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Behavioral Ethics

Because Auditing for Compliance Misses the Point

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Myths about ethics and behavior

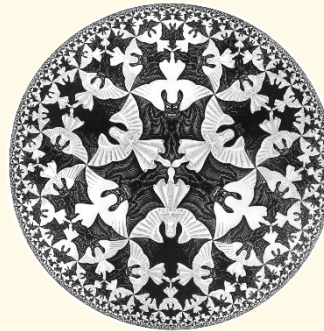
Good guys are ethical, bad guys are unethical



Dumbledore



Voldemort



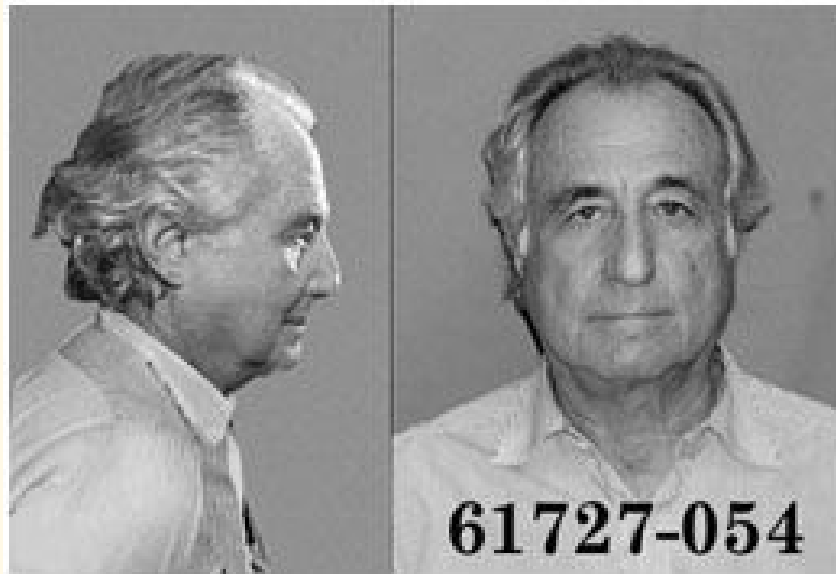
Real people are neither good or bad, black or white.
We're grey

Myths about ethics and behavior

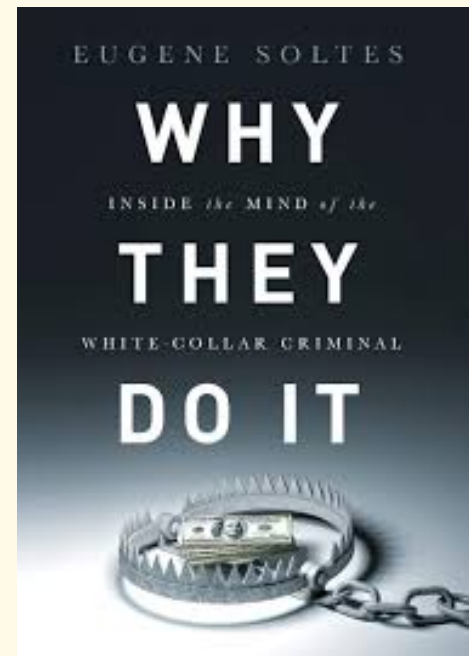
Good motives lead to good conduct and bad motives lead to corrupt conduct

We overestimate how much behavior is caused by character, intentions or abilities

Ordinary people commit evil by responding *to their circumstances* in ways they feel are righteous.



