Corporate ethics and the CFO:

Balancing principles and profits in the public eye

A report prepared by CFO Europe Research Services in collaboration with ACCA

CFO Europe research services

ACCA

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Contents

Introduction

Not all business scandals are financial, but in recent years one could be forgiven for thinking so, given the staggering number of corporate frauds perpetrated – or at least condoned – by finance chiefs.

In the early 2000s, two decades since the "greed is good" era of the 1980s, the general public learned that not only was greed still good in the eyes of many executives, but in order for greed to "work", in the infamous phrase of *Wall Street's* Gordon Gekko, the finance department was required to get creative.

This report, based on survey results in at least 18 markets, represents a truly global view of corporate ethics and the finance function.

Of course the scandals that made household names out of Enron, Parmalat, WorldCom, et al were not only the fault of finance. The governance chain broke down at many levels—CEO, board, auditor and analysts. But it was particularly worrying that in many cases it was the CFO, the guardian of the corporate purse, who abdicated responsibility or actively participated in malfeasance—hiding the evidence of bribery, masking colossal debt as profit, or swindling shareholders through complex financial machinations.

More than five years after Enron became a symbol for a new era in corporate greed, finance departments are still in the spotlight and CFOs are feeling the heat. More recent scandals involving bribery at Siemens, alleged bribery at BAE Systems, and fines meted out to British Airways for price fixing have all kept business ethics in the public eye.

> About this report

In June 2007, CFO Europe Research Services, a unit of CFO Publishing and part of the Economist Group, launched a sponsored research project with the Association of Chartered Certified Accountants (ACCA) asking senior finance executives how they view their role in creating an ethical business culture.

The report is based on the results of a survey and interview programme. In June, we surveyed 230 senior finance executives at companies in Europe, and this report is based primarily on the European results.

A similar survey was conducted in the US at the same time, and this report includes comparisons with those results, as well as the results of a similar survey launched in Asia last year. For an in-depth look at the US findings, please see our companion report: *Corporate ethics and the CFO: Balancing principles and profits in the public eye – the US perspective*. For an in-depth look at the Asia findings, please see the June 2006 report by CFO Asia Research Services: *Corporate Governance, Business Ethics and the CFO*. The reports can be found on the ACCA website: www.accaglobal.com\ethics.

For this report we conducted in-depth interviews with CFOs at the following companies:

- Belgian Railways
- Cosgrave Group
- GlaxoSmithKline
- The Nielsen Company
- OPG Group
- Masterlease
- Mustang Engineering
- Pavimental
- Royal Philips Electronics
- Unilever

CFO Europe Research Services and ACCA developed the scope for this research jointly. ACCA funded the research and publication of our findings, and we would like to acknowledge the ACCA team for their input and support. Jason Sumner, research editor of CFO Europe Research Services, managed the project, conducted the interview programme and wrote the report.

Thanks as well to the finance executives who took the time to share their views with us.

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CFOs must be squeaky clean – anything less and the company's survival could be in question. They risk losing more than their jobs too. The Corporate Fraud Task Force in the US and CFO magazine (a sister publication of CFO Europe) recently reported that 63 finance directors have been convicted of crimes since 2002.

How do CFOs balance their many other responsibilities with the need to be ethical in everything they do? How have the scandals of recent years had an impact on current corporate practices and future strategies? Furthermore, how do CFOs view their own role in creating an ethical corporate culture, and what are their biggest challenges?

These are the central questions behind the research presented here. This report, based on survey results in at least 18 markets—Europe and the US in 2007 and Asia in 2006—represents a truly global view of corporate ethics and the finance function.

Overview of key findings:

Ethics is on the agenda

Almost all respondents say building an ethical culture is considered more important than it was five years ago, and three-quarters of CFOs say it is important to them personally to help ensure an ethical culture at their companies.

Ethics support business performance

Respondents believe an ethical business culture makes an important contribution to business performance. They see the specific benefits as intangible, such as improving relationships with investors, customers and analysts. It is particularly beneficial for employee motivation, say respondents. Intangible is not to imply unimportant, but respondents do not see as much of a link between ethics and tangible metrics such as share price.

Boards have heard the message

During the past three years, the boards of directors in a majority of respondent companies have considered a host of ethical issues – including implementing a code of ethics, fraud prevention, addressing bribery and ensuring objectivity in financial reporting.

The ethics X factor

A comparison of top financial performers and underperformers identified in this survey reveals that top performers are more likely to rate their ethical corporate climate as "excellent." This suggests that overall governance at top financial performers includes strict attention to ethics.

Differing views and practices across the US, Europe and Asia

The survey revealed several differences in attitudes about ethics around the world. For example, US companies are more likely to have implemented specific processes, such as ethics training for staff or whistle-blowing policies, than their European counterparts, probably as a result of Sarbanes-Oxley, Federal Sentencing Guidelines requirements and the public attention on ethical issues over the past five years. There are similarities too. Although many companies across the globe have implemented codes of ethics, few of these have gone as far as implementing a process for providing assurance on adherence to the written ethics policy.

The CFO is more responsible for execution than strategy

Although CFOs have expanded their operational and strategic remit in other areas of the business, strategic responsibility for ethical practice still resides a step above the CFO, with the CEO or chairman. CFOs consider themselves more as the "day-to-day" guardian of corporate ethics.

Time constraints and the need to maximise profit are the biggest challenges

Respondents say the biggest challenge in fulfilling their personal desire to be an ethics champion is competing demands on their schedules. "Balancing business needs with ethical practice" was also frequently cited.

The report is divided into three parts. Part 1 looks at the rise of ethics up corporate agendas, as executives aim to turn words into action. What actions have respondent companies taken during the past three years and what actions are they considering in the next year? Part 1 also looks at whether companies favour broad, principles-based codes of ethics or more specific codes that spell out detailed policy guidelines.

Part 2 looks more closely at the CFO's role in creating an ethical corporate culture. Do respondents believe the CFO has a responsibility to be an ethical leader, and how involved should the CFO be in decisions about establishing a code of ethics or integrating ethics into staff training?

Part 3 examines the differences between European, US and Asian respondents, as well as differences between the companies we identified as top financial performers and underperformers.

Five case studies delve deeper into the themes raised by the survey results:

Pavimental: A bid for fairness – how the Italian highway builder stays on the straight and narrow when bidding for government contracts.

GlaxoSmithKline: Ethics gets a check-up – are three codes of ethics enough to police the relationship between drug marketeers and doctors in Germany?

Unilever: Best supporting actor – the CFO can contribute to an ethical culture, says the group chief auditor of the consumer goods giant, but it is the CEO who must take ultimate responsibility.

Philips: Guiding light – policing the ethics of business partners and training the next generation of ethical finance staff are two priorities at the electronics conglomerate.

Mustang Engineering: Ethics versus economics in Africa – saying no to a Nigerian venture when the economics say yes is an issue that the independent oil services provider needed to face.

PART 1 – Ethics in the spotlight
Priorities and plans

Overview: CFOs in the survey believe ethics is more important to their companies than five years ago. • The biggest driver is a desire for better reputations among investors, customers, employees and analysts. • In the last three years, company boards have given attention to a host of ethical issues such as fraud and bribery. • Majorities have checks in place such as ethics codes and whistle-blowing policies, but few respondent companies have processes in place to provide assurance that the code is being followed. • When drafting ethical codes, respondent companies are split between those that set out general principles and those that enforce specific rules. • Many respondent companies do not have written ethical codes.

Ethics more important

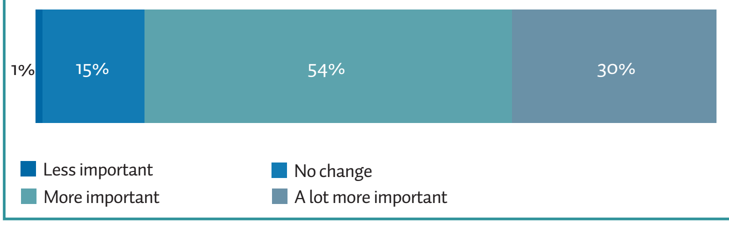
It is almost six years since the fall of Enron, but the collapse of the US energy giant still casts a long shadow over European corporates.

In our survey of European CFOs, over 80% say ensuring an ethical business culture is more important than it was five years ago. (See Chart 1.) In in-depth interviews, we asked finance executives to explain themselves – after all, hasn't ethics always been key to good business?

