Professional Skepticism in Compliance & Ethics

SCCE REGIONAL COMPLIANCE & ETHICS CONFERENCE
TAMPA | APRIL 2019

Debbie Hennelly | Founder & President | Resiliti
Suri Surinder | Senior Director | Resiliti

This Session includes Polling

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Session Objectives

• **CONTEXTUALIZE** professional skepticism and its significance in Compliance & Ethics

• **UNDERSTAND** the sources of unconscious bias that get in the way of exercising appropriate professional skepticism

• **ANALYZE** our mental skews and predispositions to proactively manage and sustain our professional skepticism

The Significance of Professional Skepticism in Compliance & Ethics
What is Professional Skepticism?

Context

Acknowledging Our Vulnerabilities

- **Ethical decision-making** and **objective reasoning** are critical to our effectiveness as professionals... but we can’t take them for granted
- Our decision-making is not always as rational or objective as we think
  - Regardless of our level of expertise and years of experience, we are all susceptible to external pressures and motivations that can create blindspots, cognitive biases and rationalizations
- We all have vulnerabilities in our perceptions and decision-making
  - Acknowledging this is always a strength, not a weakness
  - Accepting the unconscious biases that cause these vulnerabilities is critical
  - Addressing this is part of being an effective, objective professional in our field
“Truthiness”

- Concept made popular by Stephen Colbert
  - From his first segment of "The WØRD" in his debut of The Colbert Report (Oct 17, 2005)
- From Dictionary.com:
  - The quality of seeming to be true according to one's intuition, opinion, or perception without regard to logic, factual evidence, or the like: *the growing trend of truthiness as opposed to truth*...
- Distinguishing “truthiness” from fact-based, objective reasoning is key to professional skepticism

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Influencing Perceptions, Decision and Actions

My **Actions** are driven by my **Decisions**, which are driven by my **Perceptions**...

- But external motivations, pressures and influences can drive changes in my perceptions
- Changing my perceptions changes my decisions which change my actions…
Defining “Professional Skepticism”

Let’s Discuss:
• What does this term mean to you, as a Compliance & Ethics officer, leader, professional, attorney, auditor, investigator…?

• Are your definitions or expectations based on:
  • Professional standards?
  • Job descriptions and competencies?
  • Something else?

There is a professional standard—from the AICPA's auditing standards—that does very specifically define "professional skepticism"... Which of the following do you think is their definition for auditors?

- An adverse stance that involves proactively questioning the authenticity of all audit evidence.
- An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.
- An assumption that fraud is present until sufficient evidence has been collected to prove otherwise.
- A mindset applied throughout the audit that involves obtaining independent verification of all information.
A Framework for Professional Skepticism

Attributes

Knowledge
Ability
Self-Reflection

Questioning Mind
Curiosity
Objectivity

Action

Diligent Fact-Finding
Proactive Inquiry
Critical Assessment
Risk-Aware Decision-Making

Attitude

Professional Skepticism

8 Major Financial Scandals

- **Waste Management**: Reported $1.7 billion in fake earnings.
- **Enron**: Inflated assets by $11 billion.
- **Worldcom**: Inflated earnings numbers by $1.4 billion.
- **HealthSouth**: Misstated earnings by $5 billion.
- **Freddie Mac**: Booked $3.9 billion of loans as revenue.
- **AIG**: Disguised $50 billion of loans as sales.
- **Lehman Brothers**: Tricked investors out of $65 billion.

Impediments to Professional Skepticism*

**Influences on Attitude:**
- Unconscious biases
- Scheduling pressures and workload demands
- Avoiding significant conflicts with management
- Providing an unqualified opinion by a deadline
- Achieving high client satisfaction ratings
- Keeping audit costs low
- Building or maintaining a long-term engagement or client relationship

**Impacts on Action:**
- Seeking evidence that is easier to obtain, rather than more relevant and reliable;
- Obtaining less evidence than is necessary
- Giving undue weight to confirming evidence, without adequately considering contrary evidence
- Developing an inappropriate level of trust or confidence in management.

* Public Company Accounting Oversight Board
How much professional skepticism do you think there is in the compliance and ethics field, based on your experience?

