individual is driven by self-interest to maximise or increase their wealth. Watts and Zimmerman (1978) stated that a change in the accounting standards will be opposed if such changes for example taxes, regulation, management compensation plans, bookkeeping costs and political costs, affects corporation’s earnings. Deegan (2005); Deegan (2010) stated that positive accounting theory does not incorporate the notion of loyalty and morality, therefore, individual with the desire to maximise their wealth will do anything, including committing fraud.

Positive accounting theory proposes that there will be scope for manager (agent) to opportunistically select a particular accounting method to manipulate accounting information to increase the owner’s (principal) wealth, even by commit fraud. Deegan (2004); Deegan (2010) also argued that because of the position the manager is in, it will be easy for the agent not to disclose relevant information to the principal, a problem known as information asymmetry. Actions taken by the agent will benefit the agent, but at the expense of the principal and the price that the principal has to pay for the agent’s behaviour is known as the agency cost. Positive accounting theory also assumes that if the agent is remunerated based on accounting numbers, for example, on the basis of the organization’s profit, then the agent will have an incentive to manipulate accounting numbers to increase their remuneration. Cooking of books might take place to show fictitious accounting figure as though the firm is efficiently managed and such unethical behaviour could be avoided if the agent is well exposed about ethical issues and have a sense of ethical sensitivity received through education intervention.

Kohlberg’s Cognitive Moral Reasoning and Development Theory

The framework of moral development study is based on the research of Lawrence Kohlberg (Kohlberg, 1969), in the field of cognitive development in psychology. Kohlberg identifies three levels of moral development, firstly, pre-conventional, that considers societal expectations to be external to that individual, where a behavioural outcome that seems ethical may be motivated by the individual’s desire to avoid punishment or because the outcome is in the individual’s self-interest (Eynon et al., 1997; Chan and Leung, 2006). Conventional level will show an individual’s concern about the society, the welfare of others, and the perception of other about that individual’s morality. The final post-conventional level will exhibit an individual acting on behalf of others in society, where the individual believes in acting for the good of the public and that every individual has rights, which is independent of the society (Eynon et al., 1997; Simga-Mugan et al., 2005; Chan and Leung, 2006).
Kohlberg’s Six Stage Model

Kohlberg’s research brought new ideas on psychology and philosophy and are used in cross disciplines. The six-stage model can be derived as a three-level progression, stage one and two covers an egocentric understanding of fairness based on individual need, stage three and four, focuses on the notion of fairness, which is based on shared conventions of societal agreement, lastly, stage five and six, is based on a principled understanding of fairness that rests on the logic of equality and reciprocity (Gilligan, 1982).

Welton et al. (1994); Dellaportas (2006) based on the theory of cognitive moral reasoning and development argues how an individual’s ethical beliefs and an individual’s belief system controls the resolution of ethical conflict and also posits that the six stages of moral development can be explored on the basis of orientation of each of the six stages. Stage one is based on obedience motivated by avoidance of punishment, stage two on self-gratification, stage three on role expectation and approval from others, stage four on adherence to legal and moral codes, stage five on just rules determined by consensus, and stage six on self-chosen ethical principles. The stage one and two that is at pre-conventional level defines morality at external authority. Stage one of the pre-conventional level is where individuals adhere to rules because punishment can be imposed by a superior authority, as right is characterised as what is in one’s best interest. Stage two is described as following rules in the best interest of the individual and recognising that others are doing the same, this gesture is similar to a situation where one is bargaining with authority.

The stage three and four that is at conventional level defines morality at social group. Stage three is about seeking approval of friends and family which explains the need to be good in your own eyes and living up to expectations of trust, loyalty and respect. Stage four is all about obeying law and fulfilling duties imposed by agreement to avoid the breakdown of society, groups or institutions by contributing to society, groups or institutions. Finally, the stage five and six that is at post-conventional level defines morality at inner conscience. Stage five also concerns that laws are to be based on the concept of the greatest good for the greatest number described as being utilitarian. Stage six is concerned with consistent ethical principles, equality of human rights and respect for the dignity of human beings as individuals. Religiosity as one of the predictors of ethical sensitivity is at post-conventional level, therefore, morality at inner conscience is explored by using religiosity as a determinant of ethical sensitivity.