Given the chance to elaborate, CFOs invariably mention the "E word" and its meteoric impact on public opinion. They say company boards have been forced to focus more on ethics because their companies' reputations – and ability to stay in business – depend on it.

Even those who take the view that ethics is as important as it was five years ago – a view held by 15% of those we surveyed, acknowledged the significance of public opinion and the attendant media scrutiny. "It's not more important," says Kyriakos Kyriakou, CFO of eastern Europe, Middle East and Africa for global market researcher The Nielsen Company. "It's always been important, but people may think it's more important because it gets so much attention."

> Chart 1: Is ensuring an ethical corporate culture more important to your company now than it was five years ago?



Reputation the biggest driver

Company leadership is keeping a close eye on its reputation with its stakeholders. When asked how beneficial an ethical business culture is for relationships and reputations with investors, analysts, customers and employees, most respondents say it is beneficial or very beneficial. (See Chart 2.) Employees are clearly a big audience for ethical practices, and respondents make a strong link between the business culture and keeping employees motivated.

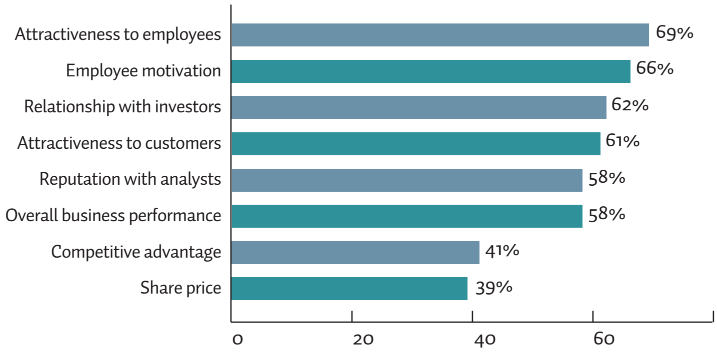
Indeed, for Martin Roche, CFO of Dublin-based commercial property developer Cosgrave Group, an ethical culture is a key ingredient of employee retention. "If people want to work for you, you know you're doing a good job," he says. "If they don't, there's something wrong."

Respondents do not see as much of a link between an ethical business culture and the share price, or competitive advantage.

The issues that matter

If ethics are more important to companies now, and it is reputation that's driving the renewed interest, what exactly are they focusing on? (See Chart 3.) Corporate

> Chart 2: How beneficial is having an ethical culture on the following items?

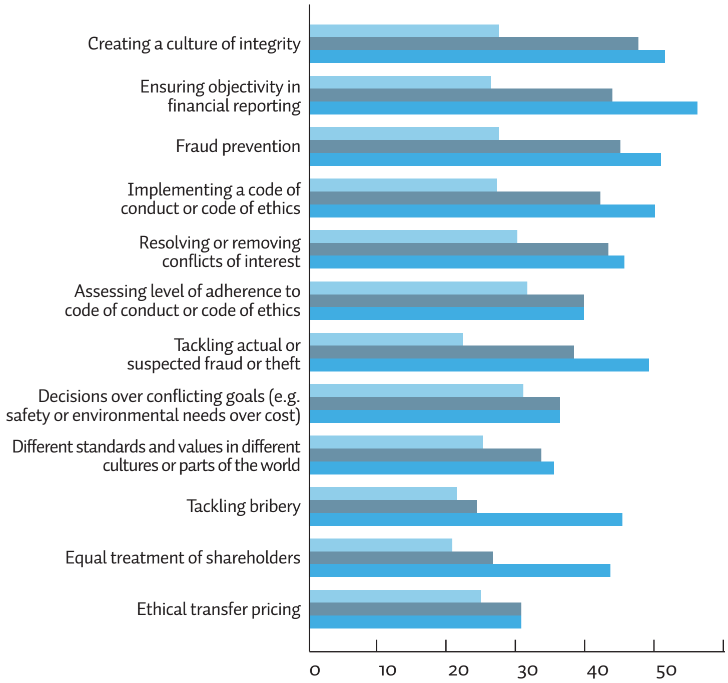


Those answering 4 or 5 on a 5-point scale, with 1 being not at all beneficial and 5 being very beneficial ethics codes, fraud prevention and ensuring objectivity in financial reporting top the list of issues considered in the last three years, and many have addressed these issues in the last 12 months as well.

Fewer boards are likely to visit these same issues within the next year, however. This seems to conflict with the extra weight that respondents say their companies are placing on ethical issues. This could be a sign that although ethics have been given a lot of attention in the recent past, in some respects, finance chiefs think the bulk of the board's agenda-setting work is over, with responsibility for execution being turned over to the rest of the company.

Although survey respondents may say their boards are, on the whole, unlikely to consider issues such as fraud prevention or ensuring objectivity in financial reporting in the next 12 months, it does not necessarily mean they won't be considering any ethical issues. It is apparent from our interviews that ethical concerns are very much on the minds of the board, and are likely to remain so for longer than the next 12 months.

> Chart 3: Which of the following issues surrounding business ethics have already received or are likely to receive the attention of your board?



The reason is simple – these "ethical" issues are integral to the industries they are in, and they must resolve them definitely to stay ahead of the competition. For property developers Cosgrave Group, it is fair wages for eastern European immigrant labour. For fleet manager Masterlease, it is transparency for customers about add-on charges when vehicles are returned. Pavimental, the Italian highway builder, needs to win government contracts without resorting to less-than-ethical tactics that have been common in the industry in the past, and which are still employed by some of its competitors. (See case study, Pavimental: A bid for fairness.)

Which ethical checks are in place?

Written ethical codes are in place in almost three quarters of respondent companies, but other measures such as formal ethics training for staff, whistle-blowing policies or establishing an ethics officer or committee, are relatively rare. (See Chart 4.)

Checking up whether ethics codes are being followed is uncommon as well. Only a third of respondent companies say they have processes to ensure adherence to their code of ethics, and independent assurance is rarer still, with just over a fifth with processes in place. Relatively few boards are considering this issue. (See Chart 3.) Fewer than 40% had assessed the level of adherence to the code of ethics in the last three years and only about a third expect to in the next 12 months. Comparing results from the UK with Western Europe revealed that half of UK boards have assessed adherence to their ethics codes in the past year, and more than 40% expect to in the next year. Only a quarter of Europeans expect their boards to consider the issue in the next year.

Good in principle

In our survey, the companies that have written ethical codes (about 70% of total respondents) tend to favour a policy-and-procedure approach – spelling out measures that must be followed in all cases – rather than a "principles" based approach, which sets out general values and standards, but leaves the interpretation of how it should be applied to employees. (See Chart 5.) For the UK, the results were reversed, with about 60% favouring a principles-based approach.

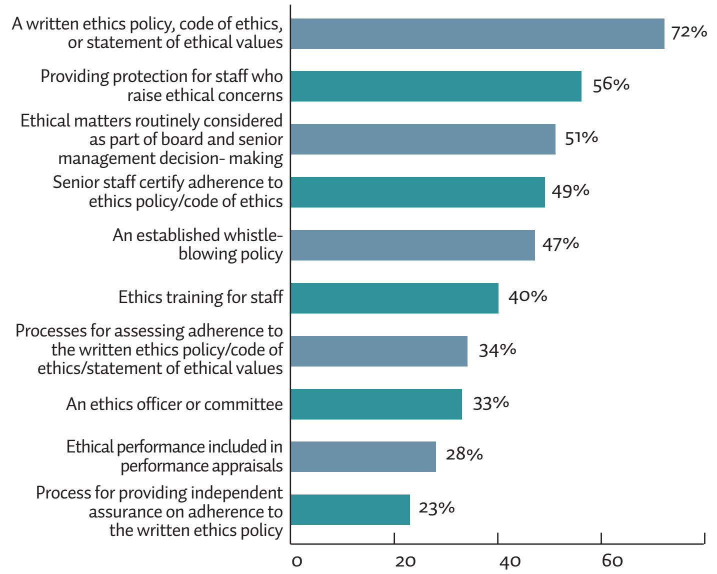
The CFOs we interviewed tended to have more than a single written code of ethics—for example, one for the entire business and another for specific functions. In practice then, companies use both approaches. This makes it likely that many survey respondents whose company's ethical code is best described as principles-based may also employ a policy-based approach too, and vice versa.

