

# Personal Competence and Internal Audit Effectiveness: The Moderating Effect of Islamic Spiritual Quotient: *A Case Study of Islamic Financial Institutions in Indonesia*

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This study aims to investigate the influence of internal auditors' competence on the effectiveness of an internal audit, with Islamic spiritual quotient as a moderating variable. The Islamic Spiritual Quotient (ISQ) instrument is derived from the four prophetic pillars, namely siddiq (truthfulness & integrity), amanah (trustworthiness), fathanah (competent & skillfull) and tabligh (advocacy & communication). Using questionnaires distributed to 38 internal auditors of Islamic financial institutions (IFIs) in Indonesia, the data were analysed using the structural equation model (SEM) based on partial least squares (PLS). As hypothesised, the findings show that the personal competence of internal auditors improves the effectiveness of an internal audit. Interestingly, ISQ clearly strengthens the positive influence of personal competence on internal audit effectiveness. The stronger the ISQ of internal auditors, the stronger the influence of individual competence on internal audit performance.

**Key words:** *Personal Competence, Internal Audit Effectiveness, Islamic Spiritual Quotient, SEM Analysis.*

## Introduction

The role of an internal audit (IA) is very dynamic and holds an increasingly important position in preventing and detecting fraud. Gupta and Ray (1992) explain that IA initially served as a shadow of independent auditing, but its function now continues to develop into one of organisational policeman and watchdog (Spira & Page, 2003). The focus of IA work has also

moved from detection to fraud prevention (Hass, 2006). IA has changed its function, from one based more on financially-oriented rules to internal and risk control (Cooper et al., 2006).

With its increasingly complex function, IA is still required to work effectively. Effectiveness is the degree and quality of the achievement of the determined objectives. Khalid et al. (2017) measured the effectiveness of IA based on the completion of the audit plan, the timely completion of the work plan, and acceptance of the given recommendations. Endaya et al. (2016) added conformity to policies, procedures, laws and regulations as indicators of effectiveness.

The effectiveness of the IA function is strongly influenced by the competence of the internal auditors. Competency is how well the preparation of audit plans, supervision, mastery of technical implementation, and audit reporting, are conducted (Laela, 2016). Competency can normally be assessed by the level of education, professional education and audit certification. Certification indicates sufficient competency; Berry et al. (1987) evidenced that the level of errors in the implementation of audit procedures was relatively higher for non-certified auditors.

Previous studies have consistently demonstrated the positive influence of internal auditor competence on the effectiveness of the internal audit function. Endaya et al. (2016) examined the relationship between auditor competencies and the effectiveness of an internal audit using a sample of 114 members of the Libyan Association of Accountants and Auditors. Their results show that the more competent an internal auditor is, the more effective the internal audit functions. Khalid et al. (2018) also found that there was a positive relationship between competence and work performance, and the effectiveness of sharia internal audits of Islamic financial institutions. Similar findings were reached by Salehi (2016), Ritonga (2016), Baheri, Rosidi, and Nurkholis (2017) and Nurdiono and Gamayuni (2018). This study aims to analyse the influence of personal competency on the effectiveness of IA functions by introducing Islamic spiritual quotient (ISQ) as a moderating variable.

In Islam, SQ is a special quotient related to human inner quality in term of their value and meaning of life as well as their responsibility to God the Almighty. SQ is centred in the qolb or heart of every individual. An-Nu'man bin Basyir radhiyallahu 'anhuma, the Prophet Muhammad peace and blessing be upon him said:

"Remember that inside the body is a lump of flesh. If it is good, then the whole body is good. If it is damaged, then the whole body is damaged. Know that it is qolb (heart)" (Narrated by Bukhori no. 52 and Muslim no. 1559).