Bernie Madoff



Not just who, but *what* is responsible. (Zimbardo: *The Lucifer Effect*)

Myths about ethics and behavior

(More...) Good motives lead to good conduct and bad motives lead to bad corruption

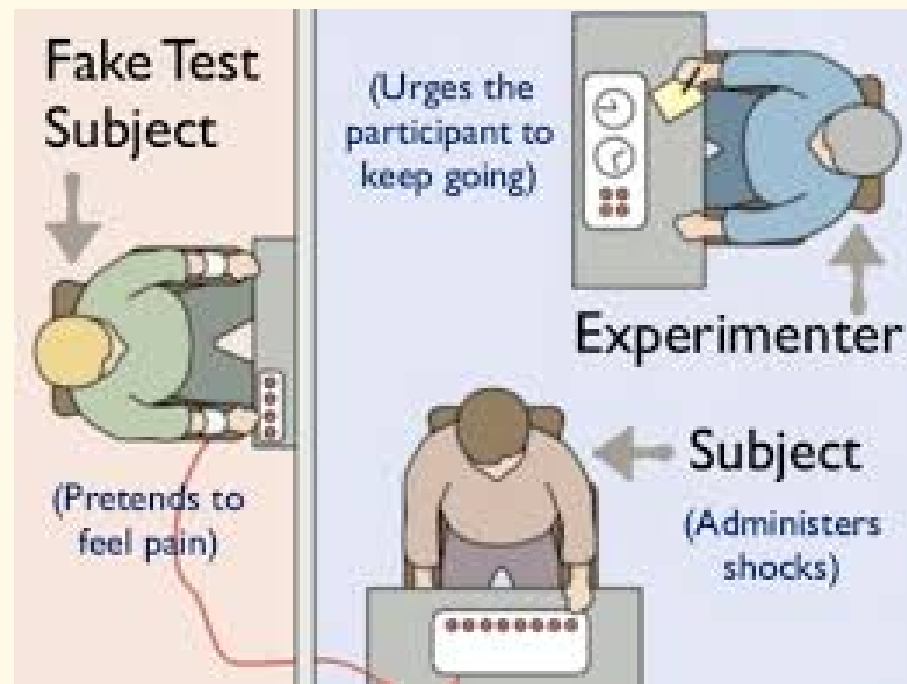
We underestimate the **power of context** to weaken the relationship between actions and intentions (Ross 1977)

Retirement savings

Exercise more

Eat healthy

The road to Hell is paved...



Milgram experiments

People usually **think** they are doing the right thing

Myths about ethics and behavior

Offenders use cost-benefit analysis before acting



If the bat and ball cost \$1.10,
And the bat cost \$1.00 more than the ball,
How much does the ball cost?

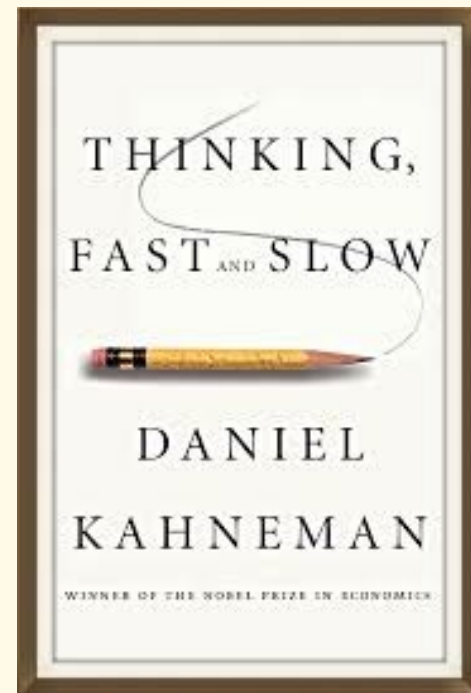
10 cents!