Pre-conventional Level – Focus on self

Stage 1  Obedience:
You do what you are told primarily to avoid punishment

Stage 2  Instrumental egotism and simple exchange:
Make a deal or only consider the costs and/or benefits to oneself

Conventional Level – Focus on relationship with others

Stage 3  Interpersonal concordance:
Be considerate, nice, and kind and you will get along with people

Stage 4  Law and duty to the social order:
Everyone in society is obligated to and is protected by the law

Post-conventional Level – Focus on personally principles of justice

Stage 5  Societal consensus:
You are obligated by whatever arrangements that are agreed to and by due process and procedures. Focus is on fairness of the law or rule as determined by equity and equality in the process of developing the rule

Stage 6  Non-arbitrary social cooperation:
Rational and impartial people would view cooperation as moral. Focus is on fairness of the law or rules derived from general principles of just and right as determined by rational people


Figure 1: Kohlberg’s Six Stages of Cognitive Moral Reasoning and Development Theory

Rest’s Four Component Model

Based on Kohlberg’s six-stage cognitive moral reasoning model, James Rest in 1983 has developed a four-component model that an individual must have performed at least four basic psychological processes to behave morally (Chan and Leung, 2006).

The four-component model that have been posited by James Rest (1983) are moral sensitivity, moral judgement, moral motivation and moral character. Moral sensitivity is about interpreting the situation and it is about how an individual’s action will affect others. Being morally sensitive will summon awareness and individuals will be more affectionate and considerate. In other words, an individual must perceive that there is indeed an ethical situation that needs to be considered
before other parts of the four-component being considered (Chan and Leung, 2006). Shaub (1989) posited that ethical sensitivity is defined as the individual’s ability to recognize that a situation has ethical content when it is encountered.

The next attribute is moral judgement. Chan and Leung (2006) posited that moral judgement is interchangeable with ethical judgement and it is about judging which action is morally right or wrong. In another term, moral judgement can also be explained as a cognitive process that justifies which action is fair or just. The third attribute, moral motivation is about prioritizing moral values relative to other values, such as personal values like friendship. Moral motivation is compromised when other values, which relates to self-interest are considered more important than doing the right thing. Chan and Leung (2006) also posited that moral motivation acknowledges the presence of human desires which may overshadow moral conviction. The last attribute of James Rest’s (1983) four component model is moral character, about having the courage and persistence in overcoming distractions. These characters are vital in order to carry out the intended moral action successfully. Chan and Leung (2006) posit that moral character believes in personal character and a strong resolve to overcome temptations.

As being posited by Rest (1986), moral behavior is the result of a multiple, complex processes and all the four components, moral sensitivity, moral judgement, moral motivation and moral character are determinants of a moral action by an individual. As these four components interact with each other, it is also vital to understand them and their inter-relationships. As posited by Rest (1986), the four components do not occur in a temporal order, but rather they comprise a logical analysis of what it takes to behave morally. Having said that, an individual’s way of defining what is morally right (moral judgement) and how it may affect that individual’s interpretation of the situation (moral sensitivity) are interrelated (Chan and Leung, 2006).

**Ethical Sensitivity**

As reported in the KPMG Malaysia fraud survey report 2009, 57% of the respondents had an opinion that the employees of their organizations are not adequately trained to recognize red flags or early warning signs of frauds.

The four psychological processes that an individual need to possess to be able to behave morally are grounded in the common foundation which is the psychology of moral reasoning. This common foundation is derived from the work of Lawrence Kohlberg, predominately the theory of moral reasoning, which focuses on a six-stage model of cognitive process. Based on Kohlberg’s six stage cognitive moral reasoning model, Rest (1983) addressed that for an individual to behave morally, they need to fulfil all the four levels, mainly ethical sensitivity, which is the ability to recognize and interpret a situation which will impact others. Apart than that, ethical judgement is the ability to judge an ethical issue as either correct or wrong, followed by ethical motivation, which is the ability to prioritise moral values as the paramount over any other inherent values and finally ethical character, which is the will power to perform an ethical conduct.