Ibn Rajab Al-Hanbali in the book *Jaami'ul 'Ulum wal Hikam* suggested that people's good deeds, their ability to stay away from evil, and to leave things that are still vague (subhat), depend on the quality of qolb. The hadith or prophetic tradition is a strong proposition that the human mind and understanding are centred on the qolb, so the spiritual quotient is a noble conscience with eternal value (Mujib, 2001). The SQ of employees accumulatively determines the success of a company. Salehi et al. (2017) proved that emotional and spiritual quotients have a significant influence on corporate financial planning. SQ is the highest level of quotient, strengthening emotional quotient; it is a source of guidance for other quotients (Covey, 2005).

Empirically, Osman-Gani et al. (2013) also proved that religiosity and spirituality significantly influence employee work performance, both for Muslims and non-Muslims. A similar study conducted by Putra (2016) also found that SQ has a positive effect on auditor performance. More specific research conducted by Sofyani (2015) concluded that participants who had a religious character education tended to behave ethically. Moreover, Li et al. (2011) concluded that yin-yang ideologies embedded in company growth are naturally an important tool for increasing marginal benefits.

This study hypothesises on the moderation role of SQ in the relationship between the personal competence of internal auditors and the effectiveness of internal audit function. SQ is measured by the Islamic Spiritual Quotient (ISQ) model developed from Antonio (2007) and also used by Rahman and Shah (2015), which refers to the four characteristics of the prophet Muhammad PBUH, namely siddiq (truthfulness & integrity), amanah (trustworthiness), fathanah (competent & skillfull) and tabligh (advocacy & communication).

Antonio argued that these four elements are the key success factors of Prophet Muhammad PBUH mission. As such, these characteristics also are applicable to any of his followers or any Non-Muslim who adopts his wisdom. To substantiate his argument, Antonio developed a structural modelling named Prophetic Leadership and Management Wisdom or ProLM wisdom model. (Antonio, 2013).

The study uses a sample of IFIs in Indonesia representing Islamic banking, insurance, leasing and microfinance. IFIs are legally shariah business entities that govern and operate according to Islamic ethics and principles. Therefore, they are appropriate for use as samples to evaluate ISQ implementation. This sample selection was also motivated by the fraud phenomenon that occurred successively in several Islamic banks in Indonesia, in the form of fictitious financing. In 2017 the fictitious financing of Islamic banks reached US\$7.5 billion. In 2018, the same case repeated in a different Islamic bank with a value of US\$40 billion. The research may encourage sharia business organisations that have grown, as well as those that are still starting up, to apply the substance of Islamic spiritual values in their business operations. The findings of the study may also encourage business entities (IFIs and non-IFIs) to implement the substance of Islamic values in their businesses.

## Literature Review and Hypothesis Development

### *Effectiveness of an Internal Audit*

IA controls the sustainability of the system and organisational governance. It's activities help organisations maintain effective control by evaluating their efficiency and effectiveness and encouraging sustainable development (IIA, 2012). Effectiveness is a step in utilising resources to produce outputs optimally, and in it is measured by the achievement level of the targets and outcomes that have been set (Salehi et al., 2017); if the results are close to the target, the effectiveness level is improving.

### *Internal Auditor Competency*

Competence is the core of human resource quality. It is the ability of auditors to apply their capabilities, expertise, experience, skills, attitudes and knowledge in carrying out their duties thoroughly and objectively (Internal Audit Professional Organisation Consortium, 2008). The auditor must be competent to establish the type and amount of evidence used in concluding the audit results (Arens et al., 2011). The State Financial Supervision Standard (2007) states that a collective inspection must have adequate professional skills to conduct inspection tasks.

The Institute of Internal Auditors (2000), as cited by Moeller (2009), describes the competencies of Internal Auditors as follows: (1) Having the ability, adequate knowledge and experience in carrying out audit tasks; (2) Providing internal audit services in accordance with standards for the professional practice of internal auditing; and (3) Developing professionalism, effectiveness and quality in providing internal audit services. Ardani (2015) also describes five competency characteristics of internal auditors based on a review of Spencer (1993), namely: having consistent motives; suitable physical characteristics and responses to the situation and information; attitudes and values; knowledge; and skills.