$$x + (x + 1.00) = \$1.10$$

$$2x + 1.00 = \$1.10$$

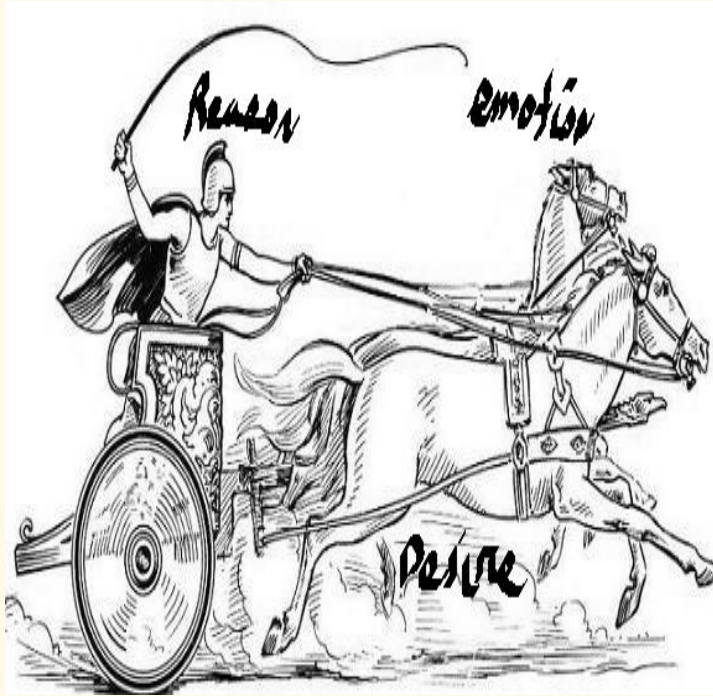
$$2x = .10$$

$$x = .05$$

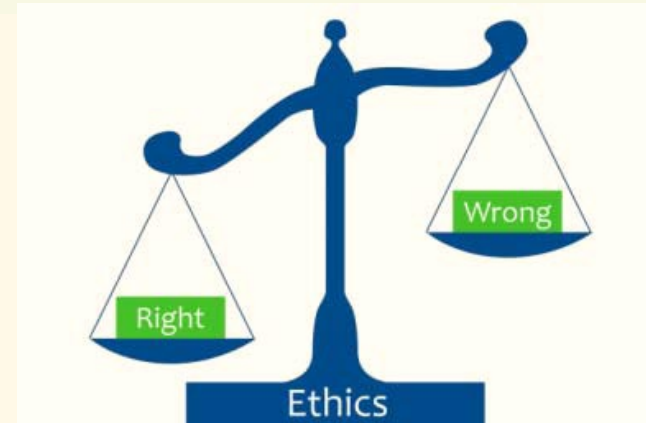


Myths about ethics and behavior

Ethical reasoning leads to ethical behavior



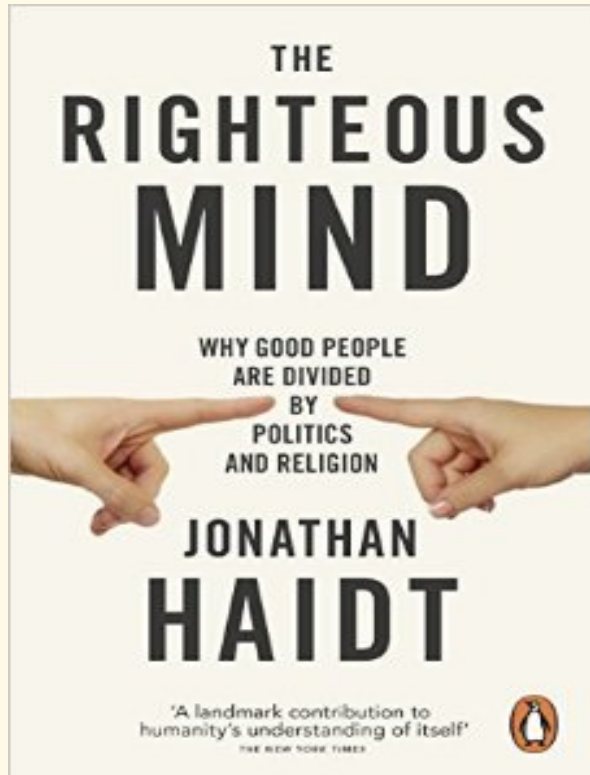
Plato (Phaedrus); Katha Upanishad



“Knowing something is wrong...and the explaining why, are completely separate processes.” Jonathan Haidt

Myths about ethics and behavior

Ethical reasoning drives ethical behavior



Ethical judgment by intuition and emotion (**elephant**) is automatic
Conscious reasoning (**rider**) to justify the judgment follows

Ethical judgement is difficult to override with reason

It's really hard to steer a determined elephant

Unconscious bias leads to unethical behavior



Most ethical problems come from unconscious bias, not from people seeking to enrich themselves.

