Corporate Governance, Business Ethics and the CFO

A research report prepared by *CFO Asia* in collaboration with ACCA

CFO Asia RESEARCH SERVICES

ACCA

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About this report

In April 2006, CFO Asia Research Services (a unit of CFO Publishing Corp), in collaboration with ACCA (the Association of Chartered Certified Accountants) launched a research program to understand the role of the CFO in issues surrounding business ethics, the drivers for change in this area, and the importance to Asian companies of practicing an ethical culture. The goal of this research was to explore the kind of commitment Asian companies have made to developing an ethical culture, what importance CFOs have attached to their companies performing in accordance with ethical practices, and whether attitudes towards ethics are changing and, if so, why.

This report presents the findings of a survey of more than 160 CFOs and senior finance executives from mainland China, Hong Kong SAR, Malaysia, and Singapore. One hundred respondents originated from Asian-based companies, while 32 and 27 of the respondents came from companies headquartered in the United States and Europe, respectively (three respondents returned their questionnaires noting that their companies were based outside these regions). This direct questionnaire-based research has been supplemented with in-depth, one-on-one case study interviews with executives at six companies spanning a range of company types, industries, and locations.

CFO Asia Research Services and ACCA developed the hypotheses for this research jointly. ACCA, the largest and fastest-growing international accountancy body, funded the research and publication of our findings, and we would like to acknowledge Paul Moxey, ACCA's head of corporate governance and risk management and the ACCA team; Adam Lincoln conducted the interview program and wrote the report.

We would like to thank the many executives who gave their time to participate in the survey and shared insights in interviews for this study.

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Study methodology

In April 2006, CFO Asia Research Services conducted a survey among *CFO Asia* subscribers. CFOs and other senior finance executives were surveyed from a range of companies and industries spread across four key markets in the Asia Pacific region: China, Hong Kong SAR, Malaysia, and Singapore. The questionnaires were self-completed online or filled in during an independently conducted direct telephone interview.

More than nine industries are represented in the survey including manufacturing, financial services, IT and communications, energy, retail, pharmaceuticals, transport and distribution, leisure and tourism, and other professional services.

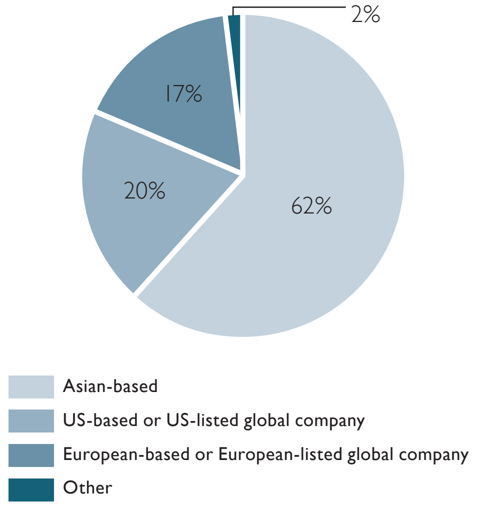
A range of company types within each country are represented including family-owned, government-controlled, publicly-listed and the subsidiaries or divisions of a larger shareholding corporation. Almost 62% describe themselves as Asian-based, 19.8% are US-based or -listed companies, while 16.7% originate in Europe.

All sizes of organizations are represented in the survey, from SMEs to local conglomerates to regional headquarters of multinational companies. Those with less than US$100m in annual turnover account for 41.4% of respondents, while 42% report annual turnover of more than US$351m. The remaining 16.1% fall between these two groups, with revenue in the range of US$101m to US$350m.

To shed further light on the data in this study, in-depth interviews were conducted with senior finance executives from six companies reflecting the diversity of the sample. These are presented as case studies in the report.

