

Loss of Talent

A threat to audit quality

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June 21, 2022

This research is made possible by funding and data provided through/by the Foundation for Auditing Research

Research question

- Improving audit quality is a main priority
 - People are the most valuable asset an audit firm has and as such key for delivering high audit quality → poor potential identification can result in a loss of valuable people, especially in a tight labor market with increased mobility, all of which poses a threat to audit quality
- RQ: To what extent is talent identified in audit firms?
 - What is “talent”?
 - Potential to perform well in a more complex future role. Focus is on knowledge gained via instruction (“technical”) vs. knowledge gained via (social) experiences (“tacit”)
 - What is “identify”?
 - The early assessment of factors/characteristics that matter at a later career stage
- Main conclusion
 - Knowledge that is important for delivering high audit quality as an engagement partner is ignored in the assessment of the pool of employees from which to choose future engagement partners

Data

- A combination of survey questionnaire data and archival data
 - All data is linked while maintaining anonymity
- Survey questionnaire data
 - Key in measuring two types of knowledge
 - Technical knowledge: A form of declarative knowledge, typically acquired from formal instruction
 - Tacit knowledge: A form of procedural knowledge, typically acquired from daily (social) experiences
 - Learning by doing and learning from others
- Archival data
 - Personnel files
 - Career history, performance and potential assessments
 - Audit engagement data
 - Internal Quality Review of audit engagement (used as measure of audit quality)

Analysis

- Two parts
 - Part I: To what extent is an engagement partner's technical and tacit knowledge associated with audit quality?
 - By examining what matters for audit quality at the engagement partner level, we can highlight which knowledge is relevant for potential identification at lower levels
 - Part II: Is the knowledge that matters for audit quality adequately assessed at lower levels in the hierarchy?
 - If performance and/or potential assessments ignore aspects that matter at a later career stage, then potential is inadequately assessed and thus inadequately identified
- Important note: none of our findings can be credibly attributed to factors not taken into account in our study
 - I will spare you the econometric details

Results/findings

- While both technical and tacit knowledge of the engagement partner are positively related to audit quality, tacit knowledge is much more important than technical knowledge (ratio of 5:3)
 - Consistent with the idea that tacit knowledge becomes relatively more important as one moves up the hierarchy
- In the assessment of both performance and potential of auditors (non-partners), the emphasis is only on technical knowledge; tacit knowledge is not related to these assessments
 - Knowledge that is most important for delivering audit quality as an engagement partner is ignored in the assessment of the pool of employees from which to choose future engagement partners
 - Such behavior is the underlying cause of the Peter Principle
 - Can lead employees to feel undervalued by their leaders, which is a key factor for quitting/moving (not specific to the audit industry)

Contribution to academic knowledge

- Prior research shows that **experienced** auditors who have higher tacit knowledge receive higher performance ratings
 - Bol, Estep, Moers, and Peecher (2018) show that this is partly due to these auditors being better at developing their employees (better human capital development)
 - We provide another reason: these auditors deliver higher audit quality
- Recent research shows that inherently subjective potential ratings poorly predict performance after being promoted (Benson, Li, and Shue 2021; Grabner, Künneke, and Moers 2022)
 - We extend this literature by showing that this is not due to “random inaccuracies” but due to systematically ignoring a form of knowledge that is of great importance later on in assessing potential now
- More research is needed on:
 - Other characteristics that might be systematically ignored
 - What causes this problem to occur

Contribution to audit quality

- With people being the key driver of audit quality, inadequate potential identification puts this quality at risk
 - The evidence here suggests such inadequate identification (and this is not unique to this study/setting)
- How might this be tackled?
 - Revisit the “skill set” that is required to advance and be successful in the firm
 - Which competencies does someone need later and map them out as well as possible
 - Develop and carefully select supervisors/mentors
 - To be able to identify potential, one must not only know what to look for but also have the skills to “see it”. A good auditor is not necessarily a good supervisor/mentor
 - Provide employees with opportunities outside of current job function
 - Challenge them and provide room for learning, which also allows observing how well they do and whether they improve (and thus whether they are fit for a more complex role)
 - Treat the assessment of potential as a core activity of a supervisor/mentor
 - Too often annual assessments are seen as “taking time away from real work”

Knowledge sharing plan

- FAR conference and other FAR-related outlets
- Presentation at academic conferences
- Submission to academic journals
- Article with main takeaways for practitioner-oriented journal

THANK YOU

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