

Professional Judgment at BDO



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Preface

Professional judgment is at the heart of what we do at BDO. It is our primary product and is embedded in our DNA. Every service we offer is created primarily through the exceptional professional judgment capabilities of our people. Doing all we can to deepen and increase the consistency of the professional judgment exercised by our people at all levels is key to continuously providing the best value to our clients and exceeding the expectations of our stakeholders. As part of our commitment to exercising sound professional judgment and developing our people, we reached out to three internationally renowned accounting and auditing scholars in the area of professional judgment and decision-making from Brigham Young University (Steve Glover, Doug Prawitt, and Bill Tayler) and engaged them to work with BDO's National Assurance leadership team in developing the BDO Professional Judgment Framework and authoring this conceptual guide.

At BDO, we pride ourselves in demonstrating exceptional professional judgment in every client interaction. We take our responsibilities seriously and we are firmly committed to the development of all of our people. This guide and the BDO Professional Judgment Framework reflect BDO's commitment to the exercise of consistent, high-quality professional judgment, which underlies all that we do. This guide provides an overview of what is required for professional judgment. It introduces the BDO Professional Judgment Framework, which is designed to assist in the development and refinement of professional judgment by members of the firm across all levels and areas. It discusses each component of the three-tiered Framework: the **baseline attributes** necessary for good judgment, the **iterative actions** that we undertake continuously throughout the process of making judgments, and the **steps of a sound professional judgment process**. It also discusses the predictable, systematic ways in which research indicates professional judgment can be compromised — the traps and biases that we must be aware of and avoid in order to consistently produce the high-quality judgment we strive to provide.

At BDO, we continually strive to uphold the highest standards of quality, equipping our professionals with the essential information they need to achieve and sustain excellence in their work. The BDO Professional Judgment Framework across our firm plays a role in developing and accelerating the judgment maturity of our professionals at all levels. Day-to-day experiences are better comprehended and assimilated in terms of a logical, coherent and process driven conceptual framework. Through both formal and on-the-job training, we can aid in the development of our people and effectively engage in the fundamental baseline attributes, the essential iterative actions, and the core judgment process that are all part of the consistent execution and demonstration of a high-quality level of professional judgment. We are confident it will help all of us at BDO to develop our people and deliver consistent high-quality judgments in our practice.



CHAPTER 1

Overview of Professional Judgment

The consistent exercise of high-quality professional judgment is the goal of the BDO Professional Judgment Framework — it is at the center of the Framework, the culmination of bringing the baseline attributes to bear, ensuring the application of the necessary iterative actions, and following the vital steps of the judgment process. It is not only essential to a professional services firm with high aspirations and ideals, but professional judgment itself is in a broader sense a means to an end — it enables us to achieve a higher purpose. This is where the BDO Professional Judgment Framework ties in to BDO's mission of providing trusted solutions in an ever-changing world. It is also where it ties into our core purpose of helping people thrive every day and into BDO's core values. Our efforts must be oriented toward these higher-level principles for which we as individual professionals and together as a firm strive to achieve. In all that we do in our pursuit of consistent and effective application of professional judgment, we must be oriented toward our highest principles and ideals as professionals and as a responsible, forward-looking professional services firm with the highest of aspirations.

But what is professional judgment? In the broadest sense, professional judgment can be described as the capacity to logically assess situations or circumstances and to draw sound, objective conclusions that are not influenced by cognitive traps and biases or by emotion. For auditors, who work in an environment where powerful motivations and incentives are in play, professional judgment is the systematic practice of making the best possible decision in light of professional standards and the facts and circumstances in a given situation, all while avoiding biases and applying an appropriate professionally skeptical mindset. Thus, the most basic, foundational ingredient that must pervade all aspects of professional judgment, in our role as an evaluator, is a mindset of professional skepticism — the central baseline attribute in the BDO Professional Judgment Framework.

While other attributes, actions, and steps are needed to consistently meet the level of professional judgment we strive to achieve, an appropriate mindset is vital to our success as professionals and as a firm.

THE IMPORTANCE OF PROFESSIONAL JUDGMENT FOR AUDITORS

Audit professionals can be proud of the tremendously valuable role entrusted to them within our system of capital markets. Our modern economic system simply could not function without the assurance we provide. We enhance the confidence that investors and users of financial statements have in making decisions of tremendous importance to themselves and to society. But this enhanced confidence can only come about through trust in the integrity and objectivity of the conclusions that we reach and communicate. In other words, **the value that we as auditors provide is fundamentally and inextricably based on the objective, unbiased exercise of professional judgment in reaching well-reasoned conclusion on which decision makers can rely** — our value as professionals primarily stems from the quality of our professional judgment, individually and collectively. At BDO, we recognize and value the trust our clients and our stakeholders place in our professional judgment, and we want to ensure that we continue to live up to the high expectations that have been placed on us.

Make no mistake — professional judgment will remain our core strength even as technology becomes more and more integrated into the business environment and in the audit process itself. In fact, we believe the rapidly increasing role of technology will only enhance the role of professional judgment in the foreseeable future. As technologies such as audit data analytics increasingly provides us with new capabilities,

there will be increased emphasis on our ability to understand our clients' businesses, to ask the right questions, and to astutely draw out the implications of the results of our analyses. Professional judgment will become more central, not less.

WHY A PROFESSIONAL JUDGMENT FRAMEWORK

The development of the BDO Professional Judgment Framework and the creation of this guide represent our commitment to enhancing the value we provide as professionals and as a firm by sharpening our ability to communicate about, train on, and exercise professional judgment with the vital foundational mindset of professional skepticism. We believe that as we learn and increasingly share common fundamental concepts and vocabulary surrounding professional judgment, we will be better able to focus our efforts on the things that matter most — the core of the issues we tackle. This will ultimately allow us to make more consistent, high-quality judgments and decisions that enhance the value we provide. As we all effectively apply our Professional Judgment Framework, we will exceed the expectations of our stakeholders. This, in turn, will contribute to our goal of achieving BDO's core purpose of helping people thrive every day and our core values.

In addition to the role of the BDO Professional Judgment Framework in helping us to achieve our ideals and aspirations as a firm, we are confident that our framework will also benefit our professionals individually and collectively. A professional judgment framework that is recognized, understood, and utilized by all professionals across the practice is fundamental to establishing a consistent, firm-wide judgment environment where auditors can effectively exercise professional judgment and skepticism. By implementing the BDO Framework, our professionals will demonstrate the same disciplined process. These behaviors will be transferable no matter the topic or circumstance and will become second nature to our professionals.

A common conceptual framework and shared vocabulary can enhance the clarity and effectiveness of communication around critical judgment issues. If you were to visit an emergency room, you would likely hear an exchange of specialized language. For example, you might hear something like: *"I've got a spontaneous pneumothorax—give me a CT, an ABG, CBC, chem 7, cardiac enzymes, and coag panel, stat."* Such specialized but shared vocabulary and understanding plays an important role in the pressured environment of an emergency room, allowing the sharing of large amounts of information effectively and efficiently. (The above sentence means that a patient has a collapsed lung with no underlying disease and the doctor is requesting a CT scan, blood tests to check oxygen levels, the number of red and white blood cells, and basic blood enzymes, and, finally, tests for markers of a damaged heart muscle and for how well the blood is clotting. Stat, of course, means "instantly" or "now.")

The point here is that a shared conceptual understanding and a common vocabulary can be powerful tools in enhancing the effectiveness and efficiency of communication in specialized environments. Everyone in the room knows what is needed without lengthy explanations while the patient's health deteriorates. In an audit setting, you might hear a manager say to a senior, *"Watch for the decision trigger here, and be careful not to get anchored to management's initial estimate."* As you will see later in this guide, this sentence conveys a wealth of information between people who share an understanding of the concepts and vocabulary around the "decision triggers" and the potential bias of "anchoring and insufficient adjustment."

A common conceptual framework and a shared vocabulary can also enhance on-the-job development of less experienced team members. It is well known that experts often have difficulty sharing what they have learned through a wealth of experience and the "school of hard knocks." Relatively inexperienced people, for their part, often find it challenging to absorb the deep knowledge that experts try to share. Part of the difficulty is the absence of a shared conceptual understanding and a common vocabulary that experts can reference in sharing and transferring their expertise to others. For those in supervisory roles, consider the importance of the judgment abilities of your team in your own ability to perform your role well within an expected timeframe. A big part of the motivation behind the BDO Professional Judgment Framework is that training around such a framework can be instrumental in accelerating the development of professional judgment skills in our less experienced professionals. Any effort undertaken to understand and use the BDO Professional Judgment Framework will be worth your personal investment, regardless of your level of experience or expertise as an audit professional.

Finally, consider the following common concern: *"How can I best demonstrate through documentation that I have exercised sound professional judgment for an important issue; particularly considering that reviewers or inspectors examining my judgment later may question it?"* Without a thorough understanding of the key ingredients of professional judgment and a coherent way to organize and articulate a description of how you got there, this is a difficult question to answer, even when you have in fact executed the judgment process very well.

Knowing the elements of a good judgment process, having a robust understanding of a coherent, logical, and complete judgment framework, and possessing the vocabulary to articulate it well will help you document your judgments in a concise and comprehensive manner. Besides, reaching a good professional judgment requires relevant training, knowledge and experience, which will help you to make informed decisions and reach well-reasoned conclusions about the course of action that is appropriate in the circumstances. In fact, the structure of a good judgment framework can provide a robust way to organize and articulate your documentation of the more difficult audit judgments you face.

We expect our professionals to apply good judgment in every aspect of their work, including in the appropriate application of this Framework. **All judgments are not created equal — they will not all require the same degree of investment in applying the BDO Professional Judgment Framework.** Complex judgments clearly call for careful investment in the application of all elements of a good judgment process and the BDO Framework can facilitate this investment. However, even relatively simple judgment situations can benefit from quick reflection on the elements of the Framework to help ensure that nothing essential is being overlooked. In Chapter 6, we discuss how the application of the Framework will appropriately differ across judgments of varying complexity and importance.

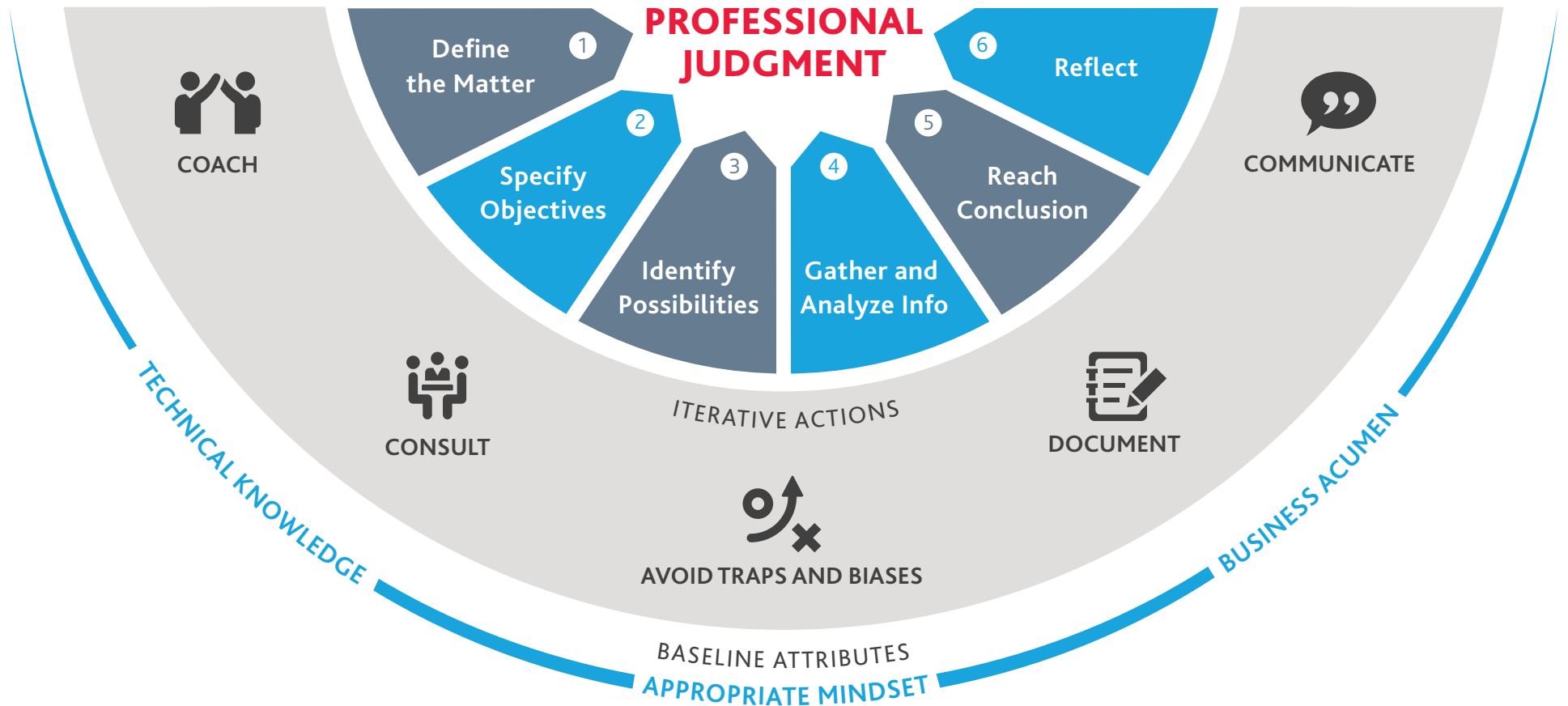
In sum, the overarching BDO Professional Judgment Framework will embed a set of behaviors to help engagement teams **address issues in a fluid, timely, collaborative and repeatable pattern.** It will drive behaviors within teams and across the firm toward consistent, desired outcomes that are supported with reasoned, evaluative judgment. It is our aim to provide our professionals with a resource to assist them in making, communicating about, and documenting the whole range of judgments they make, and in enhancing and accelerating the development of our people.



