

# Accounting Fast and Slow:

## Thinking About Analysis

By

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MBA, CPA



THE  
**KNOWLEDGE  
INSTITUTE**



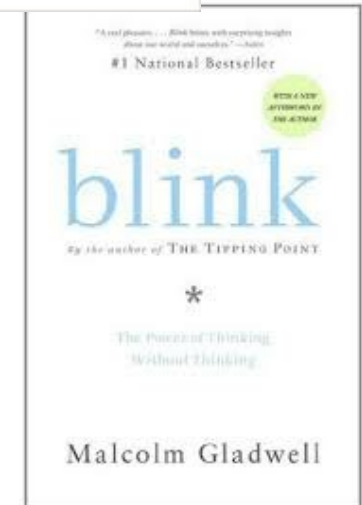
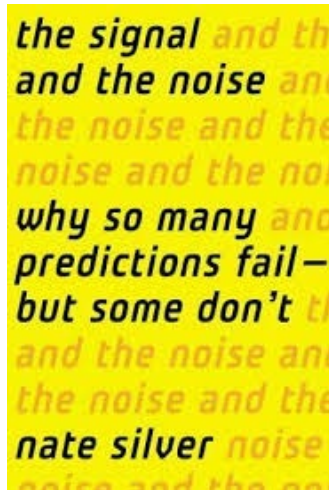
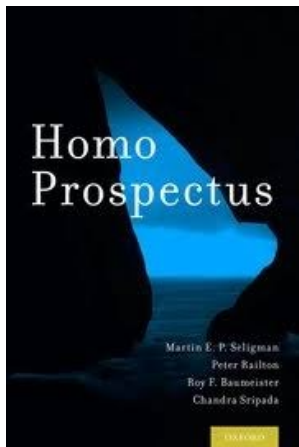
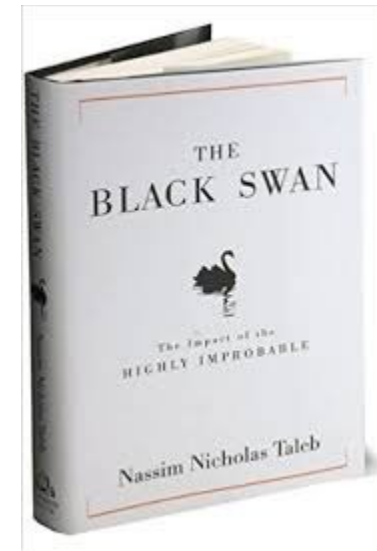
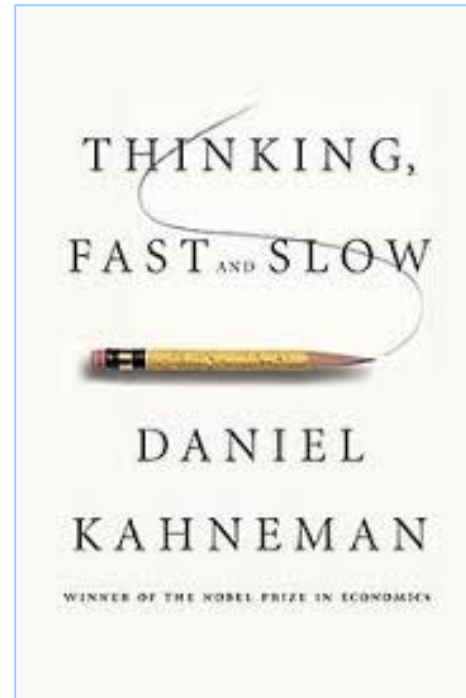
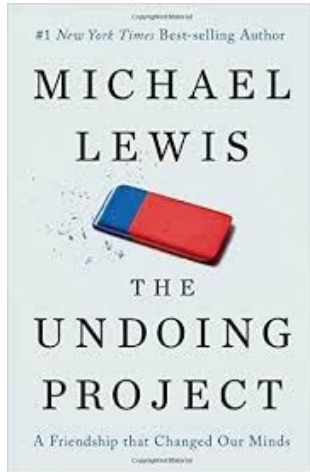
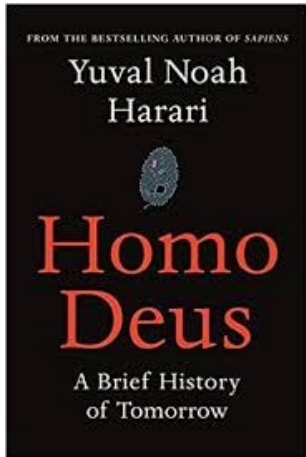
# About the Author



**John F. Levy, MBA, CPA**, is the CEO of Board Advisory, a firm that assists public companies, with corporate governance, compliance, financial reporting and financial strategies. John currently sits on the boards and audit committees of three public companies and the board of one not-for-profit. John was in public accounting for nine years and has been CFO of both public and private companies. He graduated from the University of Pennsylvania's Wharton School of Business.



