Decision Making and Ethics

A Continued Exploration of Behavior and Professional Ethics

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October 2016
Overview

- Ethics violations and the 2015 AICPA Stats
- Importance of Understanding Decision Making
- White Noise
- Cheating
- The Importance of Making Mistakes
Ethics issues

- Ethics violations run the gamut from criminal to mere oversight
- Many “good” professionals commit ethics violations due to brief lapses in judgment, pure mistake or lack of sufficient review
- In 2015 the AICPA opened 483 new ethics cases and resolved 413 cases (there were 912 cases open at the beginning of the year and 982 open at the end of the year)
- 75 of those cases resulted in Expulsion or Suspension
- 143 cases dismissed
- What do these figures tell us?
This is tax – why behavioral science?

Shocking Disclaimer: I am (still) not a scientist!
Ethics violations are routinely created by human decision making – even at the structural level (e.g. internal return review process), that structure was created and overseen by a human being making decisions about how it runs.
Science in general and behavioral economists in particular are continuing to provide new and insightful information about how humans make decisions and why those decisions are often poor
Understanding how your brain and environment affect your decision making better prepares us to critically assess our own decisions
White Noise

- Ideally identical cases should be treated the same; tax positions, billing, audits and management letters
- This is NOT the case to a surprising degree
- Kahneman, Rosenfield, Gandhi and Blaser Study:
  - Two financial firms studied
  - Teams/individuals within the firms given identical facts and asked to set price/expectation
  - While the expectation was a decision making range of 5%-10%, the actual results were:
    - 34%-62% for Firm A
    - 46%-70% for Firm B
  - This phenomenon has been labeled "White Noise"
White Noise

- White Noise isn't bias per se
- Within an organization it presents most often when:
  - Decisions vary when the same case is presented to the same individual more than once
  - Professionals in the same role make different decisions
- As a general point – such variability can be extremely costly in the business world
  - Purchasing decisions, hiring, client retention, billing, etc.
White Noise

- How does this relate to tax and accounting practice?
  - Billing/RFP quotes
  - Hiring practices
  - Assessment of risk in tax positions
  - Assessment of supporting documentation quality
  - Internal disciplinary practices

- What can we do?
  - Procedures, Policy and Accountability
  - Algorithms?
Cheating

- The infamous "Slippery Slope"
- Gino, Ordonez and Welsh Cheating Experiment
  - When given the chance to cheat "a little" in the first two rounds of a game (earning a paltry 25 cents), people were twice as likely (60% vs. 30%) to cheat on a much larger scale ($2.50) a few rounds further in the game than the people who weren't given the chance to cheat small.

- Compounding this effect, other experiments (Gino and Bazerman) suggest that when people put into "auditor" roles of such games, they are much LESS likely to report the players who gradually inflated their figures over time as opposed to all at once, despite the overall level of cheating being equivalent.
Cheating

- How does this play out in our professional work?
  - Billable Hours
  - Expense reimbursement
  - Letting slip client "cheating"
  - Client signature/disclosure requirements

- What can we do
  - Many studies on the "nudging" effect suggest promoting ethical behavior can be done effectively
    - Culture
    - Make the default decision the ethical one – make it harder to cheat
Mistakes

- One of the ways the brain learns to make "intuitive" and more accurate predictions is through the release of dopamine.

- The change in release of dopamine, which is pattern based, is one of the ways we learn from mistakes: input with positive result creates positive feedback with dopamine release. The anticipation of the positive feedback is negated when an error is made and dopamine hit doesn't occur.\(^4\)

- Damasio and Bechara Gambling game experiment
  - "good decks" and "bad decks"
    - The dopamine release, or lack thereof, started keying behavior of subjects before they were even conscious of the reason they were favoring one deck over another.\(^5\)
Mistakes

- The need to learn from mistakes
  - Carol Dweck Experiment
    - Students given relatively easy puzzles to solve – those who were praised for their efforts were nearly twice as likely to undertake a harder puzzle when presented with the option for the next challenge as students who were rather praised for their intelligence
    - When viewing themselves as simply "smart" – students were more concerned with keeping up that moniker than they were with trying something more difficult with the risk of making mistakes.
  - Making mistakes is one of the most important modes of learning and becoming an expert – "unless you experience the unpleasant (neurological) symptoms of being wrong, your brain will never revise its models."
Mistakes

- Making Mistakes At Work
- Ideally, mistakes are caught before the product is delivered – this is the reason for layers of quality control and increasing level of expertise at each level
  - Note the intuitive predictive ability of those with significantly more experience who have made many mistakes and can spot issues sometimes without even being able to articulate what is wrong
- If less experienced employees are not given the opportunity to make mistakes, and offered education and support when they happen, they are more likely to not learn the important lessons that lead to additional expertise and will be more concerned avoiding mistakes, potentially losing opportunities to approach client situations in new ways (and be more reticent to tackle more difficult work).
Footnotes

5. Id at 46
6. Id at 52
7. Id at 54
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