OVERVIEW OF BDO PROFESSIONAL JUDGMENT MODEL

With this background, let's examine the BDO Professional Judgment Framework, starting with the outer ring of baseline attributes, moving inward to the essential iterative actions, and then to the steps of a sound judgment process (see Figure 1). When all of the elements of the BDO Professional Judgment Framework are effectively in place, you maximize the likelihood of consistently exercising high-quality professional judgment. In other words, consistent professional judgment is accomplished by executing the steps of a good judgment process in the presence of the essential iterative actions and baseline attributes.

Figure 1: BDO Professional Judgment Framework



Baseline Attributes

The baseline attributes in the BDO Professional Judgment Framework form the foundation upon which our professional judgments rest. They represent key attributes that must be present in the people exercising professional judgment and consist of: technical knowledge, appropriate mindset, and business acumen.

- ▶ **Technical knowledge:** Relevant training, knowledge and experience, including a thorough understanding of the applicable professional and legal requirements, and our BDO audit methodology, as well as any other specialized skills or knowledge that are relevant to a particular judgment.
- ▶ **Appropriate mindset:** In audit settings, an appropriate mindset implies an attitude of professional skepticism, which is a required component of the auditor's due professional care in accordance with applicable professional and legal requirements' that applies throughout the audit — an attitude that includes being thoughtful, questioning, evaluative, and critically assessing the appropriateness and sufficiency of audit evidence and other information that is obtained to comply with the applicable auditing standard and rules. Such a mindset will lead naturally to "stepping back" on a regular basis throughout the process of making a judgment to evaluate our progress and ensure we bring professionalism to our work.
- ▶ **Business acumen:** A broad-based understanding of the audited entity and its environment including the industry and macroeconomic climate in which it operates, an understanding of BDOs core purpose and core values, as well as the emotional intelligence to navigate interpersonal interactions professionally and effectively.

These baseline attributes are expected to be present when any significant judgment is made during the conduct of an audit. It is important to note that (1) these attributes are to be interpreted and evaluated relative to the judgment being made, and (2) the necessary attributes may not all be present in a single individual for each important audit judgment, but they should be present in the "portfolio" of attributes brought together by an engagement team of professionals and the BDO team as a whole. At the outset of making any significant judgment, an evaluation should be made to ensure that the baseline attributes are collectively present in sufficient degree for the particular judgment in the individuals or team tasked with making the judgment. While the baseline attributes of technical knowledge and business acumen can be understood in terms of a "portfolio," each individual professional is expected to maintain an appropriate mindset in all judgment settings in our role of an evaluator. Additionally, this initial evaluation point in the framework would bring to light the potential need to consult with experts from around BDO who possess the deep technical knowledge required for the judgment.

Iterative Actions

The professional or team of professionals deemed as having the necessary baseline attributes relative to the judgment being made undertake a set of five iterative actions to be employed throughout as they apply the steps of a sound judgment process. They include coach, consult, avoid traps and biases, document, and communicate.

- ▶ **Coach:** Using the process of engaging in a significant audit judgment as an opportunity to develop and accelerate the judgment and business maturity of our professionals at different levels.
- ▶ **Consult:** Making use of resources outside of the team to ensure adequate levels of the baseline attributes are present relative to the judgment, to provide alternative perspectives (or frames), and to appropriately involve the firm in judgments that involve the management of significant risks. Consultation should occur throughout all levels of the engagement team as the judgment process moves forward.
- ▶ **Avoid Traps and Biases:** Proactively identifying where a judgment might be compromised by systematic judgment traps and biases, and taking steps to mitigate their potential to undermine the quality of the judgment.
- ▶ **Document:** Creating a record of the approach to making a judgment — as appropriate to the significance and importance of the judgment — including important aspects of the baseline attributes brought to bear, the essential iterative actions taken, and the steps involved in the judgment process. This is done sufficiently to justify and corroborate the soundness of the professional judgment made.
- ▶ **Communicate:** Appropriately conveying outputs of the judgment process to relevant parties in order to comply with the applicable professional standards and satisfy the expectations of the firm, legal requirements, the client, the engagement team, the investors, and other stakeholders.

As these actions are described as iterative, they can and should occur many times throughout our judgment process rather than at any one point or step.

Judgment Steps

Having the baseline attributes in place, together with a robust, iterative implementation of essential actions, we undertake the steps that comprise a sound judgment process: Define the Matter, Specify Objectives, Identify Possibilities, Gather and Analyze Information, Reach a Conclusion, and Reflect.

1. **Define the Matter:** Clearly and comprehensively articulate the matter to be addressed, the issue to be solved, the risks involved, the judgment to be made — a critical starting point that sets the direction for the entire judgment process.
2. **Specify Objectives:** Clearly specify what is to be achieved by making a judgment or coming to a conclusion — the outcome of this step guides the development of a set of possible alternative conclusions or actions to be taken.
3. **Identify Possibilities:** Develop a set of possible judgment conclusions or actions to be taken by considering how the objectives specified in Step 2 might best be achieved and the related impact of each possible outcome.
4. **Gather and Analyze Information:** Identify the information to be gathered, guided by the set of possible judgment conclusions or actions to be taken in Step 3. Gather and analyze the information—including contradictory evidence — in terms of how each conclusion or action might lead to the achievement of objectives specified in Step 2.
5. **Reach Conclusion:** Reach a judgment conclusion or decide on an action to be taken based on the information gathered and analyzed in Step 4.
6. **Reflect:** Step back and take a holistic view of the judgment process undertaken and the conclusion reached, considering whether any essential objective, possible conclusion, or information has been omitted, and whether the overall conclusion reached is reasonable from various viewpoints.

While the steps outlined above are deliberate and relatively intuitive, it can be surprisingly powerful to have access to a well-developed model of sound judgment as you approach important decisions, especially if the model is shared in common with other team members. This judgment model can provide an organizing framework for coaching, for documenting significant audit judgments, and even for operational matters where judgments and decisions are to be made. As you will see in later chapters, this simple judgment model provides a context in which to understand where people, including even the most experienced audit professionals, tend to systematically and predictably fall into judgment traps and biases.

Development Opportunities

Take a moment to consider how the BDO Professional Judgment Framework can help in undertaking each of the essential iterative actions discussed at left. For example, in coaching an associate on the engagement team, a manager on the team might briefly explain the judgment that the team is about to make using the BDO Professional Judgment Framework as an organizing principle in explaining the essential elements and process. Given that both professionals have been trained in the essentials of the Framework and the underlying concepts and vocabulary, the process of coaching will be consistent, effective, and efficient. The associate will be able to reference the Framework in organizing and making sense of her or his experience as the judgment process is undertaken. The Framework will provide a way for the associate to better understand tasks assigned to her or him in a broader context and to better articulate questions that arise. At the end of the process, when the judgment has been made, the manager can then coach the associate by pointing to baseline attributes, essential iterative actions, and steps in the judgment process that went well or that need improvement. In this example and in practice, the Framework provides a shared conceptual tool to organize, understand, and convey the coaching and development of our less experienced professionals. A similar application of the Framework can be made as to how it can facilitate each of the iterative actions outlined above.

SUMMARY

Learning to drive a car requires a form of conceptual framework that defines the baseline attributes of those who are allowed to take the wheel, understanding the actions that must be regularly and iteratively taken to ensure proper maintenance and knowing the basic process of safely operating the vehicle on the road, while being aware of other drivers and varying road conditions. Similarly, making complex professional audit judgments can be difficult no matter what stage of our career we are in; but having a shared conceptual framework can facilitate our collective efforts. The reality is that no matter how experienced and expert we are in applying professional judgment, we can all improve — no one has perfected the art of judgment and decision making! Having a shared, firm-wide professional judgment framework won't always result in flawless decisions, but it will help elevate the quality of our judgment processes and our judgments overall.

It is our expectation that the firm-wide implementation of the BDO Professional Judgment Framework will serve to provide a shared conceptual foundation and common vocabulary for our audit professionals, and a context to understand where predictable and systematic traps and biases can derail good judgment. It will encourage consistent behavior in driving toward desired outcomes. The Framework will facilitate consistency in reaching our objective of making sound professional judgments supported by justifiable conclusions and effective documentation. The Framework will also aid us in dealing with and clearly communicating complex issues, and in the development of our people at BDO. Good judgment takes experience, but it also takes training, repetition, and consistent application — the BDO Professional Judgment Framework provides the foundation for this effort across the firm.

We discuss the three primary components of the BDO Professional Judgment Framework in the next three chapters, beginning with a chapter on the six-step judgment process at the core of the model, followed by a chapter on the essential actions that must take place iteratively as we undertake the judgment process, and then by a chapter on the baseline attributes that must be in place for a judgment process to be effective.

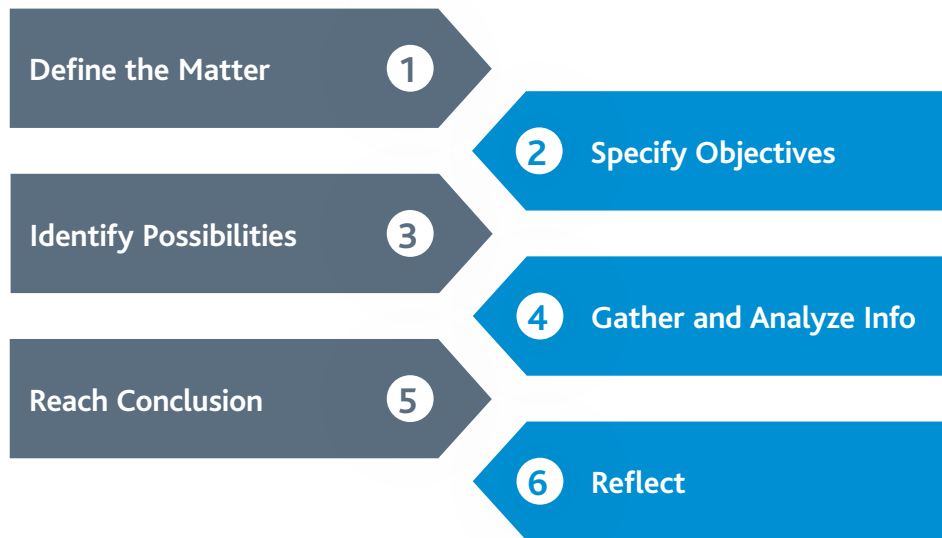


CHAPTER 2

The Steps of a Sound Professional Judgment Process

The six steps of the judgment process at the core of the BDO Professional Judgment Framework are each individually crucial to a sound judgment process (see Figure 2). In this chapter, we discuss important considerations in performing these steps and we discuss judgment traps that might be encountered when performing each step, as well as ways to avoid these traps. Judgment traps are common errors that are often made by even the best, most experienced professionals. Understanding what to do and what not to do throughout the judgment process is essential to high-quality judgments. Together, these six steps make up the core of a good judgment process that takes place within the context of the baseline attributes and the iterative actions in the Framework.

Figure 2: Six Steps of Professional Judgment



STEP 1: DEFINE THE MATTER

Taking the time to get a clear, shared understanding of the matter at hand may be the most important step of the judgment process — it lays the foundation for everything that follows, from specifying the objectives of the judgment process to identifying possibilities for resolution, gathering and analyzing information, and reaching a conclusion. However, Step 1 is the most commonly overlooked step in a judgment process. **Under-investing in this step is responsible for more suboptimal judgments than any other step in the process.** While in straightforward judgment settings this step can be very simple or completed quickly, it is important to note that for more complex judgments, getting to a clear, shared identification and understanding of the underlying matters or potential issues can take a significant amount of time and effort. Yet, the upfront time invested will invariably help with team alignment and will preempt potential rework later in the process.

Have you ever embarked on a judgment process where you thought everyone was on the same page but then other team members began offering possibilities for resolution that seemed somehow off-base? Or have you asked a newer member of the team to gather information and supporting evidence and they came back with an analysis that didn't address the crux of the matter? Or maybe you've been in a group discussion that seemed to epitomize the proverbial "ships passing in the night," but you couldn't quite put your finger on why the various parties, who typically see eye-to-eye, didn't seem to understand each other? These scenarios happen more frequently than any of us would care to admit, and they are all signs of under-investment in Step 1: Define the Matter.