GlaxoSmithKline in Germany, for example, operates under three codes – a global GSK code, a code specifically for GSK in Germany and a third, voluntary, code, that the major German pharmaceuticals all signed onto. (See case study – GlaxoSmithKline: Ethics gets a check-up.)

Our interviews reflected a range of views on what works best. Lighting conglomerate Philips uses both approaches. Its overall "business policy document" is conceptual, says Herman olde Bolhaar, senior vice president of finance, setting out general prohibitions against breaking the law. But Bolhaar and other senior executives must sign additional documents to show that they pledge specifically, for example, not to trade shares within certain blocked time periods.

"You cannot only have controls at a conceptual level," Bolhaar says. "If you just have principles, it would not work.

> Chart 4 - Which of the following measures are in place at your company?



(Percentages for respondents answering yes to whether the measure is in place at their company)

You have to make it specific. And if you have specific procedures without the backing of a [principles-based] document, then it is a random approach, and also won't work."

On the whole, Unilever favours principles, says group chief auditor Alan Johnson. "The problem with a legalistic approach is you follow the letter rather than the spirit," he explains. "And the letter doesn't always catch

> Pavimental: A bid for fairness

Six years ago the Italian government got serious about corporate governance, adopting a host of anti-bribery rules known collectively as "231" – the number of the decree.

Italian companies such as highway and airport builder Pavimental have benefited from the new regime. Before 231, the €515 million company risked losing business if it didn't play along with some notoriously loose standards when it came to winning contracts from the government, says CFO Dario Ortisi. Now conditions have improved, he says, thanks to 231, and Pavimental's strict adherence to an internal code of conduct governing relationships with public officials.

Ortisi, who joined Pavimental last year, says the temptation for corruption is especially strong in the highway industry, in which the bidding process puts the company's fate in the hands of a few powerful public officials. The measures employed can be subtle, such as exploiting family connections, to blatant pay-offs.

Within the company too, pressure exists for sales to use any means necessary to win business. If sales staff are to be totally above board, Ortisi says, "companies need to be ready to accept failure." The problem is, he adds, "If the target is €100, and the manager achieves €60 because he turned down business for ethical reasons, how readily will the company accept his bravery?"

What 231 has done is allowed companies to take a harder line against corruption. "The new regulations make my job easier," Ortisi says. "It's another tool. I can demonstrate what the company is risking if employees do the wrong thing."

An example is Pavimental's own code of ethics, which was mandated by 231. It is distributed to all new employees, and is the basis for induction workshops in which the potentially devastating consequences of ethical lapses are brought home to new recruits. In these workshops, Ortisi explains, the company stresses the need for employees "to be a lawyer before we get to the lawyers."

If companies fail at self-regulation, the punishments can be severe. Evidence of corruption in public bids can lead to fines of several million euros, or a ban on bidding for projects for six months to a year. "Basically, you're put out of business," Ortisi says.

Ortisi's only complaint is that cleaning up corruption may have inadvertently added to Italy's reputation for bureaucracy. "To some extent an ethical code means making a photocopy of something, giving it to someone for a signature, getting a receipt, etcetera. There is a lot of paperwork because of the new attention to ethical standards."

> Chart 5 - Which statement best describes your company's ethical code?

everything. The letter won't help you on those grey areas where judgement is required."

While most interview subjects agree that a written ethics code is a necessary component of an ethical culture, they say it can't be seen as a cure-all for potential abuses. "The ethical code is just a tool," says Pavimental's CFO, Dario Ortisi. "It's the responsibility of individuals to perform to an ethical standard." Accordingly, the ethical code sends a message to staff about what is and isn't be tolerated at the top ranks. But even this, Ortisi and others believe, is just one step – senior executives must lead by example. "As a manager, you must be personally untouchable and open to discuss every ethical point that can be raised," Ortisi says.

What about the CFO?

Part 1 examined the ethical priorities and activities among companies as a whole, and our survey and interviews reflect some mixed messages. Certainly ethics are very much on the minds of business leaders—the issue has risen in significance in the last five years and boards of directors have turned their attention to a number of ethical concerns in recent months. When the question turns to what specific measures are in place, however, the overall picture is disappointing—almost a quarter of companies don't have written ethics codes. What's behind the discrepancy? Part 2 explores some possible answers, while also assessing the CFO's role in creating an ethical culture. Part 3 will review the key differences between respondents in Europe, the US and Asia. CFOs in the US, for example, are more likely to believe corporate ethics builds better relationships with stakeholders. And Asia CFOs are more likely to drive ethical practices within their companies than their US or European counterparts.

> GlaxoSmithKline: Ethics gets a check-up

GlaxoSmithKline (GSK) employees in Germany operate under no fewer than three separate codes of conduct. The first code is for GSK globally, the second covers GSK in Germany, and the third was developed when the country's major pharmaceutical players banded together in 2004 to create a voluntary policy of their own.

That amounts to more than 100 pages of principles, policies and procedures covering every aspect of the drug business, from research to production to sales. Is all that paper a sign of paranoia, or a reasonable response to the reality that big pharma is in the public eye far more than most other industries?

Jean Vanpol, head of finance for GSK in Germany, thinks the latter. "We are under constant scrutiny," he declares. Nowhere is this more evident than in how the German press covers the relationship between drug reps and doctors. "We want to make sure that we do not appear as a bad example on the front page of the tabloids," he says. "There is a perception that the pharmaceutical industry sells drugs at too high a price, and is influencing doctors' behaviour. The press is watching us with a magnifying glass."

While the global and local codes have gradually been melded together, it is the voluntary industry policy that has required the most attention. It covers everything from payments for services to gifts that can be given and received, and business travel to clinical trials that can be conducted. In many respects it can be stricter than what the law requires, reflecting the industry's desire to be seen to be above reproach. "It tells you exactly how you are supposed to behave – what is allowed and what is not allowed," Vanpol says.

The 60-page document also recommended setting up a peer-review committee, which can investigate allegations of companies failing to uphold the code. Only smaller, generic producers are exempt.

Vanpol acknowledges that while GSK's finance team didn't have much of a role in the development of any of the codes, it is integral to enforcing them. A case in point: all payments from company sales representatives to doctors go through finance, where Vanpol's "gatekeepers" ensure they are kept on the straight and narrow. That includes enforcing policies such as the one prohibiting sales staff from, say, making payments from their own accounts and then getting reimbursed. "We do more than just a business check. We also do an ethical check," Vanpol says.

It was essential that the code was spelled out in a document, he adds. Doing so officially raised the profile of finance to the role of ethical guardians rather than simply the accountants whose job it is to confirm that all payments relate to an actual service or good received.

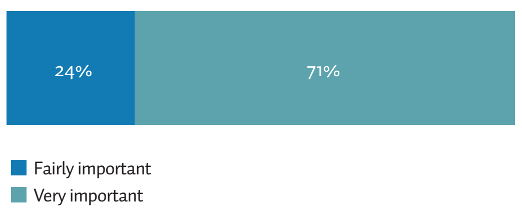
Have the three codes succeeded in raising the industry in the public's esteem? Vanpol wouldn't go that far, but he says he has a stronger sense that company reps now promote products based more on the scientific benefits than the financial rewards. "I think when a doctor prescribes a product, he makes a differentiation between A and B based on the quality of the products and the quality of the sales rep. It's no longer based upon financial incentives, and that's good."

PART 2 – The CFO's role:
In the driver's seat or along for the ride?

Overview: Although most CFOs feel personally responsible for ensuring an ethical culture at their companies, most are only partially involved in promoting ethical practices. • CFOs are more likely to take on the day-to-day responsibility for corporate ethics. • Strategic responsibility for ethical practice resides with the CEO or board. • Respondents believe they should take the lead when it comes to setting a good example for the company or acting as a mentor to colleagues. • Finance directors, however, have little desire to be involved in the nuts and bolts of setting ethical policies, reflecting their belief that these efforts should be collaborative, and that the growing constraints on their time due to the general broadening of the CFO role means it is something that can be delegated to other parts of the company.

CFOs in our survey say they feel personally responsible for ensuring that an ethical culture in their companies is upheld – almost three quarters say it is very important, and a further quarter believe it is at least fairly important. Only 5% say its unimportant. (See Chart 6.)

> Chart 6 - How important is it to you personally to help ensure an ethical culture with in the company?