Bebeau et al. (1985) posited that apart than moral reasoning development other component processes in Rest’s system is under investigated. Rest (1983) stated that the failure of any one component of the four-component model will lead to unethical behaviour and Chan and Leung (2006) posited that all the four components interact with each other. Ethical sensitivity is unique as it is a situational based questioning, (Chan and Leung, 2006; Triki, 2011; Karakoc, 2016; Shawwer and Miller, 2017) and cannot be interpreted similar to ethical judgement, (Myyry, 2003; Muslichah et al., 2017). Ethical sensitivity is one of the four components and is a process where an individual is able to recognise and have the ability to interpret any ethical issue that might prevail in a given situation. Being ethically sensitive is also perceived as being able to know their actions will affect others.

Chan and Leung (2006) argued that an individual must first of all perceive that there is indeed an issue that is having an ethical implication in a given scenario, which is ethical sensitivity. Rest (1986) also posited that the failure to recognise or interpret an ethical issue is a result of an individual having lack of sensitivity to the needs and welfare of others. Literature on ethical sensitivity instruments to capture and analyse ethical sensitivity is limited and Shaub (1989) developed a measure of ethical sensitivity to test the ability of individuals to recognise ethical issues in a given situation. Accountant’s Ethical Sensitivity Scale (AESS) developed by Triki (2011) does not limit the measure of ethical sensitivity to a particular context, unlike other scenario based ethical sensitivity measures known as Cohen et al.’s (1993) accounting-specific multidimensional ethics scale (MES).

Maisarah et al. (2009) stated that limited findings are reported in the research area of ethical sensitivity, especially the factors affecting the level of ethical sensitivity of Malaysian accounting students. Ho (2007) conducted a study to investigate the ethical sensitivity among American and Taiwanese students, where ethical sensitivity is proven to have a significant influence on certain predictors’ especially ethical intention. Chan and Leung (2006) also reported that ethical sensitivity is affected by predictors among others ethical reasoning amongst two universities in Hong Kong and established that ethical sensitivity is greater when there is a dedicated subject on ethics being taught to students. Burns and Brady (1996) conducted a study between Malaysian and American students and results shows that there are ethical differences among these two student groups. O’Leary and Mohamad (2006) also posited that the study on ethical attitudes of Malaysian, Australian and Irish accounting students was conducted with the predictors of gender and the risk of getting caught and concluded that male students are more likely to be unethical compared to female students regardless where they are from. Musbah and Cowton (2016) claimed that effect of ethical recognition of ethical decision is significant and positive. These findings advocate that there is a need to have a specific dedicated subject on ethics to educate the students better and gender makes a difference to the ethical stance of an individual.
Education System

According to Glover and Aono (1995), fraud is caused by not giving importance to ethical behaviour, due to social and educational imbalances. Ethical behavioural malfunction is a social problem that is caused by ineffective education system and any education intervention must be done systematically for maximum reach to benefit the society at large. Even though there are models to detect fraud, but fraud is still rampant, therefore behavioural aspects of perpetrators of fraud need to be investigated, by focusing on ethical sensitivity and religiosity.

The detection of accounting fraud alone would not be sufficient and the inadequate education which is the root cause need to be addressed. The prevention of accounting fraud must go hand in hand with having tighter and more stringent rules and regulations. Having a specific ethics intervention, such as accounting ethics education, will influence the ethical reasoning ability of accounting students, so that these students are able to react appropriately, when they face any ethical dilemma in the future. Albrecht et al. (2008) revealed that perceived opportunities are based on the level of external oversight and monitoring, internal monitoring and control, environmental complexity and related parties, and lastly, lack of knowledge or education, therefore ethical sensitivity is vital to mold accounting graduates into ethically sensitive accountants and auditors.