Under-investment in Step 1 of a good judgment process often happens because **we assume we have a good grasp of the key matter at hand**. Unfortunately, our definition of the matter may not be precise enough to allow for clear thinking in subsequent steps or it may be too narrowly specified. We often are susceptible to under-investing here because the key matter may seem obvious — far more obvious than it might actually be. Step 1 is critically important because, as Stephen R. Covey, author of *Seven Habits of Highly Effective People*, said, *“If the ladder is not leaning against the right wall, every step we take just gets us to the wrong place faster.”*

A key part of fully defining the matter involves fully appreciating and assessing the related risks. Risk assessment is a key foundation of our audits and occurs before we undertake any substantive procedures or perform detailed analysis. It helps us to focus our attention where it really matters. As we work to identify the matter at hand, we should determine where risks might exist so we can appropriately consider them throughout the rest of the process.

For every meaningful judgment we are faced with, it is worth asking: Do we fully and clearly understand the matter at hand and the risks involved? And: Is this understanding shared by all involved in making the judgment? For simple judgments, this might require a 10-second pause, while for extremely complex judgments, this step can involve hours or even days. Proper identification and alignment by the team in defining a complex matter will require us to bring to bear our business acumen and technical skills, all with an appropriate mindset of professional skepticism. But it is important to realize that getting to a clear, shared understanding of the matter is often not nearly as obvious or as simple as it may seem at first glance.

Three of the most damaging judgment traps can occur in Step 1 of the judgment process. After putting a label on these traps, you will start to see them all around you in the decisions people make (and you will likely start to see them in your own judgments as well.). Fortunately, awareness of the traps will allow us to identify strategies to avoid and overcome these common pitfalls.

Rush to Solve.

Successful professionals are often characterized as decisive “problem solvers.” This is because proactively tackling problems and solving them is a big part of how effective professionals achieve their success. This is an important trait. However, as with many key strengths, there’s an associated potential downside. “Problem solvers” often tend toward immediate action, and sometimes this tendency for action can result in an under-investment in Step 1. This tendency is referred to as “the rush to solve.” The problem with being in a rush to solve is that a quick and effective solution may not address the right problem.

The key to avoiding the rush to solve trap is to pause for as long as needed before taking action to be sure we individually, and collectively in our teams, have a clear and shared understanding of the matter to be resolved. This can often require only a few minutes of time, even for fairly significant judgment situations. But even if it requires lengthy discussion, it is likely to be time well spent. If you have an hour to solve a problem, spending the first 45 minutes on clearly defining the problem often is key to effectively solving the problem in the last 15 minutes. **Remember, a good solution to the right problem is better than a great solution to the wrong problem!**

While maintaining our orientation toward solving problems, we must avoid the rush to solve trap that can so often lead to under-investment in Step 1. The rush to solve trap can also derail other steps in the Judgment Framework as we will see below.

Decision Trigger.

For every judgment situation, there is, by definition, an event or a piece of information that initially makes us aware that we have a judgment to make. A “decision trigger” comes about due to the way we are made aware of a judgment situation, which often has an undue influence on how we define the matter to be resolved. A decision trigger can cause us to define the matter too narrowly, often in terms of simply making a selection among an artificially restricted set of possibilities (see Step 3). In other words, a decision trigger is yet another reason people tend to under-invest in Step 1 of a good judgment process, skipping straight to a constricted Step 3. For example, suppose you have an alarm system in your home. It is older, but it serves its purpose reasonably well. However, you get a call from a salesperson telling you that they can install a newer system that includes new features. The phone call proposing a particular new system is the “trigger.” Most people will immediately approach such a situation by conceptualizing it as a choice between staying with their existing system or buying the one the salesperson has proposed. In other words, Step 1 has been automatically defined in terms of selecting between a constrained set of possible options. But in reality, taking a few moments to come to a clear understanding of the matter at hand (e.g., achieving adequate security for your home given the risks you are most concerned about), and to clearly define your key objectives in resolving the matter (e.g., system reliability, ability to control while away, avoiding hacking or override, etc.), may well lead you to conclude that neither of the two options (keep existing system or go with the salesperson’s proposed upgrade) is best. This example might seem overly obvious, but the very reason that decision triggers can be so insidious is that they tend to blind us to a broader consideration of the important aspects of the matter at hand.

In hindsight, particularly after a suboptimal judgment, the broader view often seems quite obvious. But **key to avoiding the decision trigger trap is identifying the trigger and the influence it can have on the judgment process.** Every decision and judgment we make has one. Decision triggers aren’t inherently bad. They only become a trap when we allow the trigger to replace Step 1. But when we pause and recognize the trigger for what it is, then begin working on Step 1 to define the underlying matter at hand, we will avoid getting tripped up by this trap.



Frozen Frames.

In conceptualizing any given judgment situation, we start with a perspective or mental “frame” that represents the situation in our minds. We build on this underlying mental frame as we elaborate our understanding of the situation, but the frame guides our understanding throughout. A mental frame is simply a cognitive structure in the mind that allows us to conceptualize and understand a situation.

A frame is a particular perspective that simplifies the complex world we interact with, allowing us to cope with complexity that would otherwise overwhelm our capacity. These frames enable us to understand a given judgment situation, but they also serve to limit our ability to “see” other perspectives. Instead, we can find ourselves “frozen” into a single way of seeing a situation. Further, we are usually unaware of the frame we are using or even the fact that we have a frame at all. This can prove to be a significant trap in effectively defining a clear, shared understanding of the matter at hand.

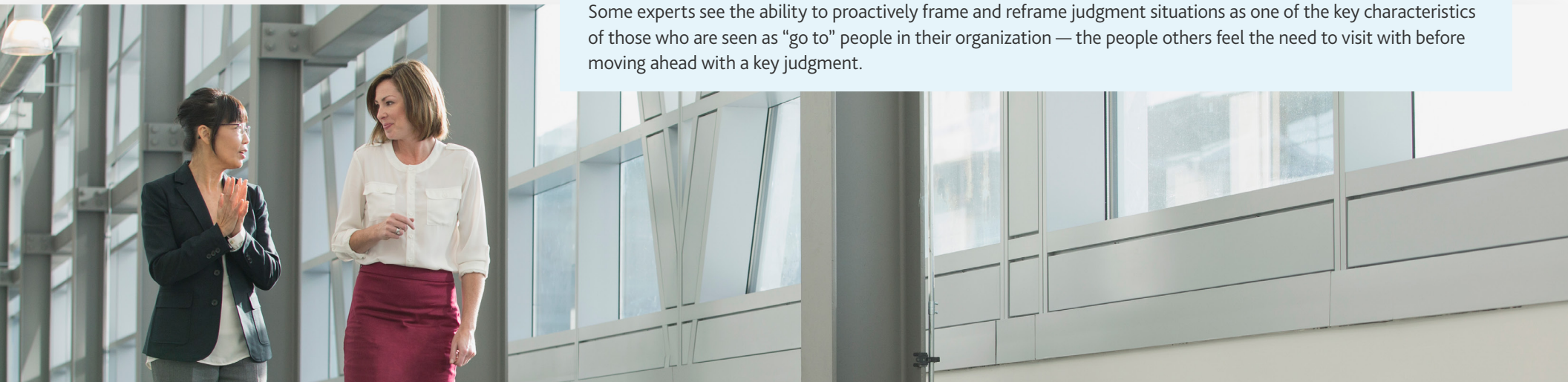
The key to avoiding the frozen frame trap is to engage in proactive framing to understand the issue from different perspectives. We usually need to broaden our perspective in defining the matter to be resolved. In other words, we need to deliberately identify the frame that is being used and then seek out alternative frames that might shed a different, and perhaps broader, light on the matter.

For example, management at our audit clients will present information to us with a particular frame in mind, perhaps relating to the need for a particular disclosure. We can help management consider other frames by asking questions such as “Do you think investors might view this disclosure differently?” Or “I can see how, from your perspective, this disclosure makes perfect sense, but from the SEC’s point of view, might they see the appropriateness of the disclosure differently?” Or perhaps “How will this look in hindsight or if it were reported in the business press?”

Proactive framing and reframing can often be accomplished by establishing intellectually diverse teams and by inviting and encouraging the expression of different viewpoints. People often tend to be too narrow in their efforts to define the matter to be resolved, so it is worthwhile to pause and to consider the big picture, explore the matter further, and look for ways we might approach it differently. Remember, there is no single best frame. Frames are simply different perspectives. Proactive framing can be quite difficult. One way to reduce the difficulty is to give yourself permission in advance to disagree with the alternative frames that you choose to consider. Seeing things from another person’s point of view doesn’t mean you have to agree with that point of view, but if you don’t proactively make the effort to understand other frames, it will be difficult for you to arrive at a shared understanding.

Actively considering the views of others can feel like nails on a chalkboard — it is cognitively painful, so most people avoid it. However, avoiding proactive framing ensures that you fall prey to the frozen frame trap.

Some experts see the ability to proactively frame and reframe judgment situations as one of the key characteristics of those who are seen as “go to” people in their organization — the people others feel the need to visit with before moving ahead with a key judgment.



STEP 2: SPECIFY OBJECTIVES

Although under-investment in Step 1 is a common cause of sub-optimal judgments, Step 2 is essential and is commonly neglected as well. In fact, **sufficient emphasis on Steps 1 and 2 is often the best predictor of a high-quality judgment.** Why is it so important that we carefully specify our objectives? If we neglect this important step, we may inadvertently arrive at a solution that is related to the matter at hand, but is sub-optimal, or fails to address important professional objectives, including those required by standards. It is common for teams to get to work implementing a chosen possibility for resolving the matter only to realize later that the chosen possibility did not achieve what was hoped — often because the objectives were not clearly specified early in the process.

Taking the time to clearly and completely specify our objectives in a significant judgment situation can be surprisingly powerful and may open our eyes to additional possibilities for resolving the matter that we may not have been able to identify otherwise.

Additionally, a clearly specified set of objectives will serve as the criteria against which we evaluate identified possibilities in reaching a conclusion (Step 5). We should ask ourselves if achieving the objectives we've specified will directly contribute to solving the matter at hand in a way that meets the expectations of our key stakeholders. If they do not, we should revisit how we are specifying the objectives until we determine we can answer that they will contribute to and meet and exceed expectations.

There are two common traps that can occur in Step 2.

Rush to Solve.

This is the same “rush to solve” trap that we discussed in Step 1. The same tendency to tackle the matter by rolling up our sleeves and taking immediate action can cause us to skip the step of defining what we hope to accomplish in the judgment process. Under-investment in Step 2 can result in an artificially restricted set of possibilities that are identified in Step 3, or selection of a sub-optimal possibility. The time we spend investing in Steps 1 and 2 of the judgment process must be sufficient to ensure that our path through the remainder of the judgment steps is taking us in the right direction. Time spent on Steps 1 and 2 will save time and resources in the long run by avoiding unnecessary re-work and costly errors.

Means to an End.

While it is obviously important that the set of objectives we specify be clear and complete, it is also important that we specify our objectives in terms of true ends, as opposed to the common tendency to articulate them in terms of means to an end. Only after we have clearly specified the objectives we wish to achieve, in terms of our end goals, can those objectives help us appropriately expand the set of possibilities we will identify in Step 3. Then our objectives can serve as effective criteria for evaluating the possibilities we have identified as we engage in Steps 4 and 5.

A good way to test whether the objectives we've specified in Step 2 are truly ends rather than means is to repeatedly challenge them by asking “Why?” until the answer to the “Why?” question is simply, “*Well it is entirely self-evident.*” For example, you might decide that a personal objective you have in life is to save \$1,000,000 for retirement. Is that really an end or a means to an end? Test the objective by asking, “*Why do I want to save \$1,000,000 for retirement?*” The answer might be, “*Because someday I want to be able to retire.*” Again, “Why?” Now we get to the crux of the issue. Perhaps you like to travel, or you'd like to spend more time with family. Asking “Why?” to these objectives probably no longer makes sense — they simply reflect your preferences and values. When these true objectives are understood, it may influence how you go about saving money for retirement or how you manage trade-offs between taking time to earn extra money versus maintaining your health or nurturing family relationships. In other words, specifying true, end objectives will directly influence the alternatives you identify and choose to pursue. Once you've asked “why” until it no longer makes sense to ask, you can feel comfortable that you've identified a true end objective and you've avoided the means to an end trap.

STEP 3: IDENTIFY POSSIBILITIES

Once we have identified the matter and specified our objectives, it's time to identify the possible alternatives that will allow us to address the matter at hand while meeting our objectives. We approach Step 3 by asking "how" we can resolve the matter and achieve the objectives identified in Step 1 and Step 2. The answers that we develop in response to this "how" question will lead to the possibilities we will identify in Step 3. (This is why those first two steps are so critical!)