(Remaining 5% indicated that it was unimportant)

To be sure, it is easy to say and much harder to put into practice. Finance chiefs may feel personally responsible for ethics, but do those feelings translate into action?

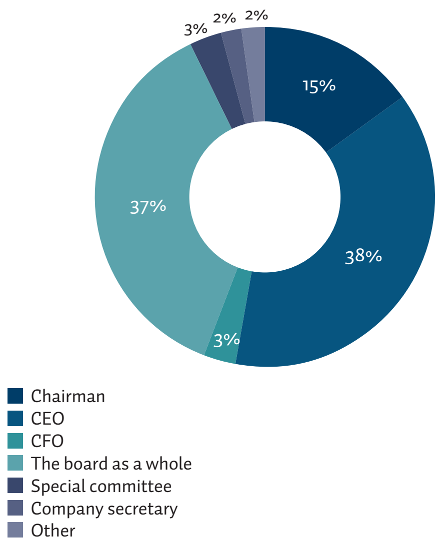
Strategy or execution?

First of all, who has ultimate responsibility for ensuring ethics? We distinguished between strategic responsibility, i.e. the final word on setting the direction for ethical practice, and day-to-day responsibility for execution.

Respondents said strategic responsibility for ethical practice resides a step above the CFO, with 90% of respondents placing it in the hands of the board chairman, the board as a whole or the CEO. (See Chart 7.) Less than 5% of respondents said the CFO has agenda-setting responsibility.

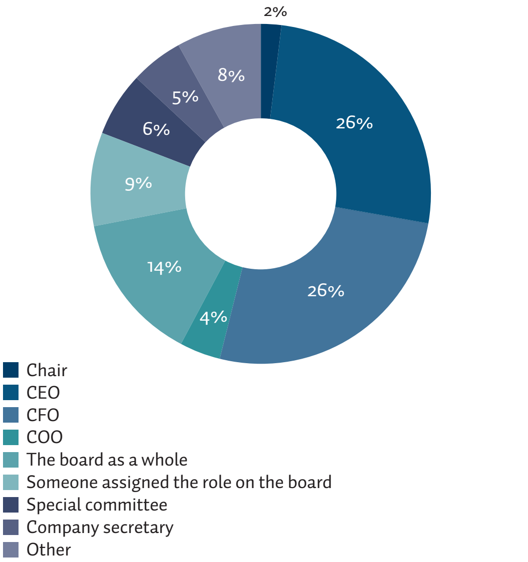
Day-to-day responsibility is a different matter, with a quarter of respondents naming the CFO as the day-to-day guardian of ethical practice. (See Chart 8.) Another quarter of respondents name the CEO as the person most likely to have day-to-day responsibility, with the rest split between the board as a whole, a special appointee or committee, the board chairman or the chief operating officer.

> Chart 7 - Who has strategic responsibility for ensuring ethical practice in your company?



So can or should the CFO be the final authority on ethics? That responsibility, says Alan Johnson, chief auditor of Anglo-Dutch consumer goods company Unilever, lies with the CEO. (See case study – Unilever: Best supporting actor.) Others disagreed that there is such a thing as "strategic" responsibility for ethics. "Ethics isn't a strategy, it should be a thread running through the business on a day-to-day basis," says Peter Phillips, Group CFO of UK fleet manager Masterlease. Ensuring that ethics, such as enforcing compliance or assessing reputational risk, permeate the business is job enough, he says. By taking care that rules are adhered to every day, the CFO will become, in his words, "the keeper of the corporate conscience."

> Chart 8 - Who has- to- day responsibility for ensuring ethical practice in your company?



How involved does the CFO want to be?

Most CFOs say they feel personally responsible for ethics, yet almost as many say the responsibility for ethical practice on a strategic and day-to-day basis, resides elsewhere in the business. The survey reveals further ambivalence between how involved finance directors actually are, and how much they actually want to be.

Roughly one third of the respondents believe they should drive the process when it comes to setting a good ethical example and act as a role model for colleagues. (See Chart 9.) The desire for full involvement decreases when it comes down to the nitty gritty, however. More than half of respondents believe CFOs should be moderately involved in establishing a code of ethics, integrating ethics into board and senior executive decision-making, or assessing adherence to a code of ethics. (See Chart 10.) CFOs have the least enthusiasm for being involved

> Unilever: Best supporting actor

As Unilever's group chief auditor, Alan Johnson is at the forefront when it comes to verifying the financials for 100 countries where the consumer goods giant has a presence. Johnson readily concedes that roles in senior finance such as his carry an enormous assumption that he will operate with the utmost personal integrity. But Johnson also believes there is a limit to the finance function's, and the CFO's, involvement. Indeed, Johnson thinks it is "dangerous" to assign ultimate responsibility for corporate governance to the CFO, as he explains in the following interview.

What is the top ethics-related issue for Unilever?
Making sure we achieve the minimum standards everywhere. We can't have a situation where one country operates in a way that's acceptable to them, but is at a lower standard than our global code of ethics requires. That undermines what the corporation stands for globally.

Should the CFO have strategic or day-to-day responsibility for maintaining ethical standards in the company?
I don't think corporate governance is specifically linked to the CFO, and it's dangerous if we imply that the CFO's role is to ensure the highest standards of corporate governance. It's actually a level above that. It's a collective responsibility of the board, and it should be assigned to the CEO. The CFO and the audit function should be part of setting the right tone in the business, but the responsibility for ensuring the highest standards are achieved everywhere must be that of the CEO.

Why do you say dangerous?
Because it puts corporate governance into one particular box. Other C-level officers play an important advisory role. Corporate governance goes way beyond financial ethics. It is personal ethics, business ethics, relationship ethics, conducted by many different people in the business. If you narrow it down to financial ethics then of course I can understand why you put it under the CFO pillar. But I see it as a much broader and complex issue.

A lot of recent business scandals have come down to unethical accounting. If that's the case why shouldn't we be looking to the CFO to play a more important ethical role?
They manifest themselves in financial scandals, but that wasn't the original intent. Let's be honest – the original intent was driven by greed. Finance let the business down and didn't blow the whistle. The CFO was complicit in all of this in many cases. All the more reason why making the CFO the guardian of corporate governance is for me very dangerous.

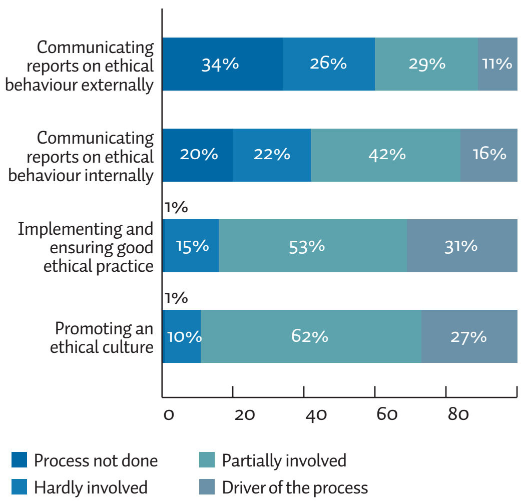
The CFOs of those companies should never have been in the senior positions they were in, because they lacked personal integrity. When the chips were down, you would expect the whistle to be blown, the gates to be put up and the CFO to say, 'This is wrong. I'm not going to be part of misinforming the market.' Even if it means personal sacrifice, so be it.

Ethics is a board responsibility with day-to-day responsibility delegated to the CEO. I very much favour the independent route, where there is a sound non-executive supervisory layer not involved in the day-to-day activities. They shouldn't benefit in any way from the success of the company, other than their personal reputation. There should be no financial reward for them if the business does better, other than the fee they get for being a non-executive director. They're incentivised by reputation rather than by the financial reward, which is why executives tend to go off the rails.

in establishing a whistle-blowing hotline, acting as an official listener for ethical concerns, appointing an ethics officer or including ethics in staff training.

In interviews, CFOs were clear that they must drive the process when it comes to financial controls and ensuring accuracy in the numbers reported externally. But why, as our results suggest, don't CFOs think they should lead the way when it comes to setting up more general ethical checks and balances? The interviews revealed a possible reason—finance directors see general ethical issues as a team effort.

< Chart 9 - How involved are you in the following actions in your company?



Take the code of ethics at Dutch electronics conglomerate Philips. "At the board of management, everybody has the responsibility for the code of conduct," says Herman olde Bolhaar, Philips' group senior vice president of finance. "It is driven in the beginning by the management committee. Then language is drafted by the legal department, and accepted and enforced by the board."