Ethics in education

Mohammad Adam Bakar et al. (2003) stated that the code of ethics has little or no significant influence on the behaviour of accountants and these codes are not useful in identifying ethical dilemmas and solving ethical issues faced by accountants. Haberman (2003); Mohammad Adam Bakar et al. (2003) postulated that greater effort is required if the accounting fraternity wants to maintain its position as a professional profession and to regain its trust back from stakeholders. Loeb (1991); McDonald and Donleavy (1995); Bampton and Maclagan (2005); Dellaportas (2006); Singh and Poduval (2009) deliberated on why ethics need to be taught to accounting students and interestingly there have been mixed responses to the need to teach ethics. The notion of nature and nurture is also brought into light, where McDonald and Donleavy (1995) argue that it is not easy to teach ethics to young adults.

The inclusion of accounting ethics as the integral part of accounting syllabus is essential in reviving the accounting profession back into the limelight, supported by professionalism, integrity, integration, and independence. Accounting practitioners have to be ethical in their professional conduct and this can be achieved by educating the future accounting practitioners on ethical behaviour in accounting through ethical education intervention at tertiary level (Oddo, 1997; Adkins and Radtke, 2004; Dellaportas, 2006; McWilliams and Nahavandi, 2006).

Mohammad Adam Bakar et al. (2003) argued that ethics and ethical issues were not discussed as part of the syllabus in the training and educating accountants and many of the aspiring accountants who intended to become auditors are not well exposed to ethics and ethical issues. It is evident that insufficient ethics coverage at tertiary level will lead to inability of students to tackle ethical dilemmas effectively Haberman (2003); Mohammad Adam Bakar et al. (2003). O’Leary and Mohamed (2006) discovered that 32% of accounting students in Malaysia were prepared to cheat in an examination and if an opportunity arises about 14% of these accounting students are willing to accept bribe at their work place. Cree and Baring (1991) posited that a significant proportion of students were found to be open to an insider-trading proposition. Haswell and Jubb (1995) noted almost 50% of male and 25% of female students indicated willingness to accept bribe if there was no risk of being caught. In tandem with the findings of the KPMG Malaysia Fraud, Bribery and Corruption survey 2013 and the 14th Global Fraud survey 2016 by Ernst & Young suggests that there is a positive relationship between the plausibility of committing unethical conducts both by students and practitioners.

According to Chan and Leung (2006), accounting students who are exposed to a core course of ‘Ethics in Accounting’, in their accountancy degree curriculum, have higher ethical sensitivity ability, compared to the students who are given only a few hours of integrated ethical interventions of their entire curriculum coverage. Therefore, a comprehensive ethics in accounting syllabus will promote a better internalisation of ethics in practice. Accounting ethics education intervention at tertiary level may possibly be the solution to eliminate or reduce accounting fraud by educating the future accounting practitioners, so that they will be more prepared when they face any ethical dilemma when they join the work force. Accounting students should be more exposed to ethical dilemma as part of the curriculum so that they will be able to tackle ethical issues appropriately.

Haberman (2003), stated that the educators have not taught ethics to students, have not taught fraud and have not taught students how to think. Albrecht and Sack (2000), stated that the educators themselves did not address ethics, values and integrity well enough, as an important issue in the correct ways, and stressed that the educators had to share the blame for the failure of Enron. Maisarah et al. (2010) concluded that appropriately structured ethics courses provided by Malaysian accounting faculties are effective in improving ethical sensitivity amongst accounting students in Malaysia, where ethics courses have the potential to reshape the ethical thinking of future Malaysian accountants and thus improve the ethical climate affecting professional practice in Malaysia. Maisarah et al. (2010) also argued that the effectiveness of the delivery and internalization of an ethics course depends on how an ethics course is taught and administered and is an important factor in improving ethical sensitivity.

Accounting Ethics

Accounting is the language for business, therefore, as International Accounting Standards Board (IASB) noted that the main purpose of accounting information is to provide useful information to the users to make decisions. Based on decision-usefulness, accounting information will be used by stakeholders in order to make sound economic decisions and
these investment decisions can only be good decisions if the accounting information on which the decisions were made is faithfully representing the actual financial standing of organizations.

