

# Professional Skepticism in Compliance & Ethics

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## Session Objectives

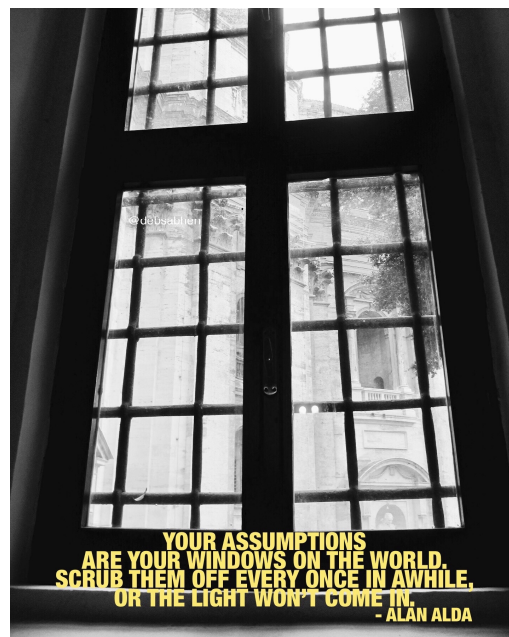
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- **CONTEXTUALIZE** professional skepticism and its significance in Compliance & Ethics
- **UNDERSTAND** the sources of unconscious bias that get in the way of exercising appropriate professional skepticism
- **ANALYZE** our mental skews and predispositions to proactively manage and sustain our professional skepticism

# The Significance of Professional Skepticism in Compliance & Ethics

## *What is Professional Skepticism?*

Context



## Acknowledging Our Vulnerabilities

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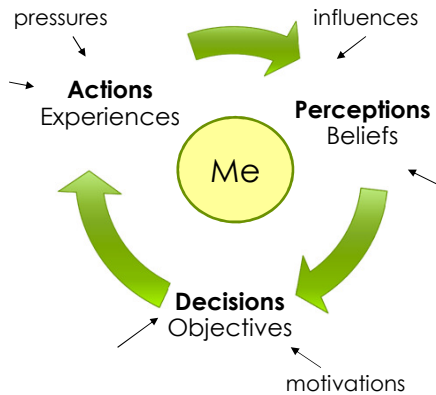
- Ethical decision-making and objective reasoning are critical to our effectiveness as professionals... but we can't take them for granted
- Our decision-making is not always as rational or objective as we think
  - Regardless of our level of expertise and years of experience, we are all susceptible 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"

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- 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

## Influencing Perceptions, Decision and Actions

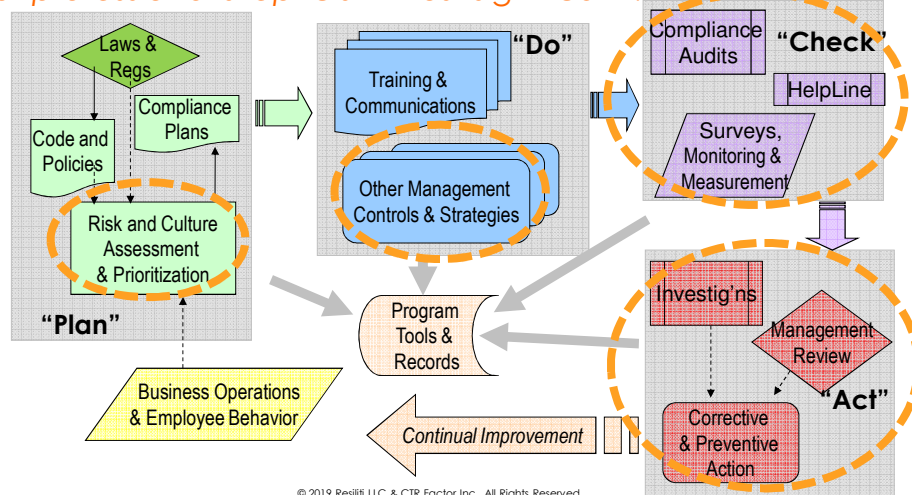


My **Actions** are driven by my **Decisions**, which are driven by my **Perceptions**...