# Resources



And many articles, blogs and personal experiences...



# Three Issues

1. How we make decisions?
2. How to make better decisions?
3. How to motivate others to make better decisions?





# One Thing

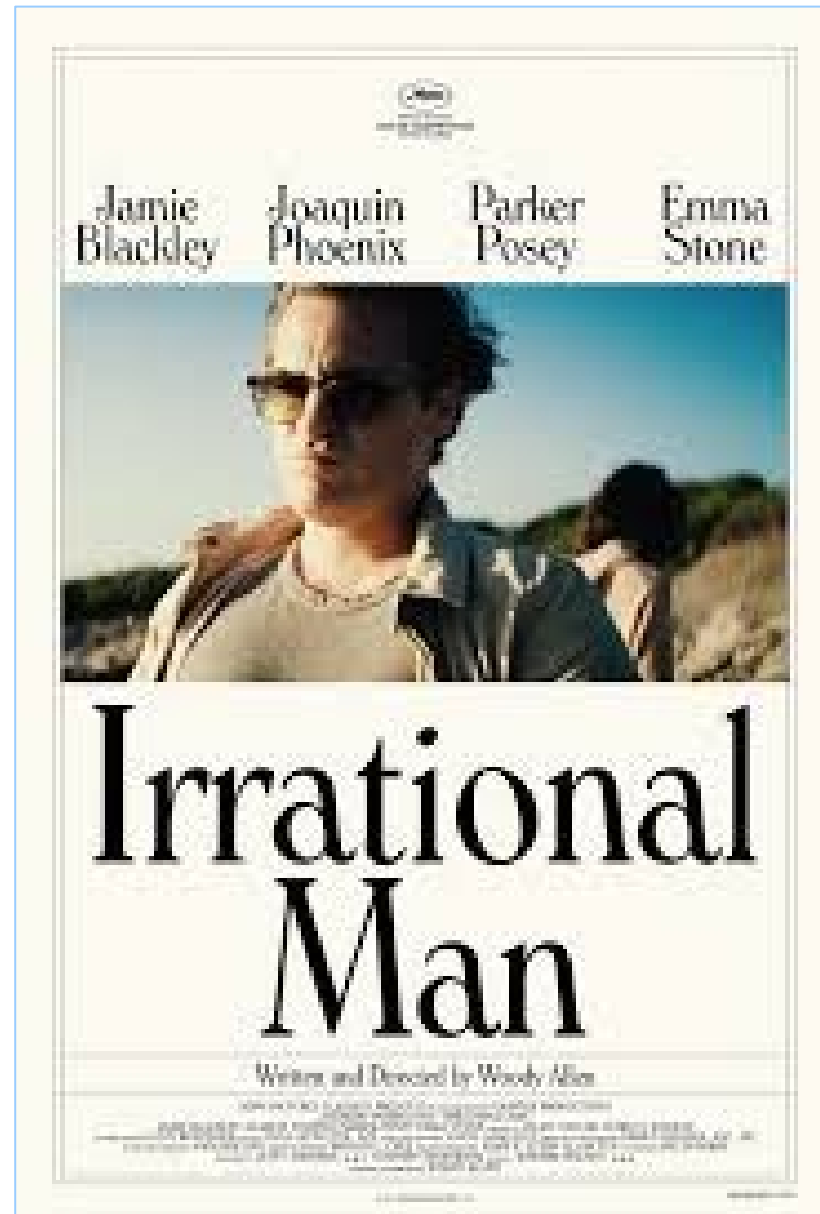


# Behavioral Economics





# The Irrational Man



# System 1





# System 2

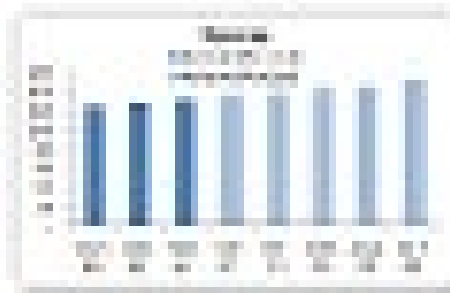


# Why System 1 Works

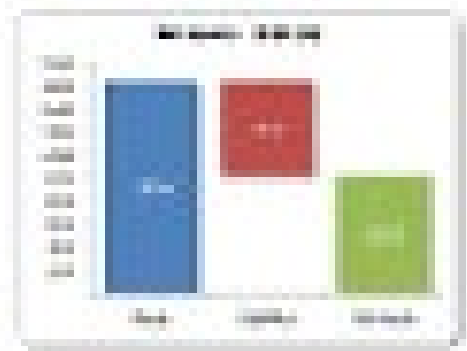


# The Spreadsheet

Account	2019	2020	2021	2022	2023	2024
...	...	...	...	...	...	...



Account	2019	2020	2021	2022	2023	2024
...	...	...	...	...	...	...



Account	2019	2020	2021	2022	2023	2024
...	...	...	...	...	...	...





# Our Role





# When to Engage System 2



## Case Discussion #1

# Steve



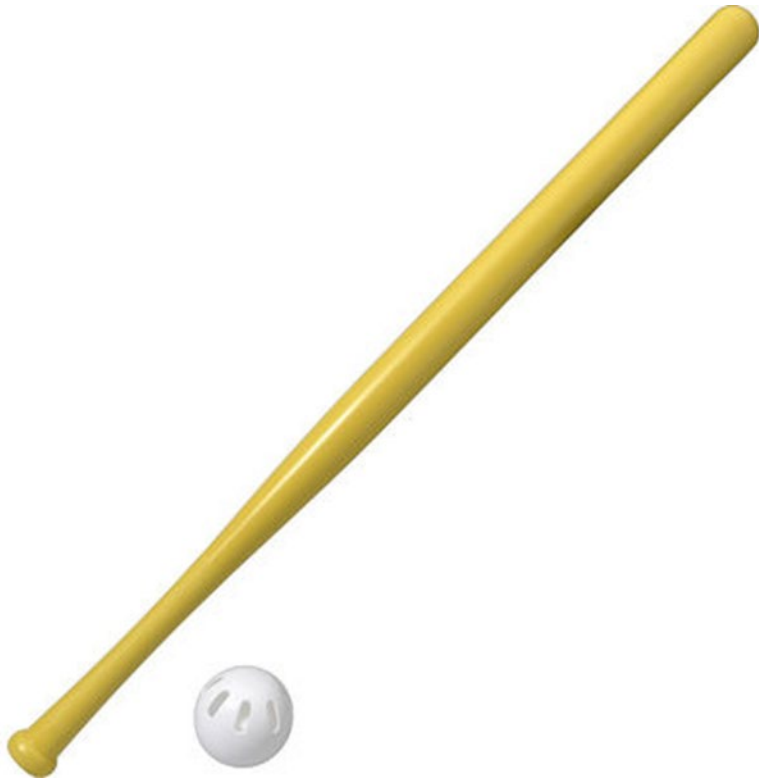
An individual has been described by a neighbor as follows: ‘Steve is very shy and withdrawn, invariably helpful but with little interest in people or the world of reality. A meek and tidy soul, he has a need for order and structure and a passion for detail.’

*Is Steve more likely to be a librarian or a farmer?*



## Case Discussion #2

# The Bat and Ball



A ball and bat cost \$1.10. The bat costs one dollar more than the ball.

*How much does the ball cost?*



# Priming

EAT – SO\_P -



WASH - SO\_P -



People primed with thoughts of old age moved slower!

Smiling people are more easily amused.







# Priming With Money

Priming with thoughts or discussions of money caused people to be:

- ✓ Less willing to ask for help
- ✓ Less willing to help
- ✓ More selfish
- ✓ Less social





# Jumping to Conclusions



Jumping to conclusions is **efficient** when:

- Likely to be correct
- Mistakes are acceptable
- Saves substantial time and effort



# Jumping to Conclusions



Jumping to conclusions is **risky** when:

- Unfamiliar situation
- Stakes are high
- No time for more information



# Substituting Questions

Target Questions	Heuristic Question
How much would you contribute to save an endangered species?	How sad does a dying dolphin make me?
How happy are you these days?	How happy am I now?
How popular will the president be in six months?	How much do I like the president?
How should we punish crooked financial advisors?	How mad do financial predators make me?
Can Elizabeth Warren be president?	Does Elizabeth Warren look like a president to me?