Chart 1

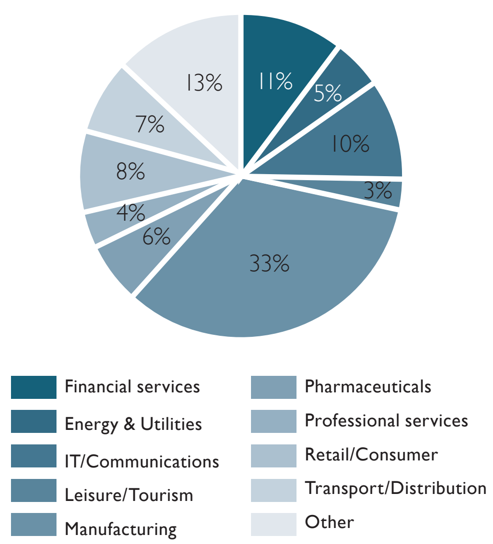
Distribution of respondents by corporate geographic base



(Total may not add up to 100% due to rounding.)

Chart 2

Distribution of respondents by industry



Introduction

This study explores the influence of the chief financial officer (CFO) in Asia on building an ethical culture in companies. Ethical practice in business is easy enough to define in a narrow sense as adhering to and promoting accepted principles of right and wrong that govern the conduct of a profession. Yet this definition, while handy enough, hardly makes a case for the powerful impact that moral behavior of officers and employees brings to bear on essential company systems and activities, and how it influences all aspects of compliance. To be sure, it is harder to establish a connection between codified ethics and practical actions than to track compliance on governance or accounting systems. But ethics can be reasonably seen as an intangible, yet powerful, catalyst and supporter of compliance. Put another way, it is not possible to legislate for ethical behavior.

Ensuring sound ethical practice requires participation – and even leadership – from all ranks within a company. This report assumes that the CFO occupies a focal point of that leadership. The rise of the profession in recent years has enabled CFOs to do far more than tend to finances and financial reporting. Increasingly, CFOs have a hand in a company's strategic direction and provide a representative face to investors and the media. CFOs are the guardians of company controls and, often, a partner to the chief executive and member of the board. This dual part of steward and strategist accords the position a unique role in disseminating ideas and attitudes on ethical practice throughout the firm. How, then, do CFOs deploy this unique position – if at all? And how do they do so in Asia, where conditions of fast growth and intense competition often place ethical pressures on companies in the race for profits?

Fairly, or unfairly, the ethical practices of Asian business have long been called into question. The region's tradition of close business connections – whether they be called *chaebol, keiretsu*, or *guanxi* – have contributed to this impression. So too have prominent scandals connecting major businesses to the favor and profit of government officials or their families. But the enormous changes affecting the region – falling trade barriers, greater market transparency, intensified regulatory clout, tougher government enforcement, and heightened investor activism – have challenged this negative view. Moreover, a number of high-profile scandals has emerged in markets held to be the world's most transparent, amply demonstrating that there's no such thing as a regional exclusive on ethics.

Indeed, it's accurate to say that global shifts in standards are facilitating – and adding pressure to – the adoption of ethical practice everywhere. The convergence or harmonization with International Accounting Standards has been a positive step towards uniformity and improved controls in territories such as Hong Kong, Malaysia, and Singapore. These accounting reforms have been accompanied by new ethical codes. At the same time, political initiatives such as America's Sarbanes-Oxley Act, with its provisions for personal responsibility and the separation of auditing and consulting, have made an impact even on non-US companies.

This research asks CFOs in Asia themselves to define their role in shaping ethical policy in the region's companies. What benefits do CFOs see as flowing from a strong company culture on ethics, and do they view themselves as the drivers of good ethics in their company? How do their own views sit with their company's commitment to developing an ethical culture? This survey sheds light on these issues and explores the growing awareness among Asian companies of the business benefits of a strong code of ethics.

Many wonder if there is room for traditional 'Asian values' in the emerging globalized environment. As Daniel Leung, regional finance director of DuPont Greater China, the US-based chemical giant, puts it: "During the Mid-Autumn Festival it's very common to take mooncakes to customers. How do you treat that? Do you get the business because of the mooncake? Hopefully the customer is smart enough to look at your products and service."

While there are ambiguities, the research reveals a ringing endorsement of the idea that best ethical practice is increasingly important to the long-term health of their companies. More than 85% of the survey's respondents say ethical practice in business is more important – or even a lot more important – than it was five years ago. If attitudes towards ethics are changing, why is this so? And how can CFOs clarify their role – to themselves, and to their company?