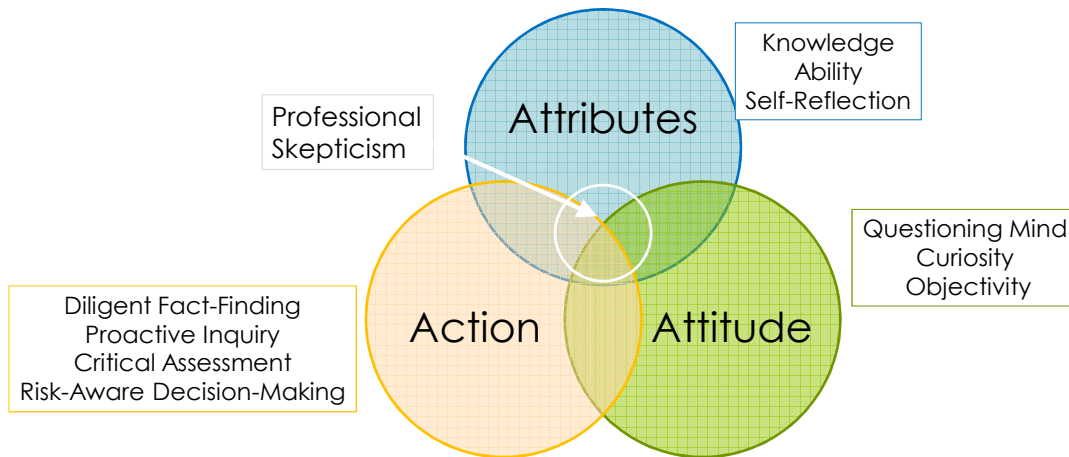
- But external motivations, pressures and influences can drive changes in my perceptions
- Changing my perceptions changes my decisions which change my actions...

## The Ethics & Compliance Management System

*Where is our professional skepticism most significant?*



## A Framework for Professional Skepticism



## 10 Major Financial Scandals

 <p>Reported \$1.7 billion in fake earnings</p>	 <p>Misstated earnings by \$5 billion</p>
 <p>Kept several billion dollars of debt off balance sheet</p>	 <p>Booked \$3.9 billion of loans as revenue</p>
 <p>Inflated assets by \$11 billion</p>	 <p>Disguised \$50 billion of loans as sales</p>
 <p>Inflated earnings numbers by \$1.4 billion</p>	 <p>Tricked investors out of \$65 billion</p>

## Impediments to Professional Skepticism\*

### Influences on Attitude:

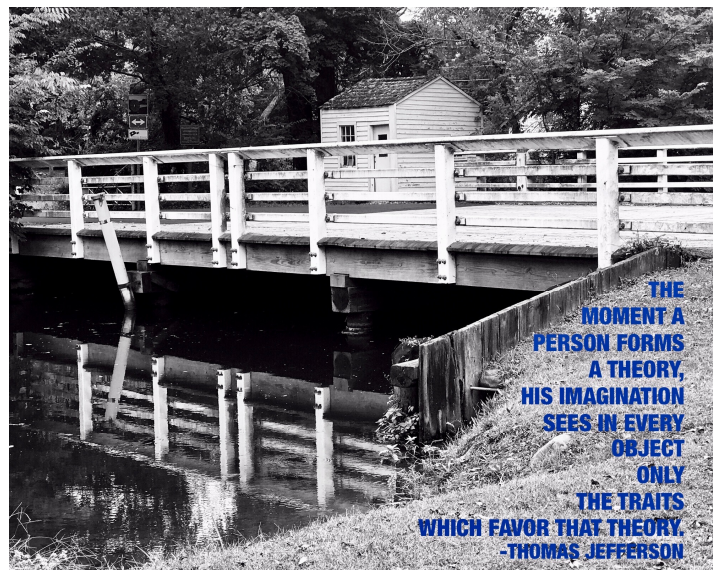
- Unconscious biases
- Scheduling pressures and workload demands
- Avoiding significant conflicts with management
- Providing an unqualified opinion by a deadline
- Achieving high client satisfaction ratings
- Keeping audit costs low
- Building or maintaining a long-term engagement or client relationship

### 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.

## Understand and Analyze

### Unconscious Bias



## 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

## Reasons for Bias

**11 MILLION**

Bits of information received every moment by the average human brain

**40**

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

**99.999996%**

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

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

## 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.

\* Harvard Business Review: "Why Good Accountants do Bad Audits"



## 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.

\* Harvard Business Review: "Why Good Accountants do Bad Audits"

## 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

## Overconfidence Bias

Tendency to overestimate one's own capabilities and talents, impacting the following areas

