

ASSESSING THE RELATIONSHIP BETWEEN HUMAN CAPITAL AND SPIRITUAL CAPITAL ON AUDIT FIRM'S PERFORMANCE

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ABSTRACT

Audit firm's performance is frequently associated with a high level of human capital and spiritual capital. Hence, the importance of these two values is always the core concern within audit firms to ensure that their professional services offered are consistent with the standard requirements in the profession. This study aimed to determine the relationship between human capital and spiritual capital on audit firm's performance. This study was conducted on audit firms operating in Johor Bahru, Malaysia. The primary data

was generated through survey questionnaires which were distributed to auditors attached to the audit firms. Statistical analysis techniques using SPSS which includes descriptive analysis and Pearson correlation analysis were used to determine the relationship of human capital and spiritual capital on the performance of audit firm. The results revealed that both human capital and spiritual capital posed significant positive relationship on audit firm's performance. The result suggests that the top management of audit firms should acknowledge and utilize human capital and spiritual capital to enhance their performance when providing professional services. Finally, several recommendations for future research have been put forward to further investigate the exponential effect of human capital and spiritual capital on the performance of audit firms.

Keywords: human capital, spiritual capital, audit firm's performance

1. INTRODUCTION

In Malaysia, the role of human capital is pivotal to the development of a world-class capital market (Muhammad and Ismail, 2009). Importantly, the development of human capital is also an enrichment of the mentality and intellectual capacity of a nation which is one of the areas targeted under the Ninth Malaysian Plan. Hurwitz *et al.* (2002) stated that a firm's profitability is derived primarily from human capital. A firm that possesses skilled employees and experienced managers is expected to yield higher performance because its manpower can bring skills and capabilities into full play (Bontis *et al.*, 2000; Rhyne *et al.*, 2002). While on the other hand, there is another element from core concept of intellectual capital namely spiritual capital which receives increased consideration as a major factor that contributes to firm's performance (Zohar and Marshall, 2004). Spiritual capital is relatively a new component within the areas of intellectual capital mainly due to limited experimental evidence on it. Likewise, Finke (2003) highlighted that spiritual capital is a new emerging concept which came after religious capital however it has no specifically clear definition or measurement related to it. Hence, it is equally important to

further explore on the exponent influence of spiritual capital on performance.

2. LITERATURE REVIEW

2.1 The Important Values of Human Capital and Spiritual Capital

Human capital and spiritual capital are the components that emerged from the core concept of intellectual capital (Bontis *et al.*, 2000; Tayles *et al.*, 2007). Human capital is the most important asset that resides within a firm. It represents the human factor in an organisation where by combination of intelligence, skills, knowledge, aptitudes and expertise that gives the organisation its distinctive character which those traits contributing to production and profitability, thus improve organizational performance (Bontis *et al.*, 2000; Tayles *et al.*, 2007; Gazor *et al.*, 2013). Additionally, Becker (1993) states that human capital is the key determinant in explaining the rise and fall of nations as well as becoming the main factor in determining individual income.

Spiritual capital is a new emerging concept from the bigger intellectual capital concept. Most past studies emphasize on the relationship between spirituality and religiosity on performance which reveals that a better spiritual condition does improve

performance (Osman *et al.*, 2012). Generally, spiritual capital is defined as intangible values that create wealth which includes trust, faith, commitment, determination and emotion of individual of which at the same time it carries organizational vision, direction, guidance, principles, values and culture (Porth *et al.*, 1999; Zohar and Marshall, 2004; Long and Mills, 2010). All these values will eventually help organizations to achieve their business objectives or goals.