Notable findings

- ***More than half the respondents believe they are responsible for promoting an ethical culture in their companies***. Some 70% of those surveyed said that they should set a good ethical example, while more than half feel they should drive the integration of ethical values into board and senior management decision-making. Just over half of the respondents said that ensuring an ethical environment is very important to them personally, while another 18% said it was vital.

- ***Many CFOs highlighted the impact of ethics on reputation.*** The survey participants acknowledge that a good ethical culture has become a requirement in business, particularly for a company's overall reputation and impact on a company's brand. The perception of a good ethical culture, they say, improves relationships with banks, institutional investors, and suppliers, and heightens a company's attractiveness as an employer.

- ***Even as internal controls improve, Asia's CFOs still worry about corporate cultural issues.*** The shift to international accounting standards and the need to comply with tougher national codes have placed new operational demands on finance departments. CFOs appear to have taken such governance-related changes in their stride. Despite media coverage of business ethics-related scandals, the biggest challenge, they say, is still 'big picture'. More than two-thirds of participants in the survey say that building an overall corporate culture of integrity is among their top three challenges; for one in three, this remains the peak issue.

- ***CFOs cite time and effort as the greatest hurdle to establishing best ethical practice, an indication of intensifying pressures on the CFO role.*** Asked to rank the barriers to developing and improving ethical practices inside their company, nearly 60% state that the time and effort involved is the biggest hurdle. Likewise, almost half say that they struggle to balance the needs of ethical practice with company culture. Broadly, these responses reflect overburdened CFOs in markets characterized by increased competition and high growth, but also marked by greater regulatory scrutiny and calls for transparency. CFOs' responsibilities to implement best practice in these dual and sometimes conflicting aspects of the Asian growth story have increased. They are feeling the pinch.

- ***Juggling regulations and codes with the realities of doing business at the 'coal-face' is a struggle.*** In-depth interviews with finance executives reveal that even the most ethically-aware companies find their standards challenged on a daily basis, especially if they have dealings with smaller operators in less-developed countries. K Sriram, group manager of internal audit at Hong Kong garment trader Mulitex, suggests: "Perhaps we need a two-tier system, with global standards in key ethical areas underscored by room for flexibility at the local level. Each country has its cultural values, its upbringing, and so it's very difficult to bring in a motherhood ethical governance system. A customized system could enable companies to project themselves internationally but keep customers and suppliers happy closer to home."

- ***Over half of CFOs report that companies have processes in place to assess adherence to their ethics policy.*** It is clear that many boards now recognize the importance of ensuring that their companies have ethical practices and it is encouraging to learn that over half of the respondents say they have processes in place to assess adherence to their ethics policy or code. Experts say that this practice is still rare in the United States and Europe, and so far there is little, if any, best practice on how it should be done. Just how companies assess their ethical practices would make a very interesting subject for further research.

- ***Sarbanes-Oxley has made a considerable impact on non-US companies.*** Clearly, the Sarbanes-Oxley law has had a profound effect on companies whose shares are traded on US exchanges, forcing them to rethink business processes they once took for granted. Grievances about the cost of compliance – in terms of staff numbers, time, and focus – are widely documented. There is too much red tape, executives say, and too many distractions from other business imperatives. Yet roughly half the executives who took part in this survey believe the Sarbanes-Oxley Act has had a positive global effect on business ethics – even though just one in five respondents work for a US-based or -listed company. There are even signs that the region's CFOs would welcome a more stringent ethical framework.

Structure of the report

This report has five chapters. Chapter 1 examines the importance of ethics to Asian businesses today, the key challenges that senior finance executives face, and the steps taken to build a culture of integrity. Chapter 2 looks at the way ethics-related responsibilities are assigned within corporate structures, and how CFOs feel about the role they play. Chapter 3 focuses on the specific measures that companies in Asia have put in place to support the practice of good business ethics, and the barriers to further improvement. Chapter 4 seeks to define the benefits that CFOs see as flowing from good governance and ethics, from both the financial and less-tangible perspectives. In Chapter 5, we ask CFOs where they turn for guidance on assurance processes and internal controls, with particular focus on the role of legislation and national codes of corporate governance.

