

A CONCEPTUAL FRAMEWORK FOR KNOWLEDGE MANAGEMENT IMPLEMENTATION BASED ON A MIXED METHOD APPROACH IN THE AUDIT PROFESSION

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ABSTRACT

Managing of Knowledge is important to achieve sustainable competitive advantage. Knowledge is an important asset to audit practitioners as they serve to safeguard investors and maintain the credibility of the financial statements issued by the companies. There is a need for these audit practitioners to innovate itself so that its existence will remain relevant considering the current challenges faced by the small and medium audit practitioners in Malaysia in maintaining the level of audit quality services. There is limited literature that examines the relationship between Knowledge Management (KM) and competitive advantage which in turn lead to value creation mainly in the audit profession in Malaysia. The paper proposes the conceptual framework based on the dimensions of KM and the resource-based view theory.

Keywords: *Knowledge management, auditing industry, resource-based view, social capital, value creation.*

INTRODUCTION

In Malaysia, the preparation and audit of financial statements are governed by the Companies Act, 2016, Financial Reporting Act, 1997, Securities Commission Act, 1993, Islamic Financial Services Act, 2013, Central Bank of Malaysia Act, 2009, Financial Services Act, 2013 (Malaysian Institute of Accountant, 2018). The incorporated companies under the Companies Act 2016 are required to ensure that their financial statements audited and complied with the approved accounting and auditing standards in Malaysia.

Financial Statements are important for making an informed investment decision in deciding capital allocation. Users of financial statements rely on financial statements to evaluate the performance of the firms. Therefore, there is a need by the audit practitioner to safeguard investors and maintain the credibility of the financial statements issued by the companies by ensuring that the financial statements are free from material misrepresentations. “Audit services are valued to public and private entities, organizations, and institutions because the assurance provider is independent and perceived as being unbiased with respect to the examined information” (Nguyen and Kohda, 2017).

Over the years, significant efforts were made to improve the quality of financial reporting and auditing requirement as guided by the accounting standards. However, audit practitioners especially the small and medium audit practitioners in Malaysia face challenges to maintain the level of audit quality services. MIA has noted, amongst others, the

challenges faced by the audit practitioners are audit clients are generally unappreciation of the value of audit which resulted in auditors have to frequently deal with delayed management accounts, poorly maintained accounting records and expected to assist to resolve their accounting issues and the low audit fees due to price competition to gain market shares. This, in turn, had led to challenges in retaining staffs due to the high demand for accountants in other sectors and countries. Therefore, in the long run, these audit firms may lack the resources and are unable to adhere to the requirements set by the professional bodies and regulators. On this matter, MIA has also cautious that remedial actions need to be taken so that the audit practitioners, as well as the audit firms, can cope with the number of companies that require audit services.

One of the important resources is knowledge of the audit practitioners. According to He et al. (2019), audit firms are knowledge-intensive organizations and therefore, they can derive competitive advantage by developing and transferring knowledge internally. Auditors work in a team and must collect relevant, appropriate and sufficient information and to document them appropriately to explain and defend potentially adverse findings in the event they are called upon to do so. To perform their job with quality and efficiency, all auditors require expert knowledge of laws, rules and regulations, understanding of the business practices as well as to be able to develop and acquire new knowledge during the audit engagements. Thus, the skills, attributes, experience and knowledge are vital to auditors to perform the engagement because audit plans depend so heavily on the expertise of auditors, the quality and comprehensiveness of the information they collect, and the findings they produce.

In this regard, we note that knowledge is a valuable resource that provides a sustainable competitive advantage to the firm's core business, however, KM appeared to be not fully or successfully implemented. There were publications on KM in an accountancy practice (He et al., 2019; Whitmore and Albers, 2006; Andekina and Medeni, 2014; Mubako et al.; 2016; Nguyen and Kohda, 2017). While there are many publications on KM, there is limited literature on the relationship between KM and competitive advantage which in turn lead to value creation mainly in the audit profession in Malaysia. Thus, this paper proposed a conceptual framework for further research to examine the relationship between KM and competitive advantage which in turn lead to value creation in the auditing industry in Malaysia. The underlying theory for the competitive advantage is based on the theory of the resource-based view (Hamel and Prahalad, 1994), and proposes a conceptual framework for further research on the impact of KM on audit firms in Malaysia. Thus, this paper is also expected to contribute to the existing literature.

We have reviewed, analysed compared and synthesized literature on KM and resource-based view to fulfil the aim of this paper. Section 2 of this paper comprises the literature review and conceptual design. Thereafter, Section 3 discusses our conclusion, implications, and significance of the study. Finally, Section 4 consists of the limitations and future research directions.