2.2 Associating Human Capital and Spiritual Capital on Audit Firm's Performance

Human capital is one of the most important assets of a firm. As for audit firm, auditors play a key role in exercising the right judgment on the reliability of a financial statement. Managers must ensure that they have appropriate and adequate personnel equipped with the required competencies and professional characteristics, so that they perform in accordance with the standards, legal requirements and expectations of the public (Cheng *et al.*, 2008). In addition to the later claims, human capital is among the core resource in public accounting compared to capital resources, organizational resources

and financial capital resources, which leads to sustainable competitive advantage and long term performance of accounting firms. Consistent to the added values of human capital, spiritual capital is equally important as a positive value on audit firm's performance. Indeed, values such as honesty, integrity, determined, trust, and high commitment do help to create organizational wealth (Zohar and Marshall, 2004; Desa *et al.*, 2011). These values are vital particularly for auditor in complying with the guidelines on professional ethics where auditors are required to maintain high integrity, objectivity, maintain good professional behaviour and independence.

While, according to Devinney *et al.* (2005), performance is a commonly area studied in organizational research which is rarely being explicitly considered or justified. He also emphasized that firm's performance outcomes are within specific areas such as financial profits (return on assets), market performance (sales, market share) and shareholder return (total shareholder return, economic value added). Generally, performance measurement can be defined as a basic management technique and had widely developed in large firms as to measure performance. Rompho and Siengthai (2012) highlighted that

performance measurement has been found to have positive linkage with human capital indicators. In addition, it enhances the effectiveness of a firm's performance through individual and organizational learning.

A number of academic studies have examined and presented evidence of performance measurement practices in various countries related to the audit environment. Cheng *et al.* (2008) studied the association between auditor quality and human capital. However, there is lack evidence relating to human capital or spiritual capital on audit firm performance. One plausible reason for the existence of this gap is the lack of public data available on audit firm activities. In some cases, previous research indicate different methods in measure performance such as impact of training, education, skills and competencies on financial performance, profitability and non-financial performances (Bontis *et al.*, 2000; Tayles *et al.*, 2007). Performance measurement is commonly associated with intellectual capital components (including human capital, structural capital, relational

capital and spiritual capital) whereby these components do influence on firm's performance.

3. THE RESEARCH FRAMEWORK

Based on the discussed literature on human capital, spiritual capital and firm's performance in the previous section, the research questions set in this study are:

1. Does human capital pose a significant positive relationship on audit firm's performance?
2. Does spiritual capital pose a significant positive relationship on audit firm's performance?

Figure 1 illustrates the research framework of this study. This framework assumes that there is a direct positive and significant relationship between human capital and spiritual capital on audit firm's performance. This research applies the assumption that human capital and spiritual capital, independently has significant positive relationship with audit firm's performance.

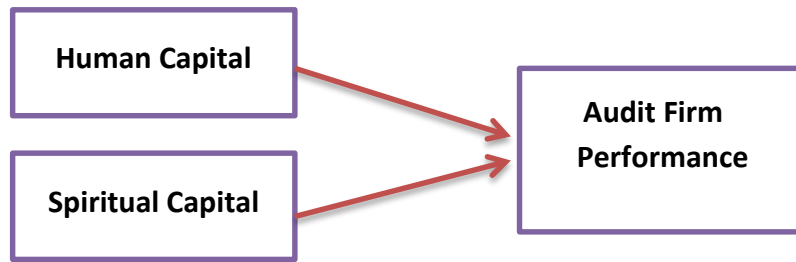


Figure 1- Research Framework

4. METHODOLOGY

In this study, two components of intellectual capital namely, human capital and spiritual capital are considered as independent variables while audit firm's performance is the dependent variable. A quantitative method of inquiry was adopted in order to achieve the stipulated objectives. The instrument used in this study is questionnaire which consists of 34 items and it was divided into four sections. Section A taps questions relating human capital. Section B was related to spiritual capital. Whilst, section C comprising the elements of firm's performance. Finally, for the section D captures information of the respondents and the firm.