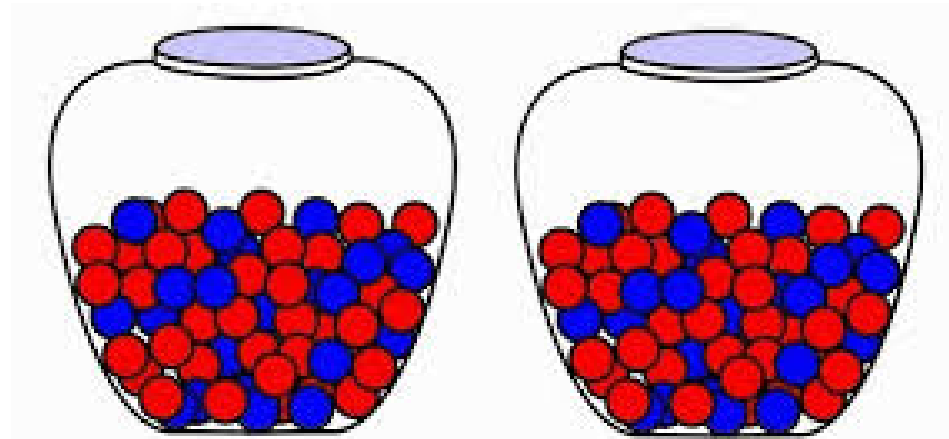


# The Fallacy of the Clutch Hitter





# The Law of Small Numbers





# The Law of Small Numbers





# Anchoring

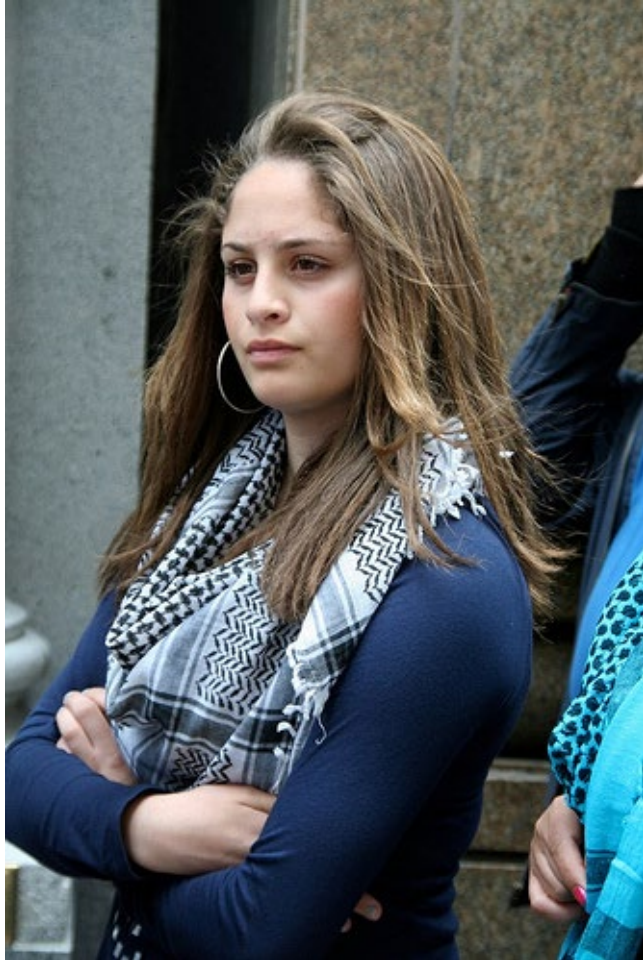






## Case Discussion #3

# Linda



Linda is thirty-one years old, single, outspoken, and very smart. As a student, she was deeply concerned with issues of discrimination and social justice, participating in numerous protests and rallies.



