When talent risk poses financial reporting risk

By Stephen T. Dabney and Michael A. Smith

The "Great Resignation" and the related competition for talent have become a pain point for the audit committee. While ensuring that the finance organization, internal audit, and the external auditor are appropriately staffed and trained is always top of mind, turnover and skills gaps can be particularly concerning when it comes to financial reporting risk and controls.

Audit committee members we've spoken to shared concerns about potential and realized control deficiencies due to such turnover, requiring probing conversations with chief financial officers, chief audit executives, and chief information security officers to diagnose the problems and set a path to shore up processes and controls. These conversations often center on new employees in control-owner roles or unfilled vacancies and the challenge of finding temporary staff or third-party solutions to handle such critical functions. The overarching challenge is to address key talent gaps before they evolve into a financial reporting deficiency or material weakness to be disclosed.

In practice, companies tend to be reactive, not proactive, when it comes to hiring for positions related to internal control over financial reporting (ICFR). An analysis of more than 24 million job postings over the seven-year period 2010 to 2017 by faculty at Indiana University's Kelley School of Business found "that a firm's response to an internal control weakness is concentrated in the period immediately following the disclosure." Moreover, they found that "internal control weaknesses change a firm's demand for financial skills outside of corporate accounting and extend to other employees, possibly those that interact with the accounting information system or whose roles interact with a firm's controls over financial reporting."[1]

Of course, in this constantly shifting financial reporting risk environment, companies are always rowing against the current when it comes to talent. According to Audit Analytics, "accounting personnel resources" was the top internal control issue cited in adverse ICFR management reports in fiscal year 2020, followed by segregation of duties related to personnel within an organization. This has been the case for the vast majority of ICFR management reports over the last five years.[2]

"These organizations have to be creative in filling gaps," said one audit committee member, stressing that the new work environment has required companies to re-establish a sense of community that inspires, attracts, and retains leaders and staff.

Both the finance organization and internal audit have been significantly impacted by the shifting risk environment, requiring those department leaders to assess whether their staffing and coverage plans are appropriate for the future. "We need to be looking to the future to assess whether there will be a change in skill sets relative to the service we provide," said one chief audit executive.

While short-term solutions and quick fixes are hard to come by, talent-related inquiry can help the audit committee better understand the strategy and the progress being made. "It is not just the turnover of staff but 'which staff?' and how you are ensuring that your highest financial reporting control and risk oversight areas have stability and are protected from too much turnover," said another audit committee member.

[1] Janet Gao et al., "Internal Control Weaknesses and the Demand for Financial Skills: Evidence from U.S. Job Postings," Working Paper, February 20, 2020, accessed at SSRN.

[2] SOX 404 Disclosures: A Seventeen-Year Review, Audit Analytics, October 2021.

The following lines of inquiry can help to enhance the audit committee's understanding of talent risk:

— How is enterprise risk impacted by talent in the finance and internal audit organizations? What is management's risk appetite relative to skills and capacity within these functions, including the impact on internal controls and corporate culture?

— What data and tools do financial reporting and internal audit leaders have to identify and address talent-related risks in their organizations? Do they have processes in place to engage to and effectively integrate temporary staff and third-party professionals, as needed, while maintaining effective internal controls?

— What enhancements could be made to the process for updating the audit committee on talent-related financial reporting and control deficiencies, as well as the company's strategy for minimizing the risk of future talent-related deficiencies?

— Does the audit committee regularly review succession planning and talent development activities in the finance organization—beyond the chief financial officer, controller, and chief audit executive?

— How is internal audit keeping the audit committee up to date with the assessment and monitoring of existing and emerging talent-related risks and the effectiveness of mitigation efforts? Does internal audit regularly assess its operating model to ensure that audit teams have the talent to provide quality assurances regarding the risk and control environment?

— Does the external auditor regularly share with the audit committee its views as to possible talent gaps in the finance and internal audit functions? How is the external auditor addressing talent gaps or risks on its own team?

For more, read Work anywhere workforce: Signals of change and the risk agenda *and* Trends in material weaknesses for non-IPO companies.

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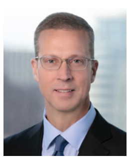

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