This study focused on audit firms located in Johor Bahru, Johor. Statistics obtained from Malaysian Institute of Accountant (MIA) has listed over 681 audit firms as their members throughout Malaysia

included Sabah and Sarawak. However, this study only selected audit firm in Johor which has been listed in MIA with 127 audit firms around this state. Due to time constraint, audit firms located in Johor Bahru were chosen to participate in this study. Primary data were gathered via survey questionnaire. Auditors attached to the firms were the respondents of this study. They were required to rate their perceptions on the given statements on a Likert-scale between 1 (Strongly Disagree) to 5 (Strongly Agree). Finally, 52 questionnaires have been collected in 2 weeks, giving the response rate of 69%.

5. RESULTS

Data gathered were analysed using the Statistical Package for the Social Sciences (SPSS) software. Analyses performed include descriptive analysis and Pearson correlation analysis. Cronbach's Alpha was

also done to confirm the reliability of the variables in the questionnaire.

5.1 Cronbach’s Alpha Test of Reliability

Reliability test among variable should be conducted in order to test the dependent of variables use in a data. Based on reliability test performed, all variable ranked above 0.7 the threshold (Pallant, 2007). The cronbach’s alpha for human capital (8 items) is 0.857, spiritual capital is 0.894 (10 items) and audit firm performance (10 items) is 0.886. Value of 0.8 above shown they have very good internal consistency reliability for the scale with this sample. As mentioned by

Pallant (2007), values above 0.7 are considered acceptable; however, values above 0.8 are preferable.

5.2 Descriptive Analysis

Table 1 shows descriptive results on human capital statements. The highest mean achieved are 4.00 on the statement of ‘Possessing ideal knowledge and skills’ and ‘Experts in job functions’. This is followed by ‘Staff are able to develop new ideas, knowledge and innovations to the firm’ with the mean score of 3.98. Overall, the mean of all the items are above 3.0 which indicate that the respondents are inclined into agreeing with the given statements.

Table 1- Findings on Human Capital

Item	N	Mean	Standard Deviation
Work contribution among staff	52	3.85	0.751
Recruitment plan among employees	52	3.62	0.953
Knowledge sharing	52	3.96	0.839
Encourage staff’s education and training	52	3.71	0.957
Competent in possess ideal knowledge and skills	52	4.00	0.626
Experts in job functions	52	4.00	0.626
Able to develop new ideas	52	3.98	0.727
Possess knowledge on key business risk	52	3.92	0.737

While, Table 2 shows the results pertaining to spiritual capital. Two items which are ‘sincerity and truthfulness’ and

‘promoting good ethics’ gained the highest mean (4.25), indicating auditor’s high agreement on both statements. The lowest

mean calculated was 3.77 on the item ‘support community services and activities to a caring culture and society’. The rest of

items have mean of 4.00 and above, showing that respondents agree on the statements.

Table 2 - Findings on Spiritual Capital

Item	N	Mean	Standard Deviation
Sincere, honest and truthful on duties	52	4.25	0.590
Always motivated and committed in perform	52	4.23	0.509
Share common belief to achieve firm's goals	52	4.04	0.713
Competent, independent, and maintain high integrity	52	4.17	0.617
Ensure firm's asset are safeguarded from mismanagement	52	4.12	0.646
Seeks ways promote good ethics and values within firm	52	4.25	0.556
Support community services and activities to a caring culture and society	52	3.77	0.703
Trust, mutual respect, understanding part of firm culture	52	4.00	0.714
Being highly ethical is core value of firm people	52	4.08	0.788
Religious values affect individual performance	52	4.00	0.714

5.3 Pearson Correlation

Pearson correlation analysis was conducted to assess the relationship between independent and dependent variables. Findings showed in Table 3 revealed that both the human capital and spiritual capital have significant positive relationship with audit firm’s performance. The correlation between human capital, spiritual capital and audit firm performance were significant at

the $p = 0.01$ level (2-tailed). Importantly, it has shown that there exists a positive relationship between the tested variables. Specifically, human capital ($r=0.605^{**}$) shows the strongest positive relationship with audit firm’s performance, followed by spiritual capital ($r=0.597^{**}$). Additionally, between both human capital and spiritual capital, there is a significant positive relationship ($r= 0.688^{**}$). Generally, the results suggest that the level of human capital and spiritual capital are relatively

high in audit firms which then bring a positive impact of audit firm’s performance.