Chapter 1
THE IMPORTANCE OF ETHICS TODAY

Cultivating and maintaining an ethical business environment with strong governance are more important today than they were five years ago.

Some CFOs who took part in this survey say that ensuring an ethical culture in business is no more important today than it was five years ago. Cause for alarm? Not at all. For them, ethics and governance have always been top of the agenda. The views of this group are summed up by a CFO who says: "Our business has been operating globally for more than 120 years and having a consistent ethical culture is one of the reasons for its sustainability."

But for the vast majority of survey respondents – nearly 86% – cultivating and maintaining an ethical business environment with strong governance are more important today than they were five years ago. Although this isn't surprising, the specific reasons for the change in mindset vary greatly – from new legal requirements to a very human fear of being shamed in public. As Gerard Nathan, CFO of Malaysian leisure and power group, Tanjong, observes: "Corporate governance is on everyone's lips, but the parameters and implications are still a subject of debate. It is not just a question of process but of mindset and values among all stakeholders – and this can pose the greatest challenge."

One thing is certain: nobody likes to 'lose face'. As one respondent observes, nervousness about doing the wrong thing has heightened: "Since the US accounting scandals, senior executives of multinational corporations are more concerned about the effectiveness of corporate governance in their own organization as they have a better understanding of the potential damage that could result from a poor control environment." Another adds: "[Sarbanes-Oxley] has contributed to enhanced awareness, even if you aren't an American company."

It seems the increased role played by government is appreciated. "In recent years the Malaysian government has placed more emphasis on transparency and globally acceptable standards," says one CFO. "At least in my organization, the ethical culture is somehow more important now, through the authorities' supervisions." It's a similar story in Hong Kong, where one CFO welcomes the government's lead in this area. The same source says: "The government has correctly identified a vision for Hong Kong as a premier international financial center and it's really up to business and society to embrace the vision and make it a reality." Another respondent observes: "Mainland China [is] implementing regulations in previously grey areas. This has helped to remove a lot of the ambiguity over the implementation of regulations."

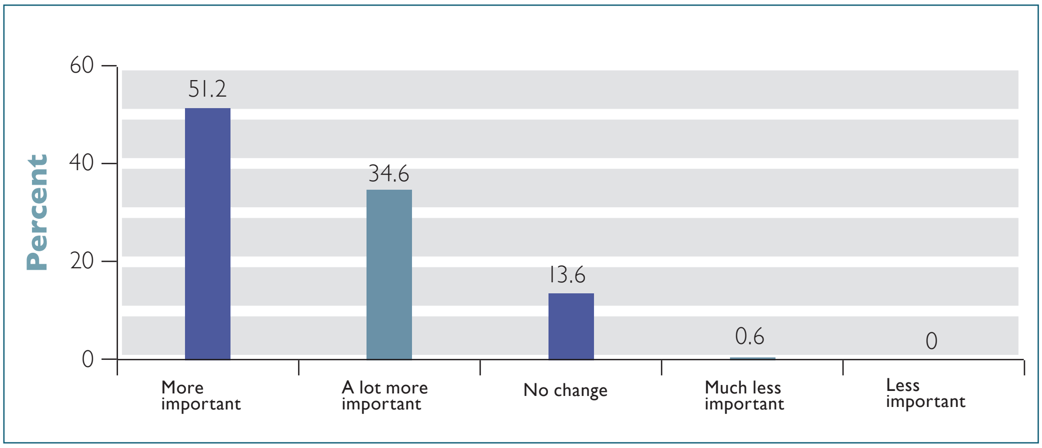
Indeed, if companies value the formalizing of an ethical framework, it is surely because it helps them cope with an increasingly complex business environment due to opening markets, falling trade barriers, and intensified competition. As one respondent notes: "There are more ways for malpractice and therefore governance is crucial to track and detect it within practices." Another adds: "The increase in the 'hire-and-fire' culture has also led to increased recklessness among employees in conducting transactions, and has created a 'me-first' attitude at all levels."