Step 3 of the judgment process often requires a disciplined balance of outside-of-the-box thinking — identifying possibilities that are not typical, yet also **in-the-box thinking** — as sometimes an appropriate approach and possible outcomes stems from experience on similar judgments. The reason Step 3 is so important, particularly for complex, difficult, high-stakes judgments, is that our final judgment can **only be as good as the best possibility we considered**. If we underinvest in this step, we may carelessly not identify appropriate possibilities for the situation. If we don't identify suitable possibilities, we can't implement them. Properly performing this step requires being open to all possibilities, not starting our analysis by trying to confirm or disconfirm the client's desired approach. The most appropriate possibilities are sometimes not the same as the client's preference, and we will limit our ability to identify and select from a broader set of possibilities if we start by trying to justify the client's position. It is our professional responsibility to take a step back and start with a 'blank sheet of paper' in identifying all relevant possibilities given the issue at hand and our stated objectives. For completeness and a check against unintended traps, it can help to get others' perspectives on possibilities we might be missing.

How can we identify possibilities or options to address the matter at hand? Some possibilities will include what we have done in similar situations, but we can't stop there. When considering what has been done in similar situations, we should consider whether circumstances, or objectives, have changed or could impact other results. What didn't work before might work now. We might consider what we have learned since the last time we faced a similar issue that could alter the possibilities before us. Or we might consider the ways in which similar situations are dissimilar: are there key details that give rise to new possibilities that should be considered, or that eliminate possibilities that were once relevant? Are there new techniques for gathering and analyzing evidence that open doors to new possibilities?

Again, if we start with a 'blank sheet of paper' and seek outside input, we will likely identify possibilities that didn't occur to us in these other situations, or that we did identify previously but did not select, though these options may be more appropriate in the current situation.

There are three common judgment traps we need to be especially careful of when identifying possibilities.

SALY (Same As Last Year).

Identify Possibilities is the step in the judgment process where true innovation can happen. Though the alternative we eventually select may end up being very similar to what has been done before, if what we have done before is the only option in the set of possibilities we identify, we have likely fallen prey to the SALY trap. Doing what has been done before is not necessarily a bad thing. These are typically tried and tested solutions. However, as Benjamin Franklin is reported to have said: *"When you're finished changing, you're finished."* We must continue to innovate and provide the most appropriate solutions for a given situation. Sometimes, that solution is the same as last year. Often, however, the solution will require innovation beyond what has been done before.

To overcome the SALY trap, we should actively identify the SALY or near-SALY possibilities and ensure that these are not the only possibilities we identify. For example, if we are writing down a list of possibilities we have identified, labelling the SALY options will highlight whether or not we are trapped in SALY thinking. If everything we have on our list is labelled SALY, we likely shouldn't end our consideration of possible alternatives.

Idea Production Blocking.

Identifying all relevant possibilities requires innovation, so we need to be careful of actions that might shut down creative thinking. Though working in teams comes with tremendous advantages, one challenge of teamwork is **groupthink**, where the team coalesces around a single way of thinking. There are many reasons this may happen — a dominant personality on the team, a desire to please or to avoid conflict, and so on. Another reason is that once we hear an idea, it's hard to set that idea aside and think of a new, completely independent idea. In other words, starting with a 'blank sheet of paper' is very, very difficult.

Idea Production Blocking occurs when an idea is shared and that idea inadvertently shuts down additional, new ideas. For example, if you asked someone to list as many fictional story characters as they can in 30 seconds and began by saying, "For example: *Huckleberry Finn*," you will likely get a much shorter list, on average, than if you don't give the "*Huckleberry Finn*" example.

With the "*Huckleberry Finn*" idea in mind, idea production is somewhat blocked. The person you asked for characters will likely respond with "*Tom Sawyer*," then move to other characters in books. Whereas a person given no example is more likely to draw from a much larger pool for their list of fictional characters, including movies, songs, fairy tales, cartoons, and books.

So, how do we get the benefit of teamwork without falling prey to idea production blocking? There are some simple strategies that will help. For instance, if we plan to work together as a team to generate alternatives, we should make sure the team knows in advance to be thinking of alternatives on their own. Setting this expectation is important because we never know who might provide thought provoking ideas. It is important to create an environment where less experienced team members feel comfortable sharing ideas without the fear of ridicule as this can stunt their innovative mindset early in their career.



Evaluation Apprehension.

Isaac Asimov, famed science fiction writer, once explained: *"...as far as creativity is concerned, isolation is required...the presence of others can only inhibit this process, since creation is embarrassing. For every new good idea you have, there are a hundred...foolish ones, which you naturally do not care to display."* When working in teams, some people find the sharing of new ideas difficult, and even professionally dangerous.

Many times, the team members who may have the most applicable thoughts regarding possible solutions to the issue at hand are those who are in the field every day and are often the most apprehensive about sharing.

If these team members are inhibited with concern over how they will be evaluated, they are likely susceptible to holding back, staying quiet, and deferring to more senior team members. We fall prey to the evaluation apprehension trap when we stay silent to avoid embarrassment, even though we may have valuable insights.

Overcoming this trap happens from the bottom up and from the top down. Every team member should have the confidence that their input is valuable and may lead to furthering and expanding perspectives. If that were not true, the individual would not be on the team. This confidence will strengthen with experience. Further, every team member should know that it is their responsibility to participate, even if they believe doing so might expose them to unwanted evaluation.

Engagement team leaders should be supportive of and empowering to team members who they believe may fall prey to evaluation apprehension. We must not allow our team members to stay quiet when their views are needed. Provide assurances to your team that being on a team requires everyone's input, and sometimes the most important input comes from those who are newest to the team. Evaluation apprehension is a natural human tendency, but if we are going to identify appropriate possible solutions to the issues at hand, we must avoid falling prey to this trap.

When working as a group to brainstorm, consider using **clustering**. This alternative to traditional brainstorming works as follows:

Before discussing any ideas, have everyone on the team write down their ideas on sticky notes — one idea per note. After sufficient time has been given to generate ideas, it's time to share the ideas. One by one, have each member of the team present every idea they wrote down — even ideas that have already been presented. As ideas are presented, stick the notes to the wall — clustering ideas that are similar together on the wall. This will do three things: 1) It ensures that being the person to present last doesn't mean you have nothing to add. 2) This method ensures that no one will free ride — an individual team member may not have any unique ideas, but they should at least have ideas that can be added to existing clusters. 3) Even the simple process of writing these ideas on sticky notes privately, then talking through each note, is a powerful way of drawing out the best ideas of the group without falling prey to the idea production blocking trap.



STEP 4: GATHER AND ANALYZE INFORMATION

Once we have identified the possible approaches and outcomes to the matter at hand, it's time to start gathering and analyzing information related to these possibilities. Interestingly, though this is the fourth step in the judgment model, it is often the first step we want to take. We tend to give limited consideration to the first three steps and immediately jump to data analysis. Partly, this is because gathering and analyzing information feels like work. We might feel like we're actually getting something done rather than just talking or thinking about doing work, but jumping to this step too soon is the rush to solve trap discussed in previous steps.

Gathering and analyzing information will require that we have the technical knowledge necessary for the task at hand (discussed further in Chapter 4). It will also require that we stay vigilant and work hard to avoid bias (discussed in Chapters 3 and 5). **Bias can be especially dangerous at this stage in our judgment process, as our personal preferences, background, and incentives can affect what information we gather and how we interpret that information.**

When gathering information, we should consider applicable standards, precedent-setting guidance, previous experience, industry practices, firm guidance, team member insights, etc. We should never limit ourselves to just a small handful of go-to sources for applicable information. That said, not all information is applicable.

We should carefully consider the reliability, validity, certainty, and accuracy of information and we should evaluate data that both supports and contradicts options under consideration.

Our analyses must be sound and our techniques used must be appropriate for the matter at hand.

Additionally, we need to be sure that the information and evidence used in our analysis should always extend beyond inquiry of management and schedules prepared by management. As the audit standards say, inquiry alone is never sufficient audit evidence, even though it is a key piece of the information we gather and analyze. After taking a step back and reviewing the population of information we have gathered, if only inquiries or management-prepared schedules make up this population, we should continue to seek out additional information from reliable outside sources to be certain we have everything we need to make a high-quality judgment. And if there is no information in our analysis that provides contradictory points of view, we may need to keep gathering.

There are many judgment traps associated with this step in the judgment process. Avoiding these traps is essential, as the information we gather and the analyses we perform will determine our final conclusion.

WYSIATI.

Many are familiar with the term "WYSIWYG" (pronounced "wizzy-wig"). This stands for "What You See Is What You Get." Fewer may be familiar with the term WYSIATI (pronounced "wizzy-ahhtty"), though many fall victim to the WYSIATI trap. WYSIATI stands for "What You See Is All There Is." When gathering information, it is essential that we don't fall prey to the common tendency to assume that the data immediately available to us is "all there is." Sometimes we have to dig for the most valuable information.

How do we avoid getting caught in the WYSIATI trap? As the auditing standards require of audit evidence, we must ensure that we have **sufficient** and **appropriate** information. **Sufficiency** refers to the quantity of information gathered. We can rarely gather every piece of information that is potentially relevant to a decision, but we must look beyond the obvious and ensure that we haven't missed valuable information that may be instrumental in our final judgment. **Appropriateness** refers to the completeness and quality of information. Some information, while superficially relevant to our judgment, may be less valuable because it lacks appropriateness in regards to reliability. For example, information that comes from a questionable source, that is incomplete, or that is highly subjective in nature is less reliable and thus, less appropriate. This information should not be ignored, but it should be duly weighted in our analyses.

Information Overload.

The pendulum of information sufficiency swings in two directions and can swing too far either way. We may assume that we have everything we need without additional data gathering (WYSIATI), but we may also gather so much information that it becomes burdensome and difficult to perform appropriate data analyses.

Avoiding information overload usually just requires looking back to Steps 1 and 2. What is the matter under consideration, and what are the objectives? With these steps as guideposts, we should work to ensure that we've gathered pertinent information and avoid gathering and analyzing information that does not relate to the issue at hand or pertain to the objectives we have specified.

Intuitive Statistician.

When analyzing data, sometimes we are tempted to "go with our gut." Indeed, some judgments require just that — a qualitative assessment of information based on experience and good professional instinct. However, most judgments can and should be backed by rigorous analyses grounded in sound techniques. Sometimes these techniques include the use of statistics. The intuitive statistician trap occurs when we "go with our gut" when we could have used more rigorous approaches to analyze data. The problem with using intuition is that **humans are very poor intuitive statisticians. In fact, even statisticians are poor intuitive statisticians.**

How do we avoid falling prey to the intuitive statistician trap? Simple: we need to always use the right tools for our analyses. When the task at hand calls for a statistical test or other rigorous analysis, **don't go with your gut, go with supportable evidence.**

FOLLOWING ARE SOME COMMON MANIFESTATIONS OF THE INTUITIVE STATISTICIAN TRAP:

Illusory Correlations. People see correlations when they are not really there. For example, a manager may glance at sales and customer satisfaction data and see a correlation between these two metrics when, in reality, there is no correlation to be found.

Invisible Correlations. People don't see correlations when they are there. For example, a manager looking at two performance metrics (say sales and customer satisfaction, as in the previous example) and does not see a correlation, but the actual statistical correlation is quite strong.

Hot Hand Fallacy. People see random repetitions of an event and believe the event is not random, but indicative of an underlying pattern. This fallacy was first demonstrated in sports but is prevalent in business settings as well. For example, when considering the performance of a firm, our tendency may be to assume a pattern after viewing two upward (or downward) quarterly outcomes, when statistically-speaking there is no pattern.

Gambler's Fallacy. People believe that random repetitions of an event will "correct" and go the opposite direction. For example, for events that understand to be truly random, we might still believe we can predict future events based on past, random events. This fallacy was first identified among gamblers ("This slot machine is due for a win."); but the fallacy is frequently seen in professional settings. For example, if weather has negatively impacted a business segment for the past three years straight, we might assume that the probability of a fourth year of bad luck is extremely unlikely. But past random outcomes do not predict future random outcomes. Consider flipping a coin: getting heads three times in a row does not mean the next flip is more likely to be tails. The next flip has a 50-50 chance of being tails, just like the first three flips.

Base Rate Neglect. People tend to assess probabilities without taking sufficient account of the base-rate probability of that event. For example, in considering the financial performance of a given division, we may look at common measures of their financial performance but ignore economy-wide indicators that could have a tremendous impact on financial outcomes. The base-rate performance we should expect, given the economy, must not be ignored or underweighted when developing our expectations.

STEP 5: REACH CONCLUSION

Reaching a conclusion can be either the easiest or the most difficult step in the judgment process. Sometimes, after we have gathered and analyzed the information relating to each of the possibilities we've identified, the solution is obvious: there is one and only one right way to go. Other times, even after collecting and thoroughly analyzing data for our possible alternatives, we are left to make a subjective determination. There is not one right way to reach a conclusion when subjectivity is involved. There are, however, three general ways you might consider making a decision in Step 5.

