Corporate ethics and the CFO:
Balancing principles and profits in the public eye:
The US perspective
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A report prepared by CFO Europe Research Services in collaboration with ACCA
Corporate ethics and the CFO: Balancing principles and profits in the public eye

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Introduction

Enron is still the king of corporate scandals, but there have been plenty more since then for an increasingly jaded public to stew over.

The list is long and infamous - WorldCom, Tyco, HealthSouth, to name only three, and more recently, the convictions of newspaper magnate Conrad Black (for fraud) and former Brocade Communications boss Greg Reyes (for backdating stock options) have kept corporate ethics in the headlines.

Of course, CFOs shouldn't be the only senior executives singled out. Governance broke down on many levels, from the CEO to the board of directors, from auditors to analysts. But in many cases CFOs actively participated, or at least turned a blind eye, to the crimes being committed.

The federal government, responding to public outrage, has gotten tougher, and the consequences for executives that cross the line have gone well beyond losing a job - 63 finance chiefs have been convicted of crimes since 2002, according to the Corporate Fraud Task Force and CFO magazine. As a result, there is a dark cloud hovering over corporate finance departments that even the most virtuous CFOs have a hard time shaking off.

This report, a unique, in-depth look at the state of ethics in corporate America, examines how CFOs operate in this new environment. Do they feel a sense of personal responsibility for ethics and the reputation of their companies? How do they view their role in creating an ethical corporate culture, and what are their biggest challenges? Looking more broadly, how have the scandals of recent years had an impact on current corporate practices and future strategies?

> 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) to find out how senior finance executives view their role in creating an ethical business culture.

The report is based on the results of a survey and interview program conducted simultaneously in the US and Europe. In June, we surveyed 138 senior finance executives at companies in the US from a range of industries and company sizes, and this report is based primarily on those results.

We conducted in-depth interviews with CFOs at:
- MGM Mirage
- Mustang Engineering
- US Department of Agriculture

For an in-depth look at the European findings, please see: Corporate ethics and the CFO: Balancing principles and profits in the public eye. For an in-depth look at a similar survey that was conducted in Asia in 2006, please see CFO Asia Research Services' Corporate Governance, Business Ethics and the CFO. These reports can be found on the ACCA website: www.accaglobal.com/ethics.

CFO Europe Research Services and ACCA developed the hypothesis 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 program and wrote the report.

We also thank the finance executives who took the time to share their views with us.
We ask too, as the five-year anniversary of Sarbanes-Oxley just passed, whether CFOs believe all of the time and money spent setting up rigorous audit controls has been worth it. We know from numerous studies that, on the whole, CFOs want to see Sarbox toned down or even repealed. But what about the spirit of the law? Has it succeeded, in other words, in making business more ethical?

Overview of key findings:

Well documented
More than 90% of companies have a written ethics policy, but few have processes in place to make sure it is being followed.

The ethics X factor
When comparing companies whose financial performance was beyond expectations with those who under performed, top financial performers are far more likely to report an excellent ethical climate. The boards of top performing companies are also more likely to have considered a range of ethical issues in the past three years, and top performers have done more to ensure attention to ethics runs throughout the organization.

Ethics rising
Most respondents say corporate ethics are more important than five years ago, and all say it is personally important to them to keep their companies on the straight and narrow. It seems corporate boards have gotten the message, and have also addressed a host of ethical issues in the last three years. However, fewer boards plan to revisit these issues in the near future.

Better relationships
Ethics makes good business sense, respondents say, especially for relationships with investors, customers, employees, and analysts. It is particularly beneficial for employee retention and motivation.

Leading the pack
CFOs in the US outpace their European and Asian colleagues when it comes to establishing ethics codes, whistle-blowing policies, providing protection for staff members who raise the alarm, ethics training and many other policies and steps to ensure ethical behavior.

The boards of top performing companies are also more likely to have considered a range of ethical issues in the past three years, and top performers have done more to ensure attention to ethics runs throughout the organization.