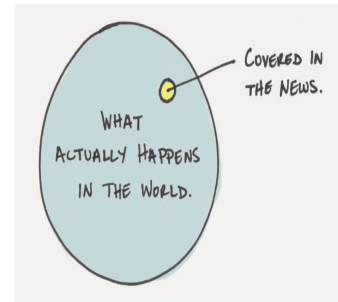
- Ability to prepare and fair value estimates
- Assess risks in enterprise resource planning systems
- Evaluate the accuracy of our performance as well as the performance of others
- Taking on too many projects
- Overpromising on deadlines
- Considering just one possibility when problem-solving
- Truncating or skipping information searches
- Making snap judgments



## Availability Bias

Occurs when investigators are influenced by the most easily retrieved data as they generate hypotheses for fluctuations, seek information, evaluate evidence, and assess risks.

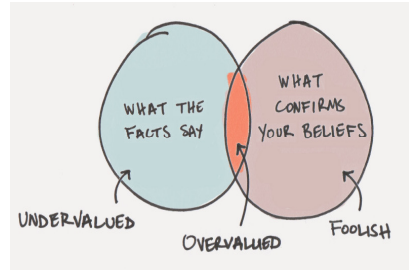
- When hypothesizing the cause of fluctuations, managers may readily recall the types of events they have personally experienced but will have a harder time generating new ideas.
- Investigators may be tempted to easily consider the explanation provided by management, but it may be more challenging for them to generate additional possibilities.
- Professionals may form judgments regarding the defensibility of positions based on the ease with which they recall similar cases, without fully considering the outcome of the cases.
- This tendency may also bias analysts' forecasts and investors' predictive earnings judgments.



## Confirmation Bias

Confirmation bias is the tendency for decision-makers to seek or interpret evidence in ways that support preexisting beliefs or expectations.

- Investigators may exhibit this tendency when
  - Evaluating the strength of internal controls
  - Selecting compliance standards
  - Estimating the probability of successfully defending a position in court.
- In reality, for an individual to know something is true, he or she must test to see how it may be false.
- If C&E professionals want to increase their professional skepticism, it is important for them to change their mindsets to seek or interpret evidence in ways that disconfirm prior beliefs or expectations



## Anchoring Bias

When estimating a value, individuals often anchor on a preliminary amount and then make adjustments to arrive at their final estimate; however, they often make insufficient judgments to arrive at the true value.

- For financial decisions, this type of bias may occur
  - During the budgeting process
  - When making capital allocation decisions
  - When conducting a cost-variance analysis.
- It may also affect analytical review procedures and sample assessments.
- Investigators are particularly vulnerable to this bias since they typically begin their process with management-provided anchors (i.e., financial statements)



## Rush To Solve Bias

The rush-to-solve bias occurs when decision-makers form a judgment without fully considering all available data.

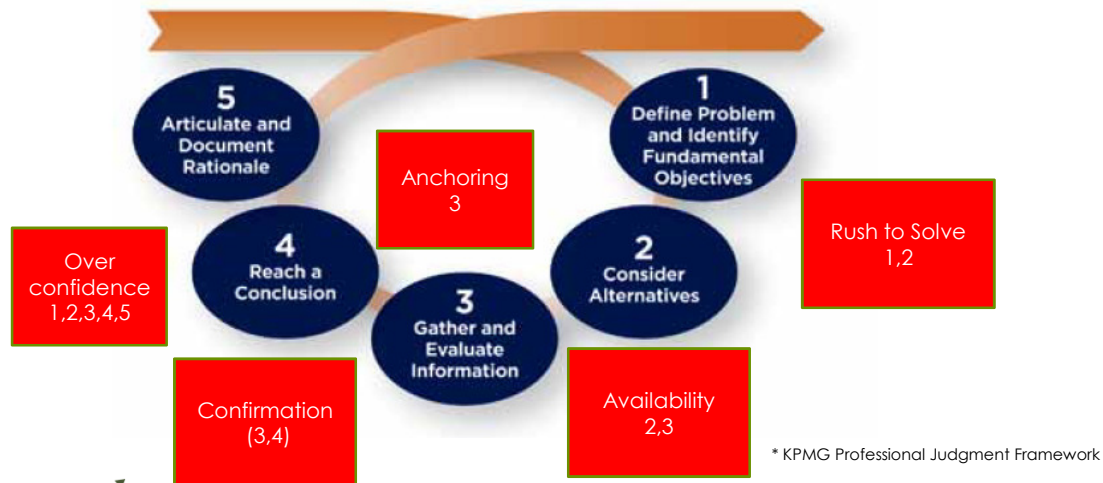
- This may occur if a management team reaches an early consensus without deliberating on an issue...
- ...or if investigators rely heavily on the perceived trustworthiness of a client when evaluating the likelihood of fraud.
- The rush-to-solve tendency may be exacerbated by external factors, such as time and budgetary pressures, and may inadvertently lead decision-makers to fall into other biases