1. **Follow intuition.** Intuitive choices are very efficient, but not always effective. They are best used when the judgment is of low importance or when a speedy decision is needed.
2. **Follow heuristics.** Heuristics are general rules or shortcuts that we use to simplify difficult judgments. For example, consider the selection of your seat on an airline flight. Rather than think about exactly which seat you want to sit in, you might use the heuristic of always sitting close to the front (or close to the back, or near the exit rows). This reduces complexity because it doesn't require consideration of all possible options. The problem with heuristics is that they often lead us to overlook the objectives we specified in Step 2. Thus, heuristics can greatly accelerate reaching a conclusion, but can diminish the quality of our judgment by overriding the work put into prior steps in the judgment process.
3. **Objectifying the subjective.** At some point, we may need to rely on intuition or simplifying heuristics, to some degree. However, it is best to use the most objective process possible for coming to our conclusion. We might consider using a weighting model that looks at the pros and cons of each alternative under consideration. We might even apply weights to conflicting objectives. For example, a company may want to increase cost transparency for their customers while maintaining their competitive pricing advantage over their competitors, but it may not be possible to share cost information with customers while ensuring competitors do not learn these costs. As possibilities are considered in arriving at a conclusion, management must weigh the importance of each stated objective and consider how the alternatives available achieve or fail to achieve these objectives.

Though it is difficult to provide explicit guidance regarding how to reach a conclusion in every situation, there are certain traps to avoid when coming to a conclusion. In other words, knowing what NOT to do can be just as helpful as knowing what to do when trying to reach a conclusion.

Ego Depletion.

The first and most common trap at the Reach Conclusion stage of the judgment process is making a final conclusion when we are mentally or emotionally worn out. **Ego depletion** is the idea that our ability to exercise good judgment and exhibit self-control draws from a finite source that can be used up. You can think of it a bucket that starts full at the beginning of the day but empties out as we work throughout the day. When the bucket is empty, our ability to make sound conclusions likely will be impaired.

Avoiding the ego depletion trap is very important. Good judgment requires a full bucket to reach a conclusion. If we are worn out and not at the top of our game, it is best to hold off on a reaching a conclusion until we've had time to rest and recuperate.

Surrogation.

Surrogation is the tendency to treat a performance metric as though it **is** what it purports to **represent**. For example, earnings is a **measure** of financial health, it is not **financial health**. A company with high earnings, large, negative cash flows and low cash reserves may not be financially healthy. An investor who falls prey to the surrogation trap might invest in this company because the investor acts as though what they wanted in an investment was high earnings (the metric) when instead, they wanted financial health (the true goal).

The problem with surrogation is that it may lead us to take actions that improve performance of the **metric** (or avoid actions that might negatively affect the metric) while hurting what we care about most. Consider a person wishing to improve their health. If the sole metric of health they consider is **weight**, they may become discouraged when they begin a strength training regimen. Because muscle weighs more than fat, their weight will likely increase at first. Abandoning the strength training might seem to make sense (because of surrogation), but this choice would have a negative effect on the individual's health.

The surrogation trap is especially problematic in Step 5. It is at this point that we are considering the impact of different actions we may take. We must ensure that we are thinking about the impact of our choice on what we care most about and not about imperfect metrics of these constructs. Avoiding the surrogation trap can be difficult. The first step is to carefully consider what each metric we use represents. Metrics are typically not, in and of themselves, useful. They are reflections of something else that matters to us. Engaging in this high-level thinking, always asking ourselves “*what is the goal I really care about*” and “*what does this metric represent*” are helpful in avoiding surrogation.

Paralysis by Analysis.

When no single conclusion jumps out as the obvious choice, our task becomes more difficult. Sometimes we need to go back and revisit our data analysis to help us differentiate between alternatives and select the best option. However, if the “optimal” choice cannot be identified, there may be some uncertainty in the conclusion that we reach. In these moments, we are at risk of the paralysis by analysis trap — continually analyzing our options and never reaching a final conclusion.

Avoiding paralysis by analysis may require including in Step 2 an explicit objective to reach a conclusion by a deadline or within a resource budget constraint. If the conclusion cannot be reached within that constraint, then the team should consult with and request input from others at BDO.

Conformity.

Most people have an aversion to being too different from their peers. Even self-proclaimed “non-conformists” may become uncomfortable standing out from the crowd in unpleasant ways. The tendency to want to conform to the behavior of other is, at some level, almost universal. Conformity becomes a trap when it leads groups to reach a consensus even though some members of the group may have misgivings about the agreed-upon conclusion. Sometimes multiple team members may disagree with the conclusion, but they believe everyone else agrees (a phenomenon known as **pluralistic ignorance**). The conformity trap is one of the major culprits behind the **groupthink** problem — where the group tends to behave as a single individual rather than as independent decision makers working together to add value from their diverse backgrounds.

Related to the conformity trap is the tendency to fully align opinions with a strong leader. While following good leadership is important, blind conformity and false agreement with a leader is detrimental to professional judgment. Good leaders are critical to the success of a team, but leaders are not omniscient. They work with a team in part because of the different perspectives, or frames, various team members can provide.

Avoiding the conformity trap can be difficult. For an individual to avoid this trap, they must have confidence in who they are and in their own skills and knowledge. They must also have the courage to swim against the tide when necessary. Fortunately, team members who simply express doubt (without actively fighting the rest of the group) can be the key to opening the door for others to express their views that may contradict the consensus. When a single member of a team expresses a contrary opinion, the conformity trap begins to dissipate and the full benefit of working with a team with differing points of view can be realized.

STEP 6: REFLECT

Though we reached a conclusion in Step 5, we have not yet completed our professional judgment process. The last step, Reflect, is an essential component to good judgment and to the development of our professionals.

Engaging in this final step allows a final opportunity to ensure that our judgment is sound and supportable and it also allows us to build experience and judgment maturity in our teams.

First, as we reflect on the judgment process, we consider whether our judgment was compromised in any way. We consider each of the five steps and whether we invested sufficient energy and resources into each step in the judgment process. We consider whether we appropriately engaged in all of the iterative actions (discussed in Chapter 3) necessary for good judgment. Further, we reevaluate whether the baseline attributes (discussed in Chapter 4) were present to support our final conclusions.

People often tend to simply skip the Reflect step; doing so can lead to suboptimal judgment. It also surrenders a valuable opportunity to identify ways we can learn and develop better judgment skills in our people. Too often an important matter may be identified in the field by an associate on the team, only to be elevated and solved by senior associate or manager without circling back to the associate to discuss the matter and how a final conclusion was reached. Fully engaging in Step 6 avoids this tendency by allowing us to examine the effectiveness of our judgment process and recognize opportunities for our own improvement, as well as opportunities to develop the professional judgment maturity of others.

Reflecting on our judgment does not have to take as much time as the other steps, but it **should be done deliberately and thoroughly**. Several introspective questions that could be considered when reflecting on our judgment include:

- ▶ Did we spend sufficient time and resources defining the matter and specifying objectives?
- ▶ Did we take time to identify all relevant possibilities, given the matter and objectives defined and specified in Steps 1 and 2?
- ▶ Did we gather and analyze the information (both confirming and disconfirming) related to each possibility we identified in Step 3?
- ▶ Did we reach a conclusion that appropriately addressed the matter, while meeting the objectives we specified in Step 2?
- ▶ Did we engage in proactive framing, considering how our conclusions may be interpreted and received by others who were not part of the judgment process?
- ▶ Did we fall prey to any of the judgment traps common to each step in the judgment process?
- ▶ Was our judgment influenced by biases (discussed further in Chapter 5)?
- ▶ Did we spend too little time (or too much time) at any stage of the judgment process?
- ▶ Did we take opportunities to coach those we worked with in the judgment process?
- ▶ Did we consult with others when necessary, and sufficiently consider their input to allow an outside perspective to inform our decisions?
- ▶ Did we appropriately document our judgment process, using the concepts and vocabulary found in the BDO Professional Judgment Framework?
- ▶ Did we communicate with all key parties throughout the judgment process and thoroughly consider feedback received?
- ▶ Will this judgment have a resulting impact on other areas within the audit?

Even during the final step of the judgment process we must carefully avoid judgment traps.

Historian's Fallacy.

The historian's fallacy trap takes two forms. The first is the tendency, when looking back on a judgment, to overlook the “fog of war,” or the uncertainty that existed during the judgment process. For example, once we have a shared understanding of the matter at hand and of our objectives, we may tend to forget the work it took to arrive at that understanding. We may then reflect on Steps 1 and 2 of the judgment process and believe that perhaps we overinvested in these steps, and that next time we should move more quickly during the early stages of our judgment.

Similar to the antidote for the frozen frame trap, proactive framing can help us avoid the historian's fallacy trap. Using proactive framing, we can attempt to evaluate the judgment process from the perspective of someone currently engaged in that process, rather than only from our current perspective at the end of the judgment process. This type of proactive framing can be especially difficult due to what is known as the **curse of knowledge**: once we have obtained knowledge, it is hard to remember what it was like to not have that knowledge. Effective documentation of our judgment process (discussed in Chapter 3) can be helpful in overcoming the curse of knowledge so we can avoid falling prey to the historian's fallacy.

Another form of the historian's fallacy is the tendency to consider the effectiveness of a judgment process by looking at the outcome of the process, rather than by considering the process independent of any hindsight that comes with a knowledge of outcomes. For example, when we reflect on a positive outcome, we tend to be excessively positive in our evaluation of the judgment process, and vice versa.

But sometimes an outstanding judgment process can lead to “bad” or difficult outcomes, and a poorly managed judgment process can lead to “good” or easy outcomes.

To overcome this form of the historian's fallacy, we must carefully consider all components of a good judgment process, rather than simply assess outcomes or overlook the uncertainty faced before reaching our conclusion. As before, doing so requires proactive framing — viewing the judgment process from the perspective of someone who is not aware of judgment outcomes. The curse of knowledge can make this proactive framing especially challenging, but doing so is essential to avoiding the historian's fallacy judgment trap.

SEQUENCE OF THE JUDGMENT STEPS

Though the steps in the judgment process are logically sequenced, the reality is that most judgments require some cycling through the steps — you will often go back and revisit earlier steps. For example, when identifying possibilities, new objectives may come to light that were not clearly specified in Step 2 (**Specify Objectives**). Additionally, sometimes the matter highlighted in Step 1 (**Define the Matter**) is perceived differently during the judgment process. Or, while working on Step 5 (**Reach Conclusion**), you may determine more data collection is needed. Or, in Step 6 (**Reflect**), you may realize that the initial conclusion reached is not supportable and revisiting Step 5 is necessary. Thus, while it is helpful to think about the judgment steps as sequential, it is common and appropriate to allow insights gained in subsequent steps of the judgment process to alter the outcomes of prior steps in some circumstances.

CHAPTER 3

Iterative Actions

In carrying out a good judgment process, there is a set of five essential iterative actions that should occur (see Figure 3). These actions are not included as part of the sequential steps of the judgment process itself, because each of them will take place at any point throughout the judgment process and because they are more repetitive and frequently occur within and between the six judgment steps.

Figure 3: Five Iterative Actions of Professional Judgment



Coach



Consult



Avoid traps
and biases



Document



Communicate

COACH

Coaching plays a major role throughout the application of the BDO Professional Judgment Framework, including in the development of the baseline attributes in our professionals. In order to develop appropriate technical knowledge, mindset, and business acumen, our people must be willing to give and receive coaching. Because no one has a full breadth of knowledge and expertise, we should draw on the knowledge of our coaches to shorten the time it takes us to develop a deep and insightful understanding of the situation we are facing. Because our professionals are our central and most valuable asset, we all need to be willing to take the time to coach.



One of the benefits of implementing the BDO Professional Judgment Framework across our firm is the role it can play in developing and accelerating the judgment maturity of our professionals.

Day-to-day experiences are better understood and assimilated when they can be conceptualized in terms of a logical, coherent conceptual framework. We encourage all of our professionals in supervisory roles to use the shared conceptual framework and commonly understood vocabulary provided by the BDO Professional Judgment Framework in on-the-job training, development, and coaching of those for whom they have oversight responsibility. Coach your people to develop and maintain the baseline attributes; coach them to improve understanding and execution of the essential iterative actions (including coaching.); and coach them to know what a good judgment process looks like in various settings and to recognize the traps and biases that can undermine that process.

Coaching is not a one-sided activity. Those **being** coached should be active participants in the coaching process. We should actively seek out opportunities to receive coaching from those with greater experience or knowledge on the matter at hand. It can be difficult or uncomfortable for people to deliver critical feedback when improvement is needed — but this is the feedback we all need to receive so we can improve our performance (and our career prospects). Delivering and receiving critical feedback can become a powerfully positive experience for all involved if the recipient not only is open to receive critical feedback but also has an attitude of actively seeking it out. Such an attitude signals to the coach that the receiver is sincerely interested in making positive strides, often resulting in additional career-enhancing opportunities. If you recognize an area for opportunity in your performance, seek out coaching so that you can perform at your best.