One of the means of ensuring faithful representation is with a practice of good governance both human and corporate governance. Corporate governance can be established with the implementation of Malaysian Code of Corporate Governance. The code of corporate governance can be helpful in maintaining certain order in governing the conduct of a corporation, may it be in terms of the preparation of financial accounting reporting, management accounting plans, taxation calculations and the entire process of auditing. Human governance is a more specific code of governance on humans that are directly involved in the preparation and presentation of the entire financial reporting process (Arfah et al., 2009). Accounting ethics can be described as a subset of human governance as many regulatory bodies will want to regulate accounting ethics to guide accounting practitioners in making ethical decision when confronted with ethical dilemmas (Ahadiat & Mackie, 1993; Armstrong, 2002; Mele, 2005; Ho, 2007).

Accounting ethics is the specific statements of governance such as the code of professional conduct for the accounting profession, derived by accounting bodies and the ability to analyse the policy and moral choice inherent by the position of accounting as the language of business (Gawthorpe & Blake, 1998). Duska and Duska (2003) posited that accounting practitioners and professionals can be guided by a set rule of code of accounting practice such as the code on corporate governance and the by-laws on professional ethics, based on IFAC’s Code of Ethics for Professional Accountants.

Ahadiat and Mackie (1993) established that accounting ethics includes fifteen qualities, namely, honesty and reliability; not discriminating on the basis of race, religion, sex, age, national origin, ancestry or handicap; conducting professional duties in accordance with corporate regulations and ethical standards; conducting professional duties in accordance with law; protecting confidential information; honoring the public trust and interest; recognizing professional limitation or constraints in rendering judgement or performance of activities; trustworthiness; avoiding any conflicts of interest; commitment and loyalty to organization; ensuring transactions are documented and fully authorized; avoiding activities that are against the environment or the public; refusal of taking gifts from clients or customers; refraining from the use of company supplies and property for personal purposes and finally refraining from giving gifts that can benefit the organization.

The By-Laws on Professional Ethics establishes the ethical requirements and standards applicable to all professional accountants, to act in the public interest and not exclusively to satisfy the needs of an individual client or employer. By observing and complying to the fundamental principles of professional ethics for professional accountants that provide a conceptual framework that professional accountants shall apply to identify and evaluate the significance of the threats and apply safeguards to eliminate or reduce threats to an acceptable level based on professional judgment in applying the framework.

Ethics in Malaysia

As Malaysia is a multiracial society, there will be variety in cultural stance and perception towards ethical behavior and it will be interesting to look into the literature that is surrounding ethnicity in Malaysia pertaining to ethical behavior and perception on ethics. Md. Zabid and Ho (2003) argued that ethnic groups have some influence on perceived business ethics. Ethnicity and its influence on ethics can also be explained to a certain extent based on Hofstede (1980), where it was established that culture can be defined as norms and values, associated with certain community in a geographical area. Therefore, studying ethics from different cultural, ethnicity and nationality lenses is justifiable because the outcome of ethical studies from these various anomalies can be significantly different.

According to Md. Zabid and Ho (2003), Nik Maheran and Filzah (2009), the Malays are motivated to their affiliation to families and groups. To the contrary Chatterjee (1987), Hamzah (1991), Nik Maheran and Filzah (2009) argued that the Chinese are motivated by financial rewards and the Indians gives more importance on the values of having extended families with hierarchically structured authority amongst their society. The findings of the study by Zabid (1989), Zabid and Ho (2003), Maheran and Filzah (2009) established that Indian mangers are less tolerant to unethical behavior compared to the Malays and Chinese managers. Md. Zabid and Ho (2003) concludes that there can be many reasons for the ethnics to behave differently based on situation that individual is in, but having said that, culture and religion also plays an important role in influencing the ethical behavior of different ethnics in Malaysia.

Hofstede and Hofstede (2005) mentioned that Confucian ethics, an ideology of guided practical ethical behavior without the influence of religion, where harmonious ethics is promulgated based on relationship amongst friends, family and society, is very common amongst the Chinese diasporas especially in Asia and this will influence the practice of business management in Chinese organizations (Wright et al., 2002). Zabid and Ho (2003), Maheran and Filzah (2009) stated that Confucianism is part of the Chinese community and is upheld based on moral values by giving importance to family, neighborhood, community, society and the environment.