LITERATURE REVIEW AND CONCEPTUAL DESIGN

Knowledge and Knowledge Management

Nonaka (1999) stated that the only source of the firm's competitive advantage is knowledge. He explained that firms are exposed to competition whereby market demand for the firms' existing products and services may become obsolete in favour of competitors' new products and services given technological advancement and proliferation. Hence, successful organisations are firms that consistently create new knowledge, spread the knowledge quickly through the organisation as well as quick in embracing the new knowledge in the technologies and/or products. Knowledge learned in an organisation can be categorised as in the “state of mind, an object, a process, a condition of having access to information and a capability” (Nonaka and Takeuchi, 1995 as cited in Iqbal et al., 2017). According to Iqbal et al. (2017), the definition of knowledge varies widely. Generally, knowledge can be categorised as tacit knowledge and explicit knowledge. “The tacit knowledge is that kind of knowledge which is applied or understood subconsciously which is also difficult to articulate. This type of knowledge is developed from direct experiences and acts and can be shared by having deep interactive conversations. The explicit knowledge, on the other hand, is knowledge which can be easily articulated, captured, transferred between people and is informal and systematic manner” (Iqbal et al., 2017).

There is a need to manage both the tacit knowledge and explicit knowledge within an organisation. The concept of KM serves to help explain the need to systematically acquire, organise, sustain, apply, share and renewing both tacit and explicit knowledge of employees so that the employees can be more competitive and effective which will enhance organisational performance which in turn create value to the organisation (Drucker, 1993). In KM, there are no universal accepted dimensions of KM. Gold et al. (2001) have proposed that KM “consists of four interrelated processes including knowledge acquisition, knowledge conversion, knowledge application and knowledge protection as these four dimensions are the minimum set of knowledge management activities investigated when developing the concept” (as cited in Yusof and Abu Bakar, 2012, pp129). Whereas, Zack et al. (2009) defined KM as “an observable organisational activities that related to the ability to locate and share existing knowledge; ability to experiment and create new knowledge; culture that encourage knowledge creation and sharing; and regard for the strategic value of knowledge and learning” (as cited in Yusof and Abu Bakar, 2012). However, we proposed to adopt the definition of KM by Wang and Ahmed (2003) as “Knowledge management orientation (KMO) is an organisation’s distinctive capability of effectively managing the knowledge system, organisational memory, knowledge sharing, a learning culture and knowledge benchmarking to achieve organisational goals”.

Knowledge Management Dimensions

The dimensions of KM are still subject to change as there is no consensus on the dimensions by researchers (Farooq, 2018). Based on the review of past literature (Farooq, 2018; Yusof and Abu Bakar, 2012), we noted that past researchers classified distinct dimensions of KM. However, for this paper, we proposed to adopt the dimensions of KM proposed by Farooq (2018), whereby it is proposed that learning orientation, knowledge sharing, organisational memory and knowledge reuse as its dimensions. These four dimensions were chosen for KM because it is able to explain the need of a culture that embrace a shared vision of

learning and open-mindedness, sharing and creation of tacit knowledge which in turn will be codified, stored and disseminated within the organisation for other employees to use in order to improve business performance such as creation of new products and services or innovating new business processes. The definitions of these dimensions of KM are set out in Table 1.

Table 1: Dimensions of KM

| Dimensions | Definitions |
|-----------------------|--|
| Learning Orientation | “Learning orientation stands for the tendency of the organisation to create and apply knowledge in an organisation” |
| Knowledge Sharing | “belief towards exchanging knowledge, insights and skills in an organisation” |
| Organisational Memory | “Organisational mechanism that captures, stores, and disseminates knowledge learned from previous experience that can be brought to bear on decisions” |
| Knowledge Reuse | “Reconfiguring and reusing foreground and background knowledge and reusing the available assets and different sets of interaction, an organisation can build a new asset of knowledge” |

(Source: Adopted from Farooq, 2018)

Social Capital is also proposed as a construct to moderate the relationship between KM and value creation. Farooq (2018) explained that social capital dealt with the harnessing of the interactions and relationship among the external and internal stakeholders of the firms, such as the employees, customers and suppliers as well as their social networks to create a competitive advantage which in turn lead to value creation through the KM process. Based on past literature, social capital was found to moderate the relationship between KM and performance (Hoffman et al., 2005). The presence of social capital in the proposed conceptual framework as a moderating factor is crucial as it is expected that social capital will improve the audit firms’ performance through the interactions between the auditors and their clients which in turn are expected to develop and acquire new knowledge to be shared with the clients’ firms and the audit practitioners during the audit engagements.

Competitive Advantage

According to Yusof and Abu Hassan (2012), competitive advantage can be measured using the growth performance construct. It can be measured from the perspective of non-financial indicators and financial indicators. However, there is no one correct dependent variable (Yusof and Abu Hassan, 2012). Nevertheless, past researchers have suggested that the growth performance may be measured based on assets, corporate turnover and number of employees (Hillebrandt and Cannon, 1990; Abu Bakar, 1993; Yusof and Abu Bakar, 2012). In view thereof, we suggest that the indicators for measuring the growth performance of an audit firm be relevant to the service-based industry.