## Case Discussion #3

### Linda is:

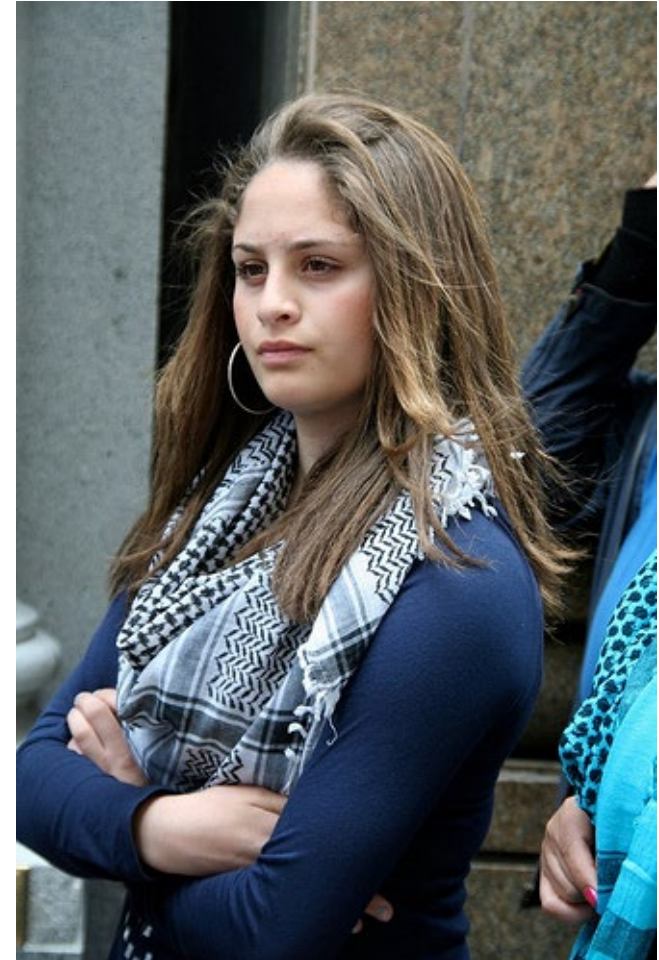
- 1) An elementary schoolteacher.
- 2) A bookstore owner who specializes in woman studies and who teaches yoga.
- 3) An active contributor to Emily's List and a blogger on the MeToo Movement.
- 4) A psychiatric social worker.
- 5) A member of the Democratic party.
- 6) A certified public accountant.
- 7) An insurance salesperson.
- 8) A certified public accountant active in the Women's movement.



## Case Discussion #3

### Linda is:

- 1) An elementary schoolteacher.
- 2) A bookstore owner who specializes in woman studies and who teaches yoga.
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# Training





# Reversion to the Mean and Projections

Assume you are doing revenue projections on four similar locations. You have determined that the industry and your organization will grow at 5.0% over the next year.

Store	Current Year Actual	Projected Next Year
1	11,000,000	
2	23,000,000	
3	18,000,000	
4	29,000,000	
Total	81,000,000	89,100,000



# Intuition and Projections

According to Kahneman financial projections should proceed through the following steps:

- 1) Begin with a baseline projection assuming no specific knowledge (last year's results or an average of a few past years' results.)
- 2) Make a prediction based solely on your intuition (System 1).
- 3) Examine in detail the basis for your intuitive number. (Engage System 2)
- 4) Adjust your final number to somewhere between the baseline and intuitive number based on your confidence after reviewing the data.



# Narrative Fallacy

We are biologically predisposed to make stories from facts:

- Man and wife die. (Wife dies of broken heart immediately after husband.)
- Rationalize away black swans
- Dangerous when limiting future actions





# We Learn Too Well







# The Planning Fallacy

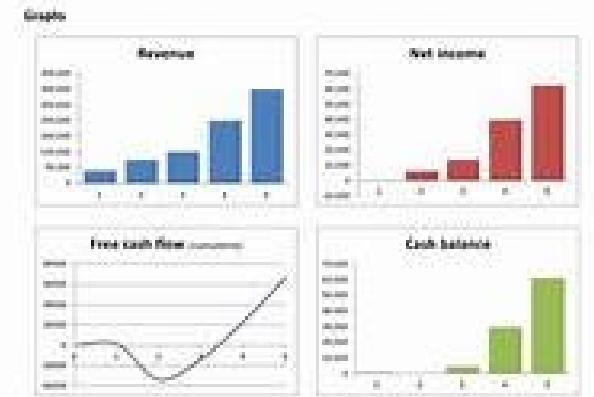
Kahneman uses the phrase “Planning Fallacy” to describe projections which :

- 1) Are unrealistically close to best-case scenarios (**overly optimistic**).
- 2) Could be improved by consulting the statistics of similar cases (**benchmarking**).

