

**FACTORS INFLUENCING ETHICAL JUDGEMENT OF AUDITORS IN  
MALAYSIA**

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**FACTORS INFLUENCING ETHICAL JUDGEMENT OF AUDITORS IN  
MALAYSIA**

**By  
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## **ABSTRAK**

Masalah etika seperti yang melibatkan Enron, Worldcom dan Global Crossing telah mempengaruhi keyakinan orang awam terhadap profesion pengauditan. Peningkatan amalan perniagaan tidak beretika telah menyedarkan kita tentang kejatuhan tahap etika masyarakat Malaysia. Kajian ini memfokus kepada auditor yang memikul tanggung jawab berat dalam mengaudit penyata kewangan. Tujuan utama kajian ini adalah untuk mengkaji faktor-faktor yang mempengaruhi keputusan etika auditor di Malaysia. Kajian ini juga mengkaji tahap perkembangan akhlak dan keputusan etika auditor. Faktor-faktor yang dikaji termasuk jantina, saiz firma, jawatan, jangkaan keadaan etika firma dan pendedahan kepada etika. Analisis telah dijalankan terhadap 76 soalan soal selidik yang diterima. Kajian mendapati bahawa sampel auditor dalam kajian ini yang mewakili populasi auditor di Malaysia mempunyai tahap perkembangan akhlak dan keputusan etika yang rendah daripada separuh. Daripada lima faktor yang dikaji, hanya jangkaan keadaan etika firma dan pendedahan kepada etika mempunyai hubungan signifikan dengan tahap keputusan etika auditor. Jangkaan keadaan etika firma mempunyai hubungan positif dengan tahap keputusan etika sementara pendedahan kepada etika mempunyai hubungan negatif dengan keputusan etika. Keputusan kajian ini berguna kepada Institut Akauntan Malaysia (MIA), kerajaan dan firma audit dalam usaha mereka untuk memperbaiki tahap etika auditor dan seterusnya memastikan keyakinan orang awam terhadap profesion pengauditan.

## **ABSTRACT**

Ethical issues like those involving Enron, Worldcom and Global Crossing have caused the public's confidence on auditing profession to decline. Many unethical business practices have alerted us of the deterioration of ethicalness among Malaysians. This study concentrates on auditors who have high responsibility in auditing firms' financial statements. This study's main aim is to examine the factors that influence ethical judgement of auditors in Malaysia. It also determines the level of moral reasoning and ethical judgement of auditors. The independent factors that are examined in this study include gender, firm size, position level, perceived ethical climate of the firm and exposure to ethics. Analyses were run for the usable 76 responses. This research found that the representative samples of auditors in Malaysia have level of moral reasoning and ethical judgement below average. From a list of five independent variables, only perceived ethical climate of the firm and exposure to ethics are significantly related to level of ethical judgement of auditors. Perceived ethical climate is found to have positive relationship with ethical judgement while exposure to ethics is found to have negative relationship with ethical judgement. The findings of this study will be useful for Malaysian Institute of Accountants (MIA), the government and also audit firms in their efforts to improve on the ethicality of the auditors and thus to ensure sustainability and keep public's confidence in auditing profession.

## **Chapter 1**

### **INTRODUCTION**

This chapter introduces the outline of the study. It covers the background of the study, problem statement, research objectives, research questions, definition of key terms, significance of the study and organization of the remaining chapters.

#### **1.0 Introduction**

Auditing is the accumulation and evaluation about information to determine and report on the degree of correspondence between the information and established criteria (Arens, Elder & Beasley, 2003). Auditors are required to make their own judgement on the fairness and truthfulness of the financial statements they are auditing.

In order to become an auditor one must possess a degree in accounting or must possess a professional qualification in accounting. He must also have the relevant working experience in accounting and must then apply to become a member of Malaysian Institute of Accountants before he can practice. There are various types of auditors such as: (1) external auditors, (2) internal auditors, (3) government auditors and (4) forensic auditors. There are various types of audits that can be performed by an auditor such as: (1) financial statements audits, (2) compliance audits, (3) operational audits and (4) forensic audits.

To conduct an audit, at least one member of the audit team must have an experience in the industrial sector of the company being audited. Auditors are individuals qualified to conduct audits. There are four levels of auditors in an audit

firm comprising of (1) audit juniors (2) seniors, (3) managers and (4) partners. An audit is performed in a team with the team comprising of all four levels of auditors. The audit juniors will be carrying out the work of tracing and vouching with the seniors supervising them. The work that is completed will then be handed over to the managers who will decide on whether the audit work conducted is satisfactory and whether the sample size is adequate, materiality level is adequate and that proper adjusting entry is made. The audit work will then be handed over to the partner for review before he signs the audit report. The final responsibility of the audit lies in the audit partner.