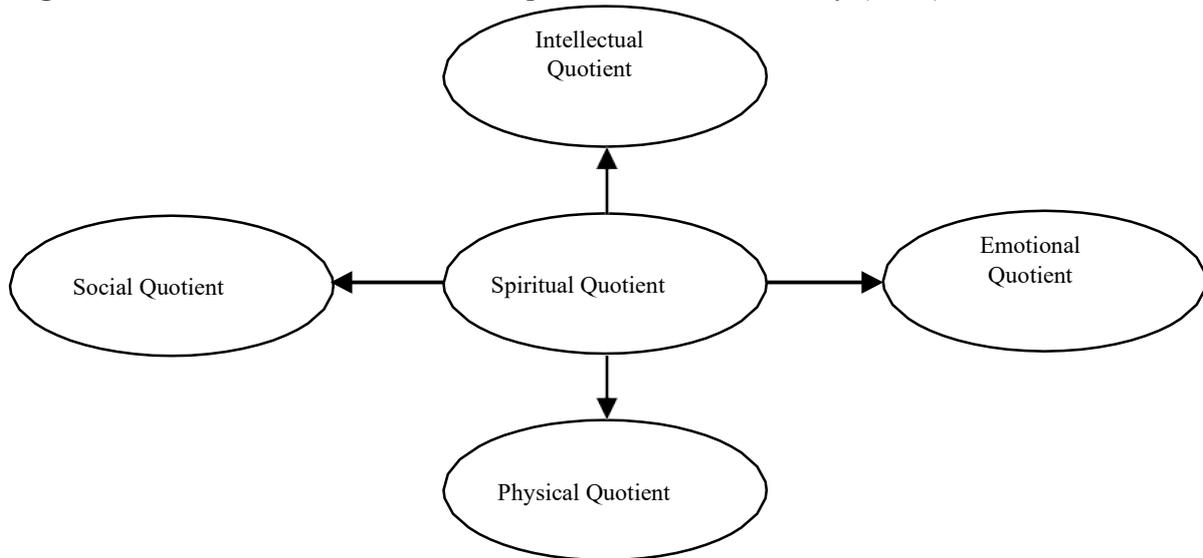
Islamic Spiritual Quotient (ISQ).

SQ is a quotient of the human soul and the highest quotient that effectively controls intellectual and emotional quotients (Zohar & Marshal, 2007). Salehi et al. (2017) mention that SQ is at the top of the quotient pyramid, strengthening, fostering and enriching other quotients below it. Similarly, Tasmara (2001) and Covey (2005) place SQ as upstream and other quotients as downstream (see Figure 1).

A person's SQ can be observed in the context of human morals. Covey (2005) clarifies that a person who is spiritually intelligent will become independent, proactive, have the right principles, be driven by values, and be able to apply them with integrity. Furthermore, Zohar & Marshall (2007) details the signs that indicate SQ has developed well, namely: 1) the ability