Companies are finding that as they evolve, the demands on them are changing. This is especially true if they harbor global ambitions – but you don't have to be listed in New York or even Singapore to be affected. As one CFO points out: "Corporate governance for non-public listed companies is gaining increasing attention not just from governmental authorities but also from bankers and rating agencies."

Such comments reflect growing awareness of the impact of ethics on all areas of a business. "Ethics help to eliminate the financial and business risks a company is exposed to due to unclean business negotiation and practices," says one CFO. Other respondents identify a fundamental shift among stakeholders. "Financial results are no longer the sole key concern for investors," says one. Another executive comments: "The stakeholders of the company – which include the shareholders, clients, staff, suppliers, and government regulators – are treating ethics as a more important factor in their decision-making."

Put simply, an ethical approach is smart, as Ong Wee Gee, CFO of IBM Singapore, notes: "The threat of legal penalties exists, but that is not the main motivation. Upholding the company's good name and reputation for integrity are important competitive advantages, and that's the main motivation."

Chart 3 In your opinion, is ensuring an ethical culture in business more or less important to your company now than it was 5 years ago? (%)



The research suggests Asia's corporate community was quick to hear the post-Enron clarion call for better ethics. With the exception of ethical transfer pricing, the majority of CFOs have addressed key ethical issues over the past three years.

That said, a systematic approach to governance and ethics remains very much a work in progress for many. Some 16% of survey respondents in Chart 4 report their company is still without a code of conduct or ethics, although they expect the issue to be addressed in the coming year. Others still have work to do in key areas such as combating fraud and bribery, resolving or removing conflicts of interest, and equal treatment of shareholders.

For all the specific demands of compliance with new laws and codes, the chief ethical challenge remains a broad one. More than two-thirds (67.9%) of CFOs who took part in the survey say that creating a culture of integrity is still among the three most important ethical issues facing their company (Table 2). For 32.1% of respondents this is the top priority. It follows that implementing a code of conduct or code of ethics, and assessing the level of adherence to such codes, is a significant concern.

Indeed, the days when Asia's CFOs were glorified bean counters are clearly over. Not surprisingly, CFOs see the need to ensure objectivity in financial reporting as a key ethical issue, but although just over two-fifths of respondents list this concern in their top three, it is the top choice of just 10.5%. Other traditional remits of the finance function, such as ethical transfer pricing and equal treatment of shareholders, do not seem be the chief cause of worry for senior finance executives. The tepid response to action taken on ethical transfer pricing reflects the current legal background on this issue. Laws that establish clear codes of corporate behavior in transfer pricing have been enacted for many years in most Asian tax jurisdictions. Only lately, however, have signs emerged that tax authorities are likely to ratchet up enforcement and exact more severe penalties than in the past. The profile of CFO responses to transfer pricing issues is likely to change over the next three years.

Table 1 Ethical issues that have already received, or are likely to receive, the attention of the board

Ethical issue	Received attention in last 3 years (%)	Received attention in last 12 months (%)	Likely to receive attention in the year ahead (%)
Fraud prevention	72.8	15.4	10.5 DNR 1.2
Ensuring objectivity in financial reporting	69.8	23.5	6.2 DNR 0.6
Creating a culture of integrity	67.3	16.7	16.0
Tackling actual or suspected fraud or theft	65.4	21.6	10.5 DNR 2.5
Tackling bribery	64.8	17.3	14.8 DNR 3.1
Resolving or removing conflicts of interest	64.2	22.8	11.1 DNR 1.9
Equal treatment of shareholders	63.6	15.4	16.0 DNR 4.9
Different standards and values in different cultures or parts of the world	57.4	20.4	19.1 DNR 3.1
Implementing a code of conduct or code of ethics*	56.8	18.5	16 DNR 8.6
Decisions over conflicting goals (eg safety or environmental needs over cost)	54.9	22.2	17.9 DNR 4.9
Assessing level of adherence to code of conduct or code of ethics	53.1	27.2	19.1 DNR 0.6
Ethical transfer pricing	47.5	26.5	21 DNR 4.9

** When we use the term 'code of ethics' we intend for the term to apply equally to similar documents such as a 'code of conduct' or a 'statement of ethical values'.*

(Respondents asked to select all that apply; total equals more than 100%)

DNR: Did not respond.