Audit performed must follow three broad standards and they are: (1) general standards, (2) fieldwork standards and (3) reporting standards.

General standards state that the audit work must be performed by persons who have adequate technicality, independent from the organization that the firm is auditing and must perform the audit work with due professional care.

Fieldwork standards state that all audits must be properly planned and supervised, there must be a proper evaluation of the internal control system and that sufficient and appropriate evidence must be gathered to assist the auditors in issuing their audit opinions.

Reporting standards state that the financial statements of the organization must comply to generally accepted accounting principles, that the principles are applied in a consistent manner and that appropriate disclosure is made and after taking all this into consideration, the auditors are then required to issue their audit opinion.

Auditing is a profession that requires its' practitioners to be ethical. The major responsibility in other disciplines is to assist the clients. How this assistance affects the rest of the society is not a major consideration. On the other hand, auditors are

confronted with more complicated professional issues. Although they are compensated by the client, their primary focus is to represent the public. An ethical conflict exists when the duties towards one group are inconsistent with responsibilities to another (Finn, 1988). This will lead to unethical conduct that will affect some of the parties involved. The questions to ask are “What is the right thing auditors should do?” and “Will auditors act ethically when they face ethical dilemmas?”

The pressure to perform well has increased in today’s competitive environment. All parties are striving to perform well and give a good impression to their employers as well as their colleagues. This applies to the auditing profession as well. Consequently, many in today’s work force are turning to unethical practices in an attempt to simply keep their jobs or derive some benefits for their companies (Labich, 1992).

Year 2002 has marked a history of the biggest corporate collapse in the United States. The Enron failure was blamed exclusively to the auditors. It has become a classic example of failed corporate governance and greed. Arthur Andersen has been criticized for the collapse of the three biggest corporations, namely Enron, Worldcom and Global Crossing. This phenomenon has affected the reputation and credibility of the auditing profession.

The Star newspaper dated 26<sup>th</sup> May 2006 reported that the jury of Enron scandal has found former Enron chief executives, Kenneth Lay and Jeffrey Skilling guilty of fraud and conspiracy over the collapse of Enron. Skilling, 52, was found guilty of 19 of 28 counts of fraud and conspiracy and faces a maximum penalty of 185 years in jail (The Star, page W39, 26<sup>th</sup> May 2006). Enron founder and long-time chairman Lay, 64, was found guilty of all six fraud and conspiracy charges and also of

federal bank fraud charges in a separate trial (The Star, page W39, 26<sup>th</sup> May 2006). Kenneth Lay faces a maximum of 165 years in jail. Both Kenneth Lay and Jeffrey Skilling will be sentenced on 11<sup>th</sup> Sept 2006.

Ethical problems not only happen in a particular place. It happens in almost every corner of the world. At our home ground, we were alerted with cases like Perwaja which involves greed. People's greed has led to the failure of the business. Other cases of unethical business practices like false reporting, corruption and bribery happen every now and then. We are alerted with these cases from our Malaysian newspaper, magazine and television news reporting.

The Star newspaper dated 19<sup>th</sup> April 2006 has published the result of a survey carried out by the Business Ethics Institute of Malaysia that aim to gauge the perception of trust among Malaysians in the integrity of several professions. Business Ethics Institute of Malaysia (BEIM) is an organization committed to promote ethics through education, inculcation and nurturing of values such as honesty, fairness, integrity and self-regulation among businesses. In the survey, there are a total of 2,074 respondents. These respondents were from 28 organizations in which four were government departments. Fifteen occupations were picked and included in the survey for the respondents to rank. Sixty-two percent of the respondents felt that politicians did not tell the truth. On the list of 15-category, politicians were ranked as the least trusted followed by business leaders, government ministers, ordinary men/women in the street, civil servants and polices respectively. Auditors were not included in the list of occupations. Should auditors were in the list, how would they fare? To what level does the public trusts auditors?

All the recent big corporate scandals involving Enron and others like Worldcom, Adelphia and Tyco had led to a US law, the Sarbanes Oxley Act (SOA)

which has the goal to overcome unethical business practices. SOA aims at strengthening corporate governance. It also attempts to regain investors' confidence in the US financial system. This law which was passed in year 2002 will give new breath to the US financial system. SOA applies to both publicly owned US companies and all companies that have registered equity or debt securities with the Securities Exchange Act of 1934. Besides that, it also regulates the Public Accounting Oversight Board (PAOB). PAOB oversees public company audits and establishes conflict of interest rules for securities analysis.