### Factors Affecting Judgment

External factors	Internal factors
<ul style="list-style-type: none"><li>• Time pressure</li><li>• Limited resources</li><li>• Client, regulatory, industry</li></ul>	<ul style="list-style-type: none"><li>• Limitations due to judgment "frames"</li><li>• Judgment short-cuts</li><li>• Bias caused by self interest</li><li>• Judgment traps</li><li>• Rush to "solve"</li></ul>

## Sustaining Our Professional Skepticism

## Professional Judgment Framework\*



## Overconfidence Bias(Practical Considerations)



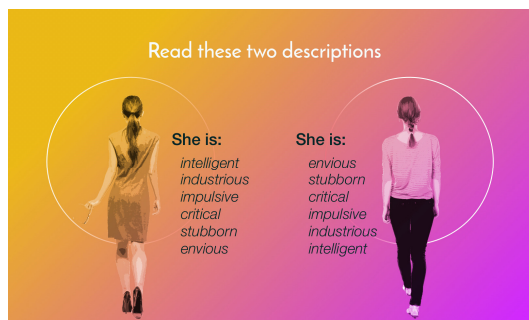
- Be self-aware of your limitations
- Remember the Dunning-Kruger effect
- Always be learning – growth mindset
- Ask yourself: What if I am wrong
- Ask others to play Devil's Advocate

## Availability Bias(Practical Considerations)



- 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(Practical Considerations)



- 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(Practical Considerations)



- 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(Practical Considerations)



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

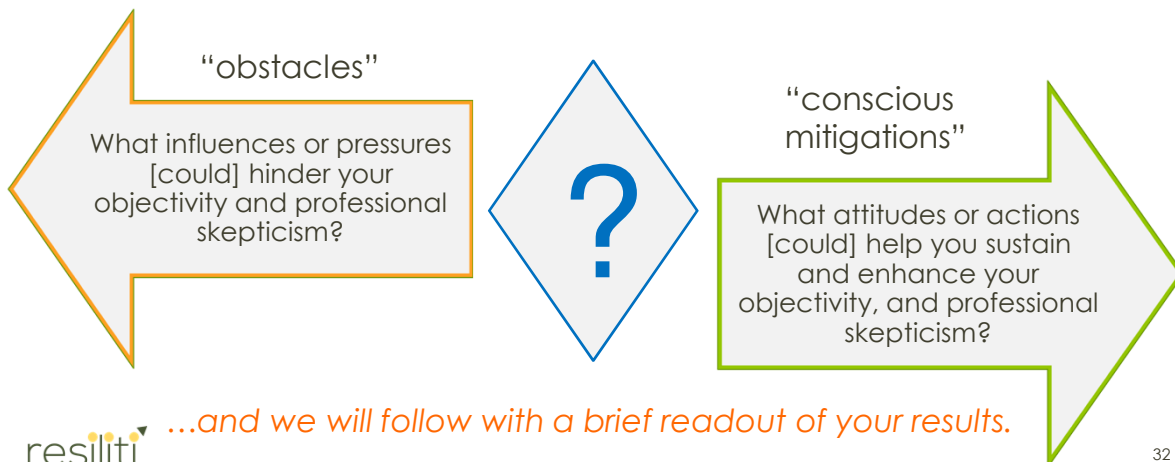
## Sustaining Our Professional Skepticism

Conscious Mitigation



## Group Exercise: Forcefield Analysis

*Please discuss and analyze in groups of 5 or 6:*



*...and we will follow with a brief readout of your results.*



## 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...?*



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*What will you  
take away  
from today's  
session?*

Professional Skepticism  
Unconscious Bias  
Conscious Mitigation



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## Review: 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

*Have we achieved our Objectives?*



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## Questions?

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Thank You!

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