Virtue ethics focuses in the character of an individual, rather than consequences of actions and also the motivation of the actions taken. Duska and Duska (2003) argued that the characteristics of an accounting practitioner are central to the level of ethics projected by the individual. Code of ethical conduct and corporate governance is generally based on the desired character that an accounting practitioner should possess and therefore the virtue ethics can be said to have laid the foundation of ethical behavior in professional accounting. Perhaps, the constructs of human governance should also be based on virtue ethics, where religion and spirituality are central to its development.
Fraud

Albrecht et al., (2008) posited that fraud and corruption are cancers that eat away society’s productivity and its occurrence reduces the economic effectiveness and efficiency and costs individuals and corporations’ tremendous amounts of money. Perpetrators of fraud gains on the expense of others committed deliberately with an intention of gaining unfair or unlawful benefit and to intentionally distort from the truth and misstatement of vital information. Glover and Aono (1995) stated that fraud involves misallocation of resources or distorted reporting of the availability of resources. Fraud reduces efficiency, productivity and innovation, because resources misused for non-constructive reasons, threatens the going concern of a firm and eliminate funds to improve education, healthcare and social standards.

Organizations might not be able to curb fraud because improving profits and controlling cost supersedes good ethical culture. The 14th Global Fraud survey 2016 by Ernst & Young concluded that more than one-third of their respondents would be willing to justify inappropriate conduct, while almost half would justify such conduct to meet financial targets. KPMG Malaysia’s fraud survey report 2004, 2009 and 2013 highlights that, fraud can only be prevented when managers and employees understand and believe that ethics is core in a management’s business methods. These managers and employees must be willing to live ethics each day at work and internalize human governance, where individuals need to be ethical in fact not only in appearance.

KPMG Malaysia fraud, bribery and corruption survey 2013 highlighted that fraud perpetrated by non-management employees increased from 34% in 2009 to 50% in 2013; and by management employees from 6% in 2009 to 18% in 2013. The most common factors that contributed to unethical behavior are poor example shown by senior management and poor ethical culture in the organization, with 68% of fraud by management and non-management employees. Based on the Fraud Survey Report 2009 by KPMG Malaysia, fraud is defined as a deliberate deceit, planned and executed with the intent to deprive another of property or rights directly or indirectly, regardless of whether the perpetrator benefits from his or her actions. 15% of the total fraud that was being committed in Malaysia by management level employees was in the form of financial reporting fraud, theft of funds at 26%, corruption 21% and theft of physical asset at 17%.

Fraud is identified as a major problem faced by businesses in Malaysia, rising by 4% compared to the survey done in 2004, which currently stands at 66% of the respondents, who are from the top management group. 89% of the respondents believed that fraud will be rising due to current economic crisis. Looking at the economic crises and national debt escalations, it is possible that fraud will worsen and financial reporting fraud will continue to be a threat to sustainability of organizations as more than 50% of respondents confirmed that fraud will increase in the future.

Accounting Fraud

Fraud threatens organizations’ sustainability and organizations face the risk of being victimized by perpetrators of fraud. Fraud can be contagious as work ethics is molded based on the behavior that is dominant in an organization, therefore organizations need to hold on to good ethical behavior with confidence and trust to curb fraud from seeping into the fundamentals. Accounting fraud is a subset of management fraud and defined by American Institute of Certified Public Accountants (AICPA) as knowingly falsifying accounting records, such as sales or cost records, in order to boost net income or sales figures, and also increases asset values such as accounts receivable and inventory. Gerety and Lehn (1997) defines accounting fraud as disclosure violation, from failure to file appropriate and required financial statements with regulators to internal fraud that shows lack of proper internal controls to willful misinterpretation of the financial health of the firm.

Types of Fraud and Fraudsters

According to AICPA, fraudsters can be categorized as firstly, those who sit at the helm of an organization and commits management fraud such as misrepresentation of financial statements, or theft or improper use of company resources. The second category is the employees of an organization that commits employee fraud and the third category is external fraud, committed by people who are neither management, nor employees of the firm.