- Very high
- High
- Low
- Very Low

Unconscious Bias

Understand and Analyze

"The moment a person forms a theory, his imagination sees in every object only the traits which favor that theory." - Thomas Jefferson
Sources of Unconscious Bias

Definition of Bias

A predisposition or preference for or against something, based upon a unique combination of internal, external, and organizational variables that influence us.
The unconscious preferences of the human brain, developed through pattern recognition, triggered due to cognitive complexity, and manifested via heuristics result in bias in everyone of us 99.999996% of the time.

Bits of information received every moment by the average human brain

11 MILLION

Bits of information processed consciously every moment by the average human brain

40

Percentage of unconscious processing of data every moment by the average human brain

99.999996%

Reasons for Bias (contd.)
Bias-Enhancing Aspects of Investigations*

- **AMBIGUITY:** People tend to reach self-serving conclusions whenever ambiguity surrounds evidence. Many decisions require subjective interpretations of ambiguous information.

- **ATTACHMENT:** Auditors are highly motivated to remain in clients’ good graces and approve their accounts. Why? Clients can fire them for delivering unfavorable audits. Also, long-term relationships enable firms to sell more lucrative consulting services.

- **APPROVAL:** Bias intensifies when people endorse others’ biased judgment—provided it aligns with their own bias. Thus, auditors may accept more aggressive accounting from clients than what they themselves might suggest independently.


Bias-Enhancing Aspects of Investigations (Contd.)*

- **FAMILIARITY:** People are more willing to harm strangers (such as anonymous investors) than individuals they know (long-term clients, for example). The deeper the investigator/client ties, the stronger the tendency toward approving dubious practices.

- **DISCOUNTING:** We tend to be much more responsive to immediate consequences than to delayed, uncertain ones. Investigators may hesitate to issue critical reports because of possible immediate damage to the relationship, loss of the contract, or unemployment.

- **ESCALATION:** People often explain away minor indiscretions—then conceal the growing problem. Unconscious bias can evolve into conscious corruption.

Strength of Bias

- **Thought** - Something on our mind, haven’t taken a side yet
- **Opinion** - Picked a side but still open to question
- **Conviction** - Opinion no longer open to be changed
- **Judgment** - Any other opinion is wrong

What bias strength do you tend to exhibit most of the time?
Sustaining Our Professional Skepticism

Types of Bias

- More than 150 different biases have been established by researchers
- We will talk about 5 of those that specifically affect professional skepticism
- Before we tell you what they are, we want you to experience them yourself
How do you rate your driving skills?
A) Poor    B) Below Average    C) Above Average    D) Exceptional

- Be self-aware of your limitations
- Remember the Dunning-Kruger effect
- Always be learning – growth mindset
- Ask yourself: What if I am wrong
- Ask others to play Devil’s Advocate

What do you think are the odds are of a plane crash vs a car accident
A) Much higher    B) Little higher    C) Little lower    D) Much lower

- Increase availability through diversity
- Focus on facts, not feeling
- Push for less available data
- Don’t confuse probability with impact
- Don’t confuse correlation with causation
Confirmation Bias

Which of these two people would be a better co-worker
A) Left  B) Right  C) Neither  D) Both

- Postpone, postpone, postpone
- Remember the rule of three
- Share the data, not the conclusion
- Seek disconfirming evidence
- Believe in circles not straight lines

Anchoring Bias

How do you view this deal?
A) Not sure  B) Not great  C) Good  D) Great

- Change the sequence of the process
- Change your benchmarks
- Ask a different question
- Ask: What would it take.....?
- Imagine you are someone else
Rush To Solve Bias

How many tests did you get right?
A) 0     B) 1     C) 2     D) 3

- Ask: What question are we answering?
- Throw out the first thought
- Get more time
- Soak in the data
- Try multiple alternative solutions

Professional Judgment Framework*

* KPMG Professional Judgment Framework
Sustaining Our Professional Skepticism

Conscious Mitigation

Self-Reflection Exercise: “Continue, Start, Stop”

As you think of sustaining and enhancing your professional skepticism:

• What are you doing well that you should continue doing?
• What are you doing in isolated instances that you should start doing more of?
• What are you doing that you should stop doing?

Will you share one point with the group…?
Will you share something with at least one person in the next week…?
What will you take away from today’s session?

Professional Skepticism
Unconscious Bias
Conscious Mitigation

Questions?

Debbie Hennelly
deb@resiliti.com

Suri Surinder
suri@resiliti.com

Thank You!