CONSULT

Consultation can be thought of in two ways: formal and informal. As you know, BDO has a formal consultation process and requirements in certain situations. This process should always be followed where required, in accordance with our policies. Such policies and practices help us manage risk at the firm level, protect our teams and professionals in situations where judgments may be subsequently challenged, and inherently should streamline activities when done early and often.



However, as one of the essential iterative actions, we encourage regular **informal consultation** because of the tremendous benefits to be gained through consulting with others in different judgment settings. This includes being able to see a situation from different viewpoints or “frames,” ensuring that we have a complete and clear view of the matter at hand, that we fully capture the important objectives we need to achieve within a particular judgment, that we have properly considered relevant alternatives and possibilities, that we have properly gathered and analyzed evidence, and that we have reached an appropriate conclusion. We can consult with other team members, superiors, subordinates, specialists, national office consultants, and in appropriate circumstances, outside experts. We all understand the value of a “second set of eyes.” We should consult with others throughout the professional judgment process, as well as in relation to the other iterative actions and baseline attributes that are part of the Framework.

AVOID TRAPS AND BIAS



Every professional, from the most experienced leader to the recent graduate, is susceptible to biases when making decisions or exercising professional judgment. We've already discussed common **judgment traps** associated with each step of the judgment process. These judgment traps are behaviors that can derail an otherwise sound judgment process. Biases are problematic ways in which we, because we are human, tend to approach situations, decisions, or our interactions with others. They distort the way we remember and process information and affect our thoughts without our being aware they are doing so. In fact, because our self-image encourages us to assume that we are unbiased, **it is far easier to detect biased decision making in others than it is to see it in ourselves**. The tendency to see the bias of others but not our own bias is common enough to have its own name: **the blind spot bias**.

Even if we go to great lengths to avoid biases, it is important to recognize that biases are present even in the most experienced professionals. **Being human means being biased**. Thus, we must do all we can to reduce biases in our judgment and actively guard against their effects. We will discuss the most common biases in more detail in Chapter 5.

DOCUMENT



In today's environment, all of us understand the importance of clear, concise, and complete documentation of audit procedures and our professional judgments. Fortunately, the key elements of adequate documentation are clearly laid out in the professional auditing standards (AU-C sec. 230 and AS 1215) as well as in the BDO USA Audit Manual, Chapter 1. As with the other iterative actions within the BDO Professional Judgment Framework, **timely and sufficient documentation is identified as an essential iterative action rather than as a step in the judgment process because it takes place throughout the process, often in an iterative manner**. If we document as we go, our work papers will better reflect the quality of the work we do and the judgments we make.

An important benefit of the BDO Professional Judgment Framework is that it will facilitate the documentation of our judgments in a way that accurately and fully reflects the care we put into every aspect of the significant judgments we make.

In the face of increasing scrutiny over the professional judgment of auditors, a question that frequently occurs within the public accounting profession is: *"How can I document that I used sound professional judgment in reaching this conclusion?"* While this is not a simple question to answer, for complex, subjective judgment settings, using the BDO Professional Judgment Framework as an organizing framework for documentation will aid immensely. Documentation of a critical judgment that includes information about each of the basic components and elements of the BDO Professional Judgment Framework is more likely to be complete and persuasive in reflecting the quality of the professional judgment applied. For example, documentation of a critical judgment might be organized in terms of the baseline attributes brought to bear by the team (i.e., relevant technical knowledge and business acumen, and evidence of appropriate mindset), the relevant iterative actions taken while executing the judgment process (e.g. consultation and steps taken to avoid biases), and each of the steps taken as part of the judgment process in coming to a conclusion (e.g., a clear statement of the matter and relevant objectives, identification of the possibilities considered, a description of the information gathered and evaluated, and a summary of how the conclusion was reached — including consideration of evidence in favor of and contrary to the conclusion.). In sum, **the best way for documentation to reflect professional judgment is to show that all the components of a comprehensive judgment framework were in place, carefully considered, and properly executed**.

COMMUNICATE

Communication is key to all the work we do. Communication should be a continuous process as delaying communication will often inhibit the successful application of professional judgment. This iterative step refers to communication within the firm with team members, subordinates, and superiors, as well as to external communication with our clients and regulators. Consultation (discussed previously) is perhaps the most important form of communication during the judgment process, but other forms of internal and external communication are also vital.



Internal Communication.

Open and clear communication with team members is essential for sound professional judgment. Further, honest, frequent feedback is necessary for continuous improvement and coaching. Actively communicating expectations between superiors and subordinates is also essential. This vertical communication flows both up and down. Horizontal communication with peers is also essential; we should be regularly communicating our thought processes and work to our team members. This communication can be informal, but it often helps to establish a deliberate plan around what communication is expected, who is involved in that communication, how frequently it will occur, and what method of communication will be used (in person meetings, email, etc.).

In addition to communication within our team, sometimes the results of our judgment process may need to be communicated beyond our immediate engagement team. When the magnitude of a judgment is significant or may have repercussions, office and practice leadership should be proactively informed in a timely manner.

External Communication.

We are required to communicate to stakeholders regarding the judgments we ultimately make. BDO is committed to timely, accurate, and professional communication with the public and regulators. Often, the quality of our work will be judged on how well we communicate the results. In other words, even the most outstanding judgment process can be questioned if communication did not happen on a consistent and timely basis throughout the process. Even the most sound, effective, and professional judgment outcome can be viewed negatively if it is poorly communicated. Indeed, if we can't articulate and communicate our rationale for making a judgment, we have likely failed to exercise professional judgment.

Good communication takes practice, and most of us can improve our ability to communicate with others. Following are five principles of good communication to bear in mind in all internal and external communication.



Principle 1: The communication we send is not necessarily the communication that is received. Because we interpret communication we send and receive based on our personal frame (as discussed in Chapter 2), even the words we say might have a different meaning to us and to the receiver. Proactive framing will help ensure that we know what is being heard (despite what we are saying).



Principle 2: Communication happens even if we don't say anything. For example, not replying to an email sometimes says more than replying says. Don't assume that because nothing was said, nothing was heard.



Principle 3: Actions speak louder than words. A person who promises on a deadline is less believable than a person who consistently meets deadlines. A person who expresses kind words is less believable than a person who actively serves. Words matter, but they should be coupled with works.



Principle 4: We have two ears and one mouth for a reason. A good rule of thumb is to try listening about twice as much as you talk. Listening is key to good communication. The most eloquent orator will fail if their power of speech is not matched by their capacity to hear.



Principle 5: Communication mediums affect meaning. Consider messages sent via email versus spoken face to face. The emotion behind the phrase "Congratulations on your promotion" is lost when read via email. The facial expressions, excitement, and happiness simply are not captured in 12-Point Times New Roman font. Sometimes punctuation can help ("Congratulations!")—but the variability in tone and emotions is severely limited in written communication. Even phone conversations lose essential components of communication. Though not all communication can (or should) happen face-to-face, referring back to Principle 1: it's important to consider that what is said is not necessarily what is heard.

CHAPTER 4

Baseline Attributes

Foundational to good professional judgment are the three baseline attributes of Technical Knowledge, Appropriate Mindset, and Business Acumen (see Figure 4). Without these attributes, the rest of the actions we take will not be effective. We may follow all of the right judgment steps and perform the necessary iterative actions, but if our technical knowledge is lacking, if we engage in the judgment process without an appropriate mindset, or if our business acumen is inadequate, our professional judgment will be compromised.

Figure 4: Three Baseline Attributes of Professional Judgment



Let's consider each of these essential baseline attributes individually. We will start with the bedrock attribute of any assurance service: an appropriate mindset of professional skepticism.

APPROPRIATE MINDSET

AU-C 200, *Overall Objective of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*, defines professional skepticism as "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." AS1000, *General Responsibilities of the Auditor in Conducting an Audit*, defines professional skepticism as "an attitude that includes a questioning mind and a critical assessment of audit evidence and other information that is obtained to comply with PCAOB standards and rules." The term "questioning mind" is a keystone of these two definitions. The central and most fundamental baseline attribute of the BDO Professional Judgment Framework is the mindset we bring to our work. This involves having the **mindset of an evaluator**, based on the questioning attitude and approach to our work that comes from an appropriate and consistently maintained sense of professional skepticism.

Maintaining an appropriate mindset means seeing ourselves as an agent for stakeholders, with an eye on our broader responsibilities to the public. We need to remember who our primary stakeholders are and our responsibilities to them in order to exercise an appropriate level of professional skepticism and maintain a questioning attitude. Approaching our audit work with a "mindset of an evaluator" will align us with our responsibilities to the public.

In addition to a questioning attitude, professional skepticism requires **skeptical action**. In other words, **we must have the moral courage not only to know what is right but also to stand up for what is right and take appropriate action**, prioritizing doing the right thing over any fear of consequence, ridicule, punishment, or loss of social status. Maintaining an appropriate, evaluative mindset may require us to ask difficult questions, push back, or take other uncomfortable and difficult steps. Doing so requires moral courage but we do not need to be disrespectful or confrontational. Keeping in mind our duty to the public trust will help us remember where our duties lie and maintain our bearings on our moral compass.

Maintaining an appropriate mindset will lead naturally to the wise tendency to “step back” periodically throughout the process of making a judgment to evaluate different aspects of our progress and to ensure our judgment is indeed professional. For example, after specifying our objectives in Step 2 of the judgment process, we might step back for a brief moment to evaluate whether our objectives are complete and clear, and whether they are truly **ends**, as opposed to being **means to an end**. Further, as we undertake the steps of a good judgment process, we may gain additional insights that may make it worthwhile to step back and reevaluate the output of previous steps, or to reconsider whether the baseline attributes are adequately present. The key point here is that if we maintain an appropriately skeptical, evaluative mindset, we will tend to periodically “step back” to ensure that we are engaging in appropriately skeptical, evaluative actions.

From time to time we may find ourselves thinking in a way that is not consistent with our commitment to professional judgment. In such situations we should take a moment to **calibrate our mindset** so that we can continue to offer our best work and live up to the trust placed in us as members of the public accounting profession and of a firm with high ideals and aspirations. At other times we may feel depleted or fatigued (as noted in the discussion of **ego depletion** in Chapter 2). We must not allow our evaluative mindset or our sense of professional skepticism to be dulled even in these moments. Maintaining an appropriate mindset plays a unique role in the BDO Professional Judgment Framework in that it is both fundamental and completely pervasive — it must be part of every aspect of professional judgment.

One important way to calibrate our mindset is to engage in proactive framing to understand the issues from different perspectives. We usually need to deliberately consider alternative frames (for example, a regulator, shareholder, or “what could go wrong” frame) that might shed a different, and perhaps broader, light on the matter.

TECHNICAL KNOWLEDGE

Technical knowledge refers to the body of knowledge expected of careful, reasonable professionals in a specific area of expertise, whether auditing, tax services, advisory, etc. Auditors face the challenging prospect of having sufficient technical expertise across multiple spectrums in order to consistently apply high-quality professional judgment. When facing significant audit judgments, teams must bring together people with sufficient technical knowledge in auditing standards, BDO audit methodology, financial accounting and reporting standards, relevant laws and regulations including security, privacy, IRS and SEC regulations.

Effective professionals are diligent in acquiring and honing technical knowledge throughout their careers. However, early in one’s career and across the full spectrum of technical knowledge, there will be weaknesses and gaps, which is why it is so important to supervise, review, coach, consult, and communicate. The fact that technical knowledge is not uniform across all of our professionals at different stages in their career highlights the importance of working in teams and using a portfolio view of technical expertise relative to the judgments being made. Few of us, if any, can be expert across all of the relevant areas related to any one audit judgment, but regardless, we must ensure we bring adequate technical knowledge to bear in the significant judgments we undertake.



BUSINESS ACUMEN

The baseline attribute of business acumen is broad. In a way, it captures “the rest” of what it takes to have good professional judgment. If we have a developed sense of business acumen, we will be better able to identify appropriate actions, potential risks, and client-specific solutions. Additionally, we will be able to add more value to the services we provide to our clients, as solid business acumen provides us with a widely applicable foundation for understanding their business and the world in which they operate. Without this foundation, the probability of quality judgment is compromised.

As it pertains to professional judgment, business acumen can be broken down into three components.