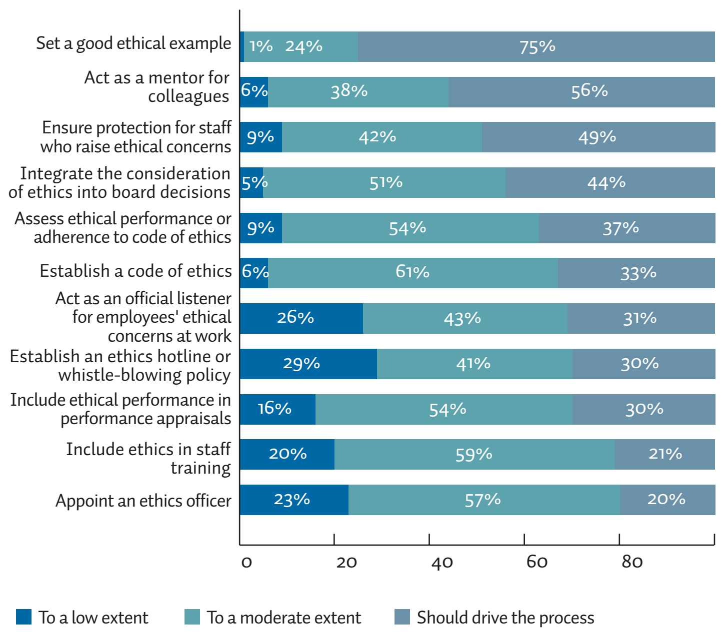
Unilever's Alan Johnson is among the senior executives on the corporate code committee that meets a minimum of five times per year. For 12 years, employees have brought their ethical dilemmas to the committee, in confidence. "It's a safe haven for people to come and talk about issues," he says. "We give guidance and support. They know it's a secure environment where they can have a discussion, and we're not sitting in judgement."

CFOs say they feel personally responsible for ethics, yet almost as many say the responsibility for ethical practice, both strategic and on a day-to-day basis, resides elsewhere in the business.

No time is no excuse

Time is another reason why CFOs don't want to get more involved. A quarter of respondents cited the "time and effort involved" as the most significant challenge to improving corporate ethics. (See Chart 11.) Another quarter said the biggest challenge is "balancing business needs with ethical practice"—in other words, exploiting grey areas in order to meet sales targets, or withholding the truth from clients in order to win business, for example. Many of the case studies included in this report highlight the difficulties that companies face—deciding whether to open an office in Africa, turning down business from potential partners because their

< Chart 10 - To what extent do you think the CFO should be involved in the following activities?



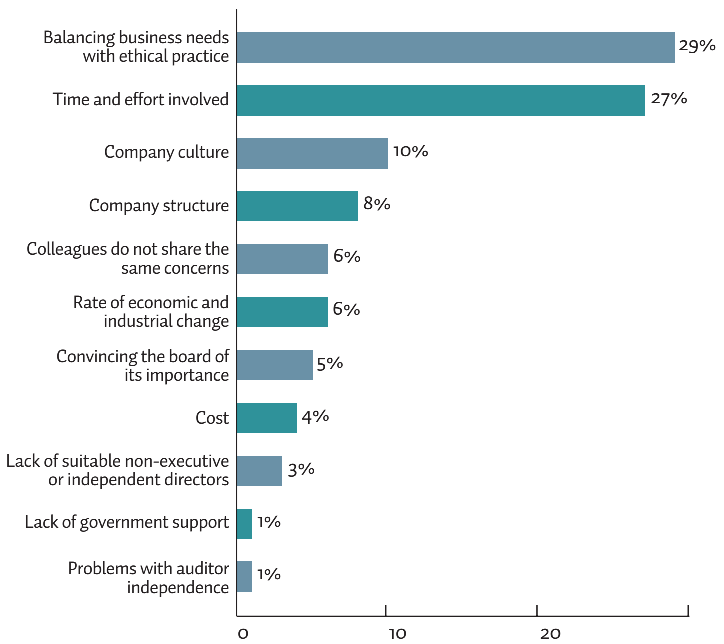
ethics are suspect or playing by the rules governing relationships with public officials, even though others in the industry may not be. A company culture that is resistant to change was the number one challenge among 10% of respondents.

"You can have a lot of formal rules but speeding still happens. Tickets do not prevent it happening. What is more effective is teaching people to realise it is dangerous to drive too fast."

Lack of time is no excuse, however, for Herman olde Bolhaar of Philips. "Nobody can get away in the current culture by saying, 'I didn't have time.' That is absolutely not acceptable. So it is a matter of priority-setting. When the company is at stake, you better pay attention and [devote] time to it."

How much time? There can be no hard and fast rule, Bolhaar says. "There are instances when 10% of my time was more than sufficient. Right now I am spending a lot of time on it, but not in a conceptual way. It's always concrete—how are we going to deal with a specific issue, and what is the right thing to do?"

> Chart 11 - What is the most significant challenge your company faces in improving ethical practices?



(Percentages of respondents answering yes to whether the measure is in place at their company)

> Philips: Guiding light

Herman olde Bolhaar has two crucial assignments for Dutch electronics conglomerate Philips and ethics are at the forefront of both.

Olde Bolhaar, an executive vice president of finance in Philips' Amsterdam headquarters, heads up joint ventures and oversees training for up-and-coming finance leaders. The dual role may seem incongruous at first, but olde Bolhaar's wide experience in a number of senior finance roles, including stints as CFO of the worldwide television business and several components businesses, makes him especially well suited for both tasks. He reports to the group CFO, a sign of how seriously the company takes its partnerships and management development.

As at any company, if ethics slip in either area, it could be devastating to Philips' reputation. Lapses by partners will reflect badly on the firm, and internally, future managers must learn what is acceptable in the Sarbanes-Oxley era. "Ethics are not only conceptual," olde Bolhaar says. "You have to translate that into specific good practices."

One of those practices is walking away from deals if they don't live up to Philips' principles. As part of his joint venture remit, olde Bolhaar heads up a vetting process that brings in purchasing to look at CSR policies and auditing to check that the accounting adheres to Philips' principles. All partners are required to adhere to the Philips code.

The self-certification system isn't perfect and there is still a considerable need for trust. Philips cannot actually check every partner to ensure they are not using child labour, for example. "Formal confirmation is something though," olde Bolhaar says. "People generally do not sign something that says they are compliant when they are not."

Olde Bolhaar wouldn't discuss specifics, but he said there have been potential conflicts between revenue targets and ethics. "When there is a lot of pressure, you see the effect," he says. "People sometimes try to find a way out and say, 'Maybe we can go over the line.' But you have to be strict and say, 'It's not allowed. We don't do that.'"

At times, olde Bolhaar employs the same approach in management training. He points to revenue recognition as an example. As a NYSE-listed company, Philips must follow certain rules about when to book a sale, and the finance team must know them backward and forward.

He tries to balance all the specific injunctions with an emphasis on principles – "not by saying you should and should not, but setting a required standard, then training them to live up to the rules."

He makes an analogy with speeding tickets to emphasise the point. "You can have a lot of formal rules, but speeding still happens. Tickets do not prevent it happening. What is more effective is teaching people to realise it is dangerous to drive too fast."

PART 3 – A study in contrasts:
Differences across geography and financial performance

Overview: CFOs in the US outpace their European and Asian colleagues in every single ethical procedure in the survey. • America's CFOs are more likely to believe corporate ethics have a beneficial effect on stakeholder relationships and Asia's CFOs are more likely to drive ethical practices within the company. • Top financial performers are more likely to believe their ethics are in order, and have more ethical procedures in place, such as a code of conduct.