Despite the obvious fear of being caught up in a damaging scandal, concern over specific incidents of unethical behavior is kept in check. Tackling actual or suspected fraud or theft is cited as the top concern by 4.9% of respondents, and tackling bribery by just 4.3%. More CFOs (9.3%) are concerned with preventing fraud in the first place.

Put another way, CFOs feel responsible for ensuring that everyone in their company is 'on the same page', regardless of where they sit on the corporate ladder or where in the world they are based. It would seem they have achieved a good degree of success on this front, with problems caused by conflicting corporate goals – such as safety or environmental needs over cost – being a top-three concern for fewer than 10% of the respondent base.

More than one-quarter (27.8%) of CFOs say that resolving or removing conflicts of interest in business relationships remains a top-three cause for concern. For 17.9% of respondents, finding common ground among the different standards and values in different cultures or geographic locations is a challenge.

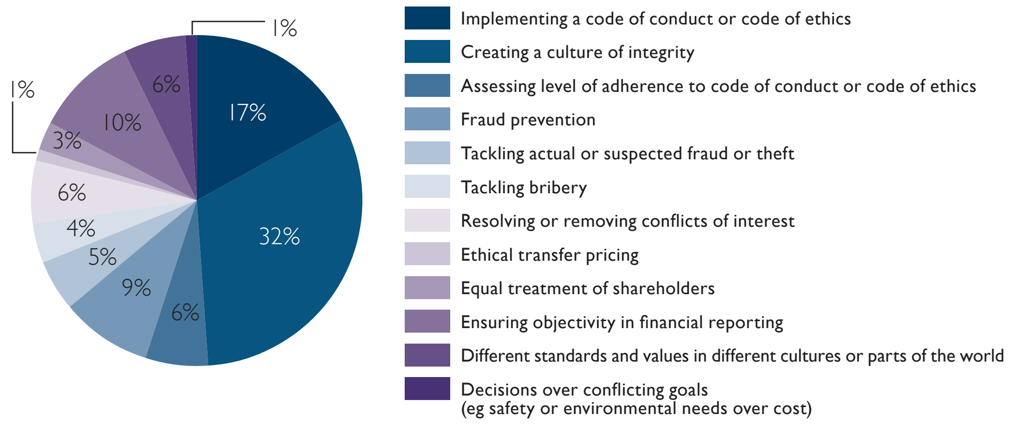
Table 2 Ethical top issues

Survey respondents were asked to select the three most important issues surrounding business ethics at their company.

Ethical issue	Percent (%)
Creating a culture of integrity	67.9
Ensuring objectivity in financial reporting	40.7
Fraud prevention	40.0
Implementing a code of conduct or code of ethics	38.9
Resolving or removing conflicts of interest	27.8
Assessing level of adherence to code of conduct or code of ethics	22.8
Different standards and values in different cultures or parts of the world	17.9
Tackling actual or suspected fraud or theft	13.6
Tackling bribery	11.7
Decisions over conflicting goals (eg safety or environmental needs over cost)	9.9
Equal treatment of shareholders	8.6
Ethical transfer pricing	0.1

(Respondents were asked to select their top three choices, in order of importance; total equals more than 100%)

Top choices



Case study: IBM Singapore
Nowhere to hide

They may not be quick to admit it, but for companies like IBM, the global computing giant, the demise of former peers in the corporate elite must be chilling. But as a blue-chip American company with revenues of nearly US$100 bn, did IBM learn any lessons from the demise of Enron and WorldCom? "IBM has always had a focus on conducting business with integrity," says Ong Wee Gee, CFO of IBM Singapore. "Our good name and reputation for integrity are important competitive advantages, and to maintain these, we depend on each and every employee."