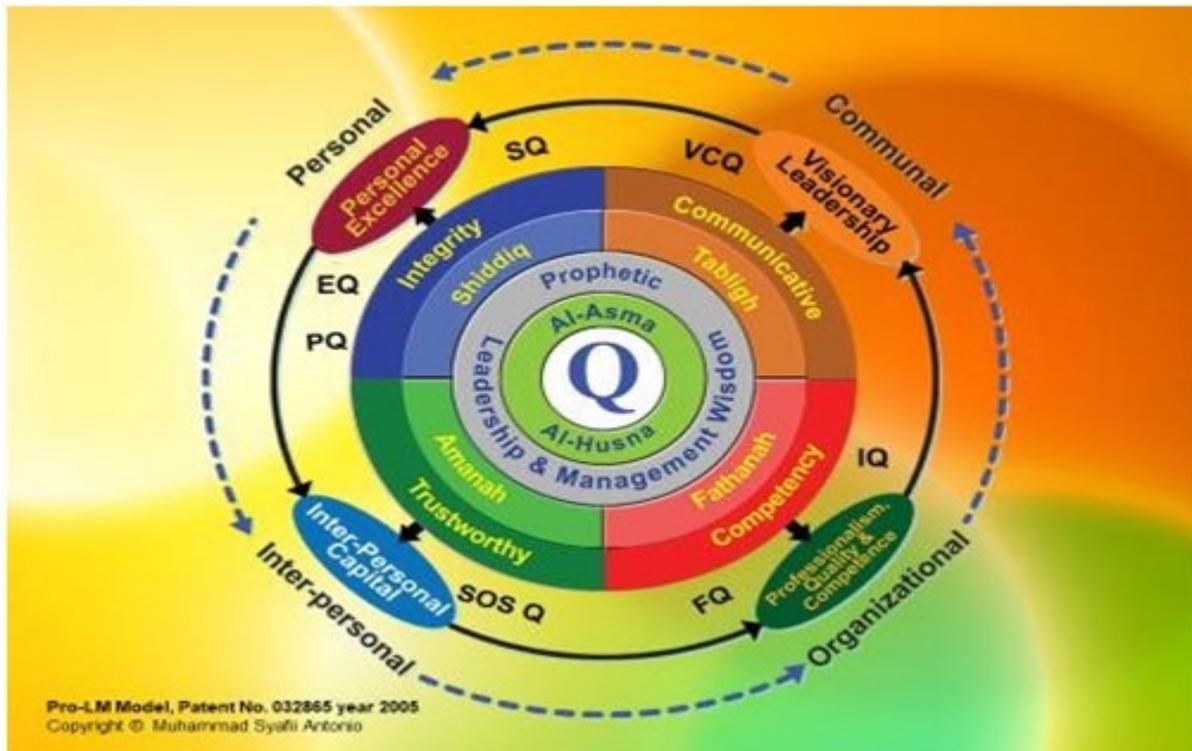
to be flexible (murunah); 2) being holistic in handling various problems (kaffah); 3) having high awareness (ihtimam); 4) being humble (tawadhu'); 5) showing sincerity and surrendering when facing the tests of life (tawakkal); and 6) having integrity in vision and values (multazim bi ru'yah wa qiyam).

**Figure 1.** SQ as a determinant of other quotients Source: Convey (2005)



The discussion of SQ in Islam, has been taking place since the birth of Islam itself. According to Muslim scholars, Muhammad SAW is the most complete human being with a high level of quotients, namely: spiritual, emotional, social, intellectual, financial, and physical quotients. Prior to his prophethood Muhammad was a successful trader with more than 27 years of experience, managing the business from Mecca to Madinah, Dubai, Jordan and Bahrain. In physical fitness Muhamad defeated Rukanah, a pre-Islamic champion of free fighting 3 times. In the military field, Muhammad led 9 big battles and 52 military expeditions. With billions of Muslim world-wide Islam becomes the second largest religion and the fastest growing religion in the world. This made Muhammad in the level of prophets Moses, Noah, Jesus and Abraham. According to Antonio the secret ingredient for this success is the four characteristics of Siddiq, Amanah, Fathanah, and Tabligh (Antonio, 2013). In the context of leadership and management, these characteristics can be described as personal and interpersonal characters which continuously and dynamically influence each other, as shown in Figure 2.

**Figure 2.** ProLM Model



People who are spiritually intelligent will always motivate themselves to uphold the values of honesty and integrity. Tasmara (2001) mentions three spiritual stages to attaining siddiq, namely: 1) being honest with oneself; 2) being honest with others; 3) and being honest with Allah, as mentioned in the Qur'an verse At-Tawbah: 119, which states:

"O ye who believe, fear Allah and be with the truthful."

Amanah is the emotional quality of a human being to be entrusted to carry out a duty or to perform a task with a certain level of results. Amanah also represents an interpersonal capital that is very much needed in establishing a harmonious relationship with family, team work, organisation and the rest of society.