Involved, but not the driver
Respondents think of themselves as leaders when it comes to setting a good example and mentoring their colleagues, but few want to be much involved with the nuts and bolts such as setting up a whistle-blowing policy or acting as an official listener for employees' ethical concerns. This reflects what they identify as their key challenge in instituting an ethical culture - time constraints.

Intended effects
Nearly 60% of respondents believe Sarbanes-Oxley has had a positive effect on ethical corporate culture. Just over a third say it has had no effect. Hardly any believe the effect has been negative.

The report is divided into two parts. Part 1 looks at how ethics is rising 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 favor 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 1 – Ethics in the spotlight: Priorities and plans

Overview: More than 80% of respondents say maintaining an ethical corporate culture is more important than five years ago. • Almost all companies surveyed have a written ethics code. • A little more than half of these codes detail specific policies, and the rest set out general ethical principles. • Company boards have considered many different ethical issues in the last three years. • Respondents agree that business ethics helps build relationships with key stakeholders, especially employees.

Our survey respondents clearly believe ethics have risen up the corporate agenda—more than 80% say corporate ethics are more important than they were five years ago. (See Chart 1.)

The reason? One company’s name still looms large, more than six years after its spectacular collapse—Enron. As one respondent, echoing many others, put it: an ethics culture “shows our customers that we won’t let an Enron happen.”

If companies say that building an ethics culture is so important today, what then has this entailed?

For one, they’ve documented their ethics policies. More than 90% of respondents say their company has done so. (See Chart 2.) This is surely the influence of Sarbanes-Oxley, which requires publicly listed companies to state that they have such policies in place, or explain why if that is not the case. Sarbox also requires public companies to set up a whistle-blowing program, which almost 80% of our respondents have done. Fewer companies monitor whether these codes are being followed. Less than half have a process in place to ensure adherence to the code, and only a fifth seek independent adherence to the code. Federal Sentencing Guidelines which recommend leniency if companies have ethical processes in place, will also likely have had an impact.

Of those with a written code of ethics, a little over half prefer one that defines specific procedures and policies.

CFOs in the US outpace their European and Asian colleagues when it comes to establishing ethics codes, whistle-blowing policies, providing protection for staff members who raise the alarm, ethics training and many other policies to ensure ethical behavior. (See Chart 5.) This may reflect the impact of Sarbanes-Oxley and US Federal Sentencing Guidelines, which mandate many of these policies. Asian companies reported they are more likely in effect 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. being followed.

Overall, most CFOs in the US and Europe think ethical business has a positive impact on stakeholder relationships, but US finance directors give consistently higher ratings. (See Chart 6.) One major difference: most of the US CFOs believe good ethical practice boosts the share price and enhances 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 saying ethics make the company more attractive to employees and boost staff motivation.
The rest prefer a principles-based approach, which sets out general guidelines and gives employees more freedom to decide what’s acceptable or not. In practice, it is likely that companies have both, as our in-depth interviews revealed.

Take MGM Mirage, the Las Vegas hotel and casino operator. There is a principles-based code for the company as a whole, then more detailed documents covering interactions with external third parties, such as equity analysts.

The document covering analysts is circulated to staff who work with investors and lenders regularly, as well as individual hotel managers who may receive external requests for information. These guidelines cover the basics of who to call within the company for information, and advise on which questions can be answered on the spot and which ones must be passed on to corporate finance. Given many regulatory changes in the past several years, selectively feeding inside information to certain analysts could be very damaging, so such guidelines are pivotal in the development of a robust ethics culture.

“It was sort of anything goes,” says Rick Arpin, MGM’s vice president of financial accounting. “It feels like the playing field has leveled. The analysts aren’t afraid to call us and ask questions, and we’re not afraid to answer a question or say when we can’t answer it.”

Boards taking action
For a majority of respondents, their boards of directors over the last three years have been focusing on the full range of ethical issues, including fraud prevention, bribery and ensuring objectivity in financial reporting.
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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 7a-7c). 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.

