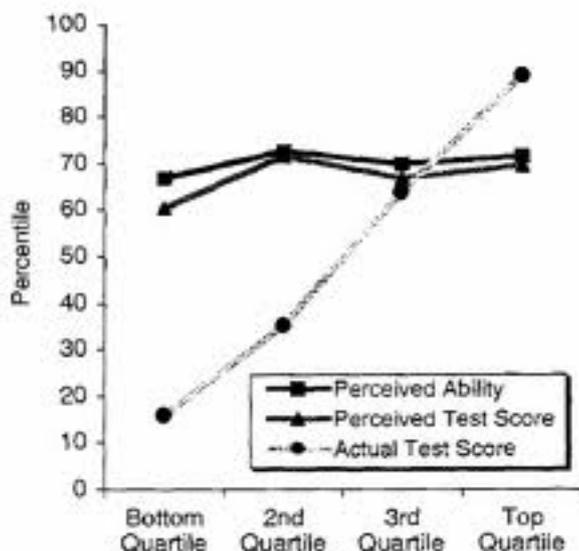


The Dunning-Kruger Effect and Other Reasons People Screw Up

Written by Nick Sanders

Wednesday, 07 November 2012 00:00



One of the greatest challenges in being a business advisor in a complex area such as law, accounting, taxes, or government contracting is to provide advice that is both honest and actionable. Giving honest advice may be a challenge, in and of itself, but one doesn't really get a lot of push-back. "What does this mean?" is not a particularly difficult question to answer. When one considers experience, research into court rulings, and knowledge of the regulations, "What does this mean?" usually boils down to one answer—perhaps with a couple of caveats if the situation is ambiguous.

However, providing actionable advice is a whole 'nother thing, entirely. "What should I do?" is a difficult question to answer, and it usually has a spectrum of possible responses. Generally, there are a number of "correct" responses. In fact, there may be no wrong answers to give, only good, better, and (hopefully) best answers. The best answer usually depends on a variety of factors, including available resources, long-term strategy, and the prevailing political winds. And the best answer today may not be the same as the best answer tomorrow or next week, depending on how the variables shift.

We've recently discussed the travails of several small businesses that have run afoul of DCAA and DCMA. Quimba Software, Inframat, and Thomas Associates, Inc. all received adverse audit reports with questioned costs. All three received adverse Contracting Officer Final Decisions. Penalties were applied. All three appealed; all three lost (though Quimba filed another appeal at the Court of Federal Claims). Though we've had little to say about the merits of Quimba's case (while the appeal is still pending), we've had lots to say about Inframat and TAI, much of which was less than complimentary.

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Why do companies such as TAI and Inframat think they can develop compliant accounting and other business systems on their own, without the advice of business advisors? When companies do hire business advisors, why is there resistance and push-back when it comes to implementing the new systems, to changing the way in which business is being managed to adapt to the changing compliance requirements?

Well, some of that resistance is undoubtedly rooted in the general resistance to any change. People get comfortable and set in their ways. Unless there's a DCAA audit report in the recent past, the sense of urgency just isn't there. "If it ain't broke, why fix it?" is the common refrain. So even the smartest and most experienced business advisor just can't push against the cultural tide that prefers to ebb and flow in the time-honored way.

Question: *"How many business advisors does it take to change a light bulb?"*

Answer: *"Just one. But it takes a long time, and it costs a lot of money. And in the end, that light bulb has got to want to change."*

The other reason for the resistance and push-back is The Dunning-Kruger Effect. What's that, you may well be asking.

The Dunning-Kruger Effect is a cognitive bias hypothesis that suggests (with supporting evidence) that people with relatively little knowledge or skill in a particular area have a tendency to *over assess* their abilities in that area, while people with relatively more knowledge or skill have a tendency to *under assess* their abilities.