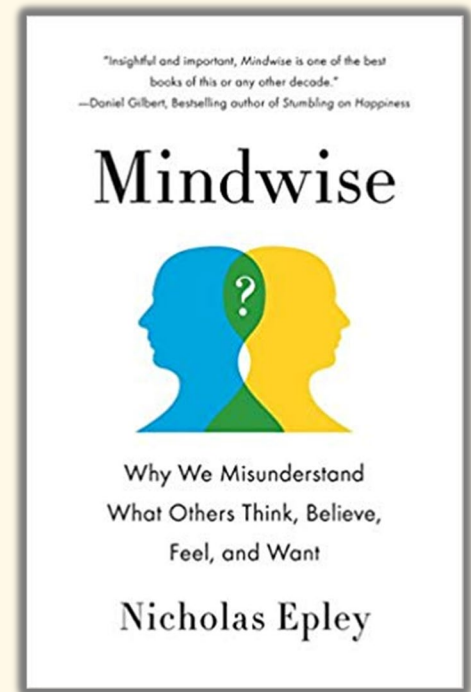
- We are more ethical than others
- We have an **illusion of objectivity**. We can put aside self-interest – but *they* can't!

92% of Americans are satisfied with their own character

HOLIER-THAN-THOU

Confirmation bias assures us that we really are right!

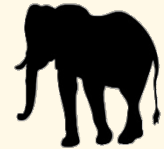
“I will look at any additional evidence to confirm the opinion to which I have already come.” Lord Molson



Unconscious bias leads to unethical behavior

Motivated Reasoning (I don't like it, so it can't be true)

The right answer is known in advance

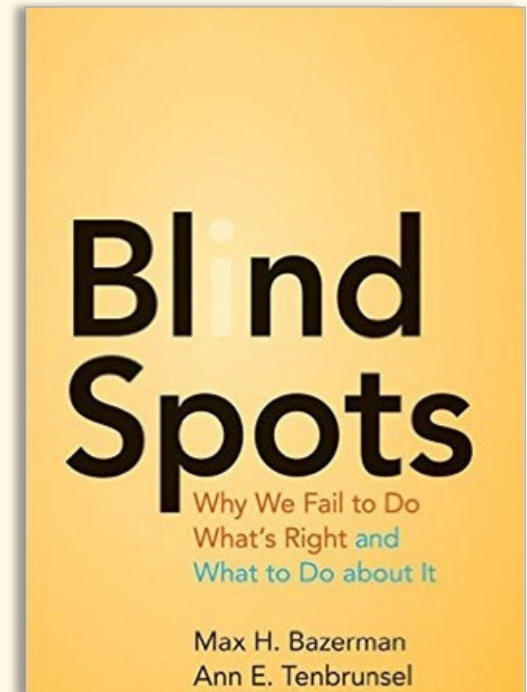


- Is human behavior causing climate change?
- Should city jobs be limited to city residents?
- Are government employees overpaid?

We have Blind Spots

Bounded ethicality: People often don't see ethical issues because of systematic and predictable ethical blind spots

Should-self and Want-self



Unconscious bias leads to unethical behavior

Overconfidence

“Human minds are overconfidence machines.”



David Brooks



93% of US drivers believe
they are better than average

94% of college professors
think they are above average

Almost all newlyweds predict
their marriages will last until
“death do us part.”