Many other countries in the world are also paying special attention to auditing issues. Country like Malaysia has followed suit to establish a board to oversee the audit firms in the country. The Accounting Oversight Board is the responsible board in Malaysia to do this. Although this board which consists of MIA members, academicians and practitioners is still very new, it has big responsibilities in overseeing the auditing profession in Malaysia.

In addition to the existing Anti-Corruption Agency (ACA), on 5<sup>th</sup> November 2003, our Prime Minister, Dato Seri Abdullah Ahmad Badawi has announced the Malaysian Institute of Integrity (IIM), which has the role to facilitate the aims and objectives of National Integrity Plan. The National Integrity Plan (NIP) and Institute Integrity Malaysia was launched on 23<sup>rd</sup> April 2004 by our Prime Minister at the Putrajaya Convention Centre. The overall objective of the NIP is to fulfill the fourth challenge of Vision 2020, namely, to establish a fully moral and ethical society whose citizens are strong in religious and spiritual values and imbued with the highest ethical standards (National Integrity Plan webpage, [www.iim.com.my](http://www.iim.com.my)).

IIM focuses its work on four sectors, namely, the public sector, the private sector, family sector and the community. It carries out its work through seven key

functions. The seven key functions are to conduct research related to the integrity of institutions and that of the community, to organize conferences, seminar and forums, to elicit opinions from various sectors on the progress made or on the obstacles face in implementing integrity, to publish and circulate printed material as well as to formulate and implement training and educational programs, to recommend new policies for the enhancement of integrity and ethics, to develop databases on integrity and ethics, to advice the government on strategies and programs in enhancing integrity and to establish networking with international organizations (National Integrity Plan webpage, [www.iim.com.my](http://www.iim.com.my)).

### **1.1 Background of the Study**

Ethics is defined as “a system of principles, by which human actions may be judged good or bad or right or wrong” (Concise Oxford Dictionary). Ethics is also defined as “enquiry into the nature and background of morality, where the term “morality” is taken to mean moral judgement, standards and rules of conduct” (Mazula, 2003; Taylor, 1975). Ethics is also being defined from a legal perspective. Pearce (1990) defined ethics as the correct procedures, based on the available facts and adequately explained.

For the purpose of this study, the pertinent factors are that the definition of ethics is concerned with human actions, that is behavior and individual make judgments (choose, decide) about their actions. Besides that, ethics is defined as “the rules of conduct recognized in respect of a particular class of human actions” (Concise Oxford Dictionary). The particular class of human actions with which this study is concerned is that of behavior in auditing firms.

Ethical issues have become a widely debated topic in our society. Society in general and auditing profession in particular has become increasingly concerned with ethics. Nowadays, many corporations have formalized their ethical views in writing, which contained statement of values, defined acceptable criteria for decision making and conveyed ground rules for behavior.

The auditing profession requires a high level of ethical behavior. Qualified and reliable people are admitted into this profession to carry out their responsibilities and perform services in the context of serving the public's interest. They are thought as "professionals". Although professionals have earned a level of respect, the key concept in this context is that professionals are also expected to adhere to a higher level of performance. The public trusts auditors to perform their assignments proficiently. Auditors must balance competing interests to perform their public service role. They should apply ethical decision making. Understanding the role of ethics is essential in the development of an auditing professional expected to exercise professional judgement in this dynamic environment.

The public has entrusted the members of the auditing profession to be among the people with high moral values and integrity. These people are required to maintain a high standard of professional conduct when auditing companies. There are some rules and regulations to monitor and govern the conduct of the auditors. An important attribute of professional judgement is the auditor's ability to make fair and just judgements. According to Mautz and Sharaf (1961) and Hansen (1990), auditor judgement is similar to that of a judge where auditors' judgements have to be fair, objective, impartial and independent.

Society has conferred on the auditing profession a special legislative franchise to provide independent financial audits of large organizations on the condition that the

profession complies with the codes of ethical conduct (Mautz, 1984, 1988). The auditor's opinion is based on professional judgement that gives credibility and integrity to the financial statements used by the community, i.e. shareholders, investors, unions, retirees, financial institutions, government bodies, et cetera. Hence, the economic well being of the community relies upon independently audited financial statements. The auditors have to keep the public's confidence in them. If auditors are not ethical, the public will not have confidence in them. This will affect the economic well being of the country.