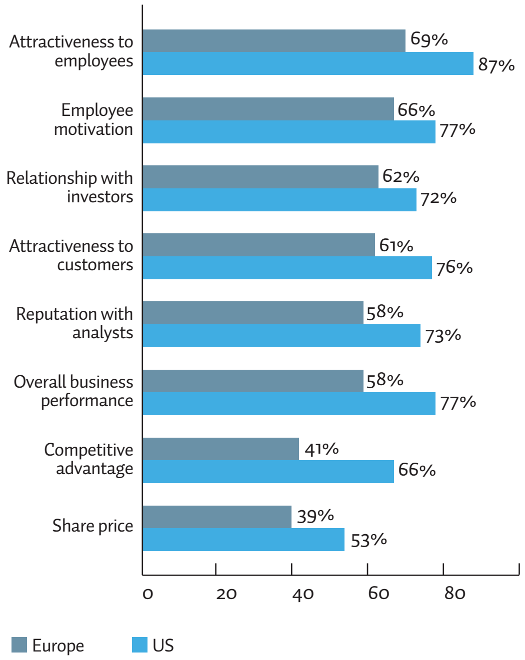
Overall, most CFOs in the US and Europe think ethical business has a positive impact on stakeholder relationships, but US finance chiefs gave consistently higher ratings. (See Chart 12.) One major difference: most of the US CFOs believe good ethical practices boost the share price and enhance competitive advantage, in stark contrast to their European counterparts, who are far less certain of the connection. Internal PR is a big driver for both regions, with significant percentages of respondents saying ethics make the company more attractive to employees and boost staff motivation. attractiveness to employees and employee motivation.

CFOs in the US outpace their European and Asian colleagues in every single ethical procedure in the survey, including establishing ethics codes, whistle-blowing policies, providing protection for staff members who raise the alarm and ethics training. (See Chart 13.) This may

> Comparing the Europe, the US and Asia

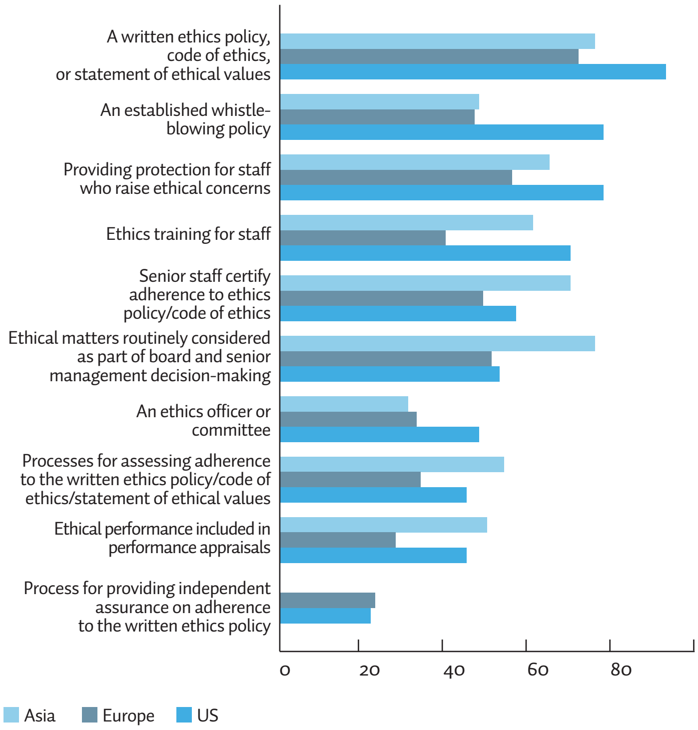
The survey underpinning this report was launched in June 2007 in Europe and the US, following a similar survey that was taken in Mainland China, Hong Kong, Malaysia and Singapore in April 2006. The Asian survey, conducted by CFO Asia Research Services and sponsored by ACCA, served as the basis for the report Corporate Governance, Business Ethics and the CFO, which can be obtained from www.cfoasia.com/research.htm. In this section, we home in on the major regional differences. (See Charts 12-16.) NB: Because the 2006 Asia survey differed slightly from the survey launched in Europe and the US, we have not included comparisons for all three regions for every question.

> Chart 12 - How beneficial is an ethical culture for the following items: US vs Europe



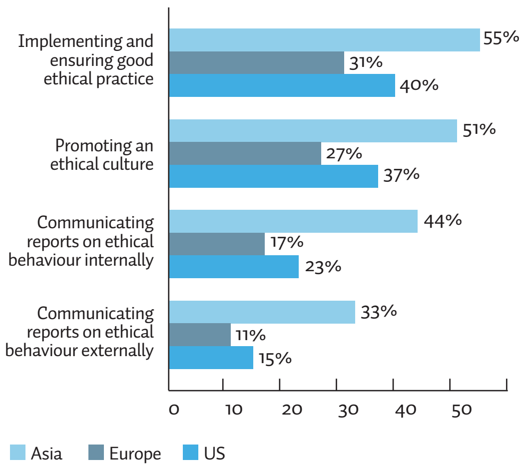
Those answering 4 or 5 on a 5-point scale, with 1 being not at all beneficial and 5 being very beneficial

> Chart 13 - Which of the following items or actions are in place at your company: US, Europe & Asia

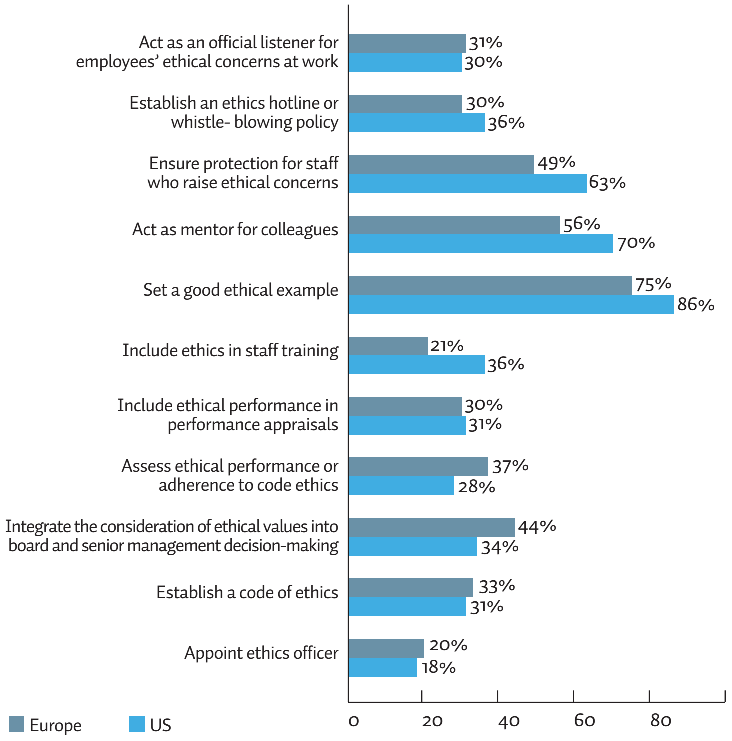


reflect the impact of Sarbanes-Oxley, which mandates many of these policies. Asian companies are more likely to have a certification system for adherence to the code than either the US or Europe, and three-quarters of Asian respondents said their boards routinely discuss ethical matters before making decisions. In general, respondent companies in Asia have more processes in place to ensure ethical codes are being followed.

> Chart 14 - Are you the "driver of the process" for the following actions at your company?



> Chart 15 - When should the CFO should "drive the process" for the following activities?



Moreover, Asian respondents claim to lead the way in promoting an ethical culture in their companies. (See Chart 14.) More than 40% of Asian respondents talk to employees about their ethical performance and a third communicate their ethical performance externally. The European and US effort in this regard pales in comparison.

US CFOs want to be more involved as role models to colleagues and in generally setting a good example. (See Chart 15.) Europeans are slightly more eager than US finance directors to include ethics in board discussions.

Finally, CFOs in the US have a higher opinion of their companies, with half calling their corporate ethical climate "excellent", compared with a quarter of Europeans (See Chart 16).

Top financial performers versus underperformers

In the European survey, we asked respondents to rate their companies' financial performance over the past three years – better than, in line with, slightly below or well below expectations.

We then compared the responses of those putting themselves at either end of the spectrum — the top performers and the under performers. (See Charts 17a-17c). In general, top financial performers believe their companies have a better ethical climate, their companies' boards have given more consideration to ethical issues, and they are far more likely than their peers to have ethics processes and procedures in place.

This is not to suggest that these companies do better financially because they are ethical. Although it may be true, this study did not attempt to link financial performance to ethical performance. Another possible explanation is the case of "a rising tide lifts all boats" – i.e. ethics is just one of many aspects of superior corporate stewardship at which top performing companies excel.

