

# Loss of Talent

## A threat to audit quality

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# 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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