Moral values and ethical behavior are two different things. Moral values are generally associated with a personal view of values while ethics on the other hand is concerned with how a moral person should behave. Moral values can reflect the influence of religion, culture, family and friends. What a person perceives as morally right might not be perceived by others to be morally right and it is unethical to impose our personal moral values on another. Ethical values are beliefs concerning what is morally right and proper as opposed to what is simply correct or effective. Ethical values transcend cultural, religious or ethnic differences and it embraces a more universal worldview. The Josephson Institute of Ethics recommends six core ethical values to abide by. They include trustworthiness, respect, responsibility, fairness, caring and citizenship. Whether the circumstance is business or life, ethical values should be ground-rules for behavior. When we live by these values, we are demonstrating that we are worthy of trust.

Different people have different levels of moral reasoning. Moral schemas, or frameworks, that reside in long-term memory, are formed through a person's recognition of similarities and recurrences in his/her sociomoral experiences, much of which occurs through education and social experience. Ethical climate in the

organization and exposure to ethical education will affect the level of ethical judgement of the auditors. If a firm does not enact and enforce codes of ethics, policies, and directives that specify, discourage, monitor, and correct unethical behavior, the auditors will be likely to involve in unethical conducts.

A firm's ethical climate dictates its ethical values and the behaviors expected, and it has been shown to influence the ethicalness of its members (Wimbush & Verbeke). It has long been suggested that ethics be incorporated into the organization (Robin & Reidenbach, 1987), and creating an ethical climate within the organization may provide one means for doing so.

Personal factors like position level and exposure to ethics is different from one individual to another. If parents put much weight to the upbringing of their kids by teaching them what is right and wrong, emphasizing correct things the kids should do and setting good examples themselves, their kids will be exposed to good ethics. Parents as the closest and most important people to their kids should instill good moral values and teach them good ethics. Besides the influence of parents to the kids, environment and peers also influence the kids. They are also exposed to ethics in schools, colleges, universities and work place. Good moral values and wide exposure to good ethics will lead to good ethical conduct.

Gender differences have become unclear in today's society if compared to the past due to the reason that women are claiming equality. However, certain traits that naturally already instilled in both genders are hard to change. Women are said to be more meticulous and place more importance to relationship if comparing to their male counterparts. Men are said to be more result-oriented. For women, morality is primarily a matter of "caring" and "being responsible" for others with whom one is

involved in personal relationships, and not a matter of adhering to impartial and impersonal rules (Gilligan, 1982).

Females appear to possess higher ethical judgment regarding violating environmental pollution standards, bribing foreign customers, corporate espionage, impartial promotion practices, ignoring product safety issues, hiring less qualified male applicants, and unacceptable CEO compensation increases (William, Carlos, Joseph & Justin, 1999). On the other hand, males appear to adopt a stricter ethical stance than females regarding collusion in construction bidding situations and illegally copying computer software (William, Carlos, Joseph & Justin, 1999).

Bigger firms are believed to have better ethical climate than smaller firms. Larger organizations are more subject to bureaucratic control and rules (Child, 1973; Indik, 1965). This perhaps makes large firms more constrained in their choices (Gunz, Gunz & McCuthen, 2002). On the other hand, smaller firms do not have so much control and rules to abide to. Clients of smaller firms are small companies which do not pay much attention on ethical judgement.

## **1.2 Problem Statement**

Despite the growth in size and expertise, the auditing profession is not without problems. It existed in an increasingly materialistic, skeptical society where ethical value is treated at a discount. The profession has reached a critical period, being under constant public scrutiny. One of the main factors why this profession is under close scrutiny is the decline of professional ethics, which has been considered the basis of public confidence. Professionals including auditors are expected to be ethical and they represent the public's interest. Auditors' actions influence not only the owners of the company they are auditing but also other stakeholders. If professionals who the public

trusts do not live up to the public's expectation, this will affect the public's confidence. We were made aware of cases on downfall of auditing. Because of the materialistic nature of human beings, we are tempted to engage in unethical conducts. There are cases whereby auditors were dishonest and carried out unethical conducts just to satisfy their personal interests or interest of the company. Cases like those involving Arthur Anderson are really testing the auditors' professionalism.

Ethics in its broader sense, deals with human conduct in relation to what is morally good or bad, right or wrong. To determine whether a decision is good or bad, the decision maker must then estimate the outcome of the decision. A good question to ask when faced with an ethical dilemma is "Will my actions be fair and just to all parties affected?" The profession provides guidance for auditors faced with ethical dilemmas through professional standards, but the ability of auditors to adhere to prescribe behavior has been questioned.