< Chart 16 - How would you assess the current ethical climate at your company: US vs Europe

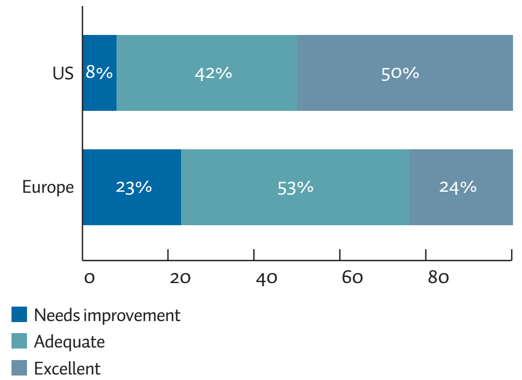
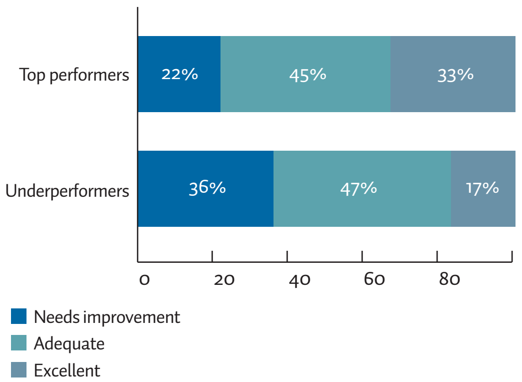
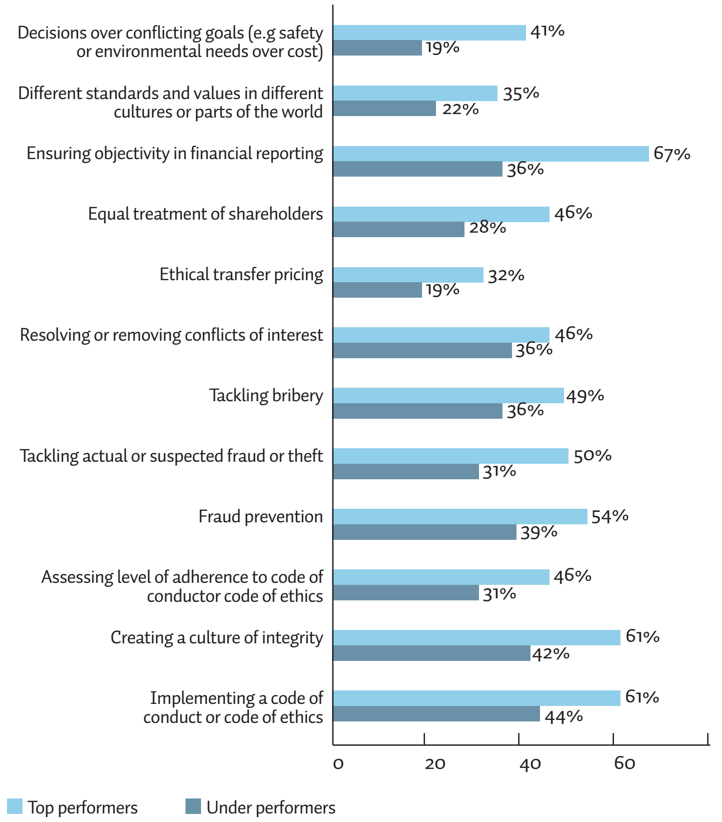


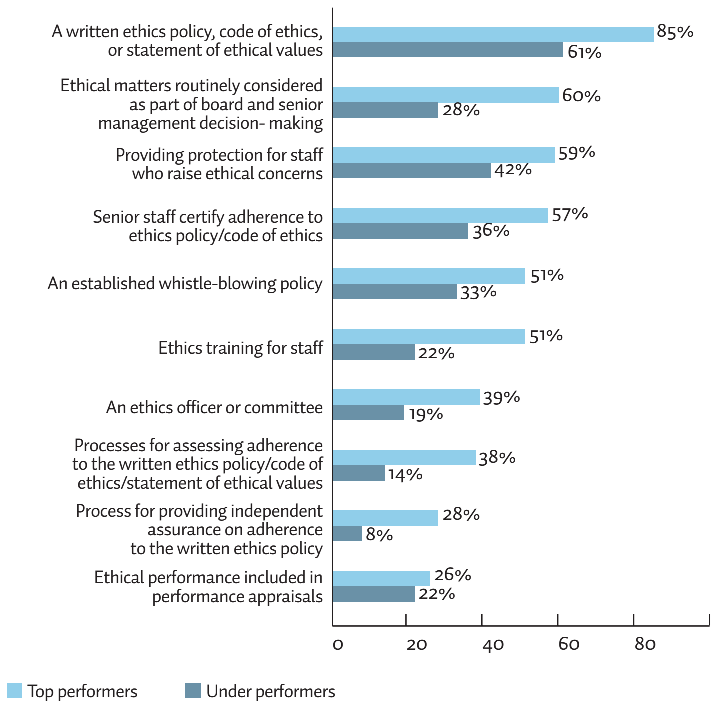
Chart 17a - How would you assess the current ethical climate at your company?



> Chart 17b - Which of these issue received attention from your board in the last three years?



> Chart 17c - Which of the following items or actions are in place at your company?



> Mustang Engineering: Ethics versus economics in Africa

What's a clever embezzler's number one rule? Be trusted. So said Meg Lassarat's father, a Texas banker, whose innate scepticism now helps shape the corporate culture at Mustang Engineering, the Houston-based engineering firm where Lassarat is CFO.

"A very important part of the finance function is to trust no one," she says. "It's great to be liked and Mustang is very strong on integrity and teamwork, but that doesn't mean we're not going to check on what you say."

That principle extends to foreign ventures. Lassarat is part of the management team that made the difficult decision earlier this year to turn down a potentially lucrative offer to set up a business venture in Nigeria. This was due to concerns about corruption and worker safety. "It was just too dangerous," Lassarat says. "It was too ethically unstable for us."

But the financial argument supporting the venture was indeed strong. There had been significant oil discoveries in the region, and Mustang, which provides engineering services to some of the world's biggest oil companies, was being urged by its clients that were already in the country to open an office there. (Mustang can provide its services remotely, but Nigerian law requires engineering firms to establish a presence on the ground.) The Nigerian offer also was a perfect fit with Mustang's strategy to expand globally.

"We had so much momentum on so many fronts," Lassarat recalls. Many long-time employees were in favour of the Nigerian expansion plan, while customers were guaranteeing them contracts and offering to pay their setup costs. "From a finance perspective, it was absolutely the right thing to do," she says. "All of the typical concerns of a CFO were taken care of."

Still, when the 15-strong management committee met to discuss the idea, Lassarat and others had doubts. "We spoke to four different security companies asking how we could protect our people. We never got an answer that was sufficient."

After "some tough discussions", the company president made the decision – to wait. Lassarat considers it a postponement. "We're going to be there someday, once they can guarantee the safety of our employees." In the meantime, Mustang has enough business in a growing industry to lessen the financial impact of the decision not to go just now.

Has Lassarat's reputation in the company suffered? After all, some companies might not look kindly on a CFO making an argument for ethics over economics. But she doesn't have any regrets.

"My colleagues and I work on a lot of issues together, and still respect each other even though we have differences of opinion." And anyway, she adds, "I can't remember a time when I was too terribly worried about not having enough friends."

Conclusion

This report began by asking how CFOs view their role in creating an ethical culture, more than five years on from some of the biggest financial scandals in corporate history and the ongoing saga of corporate bribery and price-fixing scandals in Germany and the UK.

The research shows that finance executives believe ethics is crucial to business performance, and that they personally are responsible for the ethical climate, or lack thereof, in their companies. They know that running a tight ship will help their reputation with customers and shareholders, as well as recruit and retain quality staff. Their bosses, the boards of directors have taken notice too, by addressing many troublesome issues such as fraud, bribery and corruption in the past three years.

Indeed, some of the quotes in this report speak volumes about the extent to which finance has gotten the message from the public: the talk is of policing and gatekeeping – "trust no one" and "financial controllers must watch their sales people". Effective, perhaps, but not the kind of words that engender warm feelings from colleagues.