Overconfident executives are more likely to commit financial reporting fraud. (Libby & Rennekamp 2012)

Auditor overconfidence allows auditors to believe they are right. And objective, of course. (Cohen, Pant & Sharp 1995)

Common Anticorruption Efforts

Codes of Ethics



Public Officers Law §74

Code of Ethics.

1. Definition.

As used in this section: The term "state agency" shall mean any state department, or division, board, commission, or bureau of any state department or any public benefit corporation or public authority at least one of whose members is appointed by the governor or corporations closely affiliated with specific state agencies as defined by paragraph (d) of subdivision five of section fifty-three-a of the state finance law or their successors.

The term "legislative employee" shall mean any officer or employee of the legislature but it shall not include members of the legislature.

2. Rule with respect to conflicts of interest.

No officer or employee of a state agency, member of the legislature or legislative employee should have any interest, financial or otherwise, direct or indirect, or engage in any business or transaction or professional activity or incur any obligation of any nature, which is in substantial conflict with the proper discharge of his or her duties in the public interest.

3. Standards.

- a. No officer or employee of a state agency, member of the legislature or legislative employee should accept other employment which will impair his or her independence of judgment in the exercise of his or her official duties.
- b. No officer or employee of a state agency, member of the legislature or legislative employee should accept employment or engage in any business or professional activity which will require him or her to disclose confidential information which he or she has gained by reason of his or her official position or authority.
- c. No officer or employee of a state agency, member of the legislature or legislative employee should disclose confidential information acquired by him or her in the course of his or her official duties nor use such information to further his or her personal interests.
- d. No officer or employee of a state agency, member of the legislature or legislative employee should use or attempt to use his or her official position to secure unwarranted privileges or exemptions for himself or herself or others, including but not limited to, the misappropriation to himself, herself or to others of the property, services or other resources of the state for private business or other compensated non-governmental purposes.