Moral reasoning differs from one person to another. Individual's moral reasoning is affected by the environment he/she grows up. As such, each individual's moral values development is unique. It is how the individuals perceive things from their own perspectives.

Ethical climate of the firm dictates the thinking of the employees. If a firm punishes unethical conduct, the employee will definitely think twice if they have the intention to carry out an unethical act. If the firm is not strict about ethicality of its employees' actions, the employees will not take ethical issues seriously. Therefore, it is very important for a firm to emphasize on ethics.

With the various cases of unethical conduct involving auditors which happened worldwide, we need to examine the quality of audit conducted by audit firms. Hearing cases of dishonesty and misconduct from auditors, the level of public

confidence is affected. Actions need to be taken to restore the public's confidence and also to take care of the stakeholders' interest. If there is good corporate governance but auditors do not work properly towards it, it will not make a point. Quality of audit should also be a concern.

Talking from a realistic point of view, in spite of all the codes set out by professional bodies, there are still cases related to unethical conduct of auditors. What influences auditors' decision making? Auditors are supposed to be ethical in their decision making and provide fair and objective judgements. The questions are "Are auditors really ethical in their decision making?" and "What influences ethical judgement of auditors?" That is why this study is carried out.

### **1.3 Research Objectives**

This study attempts to achieve six objectives as follows:

1. To examine the level of ethical judgement of Malaysian auditors.
2. To examine the level of moral reasoning of Malaysian auditors.
3. To examine the relationship of auditors' moral reasoning and their ethical judgement.
4. To examine the influence of gender, firm size, position level, perceived ethical climate of the firm and exposure to ethics to moral reasoning of auditors.
5. To examine the influence of gender, firm size, position level, perceived ethical climate of the firm and exposure to ethics to ethical judgement of auditors.

6. To examine whether moral reasoning mediates the relationship of gender, firm size, position level, perceived ethical climate of the firm and exposure to ethics to ethical judgement.

#### **1.4 Research Questions**

The purpose of this study is to answer the following six questions:

1. What is the level of ethical judgement of Malaysian auditors?
2. What is the level of moral reasoning of Malaysian auditors?
3. Are there any relationship between moral reasoning and ethical judgement?
4. Do gender, firm size, position level, perceived ethical climate of the firm and exposure to ethics influence moral reasoning of auditors?
5. Do gender, firm size, position level, perceived ethical climate of the firm and exposure to ethics influence ethical judgement of auditors?
6. Does moral reasoning mediate the relationship of gender, firm size, position level, perceived ethical climate of the firm and exposure to ethics to ethical judgement?

#### **1.5 Definitions of Key Terms**

The key terms in this study include moral reasoning, ethical judgement, perceived ethical climate of the firm and exposure to ethics.

##### ***Moral Reasoning***

Moral reasoning is defined as those interpersonal behaviors that are held to be right or wrong independent of governing social rules, and maintained as universally

binding (Turiel, 1983). Moral reasoning is measured using the Defining Issues Test (DIT; Rest, 1979a). DIT is a popular and reliable psychometric instrument for measuring individual moral development as detailed in Kohlberg's six stage framework.

### ***Ethical Judgement***

Ethical judgement is an individual's decision as to whether something is considered ethical or unethical, right or wrong (Schwepker, 1999). Ethics is an act that is judged as proper based on a standard of right and wrong (Alderson & Maxwell, 1994).

### ***Perceived Ethical Climate of the Firm***

Climate refers to the ways organizations operationalize routine behaviors and the actions that are expected, supported and rewarded (Schneider & Rentsch, 1988). Ethical climate has been defined as "the prevailing perceptions of typical organizational practices and procedures that have ethical content (Victor & Cullen, 1988)." They also define ethical climate as "the shared perception of what is ethically correct behavior and how ethical issues should be handled" within an organization (pp. 51–52), and state that ethical climate "helps to determine which issues organization members consider to be ethically pertinent and what criteria they use to understand, weigh, and resolve these issues" (Cullen et al., 1989, p. 51).

Ethical climate can be defined as "the policies, practices, and procedures in an organization that are rewarded, supported, and expected regarding ethics" (Schneider, 1987). In other words, ethical climate is not focused on "what is right or wrong" but rather focuses on the things that organization members perceive the organization to

see as ethical. Top management appears to play a critical role in the formation and perpetuation of a firm's ethical climate (Deal & Schein).

Ethical climates represent a subset of the array of work climates (Cullen, Victor & Bronson, 1993; Victor & Cullen, 1987, 1988). They refer to the institutionalized organizational practices and procedures that define what is considered right or wrong within the organization. They include the prevailing perceptions and beliefs regarding typical organizational practices and procedures that have ethical content (Victor & Cullen, 1987, 1988).