*Have you ever experienced the Planning Fallacy?*

**Cash Flow Statement**

	Year 1	Year 2	Year 3	Year 4	Year 5
Net income	1,000	10,000	20,000	30,000	40,000
Adjusting Depreciation	1,000	20,000	30,000	40,000	50,000
Change in working capital					
Accounts receivable	1,000	10,000	20,000	30,000	40,000
Inventory	1,000	10,000	20,000	30,000	40,000
Accounts payable	1,000	10,000	20,000	30,000	40,000
Other liabilities	1,000	10,000	20,000	30,000	40,000
Cash flows from operating activities	1,000	10,000	20,000	30,000	40,000
Investment (purchase) assets	1,000	10,000	20,000	30,000	40,000
Cash flows from investing activities	1,000	10,000	20,000	30,000	40,000
Financing (issue) debt	1,000	10,000	20,000	30,000	40,000
Proceeds from issue of common stock	1,000	10,000	20,000	30,000	40,000
Repayment of long-term debt	1,000	10,000	20,000	30,000	40,000
Cash flows from financing activities	1,000	10,000	20,000	30,000	40,000
<b>Cash flow</b>	<b>1,000</b>	<b>10,000</b>	<b>20,000</b>	<b>30,000</b>	<b>40,000</b>
Beginning cash balance	1,000	10,000	20,000	30,000	40,000
Ending cash balance	1,000	10,000	20,000	30,000	40,000



**NOW OPEN**

# Optimism



## Bernoulli's Error

Assume yesterday Jack had **\$1.0 million** and Jill had **\$10.0 million**.

Today Jack has **\$5.0 million** and Jill has **\$5.0 million**.

*Are they equally happy?*





# The Gamble and the Sure Thing





# Loss Aversion







# Bias





# Doubt is the Key







# More is Better

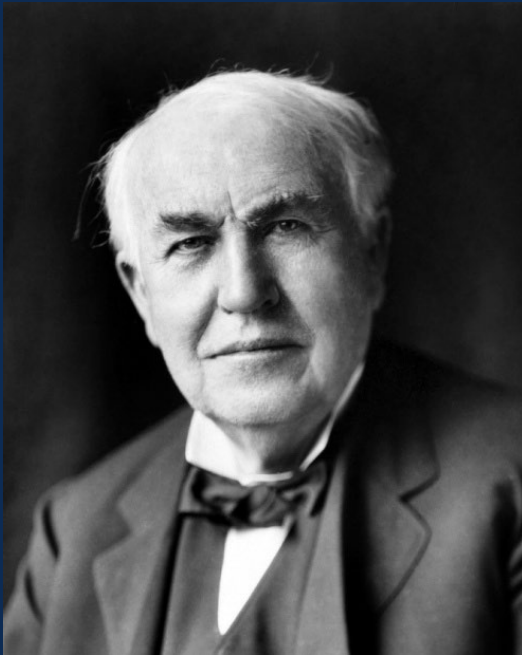


## Lone Wolf



## Working Group

“I have not failed. I’ve just found 10,000 ways that do not work.”



- Thomas Edison



# Adjust and Adjust



**“In war, everything is uncertain.”**

- Helmuth von Moltke

**“Everyone has a plan until they get punched in the mouth.”**

Mike Tyson  
Former Heavyweight Boxing Champion



# Conclusions

- There are numerous pitfalls in our decision-making process.
- Behavioral Economics provides clues as to our economy and our businesses work.
- The more we understand how we make the decisions the better our decisions and our ability to influence others.
- Our intuition, or System 1, can make good decisions, but also bad ones.



# Conclusions

- We need to invoke our System 2 for important personal and business decisions.
- There are numerous pitfalls in our decision-making process.
- The more we understand these pitfalls the better are decision making process.
- The most critical of these pitfalls is **our** preconceived notions or bias.



# Conclusions

- We have barely touched on the subject of Behavioral Economics; I encourage you to do more reading and investigation.
- Think!

# Thank You!

Please share your thoughts and comments.

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