There are two basic types of fraud, namely fraudulent financial reporting (management fraud) and misappropriation of assets (employee fraud). Fraudulent financial reporting involves manipulation, falsification, alteration of documents or records, misrepresentations, omissions, and misapplication of generally accepted accounting principles (GAAP), and asset misappropriation involves misstatements arising from employee theft and/or embezzlement.

Financial Reporting Fraud

The term accounting fraud is commonly interchangeably used with financial statement fraud or financial reporting fraud. Accounting fraud is slightly rigid in its definition, when the accounting practitioners themselves inflate the profit or sales figures and when the management of the firm manages the financial reports to suit and meet their needs by smoothing profits and managing earnings.

Based on KPMG Malaysia’s report on fraud in 2009 accounting fraud can be categorized into nine different categories. The most frequent accounting fraud is inconsistent application or interpretation of accounting policies or standards, followed by deferring expenses (e.g. to a future financial period). The next most common financial reporting fraud is unrecorded or concealed liabilities and expenses, followed by failure to provide for bad or doubtful debts and creating fictitious revenue. The sixth most common financial reporting fraud is inadequate or inappropriate omissions or disclosures followed by reclassifying or overvaluing assets. The least common method of committing financial reporting fraud is capitalizing operating expenses and bringing forward revenue (e.g. from a future financial period).
With accounting fraud on the rise, alternative measures must be looked into to retrain this issue. Rather than focusing only on greater transparency and more stringent control through improving and introducing new rules and regulations, moral reasoning ability should be addressed, where individuals justify their actions, where the negative effects on society and economy caused by accounting fraud can be mitigated by enhancing ethical sensitivity of employees. The nature of fraud committed by companies listed on Bursa Malaysia was the submission of false information to Securities Commission Malaysia in terms of incorrect disclosure of revenue and profit after tax.

International Accounting Standard Board’s (IASB) ‘principles-based’ accounting standards, promotes the concepts of ‘fair value accounting’ and ‘faithful representation’ that is supposed to be based on professional judgement. Therefore, if the preparers of the financial statements are unethical, misstatement of financial statements can be more common, as there will more room for the preparers of financial statements to report accounting numbers that are based on personal assumptions and valuations. Due to such possibilities, financial reports might not always show the actual picture of a firm’s value, paving way for creative accounting and earnings management. (Griffiths, 1987)

Jacob and Jorgensen (2007) stated that earnings management by managers are evident during the fourth quarter of the reporting period and Ahmad-Zalukki et al. (2011) stated that earnings management is evident in initial public offerings in Malaysia to attract prospective investor. Perols and Lougee (2011) proved that organizations can manipulate financial statements by managing their earnings using discretionary accruals or by committing fraud. Therefore, being ethically educated and conscious about ethical sensitivity can curtail earnings management from escalating into fraud.

Religiosity

McDaniel and Burnett (1990) posits that religiosity is a devotion to God by following the principles created by God, but for the capitalist, the gap between governments and religion in terms of the need of reconciliation is widening, because religion is seen to be not necessary to maintain good morality. We need religion to protect ourselves from unethical menace, therefore religiosity as a predictor of ethical sensitivity promotes ethical behavior that builds an individual’s ethical sensitivity intrinsically.

Gorsuch and McPherson (1989) identified two subcategories of extrinsic religiosity, personal extrinsic and social extrinsic, therefore research into the area of religiosity based on the questionnaire designed by Allport and Ross will have three constructs on religiosity, namely intrinsic, extrinsic personal and extrinsic social. Extrinsicly religious (social and personal) individual appear to be religious but do not practice the values of any particular religion. Extrinsic social religiosity inclined individuals, who take religion for social needs and extrinsic personal religiosity inclined individuals who take religion for personal reason is supposed to be ethically not sensitive. Intrinsic religiosity is to internalize religion teaching, therefore are more ethically sensitive and are supposed to be ethically sensitive (Gorsuch and McPherson, 1989; Vitell et al., 2005). O’Fallon and Butterfield (2005) reviewed a hundred and seventy-four studies on empirical ethical decision-making literature and concluded that only ten of it has religion as a construct, divided into religion per se and religiosity (level religiousness). Singhapakdi et al. (2000) posited that most of the scenarios that were used to examine the relationship between religion and the perception of ethical problem showed a positive relationship and other researchers also found that there is a significant relationship between moral reasoning and religious commitment (Wimalasiri et al., 1996; Clark and Dawson, 1996; Tse & Au, 1997; Muslichah et al., 2017), while Wagner and Sanders (2001) concluded that individuals with higher religious beliefs are more likely to be ethical.