### ***Exposure to Ethics***

Exposure means the act of subjecting someone to an influencing experience (WordReference.com). Exposure to ethics concerns with the level of rules and conducts that have been made known to the individual. Basically exposure to ethics concerns about ethics education.

### **1.6 Significance of the Study**

Effectiveness and reliability of financial information has increasingly become an essential activity to ensure that auditors have faithfully audited the financial information given by the company. However, there are factors influencing ethical judgements of auditors in making the right decisions. Therefore, this study will contribute to the factors that influence auditors to make ethical judgement. It is also hoped that the findings of this study would contribute to the literature of the ethical judgement in auditing industry.

The Cognitive Moral Development Theory (CMD) is applied to auditing context to understand the moral reasoning level of auditors. The literature on moral

reasoning in Malaysia will be extended to using the Defining Issues Test (DIT) to measure moral reasoning in Malaysian context.

This study will dictate whether auditors in Malaysia are ethical in carrying out their auditing jobs and also measure how exposed are them to ethics. We will be able to tell MIA whether auditors are aware of MIA ethics. We will also make aware to MIA on the factors that influence auditors' ethical judgement. MIA will be able to design plans to improve auditors' ethical judgement from the result of this research. They will know the areas that they should focus on in order to improve on the level of moral reasoning and ethical judgement of auditors.

Besides that, in view of the National Integrity Plan, we can determine whether this plan is being indirectly followed and practiced. The result of this research will also be useful for Malaysian Institute of Integrity (IIM). This research will provide more insight into literature on ethical judgement in Malaysia.

## **1.7 Organization of the Remaining Chapters**

This research is presented in six chapters including this introduction chapter. The next chapter, which is Chapter Two discusses about moral reasoning. It covers discussion about Cognitive Development Theory and Defining Issues Test 1 (DIT 1). Chapter Three consists of Literature Review which discusses about the theories, theoretical framework and hypotheses. Chapter Four discusses the methodology of the study. It details the research design, the variables, the population and the sample, the procedure, the measures and the data analyses. Chapter Five presents the analyses done for the study and also the findings of the study while Chapter Six discusses the interpretation and recapitulation of the study, implications of the findings, limitations of the study and suggestion for future research. It then concludes the research.

## Chapter 2

### MORAL REASONING

#### 2.0 Introduction

The chapter will be defining Cognitive Development Theory which outlines the stages of moral development, discusses about moral reasoning as measured by the Defining Issues Test 1 (DIT 1), highlighting consistency and reliability test of DIT 1 and lastly explains scoring of DIT 1.

#### 2.1 Cognitive Development Theory

The cognitive-developmental perspective traditionally has focused on understanding the way individuals develop their cognitive conception of morality. Morality is the individual's definition of what is "good" or "right". Four characteristics can be used to describe the cognitive-developmental perspective: cognitive, structural, developmental and sequential. The approach is *cognitive*, as it acknowledges that reasoning is an integral component of the moral decision process. It is *structural* as it focuses on the cognitive structures that delineate the various levels of moral reasoning. It is *developmental*, as it traditionally has focused on the acquisition of the cognitive structures over time. Finally, it is *sequential* in that development may progress only in one direction (Ponemon & Gabhart, 1993). The cognitive-development approach to moral decision making has been summarized by the metaphor of a staircase: moral development advances like steps on a staircase, development progresses by going up the staircase, one step at a time and always in the same order (Rest, 1994).

Kohlberg's Theory of Moral Development (1981, 1984) creates a stage for moral reasoning where he identifies three levels of moral development: pre-conventional, conventional and post-conventional, with two stages within each level. It provides a theory that explains the human decision-making process prior to ethical behavior.

At Level One: Pre-conventional Stages, the first two stages (stage 1 and 2); individuals are able to respond to rules and social expectations and can apply the labels good, bad and wrong. Right and wrong are interpreted in terms of the pleasant or painful consequences of actions or in terms of the physical power of those who set the rules (Manual, 2002). Their behavior is driven by a desire to avoid punishment or to earn rewards.

At Level Two: Conventional Stages (stage 3 and 4); the individuals are more concerned with societal expectations. Maintaining the expectation of one's own family, peer group, or nation is now seen as valuable in its own right, regardless of the consequences (Manual, 2002). Doing what is right is motivated by the needs to be seen as a good performer in one's own eyes and in the eyes of others (Manual, 2002).