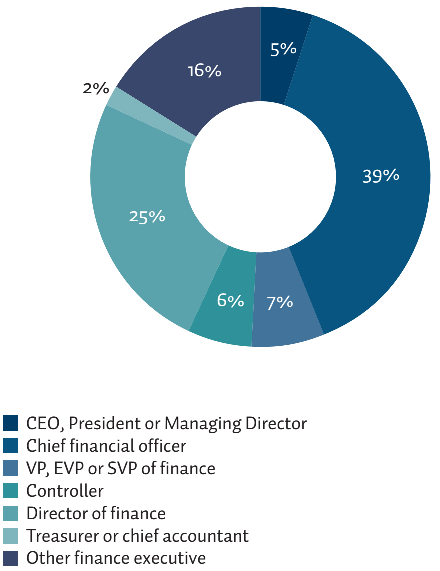
It raises the question of whether finance is going too far with controls – after all, as Dario Ortisi, CFO of Pavimental, pointed out in this report, there is a danger that a concern for ethics turns into a concern for filling out the right paperwork. But in a sense it is the public, by demanding strict legislation to stop the next Enron or Parmalat, that has forced the finance department to crack the whip.

But finance executives must be careful not to sacrifice the qualities that have allowed so many to progress through the ranks from accountant to controller to business partners. They will be especially important as companies expand globally, and finance chiefs increasingly find themselves having to transpose what may be routine ethical practices at home to sceptical business partners abroad.

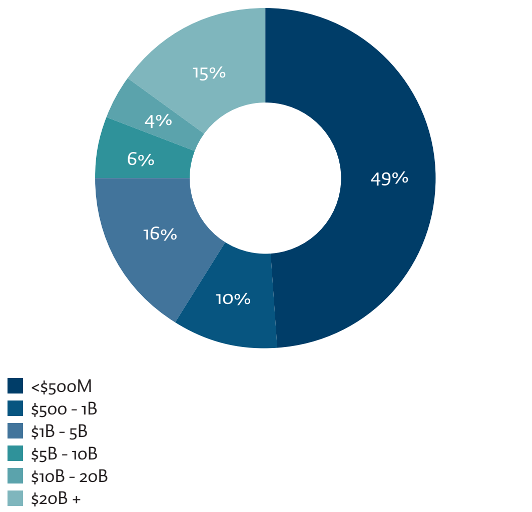
Study Methodology

CFO Europe Research Services surveyed 230 European senior finance executives for this study through an online survey conducted in June 2007. Responses came from a cross-section of all major industries. The following is further demographic information about the respondents.

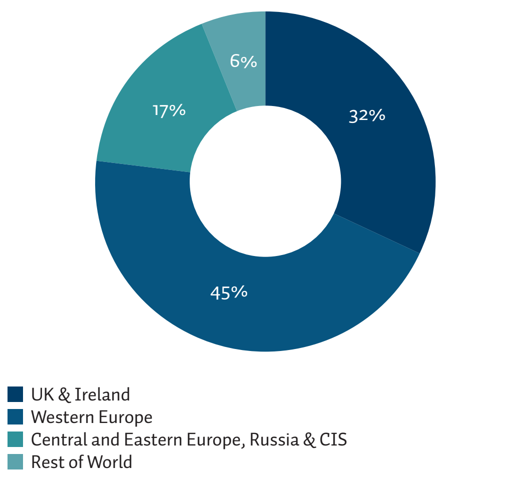
> Chart 18 - Job title



> Chart 19 - Revenue



> Chart 20 - Respondents' location



ACCA

Corporate Ethics and the CFO

This report forms part of an ambitious multinational survey of corporate ethics carried out by CFO Research Services in collaboration with ACCA - the other two pillars of the project, using consistent research methodologies, cover the US and South East Asia. Taken together, the three reports comprise (to our knowledge) the first such study of business ethics across major economic regions and it therefore provides a basis for regional comparisons to be made on how CFOs approach ethics in today's business environment.

The encouraging conclusion is that CFOs in all regions report that building a culture of ethics within their companies has a higher priority than five years ago. CFOs say it has a beneficial effect on business performance internally, in terms of staff trust, loyalty and motivation, more reliable financial reporting, and improved corporate culture; and it also boosts external relationships such as those with investors, customers and analysts. CFOs also perceive a very real risk to their personal and corporate reputations if they do not give ethics a high enough priority.

But there are definite differences between the regions. US companies seem to have made more progress than their European counterparts in terms of devising and implementing specific policies – written ethics and whistle-blowing policies, employee training in ethics, and the formation of ethics committee (of board members or employees) were all more widespread in the US. The responses from South East Asian companies, by contrast, suggest they lead the way on assurance processes to ensure adherence to ethics codes, and CFOs there also took a more active role in talking to employees about ethical performance and communicating this externally.

CFOs in the US were also more confident about their company's ethical performance than the Europeans. Fully 50% of American CFOs rated the ethical climate as 'excellent' compared with just 24% in Europe.

There may be 'push' factors leading to an increased focus on ethical policies in the US – the effects of the Sarbanes-Oxley requirements, the Corporate Fraud Task Force and the threat of Federal Sentencing Guidelines for wrongdoers would be enough to focus CFOs' attention on ethical issues. But there is a clear 'pull' factor as well – US CFOs asserted more strongly than their European counterparts that good ethical practices boost share price and enhance competitive advantage.

While this survey did not specifically aim, as previous studies have done, to examine whether there is a causal link between strong ethical focus and good business performance, nonetheless it revealed additional evidence of a correlation between the two. The European CFOs in those companies that had outperformed the others financially believed that their boards had given more consideration to ethical issues, had more processes and procedures in place, such as ethics training to help ensure ethical behaviour, and most importantly, a strong ethical climate.

Individual descriptions from respondents of the key benefits of an ethical culture also strongly suggested a clear link between ethics and business performance. And while it could be argued that that top performing companies are better at corporate stewardship generally - and so their superior ethical performance simply reflects that - the fact that the stronger financial performers did better in each of the 22 different ethical practice and policy areas covered tends to suggest a clear correlation.
There are some areas of disappointment uncovered by the research. Despite the increase in ethical focus a quarter of companies in Europe still do not have written eth-

ical codes. And across all regions surveyed, the number of companies that have implemented a process for providing assurance on adherence to the written ethics policies is modest. The number that had this externally verified is smaller still.

This is an area where the CFOs must take an active role in persuading their executive colleagues of the need, not just for the creation of ethical policies and processes, but for assurance that they are being adhered to. The CFO after all, as the guardian of the corporate finances, is well-placed to act as the keeper of the corporate conscience. At GlaxoSmithKline all payments from sales representatives to external customers go through the finance department where the CFO says his team 'do more than just a business check – we also do an ethical check'.

But the role of the CFO as ethical guardian is by no means universal. The survey shows that only a quarter of CFOs are responsible on a day-to-day basis for ethical practice in their companies. And this, it seems, may suit many: while most believed they had a key role to play in the establishment of an ethical culture, 90% said the overall strategy had to be a CEO or board responsibility. There was also concern amongst some about how much time they had to devote to ethics issues with the pressure to maximise results.

These CFOs may do well to heed the words of Philips' finance chief. "Nobody can get away in the current culture by saying I didn't have time. That is absolutely not acceptable. It's a matter of priority-setting. When the company is at stake, you had better pay attention to it." This quotation gets to the nub of the issue. Is the increased focus on ethics shown by this research simply a defensive mechanism by companies, or a genuine belief that it represents good practice? ACCA believes strongly that in a world of ever-tighter regulation, ethics and professionalism has a higher value than complying with legislation.

Throughout 2007, ACCA is holding events around the world to coincide with the launch of its new professional qualification which puts ethics and professionalism at the heart, following a major global consultation exercise, with 30,000 stakeholders responding. Businesses have had a large say in the outcome. One innovation in the new qualification is the creation of a separate additional ethics module, which will simulate practical ethical dilemmas for finance professionals. Members attending these events have considered what ethics means to them, and we believe that, like us, they will be heartened that this survey shows a correlation between strong ethical and business performance.

For CFOs must play a crucial role, not just in ensuring probity in financial stewardship but in setting the right ethical example for the rest of the organisation to follow. As focal points of financial leadership, they are today responsible for far more than financial reporting – they contribute to strategic direction and represent their employers among investors and the media. They must show leadership and 'walk the talk' to ensure that ethical practice is embedded throughout the company.

It is a competitive imperative. Talented employees – human capital – make the difference in today's competitive market, and it is these employees who, above all, are demanding ethical performance from their employers. CFOs along with board colleagues must drive the integration of ethical values into senior management decision-making, and into organisational culture. In this way, companies can improve brand values with customers, strengthen relationships with banks, investors and suppliers, and add to their appeal as employers of choice.

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