Revised September 2016



Volkswagen Group
Code of Conduct

No evidence Codes by themselves affect behavior

Common Anticorruption Efforts

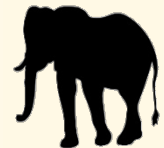
Threatening Punishment

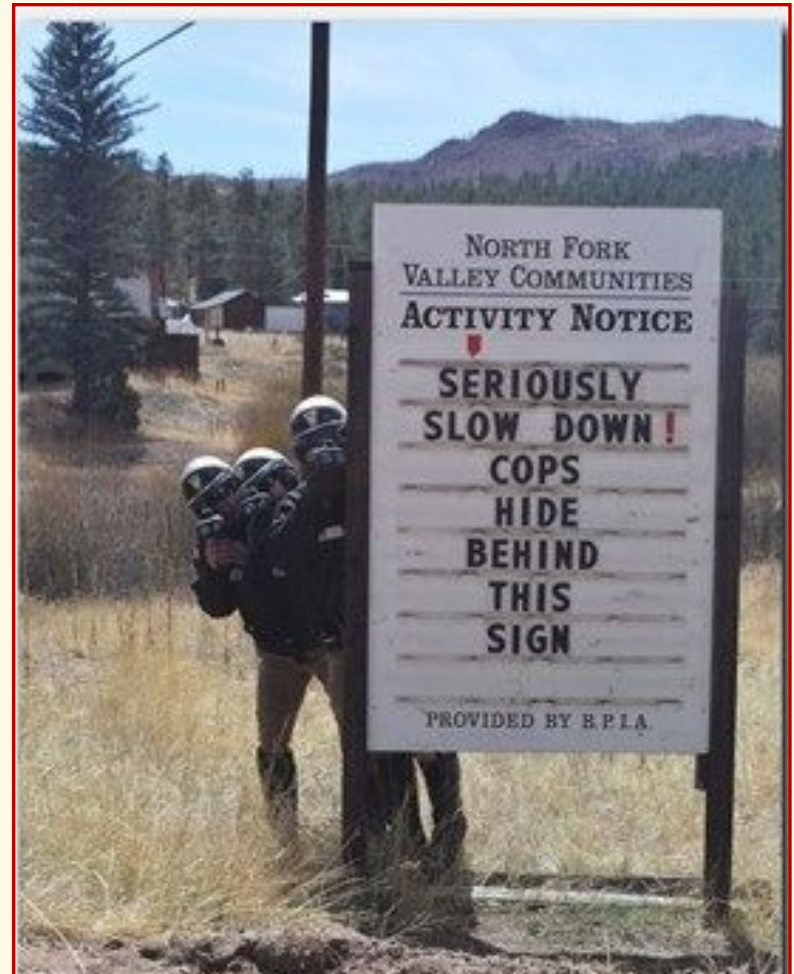


Rikers Island, New York City



Evidence unclear that punishment works

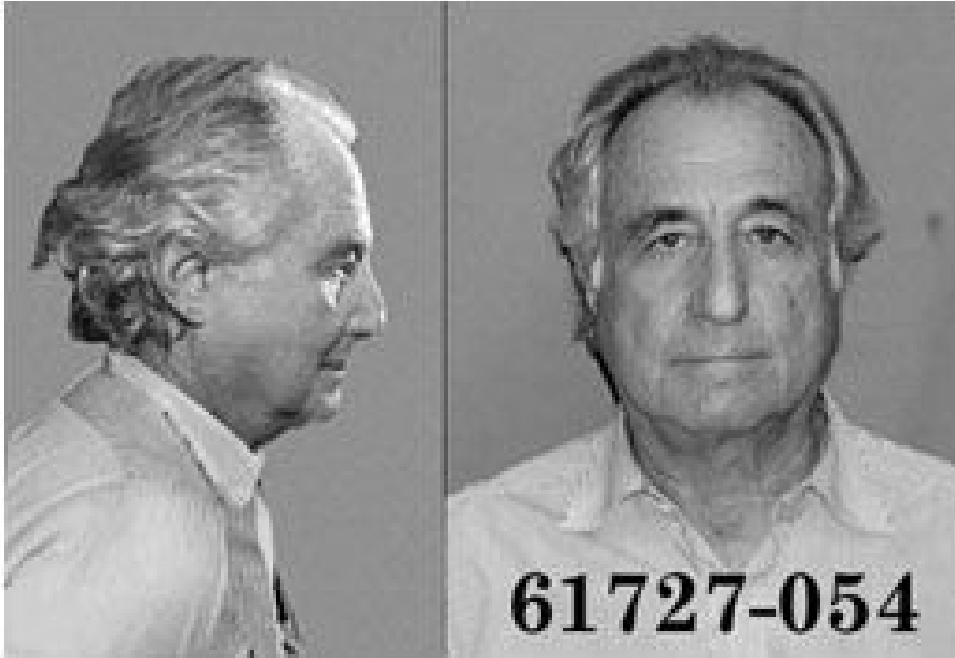




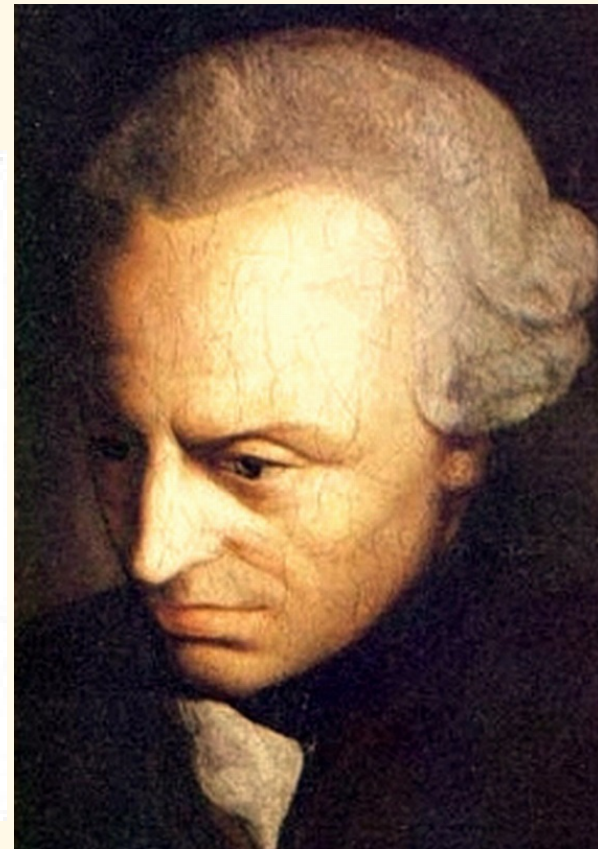
The threat of being caught deters!
Suggests: Audits and inspections