1. **Understanding the Client.** We must have a deep understanding of our client’s industry, business model, management, culture, regulatory environment, and so on. This understanding comes through research, direct work and experience with the client, experience in other related settings, and formal training. It also comes through continuous communications with the client (as discussed in Chapter 3). Until we understand our client, we are not qualified to engage in professional judgment that affects our client.
2. **Understanding BDO.** All employees who undertake professional judgment at BDO must understand who we are and what we stand for as a professional services firm. They must know and internalize of our firm’s culture, core purpose and core values, as well as policies in place around the services we provide. This understanding and internalization will come over time but can be expedited through training and exposure to and use of the BDO USA Audit Manual, and other resources (such as this guide). Knowing the “why” behind BDO policies and initiatives will empower us to engage in the high level of professional judgment to which we aspire.
3. **Emotional Intelligence (EQ).** Emotional intelligence refers to our ability to understand, navigate, and appropriately influence our own emotions and behaviors, as well as the emotions and behaviors of others. BDO recognizes that the EQ of its professionals is critical to their individual success and to the success of the firm. Developing your EQ will help in your professional judgment and all your professional relationships. EQ can be broken into four parts:
 - **Self-Awareness:** The ability to recognize our emotions as they happen and to recognize our strengths, weaknesses, and motivations. Self-insight is key to continuous improvement. It helps us know where to seek additional coaching, where more consultation is needed, where we might be prone to bias, and more.
 - **Self-Management:** The ability to control our emotions and impulses in an effective and healthy way and to adapt to changing circumstances. Understanding what we need to change and actually changing are two different things. Those with good self-management make the changes needed to ensure consistent, high-quality professional judgment. The ability to self-manage is also key to having the courage to maintain and act on a professionally skeptical, evaluative mindset.
 - **Social Awareness:** The ability to recognize the needs, wants, motivations, pressures, and emotions of those around us. We don’t exercise professional judgment in a vacuum — others are affected by the judgments we make. Understanding how others will react or interact with those judgments is essential for ensuring high-quality outcomes. For example, recognizing the motivations of client management is a key component of designing and conducting effective audit procedures.
 - **Social Skills:** The ability to use interpersonal skills to communicate and interact effectively with others and influence their behaviors in constructive ways. Our ability to have positive, constructive interactions with our colleagues and clients is necessary to providing high-quality professional judgment and accelerating it in our professionals at all levels. Without the ability to communicate and interact effectively, our judgment, no matter how great, is of little value.

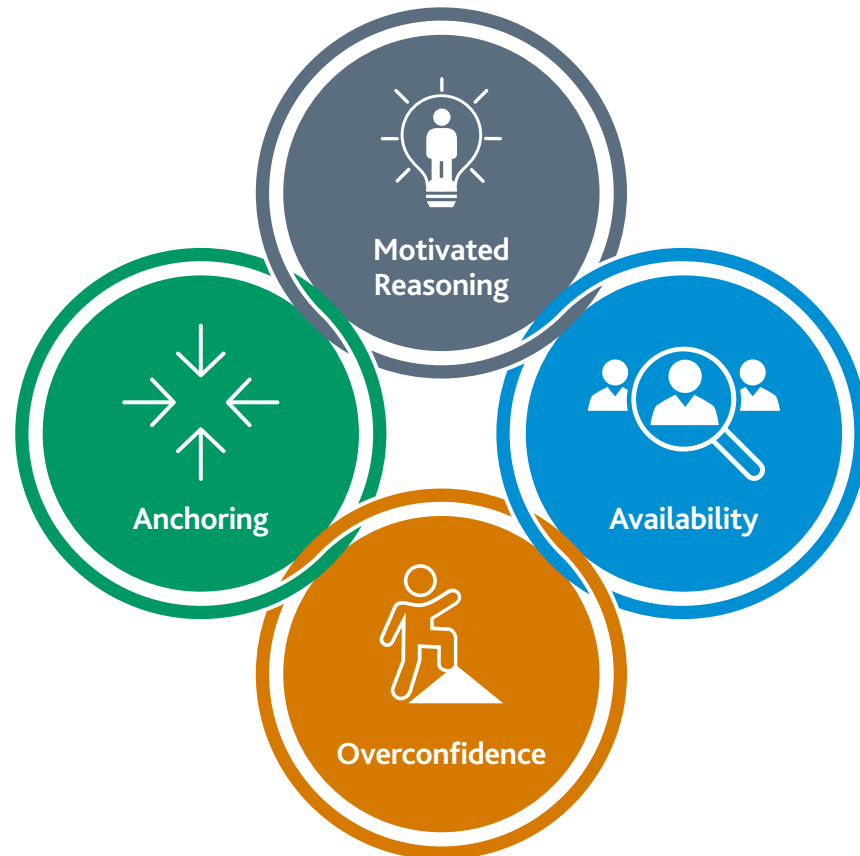
Though we often think of “acumen” as skills or talents that we are born with, most of the key components of good business acumen can be acquired through training and experience. Some of these components (like good EQ) come more naturally to some people than to others. However, we must all work to ensure that we have the necessary business acumen to provide the highest quality professional judgment possible.

CHAPTER 5

Common Biases

One of the iterative actions discussed in Chapter 3 is to “Avoid Traps and Biases.” Chapter 2 reviews the most common traps to avoid throughout the judgment process. In this chapter, we will review the cognitive biases that distort the way we recall and process information. These biases happen non-consciously. In other words, we are typically completely unaware that these biases are affecting our behavior. What’s more, the biases we discuss in this chapter are common even among the most experienced and honest decision makers. Though it is not possible to completely eradicate bias from our judgment, it is possible to significantly reduce the effects of bias. With enough awareness, training, and practice, some specific forms of bias can be eliminated. With each bias we discuss in this chapter, we will also provide some simple methods to reduce, and where possible, eliminate the effect of the bias on our judgments.

Of course, the first step towards overcoming bias is awareness that the bias exists. Four of the most common biases that affect the professional judgments of auditors are motivated reasoning, availability, overconfidence, and anchoring.



MOTIVATED REASONING

Motivated Reasoning may be the most pervasive and subversive of all of the cognitive biases that affect our judgment. It is the tendency to “see what we want to see” in data. In other words, our **reasoning** is affected by our **motivation and our preferences**.

This bias can take many forms. We may truncate our information search once we find data that supports our preferred conclusion. We may ignore or underweight information that is contrary to our preferences, and overweight information that better aligns with our preferences. We may discredit or disbelieve data sources for information that conflicts with our preferences. Or we may interpret ambiguous information in ways that are consistent with our preferences.

Motivated reasoning can happen even when we use good analytical techniques and statistics to support our conclusions. The tendency to engage in data-driven motivated reasoning has led to the adage: **if you torture the data enough, it will confess to anything**.

The “motivation” behind motivated reasoning can be hard to spot. It can come from financial incentives, desires for promotion or influence, social pressures, personal preferences, time pressure, client preferences, and more. Most importantly, motivated reasoning is not a conscious effort to muddy data or skew decisions to favor our own self-interest. On the contrary, motivated reasoning can occur even when a decision maker is trying hard to be unbiased, objective, and ethical. The human tendency to succumb to motivated reasoning involves collecting just enough evidence that we can feel — for ourselves—that we have done a good job of being objective.

A close cousin to motivated reasoning is the **confirmation bias**. This bias involves a specific tendency to only consider confirmatory information when testing a hypothesis or prediction, rather than looking for **disconfirming** information. Though this bias was only recently **named**, philosophers have known about it for a long time. In 1690, Francis Bacon wrote, *“It is the peculiar and perpetual error of the human understanding to be more moved and excited by affirmations than by negatives.”* As with most biases, the confirmation bias is seen even among top accounting professionals. For example, when a tax client has a particular preferred tax strategy, research has shown that tax professionals tend to seek out court cases that provide **support** for that strategy, but do not search for instances where the courts have denied the client’s preferred tax treatment.

Another bias that is closely related to **motivated reasoning** is known as the **backfire effect**. Sometimes motivated reasoning is so strong that when we are presented with data that is inconsistent with our preferences, we walk away from the data presentation **even more convinced** of our prior preferences. In other words, our response to the data is the opposite of what the presenter was hoping to accomplish with the data-driven analysis. Interestingly, the part of the brain that is activated when the backfire effect occurs is the same part of the brain that is activated when we are physically threatened. In other words, the strong negative response that we sometimes feel, or that we receive from others, when data-driven “bad news” is presented, is a physiological response tied to deeply ingrained bias.



So what can be done about motivated reasoning and its cousins the confirmation bias and the backfire effect? As stated above, the first step is awareness. Knowing that we have this tendency, and that our clients have this tendency, is essential. But there are other specific steps we can take.

- ▶ **Make the Opposing Case.** Since the confirmation bias involves a tendency to only consider confirmatory information, we should actively consider what could go wrong and take time to consider the opposing case from management's explanation. In some cases, the best way to make the opposing case is to actively seek disconfirming information. Finding this information does not necessarily mean we reverse course but searching for it does help ensure that we will have all the appropriate data to make an objective decision.
- ▶ **Seek Contrary Opinions.** Outside of awareness, the best antidote to motivated reasoning is to seek the opinion of a trusted outsider, preferably an outsider who frequently sees situations differently from ourselves. For example, asking a subordinate if our judgment was free from bias will not be as effective as asking a peer. Another way of saying this is that we should seek to see the situation from different frames (as discussed in Chapter 2).
- ▶ **Post-mortem Analysis.** Considering how our decisions will look to an outsider when read on the front page of the news can help us gain perspective into our own potential motivated reasoning.
- ▶ **Recusal.** Occasionally, when we know that our personal preferences will likely hinder our ability to be objective despite our best efforts and desire to be unbiased, we should recuse ourselves from the judgment. Although situations that call for recusal are rare, sometimes it is the best way to ensure objectivity.



AVAILABILITY

Availability is our tendency to remember vivid or **salient** information more rapidly than information that may be more relevant, but that is less **available** in our memory. Most importantly, this ease-of-recall then affects our use of the information. Information that is easier to bring to mind tends to be weighted more heavily in our judgments.

Like motivated reasoning, the availability bias can take many forms. Sometimes the most recent information we encounter is over-weighted. This form of availability is known as the recency bias. Sometimes the first information we encounter is over-weighted. This form of availability is known as the **primacy bias**. The primacy bias is behind the adage **first impressions matter** (they really do!).

While the first and the most recent information we encounter are often weighted heavily due to availability, information obtained during any part of our judgment process can be made to be more salient than other information, thus leading to an availability bias. Sometimes information is more salient because of the way it is presented or who is presenting it. Often extreme outcomes are salient, though they are not always particularly informative. Even simple repetition can lead information to be more available. For example, research has shown that mere repetition of the same good news for a company can have a continuing positive effect on that firm's stock price. In fact, even bad news can increase saliency and lead to a **positive** availability bias, so long as we don't recall the details behind the news. This tendency is behind the adage **any news is good news**.

Availability can severely hinder our ability to be objective and make good judgments. For example, consider Step 3 in the judgment model: Identify Possibilities. If we tend to only identify the possibilities that come most easily to mind, we are likely to select a suboptimal alternative. Or during Step 4: **Gather and Analyze Information**, we may overweight the likelihood of a given outcome because of a similar experience that is readily available in our memory, inappropriately swaying our judgment. Snap judgments are the most likely to be affected by the availability bias: when we rely on our memory instead of other data sources, we are likely to fall prey to the availability bias.

As before, the best mechanism to fight availability is awareness. Awareness after the fact, however, may not be sufficient to help us reduce our tendency to succumb to the availability bias. Following are additional methods to fight the availability bias.

- ▶ **Dig into the Data.** Availability happens when we rely on our imperfect memory to make decisions. Perhaps the best way to combat the availability bias is to ensure that our judgments are data-driven. Ensuring that our decisions are driven by data is not a cure-all (for example, motivated reasoning can occur even with ample data usage), but it can help to significantly alleviate the availability bias.
- ▶ **Good Documentation.** Because our tendency is to weight the information that is salient more heavily than other information, it is imperative that we accurately document all pertinent information and how it is used in our judgment. Without good documentation, it may not be possible to make use of the first (and best) solution to availability: digging into the data. As discussed in Chapter 3, this iterative action (document) is a key component to avoiding bias.
- ▶ **Adjust the Order.** Because the order in which information is presented can matter — due to the primacy and recency biases—we should carefully consider the order in which we review information. Do we always look at information from a certain source first or last? If so, adjusting the order may make sense. Also, when possible, have different reviewers or decision makers consider the information in a different order to ensure that no one option is consistently over-weighted due to the availability bias.

OVERCONFIDENCE

Overconfidence is perhaps the most misunderstood of the judgment biases. The overconfidence **bias** is not necessarily about bravado, audacity, or boldness, though sometimes this bias can lead to those traits and behaviors. When we succumb to the overconfidence bias, **we underestimate the uncertainty that exists in a given setting.**

Evidence of overconfidence is seen in almost every profession and throughout history. Consider the memorable comment of Lord Kelvin, famed British mathematician and father of the first and second laws of thermodynamics. In 1895 he proclaimed that *“Heavier-than-air flying machines are **impossible**.”* Note the complete certainty with which this brilliant physicist was completely wrong. Just eight short years later, the Wright brothers made their first flights at Kitty Hawk. Kelvin was an expert, but he underestimated the uncertainty that still existed in the realm of physics.

The overconfidence bias is common among business professionals. For example, evidence of overconfidence is seen when we overpromise on deadlines, underestimating all of the factors that could keep us from accomplishing our objective by the proposed deadline. This particular tendency is so common it's known as the **planning fallacy**. This form of overconfidence can also lead us to take on too many projects. Overconfidence can also lead us to identify only one, seemingly “sure,” alternative when working through the judgment framework. Overconfidence can also be the root cause behind the judgment trap we discussed in Step 3 of the judgment model—What You See Is All There Is (WYSIATI). Indeed, overconfidence can lead us to underinvest in the entire judgment process because we underestimate the uncertainty that abounds and thus mistakenly believe that the components of good judgment are not needed.