We used to call that phenomenon: *"A little knowledge is a dangerous thing."*

Candidly, we run into this situation frequently. Somebody with a little knowledge of the FAR Cost Principles thinks they know all about Cost Accounting Standards. Somebody with experience in Firm Fixed-Price contract types thinks they understand the requirements of Cost-Plus contract types. Somebody who read the DCAA Information for Contractors pamphlet thinks that they're ready to support the next DCAA audit of the adequacy of the accounting system—or perhaps that they understand how to put together the next annual proposal to

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establish final billing rates. Somebody who attended a three-day seminar on something just became the local expert in it. It's a natural human bias.

But that doesn't keep it from being dangerous to the bottom-line of your company.

We recently came across The D-K Effect. In one case, this long-time client hired a bookkeeper, which was a smart move. Getting the bookkeeper to prepare the proposal to establish final billing rates was also a smart move, since the data came from the accounting system that the bookkeeper maintained. But then the client wanted the bookkeeper to certify as to the adequacy of the entity's accounting system for cost-plus government contracting. That was *far* outside the domain of the bookkeeper's expertise. (Pun intended.) In addition to the possible conflict of interest, the bookkeeper simply had no experience with the FAR or CAS or any other of the requirements of cost-plus government contracting.

So what did the bookkeeper do? Why, the bookkeeper called Apogee Consulting, Inc. and asked us to tell them how to conduct the audit and whether or not they should certify as to the accounting system adequacy. Not as a subconsultant, but on the Q.T. so that the bookkeeper could look like it knew what it was doing.

Our reply? *Yeah, no.* We pointed the bookkeeper to the SF 1408 and then washed our hands of the situation.

Note: the bookkeeper didn't even know about the SF1408 or what it meant. The bookkeeper did not have access to the DCAA's adequacy checklist. And *this* was the entity that was supposed to certify?

We also did not call up our long-time client and say, "*WTF are you thinking?*" We didn't do that because it could have been seen as sour grapes. Hey, the client spends the client's money the way the client wants to. If the client wants to hire unqualified people, then that's the client's decision.

But this was clearly The Dunning-Kruger Effect in action. The bookkeeper had a CPA. In the

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mind of the client, that meant the bookkeeper was qualified to certify the accounting system. Kind of like expecting your family doctor to perform brain surgery, but there you go. More importantly, in the mind of the bookkeeper, how hard could this be? Debits, credits, controls, reconciliations. *Et voila!* Certification. Both the client and the bookkeeper had a little knowledge about the requirements ... and both over estimated their knowledge and expertise—which led to bad decision-making.

Another example of The D-K Effect in action was this other client who kept insisting that all indirect cost allocations had to follow the allocations already programmed into the expensive SAP accounting system. Trying to explain that what worked for financial reporting and internal metrics would not work for cost-type government contract accounting proved to be a futile task. Ultimately, we compromised on some allocation bases that would never work for a CAS-covered contractor, but which might work for a small business (one that was exempt from CAS).

Unsurprisingly, the DCAA auditor had trouble accepting the allocation methodology. But the key point here is that, once the allocation methodology had been established, the client dismissed us and handled the DCAA audit on its own. After all, since the client knew the allocation methodology cold, what value could a business advisor add?

You will be not be shocked when we tell you that the client failed the audit. The allocation bases were acceptable—barely. But one needed to be able to cite to the regulations and audit guidance in order to sell the methodology to the auditor, and the client simply had no ability to do so. That's The D-K Effect in action.

We could go on and on. You can't do this consulting gig for any length of time and not see The D-K Effect in action on a frequent basis. Decisions are suboptimized because the internal expertise is over assessed while the external expertise is under assessed. This is particularly evident in the implementation phases of projects, where resistance to change is heightened.

So, dear readers, try to be aware of The Dunning-Kruger Effect (and other cognitive and social biases) and mitigate it by recognizing the limits of your own expertise. Don't try to leave the bounds of what you know and "wing it" by guessing about what you don't really know. Hire subject matter experts, and listen to them.

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That's not to say that all self-proclaimed subject matter experts are equal, or that they are all worthy of veneration. The fact is, you must do your due diligence on the consultants you hire, the same way you do your due diligence on the employees you hire.

If you are aware of your limitations, and think you've picked the right business advisor—then listen to what your advisor tells you. And do it.