Common Anticorruption Efforts

Ethics Training



Bernie Madoff

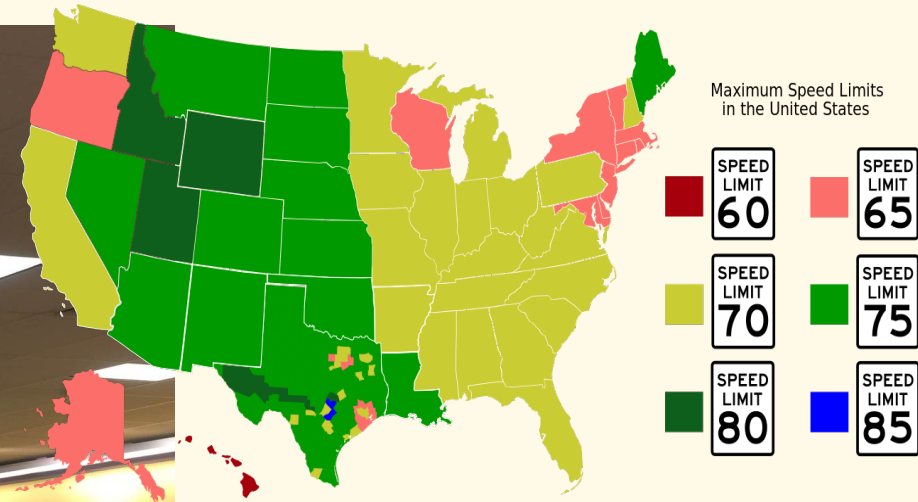


Immanuel Kant
17th Century Philosopher

Scant evidence ethics training changes behavior
No evidence ethics training makes long-term change

Common Anticorruption Efforts

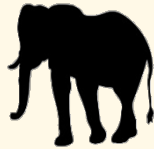
We Need More Rules!



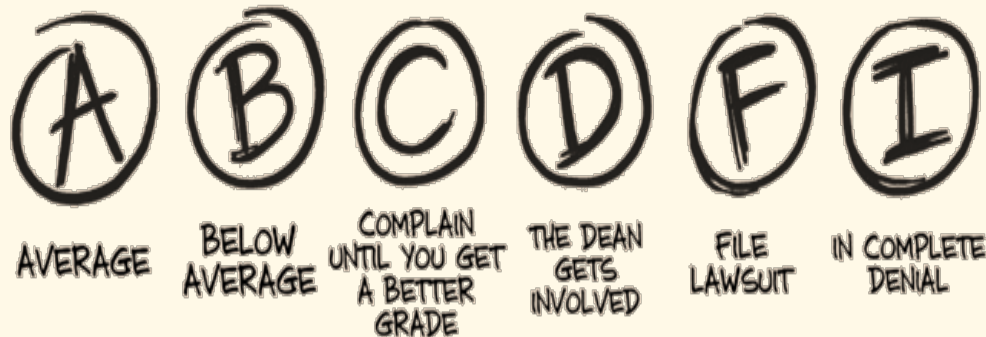
Examine the ethical system

What forces are acting on the people involved?

Good Grades!