Table 3 – The Relationship between Variables

Variables	HC	SPC	AFC
HC	1	0.688*	0.605**
SPC		1	0.597**

** Correlation is significant at the 0.01 level (2-tailed)

Note: AFP=Audit Firm Performance; HC=Human Capital; SPC=Spiritual Capital

6. DISCUSSION AND CONCLUSION

This study aimed to examine whether there exist a relationship between human capital and spiritual capital on audit firm’s performance. Statistical analysis (Pearson correlation) performed revealed that both human capital ($r = 0.605$, $p < 0.01$) and spiritual capital ($r = 0.597$, $p < 0.01$) do have a significant positive relationship with audit firm’s performance. Consistent with notions by Bontis *et al.* (2000) and Gazor *et al.* (2013), this signifies that values in human capital such as intelligence, skills, knowledge, aptitudes and expertise are vital traits that contribute to an improved performance. This holds equally the same with spiritual capital where its values such as sincerity, honesty, trust, promote good ethics, motivated and committed in performing duties are essential in developing greater organizational performance. The outcome pertaining to

spiritual capital is consistent with arguments highlighted by Zohar and Marshall (2004) and Desa *et al.* (2011). As for the result, it indicate that level of human capital practice in audit firm in Johor Bahru are capable to generate profitability, foster value and growth, and improve overall organization performance.

Another point worth noting is, based on the descriptive findings, the mean score of 3.66 for ‘recruitment plan among employees’ is the lowest mean score among all statements given. This indicates that, audit firm is not performing recruiting process otherwise less give impact on this practice. According to Noe *et al.* (2014) identify and attracting potential employees is the primary purpose to get the best, suitable and competitive employees to the firm. Thus, it is very important for the management to establish a recruitment plan in their firm in order to bring in and retain competent employees to achieve firm’s goal.

Additionally, the statement on ‘management encourages and supports on staff’s education and training’ showed a mean score of 3.71 which is also relatively low. This is inconsistent with the point raised by Brocheler *et al.* (2004), stating that education among auditor will increase the performance of audit firms hence increase the audit firm survival. Thus, with insufficient support from the management it is difficult to audit firm to increase their performance. The practice should be in line with of the study specified human capital is bring positive influence on performance and it is a core resource within public accounting (Bush *et al.*, 2008) and the resource that provides sustainable long-term performance (Barney, 1991).

Interestingly, the findings disclosed have led to a discussion on the need for audit firms to manage human capital and spiritual capital in order to help them achieve higher performance. Since that is the case, therefore it is vital that the audit firm’s management or partners take into consideration of establishing a proper recruitment plan and package, scheduled training, encourage innovativeness, knowledge sharing, foster a highly ethical culture and high motivation. This in particular, is pointing out the ultimate need for audit firms to establish a

systematic human resource development (HRD) framework which facilitates, among others, employees training, career development, identifying key human capital values and work goals. Likewise, Kim (2012) emphasized that, business and organizations place greater concern on issues including performance, productivity, learning capacity, effective work dynamics and strategic management within the context of HRD. Indeed, with a proper management and utilization of human or spiritual values, it could influence organizational development and performance, economy and sociocultural environments (Zohar and Marshall, 2004).

Since this study was confined to several limitations such as time constraint and availability of respondents, several recommendations are put forward for future research. It includes the need to widen the survey to a larger geographical area in Malaysia, extend the data collection method to include interviews and gather views from audit firm’s clients in order to achieve a holistic view of related issues. In conclusion, audit firms and or any other organizations should place a serious attention on identifying, managing and acknowledge these intangible values which do reside in employees and organization itself. These

values when managed strategically could empower firm's performance and business sustainability.

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