Respondents reckon all the board focus on ethics benefits the business – more than half see a direct impact on the share price and two-thirds think ethical business aids competitive advantage (See Chart 6). It also benefits relationships with stakeholders, especially employees. Significant percentages think doing the right thing motivates staff and keeps them from jumping ship. “Employees are happy, proud and loyal to work for a company that has high integrity,” observes one respondent.

(See Chart 4.) Fewer boards are likely to visit these issues within the next year – perhaps a reflection of the view that the board’s direction-setting work is largely finished. If that is indeed the case, the pressure is now on executive management to follow through on these policies.

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

| Chart 6 - How beneficial is an ethical culture for the following items: US vs Europe |
| Attractiveness to employees | Europe | US |
| Employee motivation | 66% | 77% |
| Relationship with investors | 62% | 72% |
| Attractiveness to customers | 16% | 72% |
| Reputation with analysts | 58% | 76% |
| Overall business performance | 58% | 73% |
| Competitive advantage | 41% | 66% |
| Share price | 39% | 53% |

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

| Chart 7a - How would you assess the current ethical climate at your company? |
| Excellent | Under performers |
| Top performers | Adequate | Needs improvement |
| 19% | 35% | 3% |
| 62% | 37% | 29% |

| Chart 7b - Which of these issues received attention from your company’s board in the past three years? |
| Decisions over conflicting goals (e.g. safety or environmental needs over cost) |
| Different standards and values in different cultures or parts of the world |
| Ensuring objectivity in financial reporting |
| Equal treatment of shareholders |
| Ethical transfer pricing |
| Resolving or removing conflicts of interest |
| Tackling bribery |
| Tackling actual or suspected fraud or theft |
| Fraud prevention |
| Assessing level of adherence to code of conduct or code of ethics |
| Creating a culture of integrity |
| Implementing a code of conduct or code of ethics |

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

| Chart 7c - Which of the following items or actions are in place at your company? |
| Process for providing independent assurance on adherence to the written ethics policy |
| Processes for assessing adherence to the written ethics policy/code of ethics/Statement of ethical values |
| Senior staff certify adherence to ethics policy/code of ethics |
| Ethical matters routinely considered as part of board and senior management decision-making |
| Providing protection for staff who raise ethical concerns |
| An established whistle-blowing policy |
| Ethical performance included in performance appraisals |
| An ethics officer or committee |
| Ethics training for staff |
| A written ethics policy, code of ethics, or statement of ethical values |

Those answering 4 or 5 on a 5-point scale, with 1 being not at all beneficial and 5 being very beneficial
PART 2 – The CFO’s role: In the driver’s seat or along for the ride?

Overview: All respondents feel a personal responsibility for ensuring ethics in their companies. • Strategic responsibility for ethics resides a step above the CFO, with the chairman or the CEO. • CFOs are more likely to be the day-to-day guardian. • Respondents are happy to set a good example and serve as a role model for their colleagues but their enthusiasm for a proactive involvement in ethics development wanes as the time commitment rises. • A majority of respondents believe that Sarbanes-Oxley has had a positive effect on corporate ethics.

All of our survey respondents say their companies’ ethics are personally important to them. As one respondent noted: “We’re the folks who our employees see as leading the way on ethics.”

How does this personal sense of responsibility manifest itself in the companies they work for?

Strategic responsibility for ethics, in our respondents’ opinion, is more likely to reside with their bosses—the chairman or CEO. (See Chart 8a.) Less than 5% say the CFO has strategic 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 8b.) Another third of respondents name the CEO as the most likely to have day-to-day responsibility, with the rest split between the board as a whole, a special appointee or committee, legal or compliance officer, the board chairman or the chief operating officer.

One respondent disagreed with the question’s premise, remarking, “Responsibilities shouldn’t rest with a single individual as the survey implies.”

The interviews confirmed this view to some extent. As a practical matter, “day-to-day responsibility” is a joint effort. For example, at MGM Mirage, when it comes to carrying out due diligence on potential international partners, finance is part of a cross-functional team. Although the casino owner’s partners in China, the Middle East and elsewhere are beyond the reach of the law in Nevada, where the firm has its headquarters, MGM could lose its license for transgressions by partners, no matter where they are based.