At Level Three: Post-conventional Stages (Stage 5 and 6), the individual no longer simply accepts the values and norms of the group to which the individual belongs. Instead the individual now tries to see situations from a point of view that impartially takes everyone's interest into account. Their behavior is driven by universal ethical principles such as justice, rights and honesty.

Kohlberg's theory helps to understand how individual moral capacities develop and reveals how individual can become increasingly sophisticated. It is crucial to understand how individual use and understand the moral standards that they hold.

Research by Kohlberg shows that, although people generally progress through all the stages in the same sequence, however not everyone progresses through all the stages.

Table 2.1

*Kohlberg's stages of moral development*

Level One: Pre-conventional Level	
Stage One	Punishment and Obedience Orientation
Stage Two	Instrument and Relativity Orientation
Level Two: Conventional Level	
Stage Three	Interpersonal Concordance Orientation
Stage Four	Law and Order Orientation
Level Three: Post-conventional, Autonomous or Principles Level	
Stage Five	Social Contract Orientation
Stage Six	Universal Ethical Principles Orientation

**2.2 Moral Reasoning and Defining Issues Test 1 (DIT 1)**

The Defining Issues Test, DIT (Rest 1979a) was used for measuring this variable. DIT consists of six series of questions asking the respondents to make an action about the particular social dilemmas. In this study, the short form DIT 1 was used. It highlighted only three social dilemmas. The DIT presents a number of considerations for each dilemma that reflects reasoning at the different stage levels of moral development (Kohlberg, 1969). The standard measure for each dilemma is the “P-score”. It is calculated from ranking assigned to principal items of consideration in the resolution of several short cases describing hypothetical moral dilemmas.

The DIT is less formalistic resulting in more conceptual definitions of stages (Rest, Narvaez, Thoma & Bebeau, 1999). The central premise of the DIT is that at different points of development, people decide how to solve dilemmas dissimilarly. This is because they not only interpret the dilemmas differently, but they also understand what is right and fair differently and define the critical issues distinctively (Rest, 1986).

The DIT utilizes Kohlberg's story dilemmas accompanied by a range of prototypic statements which set out to define the heart of each dilemma. Subjects to whom the test is administered are required to rank the four most important issues in order of importance. Each issue statement has a corresponding score which can be coded and the scores aligned to a specific stage in Kohlberg's model.

The P-score on the DIT is the most widely used measure of an individual's level of moral development. The P for principled score is the percentage of principled moral reasoning an individual uses to determine how a hypothetical moral dilemma ought to be resolved. It is calculated from the ranking assigned to principle items of consideration in the resolution of the short cases describing the hypothetical moral dilemmas.

The four items of consideration which a subject ranks as most important are assigned a specific number of points (four points for first rank, three points for second rank, two points for third rank and one point for fourth rank). The P-score is computed by adding the total points allocated to principled items for all dilemmas, and then converting the total points to a percentage of total possible points (Rest, 1986). Davison and Robbins (1978) reports that, based on the six-story DIT, the reliability of the P score is generally in the upper seventies and eighties for both test-retest reliability and internal consistency (as measured by Cronbach's alpha).

Table 2.2 shows the column or stage of each of the 12 items asked in the three dilemmas (three cases). For example, item one or statement one of the first case which reads “*Whether a community’s laws are going to be upheld*” is a statement to measure Stage 4 of Kohlberg’s CMD. Therefore, number 4 appears for item 1 for Case 1. The second statement “*Isn’t it only natural for a loving husband to care so much for his wife that he’d steal?*” is to measure Stage 3 of Kohlberg’s CMD. Therefore, number 3 appears for item 2.

Table 2.2

*Table of CMD Stages for each item of DIT 1 (short-form)*

	Item											
	1	2	3	4	5	6	7	8	9	10	11	12
Case 1	4	3	2	M	3	4	M	6	A	5A	3	5A
Case 2	3	4	A	4	6	M	3	4	3	4	5A	5A
Case 3	4	4	2	4	M	5A	3	3	5B	5A	4	3

Defining Issues Test, James Rest (1979)

The respondents were requested to rank the four most important statements for each case after rating each statement. If the first statement of Case 1 is ranked as the most important, then a point of 4 will be given. The second most important statement is given 3 points, the third most important statement is given 2 points and the fourth most important statement is given 1 point. This also applies to Case 2 and Case 3.