Fathanah means professionalism, quality oriented and competency or mastery of certain fields. Someone who has a fathanah attitude does not only master certain fields, but also applies this mastery to other fields (Antonio, 2013). Tasmara (2001) states that a professional whose proficiency is based on noble morals has wisdom in thinking and acting.

Finally, tabligh is the quality of advocacy and communication skills that should be possessed by every leader and individual. Tabligh represents an intellectual, emotional, social and

spiritual abilities that gives meaning to life and work. Tabligh is very much needed by every personal, professional, managers and leaders with transformational vision.

### ***Hypothesis Development***

Audit effectiveness is assessed based on the level of outcome achievement (how many internal audit findings are reported; whether the audit plan has been implemented; whether the recommendations on internal audit findings have been implemented; and how far the implementation has improved company performance). Overall audit outcomes can be realised by completing the competency components owned by internal auditors (Khaled et al., 2017). Ashour, Sukoharsono, and Ghofar (2015), Baheri and Nurkholis (2017), Sholihah et al. (2018) and Nurdiono and Gamayuni (2018) emphasise the claim that the competence of internal auditors improves the quality of the audit process. Competence in the form of behavioural skills, namely morality and flexibility, can encourage internal auditors to control work ethics and increase compliance with standards (Pickett, 2000).

Competencies can be strengthened through certification programmes. Berry (1987) demonstrates that there were relatively many errors in the implementation of audit procedures by internal auditors who were not certified. Certification is also one of the reasons for management (users of internal audit services) to make recommendations based on audit results (Myers & Gramling, 1997). Laela (2016) also mentions that certification is proof of integrity and may improve the reliability of IA work. Therefore, the first hypothesis is proposed as follows:

**H1: Internal auditor competence has a positive effect on the effectiveness of an internal audit.**

The development of SQ may be indicated by a firm's adherence to the truth (Zohar & Marshal, 2007). According to Covey (2005), SQ can develop integrity skills. Therefore, integrity ensures that audit performance is influenced by the strong SQ of the internal auditors. The encouragement of SQ further strengthens the competence of internal auditors. Osman-Gani et al. (2013) verify that spirituality has a significant positive effect on performance; the stronger the spirituality, the more effective the performance.

In Islam, SQ is described as the strong power of every individual who has heart purity /qolbun saleem (Rahman & Shah, 2015). Qalbu includes all things that are profound, and contains mental values (Siswadi, 2015). The purity of qolb can strengthen one's obedience to rules; in fact, qolb is able to protect people from things that are prohibited by legal provisions (Rahman & Shah, 2015). The purity of qolb ensures the internal audit process is conducted in accordance with compliance to existing standards and procedures.

Antonio (2013) argued that these four elements of shiddiq, amanah, fathanah and tabligh, are the key success factors of Prophet Muhammad PBUH mission in various spectrums of his leadership. In Antonio's (2007) analysis, Muhammad PBUH at least has demonstrated his big success at least in 8 spectrums of leadership and management, they are (1) personal leadership and self-development (2) business and entrepreneurship (3) family management (4) dakwah or prophethood management (5) socio-political leadership (6) educational management (7) legal aspect leadership and (8) military leadership.

In the field of accounting and auditing, the character, Siddiq will guide auditors to follow the existing rules properly in order to achieve ideal conditions. Internal auditors who are trustworthy will tend to provide maximum work performance. The character of fathanah encourages internal auditors to develop problem-solving skills holistically and continuously, while those who adhere to the principle of tabligh will produce and communicate audit reports that are more transparent and realistic. Therefore, the second hypothesis is as follows:

**H2: ISQ strengthens the positive influence of internal auditors' competence on the effectiveness of internal audits.**

## Methods

The respondents in the study were internal auditors working in IFIs with head offices in the capital city of Jakarta. Our primary data to measure competency, effectiveness of internal audits and ISQ were summarised in the form of questionnaires that were collected through a survey. They were distributed personally and directly to the respondents. The questionnaires consisted of three parts, namely competency, ISQ and the effectiveness of internal audits. They were developed from previous studies with several questions modified. Four aspects of competence were employed, as previously used by Picket (2000) and Laela (2016), namely education level, educational linearity, professional education and work experience. The study also employs internal audit effectiveness indicators developed previously by Endaya et al. (2016) and Khalid et al. (2017), who combined them into four indicators as follows: 1) audit findings reporting; 2) audit planning implementation; 3) acceptance of audit recommendations and their implementation; and 4) auditee's compliance with policies, procedures, laws and regulations. To measure ISQ, the study developed instruments previously used by Rahman and Shah (2015) and refined based on the work of Antonio (2007; 2013) consisting of the four characteristics of the Prophecy: shiddiq, amanah, fathanah and tabligh.

To examine the proposed hypotheses, we used the following mathematical model:

$$EFIA = \alpha_0 + \alpha_1 CIA + \alpha_2 ISQ + \alpha_3 CIA * ISQ + \varepsilon$$

EFIA: Effectivity of internal audit  
CIA: Competency of internal auditors  
ISQ: Islamic Spiritual Quotient  
 $\alpha_0$  : Intercept  
 $\alpha_1-3$ : Coefficients  
 $\varepsilon$  : Error

The hypotheses were tested using the structural equation model (SEM) based on partial least squares (PLS). PLS is the most appropriate analytical method for this study because it is based on few assumptions (Wold, 1985). The data do not have to be normally distributed and samples do not have to be large. The data analysis method using WarpPLS version 5.0 was employed.

## Findings

Of the 46 IFIs invited to participate, only ten were willing to be involved in the research. The number of final respondents was 38 internal auditors from three fully- fledged Islamic banks, five Islamic insurance companies, one Islamic venture and one Islamic micro-finance company. The profiles of the respondents according to education category, linearity of education and certification are presented in Table 1.

**Table 1:** Profile of Respondents

Category	Number of Respondents
<b>Education level:</b>	
Undergraduate	26
Master's Degree	12
Doctoral Degree	0
<b>Linearity of Education:</b>	
Linear	21
Non-linear	17
<b>Certification:</b>	
With certification	11
N/A	27
<b>Length of Work Experience:</b>	
<3 years	12
3-5 years	22
>5 years	4

Table 2 presents the descriptive statistics that contain the minimum, maximum, average and standard deviation values of each variable.

**Table 2:** Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
CIA	4.00	10.00	6.50	2.01
ISQ	68.00	96.00	86.32	6.50
EFIA	38.00	59.00	50.13	5.01

EFIA: Effectivity of internal audit, measured using 16 questions on a 1-4 Likert scale (Endaya et al., 2016; Khalid et al., 2017)

CIA: Competency of internal auditors, measured using 4 questions on a 1-4 scale (Picket, 2000; Laela, 2016)

ISQ: Islamic Spiritual Quotient, measured using 24 questions on a 1-4 scale (Antonio, 2007; Rahman & Shah, 2011)

Of the four items used to measure the CIA variable, namely the level of education, linearity of education, professional education and work experience, 12.00 is the maximum possible value and 4.00 is the minimum. The mean of CIA is 6.50, indicating that the competency of internal auditors is in the medium category. The average ISQ value is 86.32, which shows that its implementation is quite high, while the EFIA variable has an average value of 50.13. This shows that the level of effectiveness of the internal audit is moderate.

A convergent validity test was used to ensure the validity of the instruments. An item was valid if the outer loading value was greater than 0.5. The results indicate that the outer loading values of all items were above 0.5. To test reliability, we used Cronbach's Alpha ( $>0.6$ ) and a composite reliability test ( $>0.7$ ). The results show that all questionnaire instruments in the study met the reliability test requirements. Similarly, the results of the multicollinearity test show that the VIF values of all the variables are below 5-10, which means that they are free from multicollinearity.

The structural model aimed to assess the relationship between the constructs, significance values and R-square of the research model, as presented in Table 3. The model explains 84% variance of EFIA as the dependent variable.