GRADE INFLATION



Sonner, B. S. (2000). A is for “adjunct”: Examining grade inflation in higher education. *Journal of Education for Business*, 76(1), 5-8.



Fraudogenic Incentives

SINGLE-OUTCOME PERFORMANCE MEASURES

- ❑ A compensation system that rewards bank employees for the number of new accounts they open begs for fraud.



- ❑ A compensation system that rewards government officials who reduce wait times for services begs for fraud.



U.S. Department
of Veterans Affairs

Fraudogenic Professional Structures

ALLEGIANCE FOLLOWS THE MONEY

A system that gives clients the power to hire, fire, and pay professionals, yet requires those professionals to serve the public interest first, begs for falsehoods.



Fraudogenic Management

Stress and Deadline Pressure

More misconduct when people are tired or pressed for action.



No Segregation or Rotation of Duties

Lack of internal controls facilitates corrupt behavior.

Goals Gone Wild!

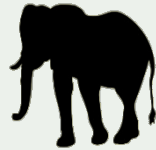
Stretch goals beg for stretching the truth and measure management.



Ethical Culture Correlates with Ethical Behavior



Frauductive Ethical Culture



Negative Elements

(DISQUALIFIERS)

ORGANIZATIONAL UNFAIRNESS
ABUSIVE MANAGER BEHAVIOR
SELFISH ORIENTATION
LACK OF AWARENESS
FEAR OF RETALIATION



Other Indicia of a Frauductive Culture

Short-term orientation

Focusing on immediate goals (quarterly profits) leads to measure management.

→ a long-term focus creates more value, and makes gaming the numbers unproductive

“Business” frame predominates

Narrow cost-benefit and profit focus crowds-out broader ethics concerns.

→ ethical fading, moral disengagement

Strategy: Ethical nudges and ideas

Sign at the top!

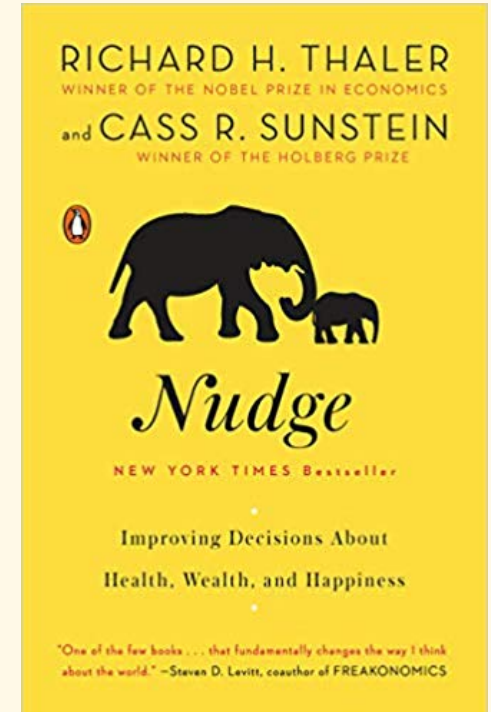
Internal controls

Avoid Diffusion of Responsibility

Incentivize with care

Don't rely on personal integrity or the criminal law to override your fraud-inducing systems.

Stewardship of public resources is sacred.



Strategy: Ethical design principles

Make it easy to do the right thing.

- Removing obstacles is often the more effective approach
- Reward good process not just good outcomes

Attend to risk with a systems view

- Are the systems actively encouraging unethical behavior?
- Imagine how a tired, stressed, or person with weak self-control would react in that situation

Deal with the elephant in the room

- Most corruption comes from unconscious bias and automatic thinking, not cold cost-benefit calculation
- Persuade the elephant with *emotional* appeals

Honor, integrity, reputation

Shared pro-social values



Encourage good behavior by shaping the path

Law and policy should not have to work so hard.

“Ethics is not a belief problem, it’s a design problem.”

Prof. Nick Epley,
University of Chicago



Selected References

(with gratitude to these and other scholars)

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