Table 2.3

*Table for CMD Stages for each statement of Short-form DIT 1 – Case 1 (The Drug)*

CMD Stages	Statements
4	Whether a community's laws are going to be upheld?
3	Isn't it only natural for a loving husband to care so much for his wife that he'd steal?
2	Is Encik Tan willing to risk getting shot as a burglar or going to jail for the chance that stealing the drug might help?
M	Whether Encik Tan is a professional wrestler, or has considerable influence with the professional wrestlers?
3	Whether Encik Tan is stealing for himself or doing this solely to help someone else?
4	Whether the druggist's rights to his invention have to be respected?
M	Whether the essence of living is more encompassing than the termination of dying, socially and individually?
6	What values are going to be the basis for governing how people act towards each other?
A	Whether the druggist is going to be allowed to hide behind a worthless law which only protects the rich anyhow?
5A	Whether the law in this case is getting in the way of the most basic claim of any member of society?
3	Whether the druggist deserves to be robbed for being so greedy and cruel?
5A	Would stealing in such a case bring about more total good for the whole society or not?

Defining Issues Test, James Rest (1979)

Table 2.4

*Table for CMD Stages for each statement of Short-form DIT 1 – Case 2 (The Prisoner)*

CMD Stages	Statements
3	Hasn't Encik Salleh been good enough for such a long time to prove he isn't a bad person?
4	Everytime someone escapes punishment for a crime, doesn't that just encourage more crime?
A	Wouldn't we be better off without prisons and the oppression of our legal system?
4	Has Encik Salleh really paid his debt to society?
6	Would society be failing what Encik Salleh should fairly expect?

Table 2.4 (Continued)

M	What benefits would prisons be apart from society, especially for a charitable man?
3	How could anyone be so cruel and heartless as to send Encik Salleh to prison?
4	Would it be fair to all prisoners who had to serve out their full sentences if Encik Salleh was let off?
3	Was Puan Rokiah a good friend of Encik Salleh?
4	Wouldn't it be a citizen's duty to report an escaped criminal, regardless of the circumstances?
5A	How would the will of the people and the public good best be served?
5A	Would going to prison do any good for Encik Salleh or protect anybody?

Defining Issues Test, James Rest (1979)

Table 2.5

*Table for CMD Stages for each statement of Short-form DIT 1 – Case 3 (The Newspaper)*

CMD Stages	Statements
4	Is the principal more responsible to students or parents?
4	Did the principal give his word that the newspaper could be published for a long time, or did he just promise to approve the newspaper one issue at a time?
2	Would the students start protesting even more if the principal stopped the newspaper?
4	When the welfare of the school is threatened, does the principal have the right to give orders to students?
M	Does the principal have the freedom of speech to say “no” in this case?
5A	If the principal stopped the newspaper would he be preventing full discussion of important problems?
3	Whether the principal's order would make Maniam lose faith in the principal?
3	Whether Maniam was really loyal to his school and patriotic to his country?
5B	What effect would stopping the paper have on the student's education in critical thinking and judgment?
5A	Whether Maniam was in any way violating the rights of others in publishing his own opinions?
4	Whether the principal should be influenced by some angry parents when it is the principal that knows best what is going on in the school?
3	Whether Maniam was using the newspaper to stir up hatred and discontent?

Defining Issues Test, James Rest (1979)

### **2.3 Internal Reliability Check of the Short-form of Defining Issues Test 1**

For each respondent's response, there are two internal reliability checks. One is the "M" score and the other one is the Consistency Check.

"M" items were written to sound lofty and pretentious but not to mean anything to the respondents. These items do not represent any stage of thinking but rather represent a respondent's tendency to endorse statements for their pretentiousness rather than their meaning. In the questionnaire, respondents were made known of the instructions before they attempt to answer the three dilemmas in Section C. On the instructions to the respondents, attention was drawn to the possibility that some items may "sound like gibberish" or that one may be unsure about its meaning. In these cases, respondents were instructed to rate and rank the items low. If respondents consistently rate and rank the "M" items high, it can not be said for sure that the respondents has the proper test taking set, and the protocol must be discarded. For questionnaires using the short-form DIT like in this research, if "M" raw score of greater than 4, the questionnaires will be eliminated. For an example, in Table 2.9 in the next sub-section, M score is zero. Therefore, this questionnaire passed the M score check.

The second reliability check on the responses is the Consistency Check. This involves a comparison of a respondent's ratings with a respondent's rankings on the four most important items. If the respondent ranks an item the most important, there should be no higher rated items than the most important item. Tie in rating with the most important item is acceptable. Similarly, if a respondent ranks an item second most important, then his/her rating for that item should have no other items rated higher except the item ranked most important. There are inconsistencies between the respondent's rankings and ratings if there are items not chosen as first and second