Value Creation

According to Farooq (2018), value creation refers to the application of knowledge in creating value such as improving business performance. It refers to a cycle whereby the employees create tacit knowledge from existing knowledge which then is stored and codified within the firms as explicit knowledge. The cycle of creating new knowledge then continues to repeat itself. Farooq (2018) explained learning orientation, knowledge sharing, organisational memory and knowledge reuse are crucial dimensions of KM which will lead to superior business performance as well as to further improve the value of the firm. Without the value creation cycle, competitive disadvantage is probable considering that firms are not managing knowledge to improve their business performance. The inclusion of value creation as a construct is also supported by the “Socialization, externalization, combination, and internalization (SECI) model” proposed by Nonako (1990).

Conceptual Framework

The underlying theory for the conceptual framework is the resource-based view theory. The research proposes a conceptual framework for KM whereby we attempt to explain the relationship between KM and competitive advantage. The model is extended to include the study of the relationship between competitive advantage and value creation. Resource-based view theory was developed to understand how firms can incorporate KM into the firms’ processes to formulate and apply value-enhancing strategies to achieve sustainable competitive advantage (Halawi et al., 2005). Figure 1 set out the conceptual framework. The proposed model and hypotheses are as follows:

- H1: Learning orientation is positively related to KM which leads to value creation.
- H2: Knowledge sharing is positively related to KM which leads to value creation.
- H3: Organisational memory is positively related to KM which leads to value creation.
- H4: Knowledge reuse is positively related to KM which leads to value creation.
- H5: The knowledge-based view is related to competitive advantage.
- H6: Competitive advantage is positively related to value creation.
- H7: Social capital moderates the relationship between KM and value creation.

The proposed conceptual framework is as shown in Figure 1.

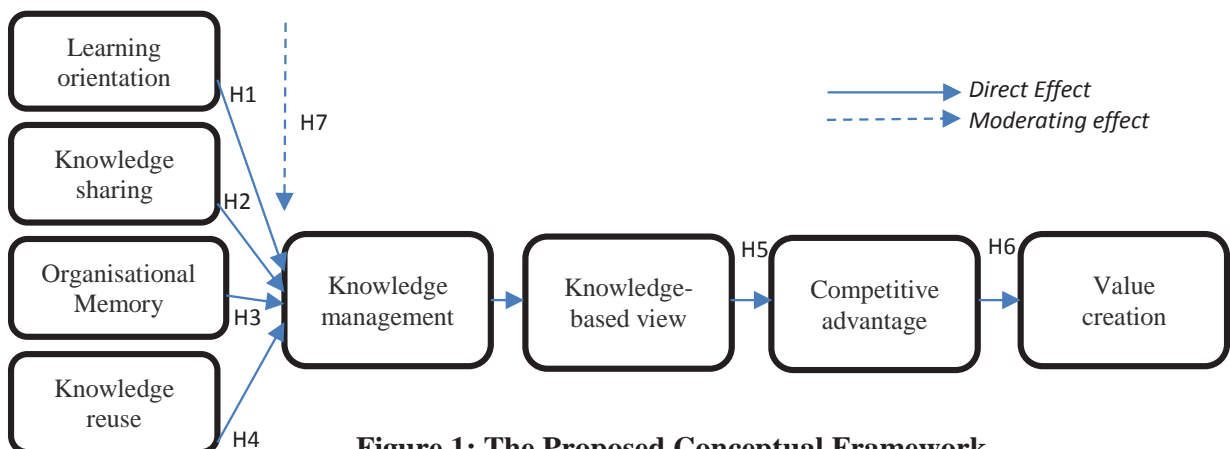


Figure 1: The Proposed Conceptual Framework
(Source: Adopted from Farooq, 2018)

CONCLUSIONS, IMPLICATIONS AND SIGNIFICANCE

Audit practices need to be aware of the changes in the marketplace, adapt and to make changes to their business model to remain competitive to support the growing economy. Considering that audit firms are knowledge-intensive organizations, knowledge as resources will be vital to provide audit firms with the knowhow to support the growing economy and the business community. A growing economy is supported by the growing companies whereby these companies play an important role in creating job opportunities, increase employment, be innovative and competitiveness. Growth in business performance can only be achieved through knowledge. Thus, this paper has proposed to look at KM and competitive advantage which in turn led to value creation in the audit profession using the RBV.

LIMITATIONS AND FUTURE RESEARCH DIRECTIONS

This paper is only on a conceptual framework paper of which the facts presented here are limited to the papers that have been reviewed and analysed. There is no discussion based on empirical data in this paper. Hence, as part of future research, the proposed model and hypotheses discussed in this paper can be empirically validated using exploratory factor analysis and confirmatory factor analysis on data collected through questionnaires survey. Researchers are encouraged to complement quantitative research design with a qualitative research design. Khalifa et al. (2013) had proposed the use of triangulating system design survey methodologies by researchers to gain a better understanding of the observed pattern in the data (Byukusenge and Munene, 2017; Agarwal and Marouf, 2016). We hope that by understanding this framework as well as the dimensions considered herein, empirical research shall be performed by researchers, practitioners and policymakers to formulate appropriate recommendations, strategies and/or policies for the adoption implementation of KM.

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