**Table 3:** R-Square & Adjusted R-Square

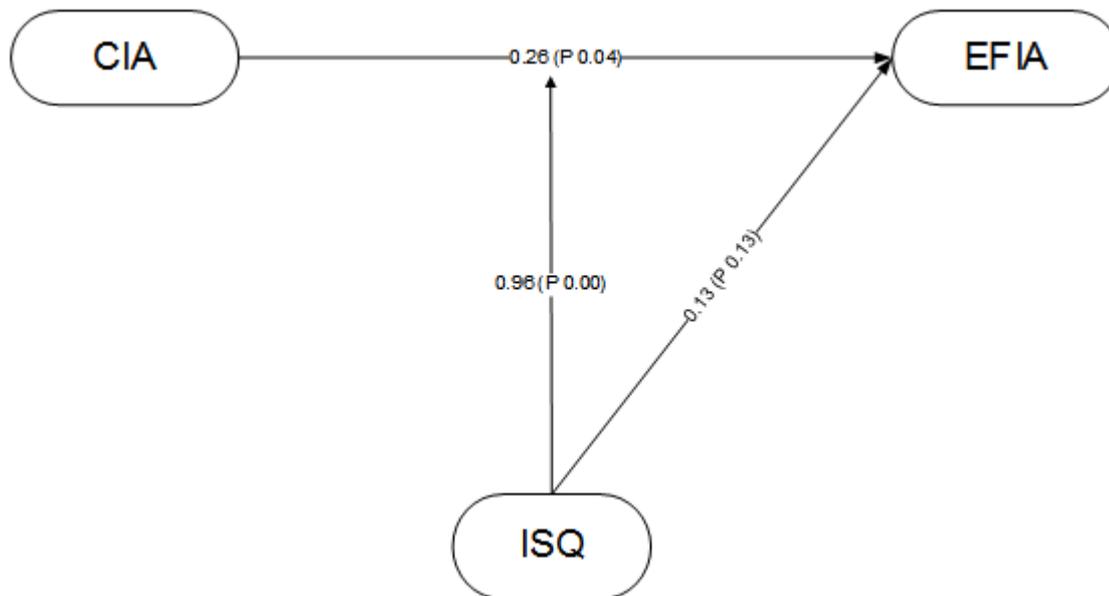
	R-Square	R-Square Adjustment
EFIA (Y)	0.850	0.841

A conformity test of the constructs between variables was also conducted using Goodness of Fit (GoF) (see Table 4). Based on Table 4, it is concluded that the model meets the ideal criteria, and that only NLBCDR still shows a value which is below ideal. Overall, the research model is classified as a good fit model.

**Table 4:** Goodness of Fit (GoF)

Indicator	Value	Ideal
<i>Average path coefficient (APC)</i>	P<0.001	<= 0.05
<i>Average R-Squared (ARS)</i>	P<0.001	<= 0.05
<i>Average adjusted R-Squared (AARS)</i>	P<0.001	<= 0.05
<i>Average block VIF (AVIF)</i>	1.312	<= 3.3
<i>Average full collinearity VIF (AFVIF)</i>	2.507	<= 3.3
<i>Simpson's paradox ratio (SPR)</i>	1	1
<i>R-squared contribution ratio (RSCR)</i>	1	1
<i>Statistical suppression ratio (SSR)</i>	1	>= 0.7
<i>Nonlinear bivariate causality direction ratio (NLBCDR)</i>	0.5	>= 0.7

**Figure 3.** Output Model



CIA: Competency of Internal Auditor

EFIA: Effectiveness of Internal Audit Functions

ISQ: Islamic Spiritual Quotient

Figure 3 shows that the structural path in the study is positive, as marked by coefficients  $\beta$  with positive direction. Internal auditor competency (CIA) is proven to have a positive effect on internal audit effectiveness (EFIA), with a p-value of 0.260. The second hypothesis is accepted with a positive  $\beta$  value of 0.000. The moderation variable (ISQ) increases the positive influence of internal audit competency on the effectiveness of an internal audit, with a p-value of 0.040. Therefore, ISQ is proven to strengthen the positive influence of internal auditors' competence on the effectiveness of an internal audit. The effect of ISQ on internal audit effectiveness is not

significant (p-value of  $0.201 > 0.05$ ), which indicates that inserting ISQ as a moderating variable is perfectly appropriate.