Singhapakdi et al. (2000) posited that there was a significant positive relationship between religion and ethical intentions. To further strengthen the contestation on the inclusion of religiosity as a predictor of ethical sensitivity, Kennedy and Lawton (1996); Kennedy and Lawton (1998) concluded that a more religious individual has lower willingness to engage in any unethical behavior and O’Fallon and Butterfield (2005) concluded that religion has a positive relationship with ethical decision making. Bloodgood et al. (2007) found that students who attended worship services more frequently were less likely to cheat.

According to Allport (1950), religious motivation is differentiated by intrinsic and extrinsic religiousness, where the extrinsically motivated person uses his or her religion whereas the intrinsically motivated person lives his or her religion. Religiosity has also been a very important area of research in the marketing field, especially investigation about religiosity and consumer attitudes, where Vitell et al. (2005) concludes that intrinsic religiousness is a significant determinant of consumer ethical beliefs but extrinsic religiosity is not related to those beliefs.

Maisarah et al. (2009) conducted a study about religiosity and investigated its effect on the ethical sensitivity of Malaysia accounting students and concluded that students who attend religious schools were found to have higher levels of ethical sensitivity. Maisarah et al. (2009) also posited that there is connection between one’s religiosity and ethical sensitivity, where a person who strongly adheres to the rules of their religion may be inclined to have better ethical awareness or sensitivity on questionable situations.

Religiosity can be explored further to address its predictability of ethical sensitivity and hence addressing the core problem of accounting fraud. Religious belief influences general attitudes and understanding about how to run daily chores, approach towards work, poverty and leisure. Therefore, rather than just maximizing firms’ profit and maximizing shareholder’s wealth and firms’ value, organizations have to be more humane to its stakeholders to ensure the survival of the organization in the long run to enhance sustainability (Siegel and Marconi, 1989). Syariah based economy emphasizes on ethical, social, and religious factors to promote equality and fairness for the good of society collectively that ties together the importance of ethics, wealth distribution, social and economic justice and the role of the state to implement and regulates law (Dhumale & Sapcanin, 1999; Samad et al., 2005), compared to an economy that creates inequality in the distribution and accumulation of wealth that causes unethical behavior amongst stakeholders. When the distribution
of income is proper, there will be harmony in the economy and society, due to good ethical behavior and ethical sensitivity via religion and spirituality as the core of human governance, on which corporate governance should be built upon (Arfah & Azuiddin, 2009).

CONCLUSION

Understanding how ethical sensitivity works will assist in identifying methods to be used to teach ethics to students in the most effective way in imparting ethical conducts that are practical. These pedagogy of teaching will identify the most effective teaching style to ensure that the students are able to enhance their ability to be ethically sensitive and will assist policy makers, namely the Ministry of Higher Education of Malaysia (MOHE), Malaysian Institute of Accountants (MIA) and Malaysian Qualifications Agency (MQA), to restructure the accounting program’s syllabi to apply the methods to teach ethics in institutions of higher learning in Malaysia practically and not just in theory.

Policy makers should work together with the institutions of higher learning in Malaysia to inculcate ethics and corporate governance as a subject to embed accounting ethics in the curriculum of accounting program offered in the public and private tertiary education providers in Malaysia. Strategies and policies can be formulated to enhance the level of ethical sensitivity of accounting students at tertiary level in Malaysia to prepare them to be ethical and to be fit for the business environment, by inculcating religious studies relevant to accounting ethics to enhance their ethical sensitivity, so that human governance can be established.

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