As with motivated reasoning and availability, awareness is key to combating overconfidence. But awareness alone will only get you so far. Following are specific strategies to employ to fight the overconfidence bias.

- ▶ **Know What You Don't Know.** In his book *Walden*, Henry David Thoreau attributes to Confucius the adage: “To know that we know what we know, and that we do not know what we do not know, that is true knowledge.” While it may seem circular to ‘know what we don't know,’ it's actually essential. Recognizing that there are gaps in our knowledge and that unpredictable events will likely occur is key to good judgment. For example, to base a time estimate entirely upon factors we can control and predict places zero probability on the uncertainties that constantly arise actually happening. We must come to the knowledge that there are things we don't know and behave accordingly.
- ▶ **Red Flags of Certainty.** Any time you hear yourself or a colleague say they are 99% sure, pause and ask yourself what is uncertain and whether overconfidence may be at play. It may not be, but statements of certainty or of arbitrarily high probability are red flags that may indicate an underweighting of uncertainty.
- ▶ **Pre-mortem Thinking.** Perhaps the best antidote to overconfidence is pre-mortem thinking. Unlike a post-mortem analysis, which happens after the fact, pre-mortem thinking is the act of considering everything that could possibly lead to a bad outcome. For example, if a home builder promises to deliver a completed construction project by a given date, rather than ask the builder, “How sure are you that you will be done by the deadline?” the owner would be wise to say instead, “Let's imagine the project is not done by the deadline — what are all the factors that could have led to this failure?” The builder may be inclined to respond with, “Don't worry, we'll be done on time.” To which the owner would wisely respond, “I know, but let's assume it did happen — that we already missed the deadline — what could have caused that?” Ideally, the builder would then carefully consider all of the uncertainties that exist in a building project: the reliability of subcontractors, the weather, the availability of supplies, the health of the builder, etc. Once these factors are appropriately considered, probabilities could be assigned to these factors. At that point, the builder will likely reassess the certainty surrounding their completion of the project by the agreed-upon deadline.

ANCHORING

Anchoring is among the earliest studied judgment biases discussed here. The full name of this bias is **anchoring and insufficient adjustment**. This describes our tendency to anchor to an initial numeric estimate and then fail to sufficiently adjust away from that anchor when making our own numeric assessment. What makes this bias especially troubling is that it occurs **even if we know the initial anchor is wrong**. In fact, study after study has shown that even absurd or completely random numeric anchors can have a strong impact on professional judgments.

Where do these anchors come from? It could be management's initial estimate, previous period results, performance benchmarks, targets, market rates, or the opening bid from a counterpart in a negotiation. In fact, when a numeric judgment is required, you almost never start with a blank slate. Note that having an anchor does not mean that we will necessarily arrive at the wrong answer. It just means that if we need to adjust away from the anchor to get to a more accurate or appropriate number, this starting point, whatever it is, will act like a strong gravitational force, pulling in our eventual judgment. Our tendency will be to insufficiently adjust away from the anchor.

What can be done about the anchoring bias? Once again, awareness is the first step. Any time a numeric judgment is to be made, know that, on average, our tendency will be to stay irrationally close to the anchor.

Additional strategies for combating the anchoring bias include:

- ▶ **Clean the Slate.** In some situations, you may be able to approach a judgment without an anchor in place. For example, if asked to give an independent assessment of the probability of a given event, avoid asking for the assessment of others or a reasonable probability range. Starting without a numeric anchor is the ideal, though it is rarely possible.
- ▶ **Get a Fresh Perspective.** If you have already been exposed to an anchor, inviting another person who does not have the same anchor in mind to assist in your assessment can be helpful. As explained earlier, getting the points of view of others can help in reducing multiple biases — not just anchoring.
- ▶ **Consider Multiple Anchors.** When anchors are “dropped,” don't allow them to sink too far before you consider additional, independent anchors. For example, if assessing the performance for a division, a manager may be presented with last year's performance as a benchmark. Industry benchmarks could also be considered, as this number will likely be independent from prior year performance.
- ▶ **Identify the Anchor.** Even when we know about anchoring bias, we might fail to recognize that an anchor is present. Take the typical salary negotiation. Though not explicitly stated, the anchor in this negotiation is almost always the current salary. This may be appropriate, but consider other possible anchors: market rates, peer salaries, average cost of living, etc. What the anchor is matters, since the tendency will be to stay too close (either above or below) that anchor. Thus, recognizing the anchor and its potential influence becomes essential.

The list of biases discussed in this chapter is by no means exhaustive. Researchers have identified literally hundreds of judgment biases. However, **these four main biases (motivated reasoning, availability, overconfidence, and anchoring) capture four of the most common, and most problematic, tendencies to which professionals fall prey.** Also note that while working in teams can help to mitigate these biases, most of these biases can persist even when working together in a team. This is due, in part, to our tendency to conform (as per the conformity trap discussed in Chapter 2).

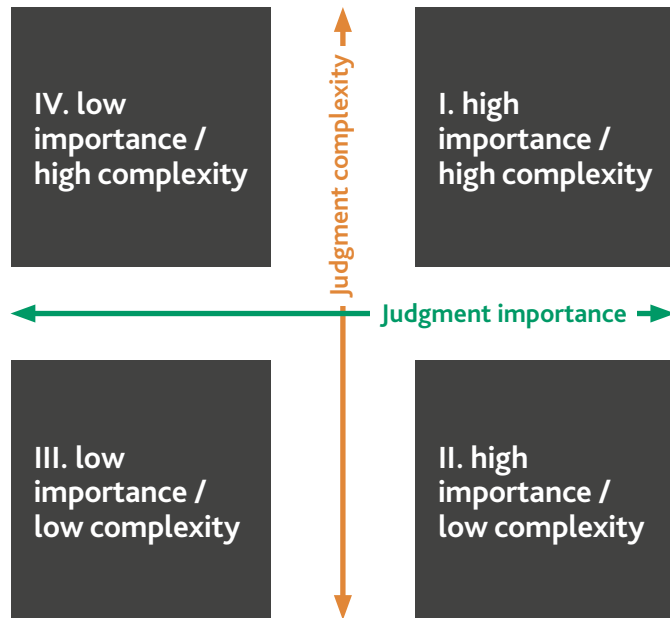
A knowledge of these biases and of the judgment traps discussed in Chapter 2 is essential. The consistent exercise of sound professional judgment requires consciously and actively working to avoid these traps and biases.

CHAPTER 6

Applying the Judgment Framework Judiciously

We expect our professionals to apply good judgment in every aspect of their work, including in the appropriate application of this Framework. This includes recognizing that not all judgments are created equal — not all judgments will require the same degree of investment or the same degree of care in applying the BDO Professional Judgment Framework.

A useful way of classifying judgment matters is to place them into one of four different quadrants in a two-dimensional graph, where the X-axis represents judgment importance, and the Y-axis represents judgment complexity.



Quadrant I.

This quadrant represents judgment matters that are both important and complex. Such judgments are typically far fewer in number than low importance / low complexity Quadrant III judgment matters. Examples of Quadrant I judgments might include developing an independent fair value estimate for a complex, material financial instrument that is not traded in an active market, or concluding on the most appropriate accounting treatment in a situation where accounting standards are less than definitive. These are the judgments that call for a full and careful consideration of each element of the BDO Professional Judgment Framework—each of the baseline attributes, each relevant iterative action, and, of course, the steps of the core judgment process. These judgment situations require that our professional judgment be both sound and fully reflected in our documentation. Quadrant I judgments present important coaching opportunities.

Quadrant II.

This quadrant encompasses judgment matters that are important but that are not particularly complex. An example of this kind of judgment is concluding on the results of a routine audit procedure for a highly material account, such as drawing implications from a statistical sample of accounts receivable confirmations. For Quadrant II judgments we might quickly reference the BDO Professional Judgment Framework to help ensure that we are considering all relevant aspects of the judgment and that we aren't neglecting any element of the judgment—but the process is routine and will probably go quickly.

Quadrant III.

This quadrant reflects the hundreds of judgments we make on a daily basis, most of which, in and of themselves, relate to judgment matters that are not particularly critical or complex. These might include, for example, routine audit judgments for which the matter is narrowly defined, the objectives are few and clear, and the set of possibilities to resolve the matter is constrained or pre-defined. For these relatively simple, less-important judgments, we need to take sufficient care that we accomplish what is needed, but these matters typically do not require a significant investment of our time and energy. A cursory review of the BDO Professional Judgment Framework is likely to suffice in the majority of these judgments. In fact, for some of these cases we can apply a simple golf analogy: "If it's a two-inch putt, just tap it in."

Quadrant IV.

Finally, some relatively rare judgment matters can be characterized as being of relatively low importance but are nonetheless complex. In these Quadrant IV judgment situations, we would be likely to focus our attention, for just a few moments, on Steps 1 and 2 of the judgment process to make sure we are appropriately gauging the importance and purpose of the judgment. One of our objectives for a judgment matter that is truly unimportant but complex might be to "not waste too many resources over-thinking this matter." In contrast to a simple Quadrant III judgment matter, Quadrant IV isn't so much about "tapping it in," it's about "tapping it...and moving on." We again note that Quadrant IV judgment matters are relatively rare—less important matters are typically not highly complex.

The point here is that not all judgment situations are created equal and not every judgment needs to be run as carefully through the BDO Professional Judgment Framework. Some judgments are simply more complex or more important than others. These are the judgment situations that call for greater investment in ensuring that we have a clear, shared identification of the matter to be resolved, and that we haven't fallen into one of the traps that can cause us to deviate from a good judgment process. In other words, part of defining the matter to be resolved (Step 1) is to determine whether the judgment situation involves a straightforward matter to be resolved, unambiguous objectives, and clearly identified possibilities for resolution, or whether the judgment situation is complex, ambiguous, or multi-faceted enough that it merits an investment of time and energy to approach Step 1 carefully and then to move ahead in applying the full BDO Professional Judgment Framework.

Some of the questions that can be asked to make this determination are:

- ▶ Could the matter be viewed more broadly, or is it a simple matter that is fully captured by a specific, narrowly-defined frame?
- ▶ Could we benefit by considering alternative ways to frame the matter?
- ▶ Have we approached a matter of this kind before, i.e., is this a routine judgment?
- ▶ Is the matter ambiguous or highly subjective?
- ▶ Are there strong incentives or motivations in any of the parties involved, or are there significant risks of misstatement?
- ▶ Is the matter complex or ambiguous enough that we might fall prey to unarticulated viewpoints or assumptions?

CHAPTER 7

Summary and Conclusion

The BDO Professional Judgment Framework articulated in this guide encompasses a sound, comprehensive approach to consistent, high-quality professional judgment. It lays out the vital components of the fundamental baseline attributes of the professionals involved in making significant judgments, the essential iterative actions that support a good judgment process, and the key steps of that process. As said at the outset, we believe the BDO Professional Judgment Framework can play a vital role in your career and will help us individually and as a firm execute, articulate, and communicate our professional judgment using commonly shared concepts and vocabulary. We are confident that firm-wide integration of this Framework into our methods, tools and learning will help develop our people and consistently deliver high-quality judgments in our practice. Deepening, enhancing, and increasing the consistency of the professional judgment exercised by our people at all levels is key to continuing to provide the best value to our clients and to exceed the expectations of all our stakeholders.

SUMMARY

At their foundation, the value of BDO's services is in the consistent, high-quality professional judgment exercised by its professionals. We place great importance on developing and exercising professional judgment in all we do. The BDO Professional Judgment Framework is a resource that can facilitate communication, documentation, coaching, and training around professional judgment throughout the firm.

We recognize that BDO professionals are faced with many complex judgments and decisions in stressful, pressure-laden environments, and that our people are exceptionally good at what they do. **The BDO Professional Judgment Framework is intended to facilitate the outstanding professional judgment that already takes place in the firm.** It seeks to do so by helping to ensure that our significant judgments are undergirded by a set of fundamental baseline attributes focused on an evaluative mindset, technical competence, and broad business acumen; that our judgments incorporate the essential iterative actions which help ensure the quality of our judgment processes, produce documentation that demonstrates our professional judgment, and serve to develop our people; and that our judgments follow the steps of a sound judgment process that is highly likely to produce consistent, high-quality professional judgments. The BDO Professional Judgment Framework is intended to facilitate our efforts to execute, document, and communicate our outstanding professional judgment capabilities, individually and as a firm. We are confident that usage of this Framework will enable us to make a difference in our people and the services they provide. We invite you to join us in this firm-wide effort.

Our purpose is helping people thrive, every day. Together, we are focused on delivering exceptional and sustainable outcomes and value for our people, our clients and our communities. BDO is proud to be an ESOP company, reflecting a culture that puts people first. BDO professionals provide assurance, tax and advisory services for a diverse range of clients across the U.S. and in over 160 countries through our global organization.

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