## Discussion

The higher the competence of an internal auditor, the higher the level of effectiveness in conducting an internal audit. This study strengthens the research of Pickett (2000), Laela (2016), Endaya et al. (2016) and Khalid et al. (2017). The findings also support Berry's (1987) study, which found that there were a relatively high number errors in the implementation of audit procedures by uncertified internal auditors.

Complete competencies will encourage better audit process performance. In addition, management, as the users of internal audit services, will consider such competency a reason to apply any audit recommendations made (Myers & Gramling, 1997). The more audit recommendations that are applied, the more effective the audit results, which may contribute to improvement of the company's business processes. Internal auditors who have complete competence will also display good work ethics, which can be shaped by behavioural skills (Pickett, 2000) and work experience (Laela, 2016). Ethics are important in the audit process because they are closely related to information testing and evaluation. The more experienced an internal auditor is, and supported by mastery of behavioural skills, the ability to detect fraud will increase, so work experience will become a measure of competency indicators. Audit is effective if fraud is detected appropriately. Khalid et al. (2017) state that the effectiveness of internal audits can be measured by how many findings are reported. They also argue that this effectiveness can be realised through the completeness of competencies. In addition to professional education and work experience, the level and linearity of education is also a component of competence. Furthermore, comprehensive competence is also manifested in its compliance with audit policies, procedures, laws and regulations (Endaya et al., 2016).

ISQ has an effect on strengthening the positive influence of internal auditors' competence on the effectiveness of internal audits. ISQ in this study has shown a perfect moderation effect. This is indicated by the significant results of the CIA coefficient against the EFIA, while those of the ISQ coefficient against the EFIA are not significant. The results of the CIA coefficient against the EFIA, which is added to the moderating effect, are significant. The higher the ISQ of an internal auditor, the greater the influence of his/her competence on the effectiveness of internal audit. These findings support Osman- Gani et al. (2013), in that spirituality has a significant positive effect on performance. SQ plays a significant role in the process of developing human integrity (Covey, 2005), and encourages willingness to develop continuously (Zohar & Marshal, 2007).



Four main aspects of ISQ, namely Siddiq, Amanah, Fathanah and Tabligh have proven to have a moderating effect, which strengthens the positive influence of competence on an internal audit. Internal auditors who have a siddiq personality are encouraged to be honest with themselves, with others, and with Allah, which leads them to follow the rules. Amanah motivates internal auditors to perform tasks to the best of their performance, as Allah calls on humans to fulfil the mandate given to them (Qur'an Surah An Nisa: 58). Meanwhile, the fathanah aspect is in line with the internal auditors' code of ethics, which encourages problem-solving abilities to be developed holistically. The more developed the ability of an internal auditor to solve problems, the higher the level of management trust, leading to a high probability of audit recommendations being applied. Likewise, the aspects of Tabligh result in transparent and realistic audit reports; this is the impact of openness and a communicative nature. As a result, tabligh may improve teamwork performance.

### **Conclusion, Limitations and Implications**

First, internal auditor competence has a significant positive effect on the effectiveness of internal audits. The more comprehensive the competence of an internal auditor, the higher the level of effectiveness of the internal audit. Second, ISQ has been proven empirically to be a moderating variable that strengthens the positive influence of internal auditor competence on the effectiveness of the internal audit. If an internal auditor has a higher ISQ, this will increase his/her professional competence, and will increase the effectiveness of the internal audit performance.

The model in this study is quite simple, using only two independent variables. Subsequent research could be improved by adding control variables, such as management support and spiritual conditions in the work environment. Another issue is the low number of respondents, meaning the research is less comprehensive in representing IFIs in Indonesia.



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