In the early stages, MGM’s security department makes the first assessment, sifting through a mountain of publicly available data for any criminal convictions, SEC violations, or any other relevant information. The CFO then reviews the information and works with the security department to determine whether further action is necessary. If the CFO identifies any potential issues, they work with the board and other executives to develop a plan to mitigate the risk. This ensures that the company remains compliant with all relevant regulations and maintains its license for operations in Nevada.
lations, bankruptcies or regulatory violations. The management team gets a “feel” for the other side through face-to-face meetings. “It’s an overall sense of the other party,” says Rick Arpin, MGM’s vice president of financial accounting. “Are they fair, are they going to deal with their partners and future vendors as we would? Are they going to treat their suppliers fairly? Are they going to embrace a diverse workforce like we do at our company? Those things are critical to us.”

How involved is the CFO?

We asked respondents to rate how involved they are in setting ethical policies and procedures and how involved they think they should be. More than one-third of respondents say they are a driver of promoting an ethical culture and implementing and ensuring good ethical practice. (See Chart 9.) The majority say they are at least partially involved in these activities. Partial involvement, however, may mean collaborative efforts such as the one found at MGM Mirage. Fewer CFOs are involved in communicating ethics, either to employees or externally. Indeed at one-quarter of respondent companies, ethics is not communicated at all to the outside world. CFOs believe they should drive the process when it comes to setting a good example for the rest of the company or acting as a mentor for colleagues. (See Chart 10.) However, there is less willingness to be involved in specific activities, such as setting up a whistle-blowing policy, including ethics in appraisals or appointing an ethics officer.
Over half of respondents cite the “time and effort involved” and “balancing business needs with ethical practice” as the most significant challenges to improving corporate ethics.

It is likely that our respondents’ reluctance to get involved in specific activities reflects one of their key challenges—time constraints. Over half of respondents cite the “time and effort involved” and “balancing business needs with ethical practice” as the most significant challenges to improving corporate ethics. (See Chart 11.) A company culture that is resistant to change was the number one challenge among 11% of respondents, with a further 15% naming this as their second biggest challenge, followed by company structure at nearly 25%.

**Intended effects**

Poll after poll has shown that finance executives want to see Sarbanes-Oxley toned down, reformed or repealed. They may eventually get their wish, but for the moment some of the most onerous parts of Sarbox—such as 404 on internal controls—are here to stay.

Although finance chiefs may complain about the time and expense of implementing Sarbanes-Oxley, our survey shows that they also believe Sarbox is second only to attracting the right people as the most important driver for ethical practice. (See Chart 12.) They also believe it has had a positive effect on the ability of companies to build an ethics culture. (See Chart 13.) A little more than a third believe Sarbox has had no effect on ethics. No one says it has had a negative effect. Most respondents seem to think that the medicine may have tasted bad going down, but once digested it has done some good after all.
Conclusion

CFOs’ hearts appear to be in the right place. Our survey respondents clearly believe that corporate ethics has risen in importance in the last five years. They know that staying on the straight and narrow is key to “avoid an Enron,” as one respondent says. It is also vital to keeping stakeholders—customers, investors and employees—on side. Moreover, our respondents feel a keen personal stake in how their companies are perceived by the outside world. That’s the good news.

The question is, are they converting words into action? Our survey has some mixed messages. Compared with Europe, the US has many more procedures in place to prevent wrongdoing such as ethical codes and whistle-blowing policies. US firms are addressing bribery more aggressively both at home and abroad, largely due to the influence of the Foreign Corrupt Practices Act, which bars publicly traded companies from paying bribes to foreign government officials.

But while company boards have addressed many ethical issues such as bribery in the past three years, fewer expect to revisit them in the future, suggesting that they feel that in some ways their work is done. This is somewhat worrying, because enforcing corporate ethics requires constant vigilance from the top. While the finance executives say they want to be at least partially involved in many of the activities such as setting up ethics codes—which is positive—relatively few see themselves as the driver of the process in many important areas.

This argument might be exasperating for a time-constrained CFO. What, after all, have many finance departments been doing the last few years, if not implementing a meticulous set of controls mandated by Sarbanes-Oxley, and intended to clean up corporate accounting? They have done as required in other areas too, our survey confirms, and adopted codes of ethics and whistle-blowing policies. What else then, the frustrated CFO might ask, does the public want?

This research points to a few ways forward. First, the vast majority of finance directors who play by the rules must understand that it will take years to regain the public trust that was destroyed by the scandals of the past decade.

Second, stakeholders want some assurances that words match actions. The survey shows that although codes of ethics are in place, few companies have processes to assure they are being followed. What’s more, many don’t link ethics to employee evaluations. That’s a difficult job of course, and harder still when bonuses are based on short-term targets, not how well someone followed the rules. But it is not impossible.

Third, the survey also shows a dearth of communication about ethics outside company walls. This reflects a worry that boasting about and drawing attention to ethics can lead to ruin if any hint of wrongdoing eventually surfaces. The worry is legitimate, but also demonstrates a lack of courage.

Finally, as companies expand globally, finance chiefs will increasingly need to convince far-flung business partners why it is in their interest to uphold the highest ethical standards. That can only happen when role models show how it can be done.
Corporate Ethics and the CFO

This report forms part of an ambitious multinational survey of corporate ethics carried out by CFO Europe Research Services in collaboration with ACCA (the Association of Chartered Certified Accountants) - the other two pillars of the project, using consistent research methodologies, cover Europe and South-East Asia. Taken together, the three reports comprise (to our knowledge) the first such study of how CFOs approach business ethics across major economic markets.

ACCA is encouraged that CFOs in all regions report that building a culture of ethics within their companies has a higher priority than five years ago. It has, they say, 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.

One key finding is that top financially-performing companies were also far more likely to report an excellent ethical climate. While no causal link was shown, the report revealed important evidence of a correlation between strong business and ethical performance. American CFOs argued strongly that good ethical practices boosted share price and competitive advantage.

US companies also lead their counterparts in devising and implementing specific policies: written ethics and whistle-blowing policies, staff ethics training and the formation of ethics committee were all widespread in the US. American CFOs were also noticeably more confident about their companies’ ethical performance than European respondents. Fully 50% of US CFOs rated the ethical climate as “excellent” compared to just 24% in Europe.

Where the US does need to improve is making sure ethics policies are being followed. While 90% of US firms had written policies, only half of these had assurance processes to ensure adherence to ethics codes.

And worryingly, most US CFOs believed that having spent considerable time on ethical issues over the past three years, their boards would not be inclined to repeat this in the next three. Ethics is not something that can be turned on and off.

The shadow of Enron remains strong in the US, and as one respondent put it, an ethical culture “shows our customers we won’t let an Enron happen.” The Corporate Fraud Task Force and the threat of Federal Sentencing Guidelines for wrongdoers have also played a part. Most CFOs said they were happy to set a good example to other staff, or act as mentors for colleagues, but they did not want to be drivers of ethical policies or devisers of strategy. Only 25% had day-to-day responsibility for ethical practice, a similar percentage to Europe and Asia.

ACCA believes CFOs should show leadership on ethics, as a leading global provider of professional accountancy qualifications, with 296,000 students and 115,000 members in 170 countries. Throughout 2007, ACCA has been holding events around the world, including in New York, to coincide with the launch of its new professional qualification, which puts ethics and professionalism at its heart – ethics is covered in 11 out of 16 papers in the new syllabus. A key innovation in the new qualification is the creation of a separate additional ethics module, which will simulate practical ethical dilemmas for finance professionals, and be relevant for finance professionals in whichever sector they choose to pursue their careers.

Professional accountants and business leaders 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.

www.accaglobal.com/ethics
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