Reputation has played a huge part in IBM's success, certainly. The trouble is, sometimes people slip. Last year, for instance, IBM was forced to restate its 2004 revenue figure for its Global Services unit by US$260m, after discovering improper sales of third-party hardware at its Japanese unit. In a filing to the US Securities and Exchange Commission (SEC), the company conceded that a review of third-party agreements had found "certain IBM Japan employees acted improperly and inconsistently with IBM's policies and practices."

To a company of IBM's stature such revelations are embarrassing, and can prompt a dip in share price. But they are rarely fatal. When you are a regular fixture in the top ten of the Fortune 500 rankings, and feature on lists of most-admired companies, you have to know a thing or two about dealing with intense scrutiny.

But for IBM, like most companies, the particular challenge of recent years has been juggling the expectations of stakeholders while achieving compliance with a raft of new rules and regulations on financial reporting and governance. Even when a business has every resource available to it – IBM's massive portfolio of technology and services includes software designed to help its customers cope with Sarbanes-Oxley – this isn't always easy. That fact was reinforced earlier this year when the SEC formalized a probe into IBM's disclosures of its first-quarter 2005 earnings and expensing of stock compensation. IBM began expensing the value of its stock options in the first quarter of 2005, a year ahead of when it was required to do so, and some analysts had complained that IBM's guidance about the impact of the move on its quarterly earnings had been confusing.

Despite such setbacks, Ong says IBM hasn't been spooked by the scandals that have befallen others. He says the company's audit committee "has always been demanding" and that the company's relationship with its external auditor continues as before. But with 329,000 employees in 75 countries the need to cultivate a unified set of ethics, supported by standard processes, is more important than ever.

To this end IBM has a global set of business conduct guidelines which every employee at IBM is required to read and verify once a year. The guidelines are based on legal and trading regulations, as well as Big Blue's own set of values. The same guidelines apply in every country – subsidiaries are not given rein to tailor their approach – and are incorporated into employee orientation. "Among the measures outlined are the processes employees can follow to raise any concerns with confidentiality and confidence," Ong explains. Furthermore, ensuring that employees are clear about IBM's zero-tolerance approach to breeches of its conduct guidelines are a formal part of managers' annual objectives.

Ong says that as CFO, he sees himself as an important role model on ethics and governance within the company. "I am always clear in my message to my leadership team that I will never compromise ethics for anything, including achieving revenue or other financial targets," he says. "I encourage all our senior executives to take ownership in upholding integrity and ethics within their units." Does this mean he sees himself as a mentor? "Yes. I would like my role to evolve to a level where I am seen as an advisor, while everyone else is a role model themselves," Ong says. ■

Case study: Sinochem International

The good oil on governance

It could be said that Li Dun is living the Chinese dream. Born and raised in the PRC, he graduated from a Chinese university in the early 1990s. After paying his dues at a local company he moved to Singapore, where he studied for professional accreditation and worked for a listed company. In time he was promoted to finance chief of that firm's China operations, but in 2004 came an offer that was too good to refuse. Fu Bo, formerly a top executive with GE China, had been appointed CEO of Sinochem International and he wanted to populate his management with like-minded souls. Li became the first to be 'imported' from outside the Sinochem group into the CFO post – a role that put him in an office in Shanghai's iconic Jinmao Tower, at the crux of a company that is emblematic of China's ambition to turn fusty state-owned enterprises into thrusting MNCs.

Sinochem International was spun out of Sinochem Corporation, one of China's four state-owned oil giants, in 1998. Its logistics business comprises three subdivisions: petrol tankers, oil and chemical terminals, and containers. The company made its debut on the Shanghai Stock Exchange in 2000, and now boasts revenues of US$2 bn, 1,600 employees, and a customer list that includes BASF, Shell, and BP. But when Li arrived two years ago he found fundamentals still needed to be tackled. "Until the 1990s Sinochem wasn't a real-world company, it was an organization," he says. "The reporting systems, internal controls, and analysis systems were still not mature."

With his team, Li set about changing that, starting with a balanced scorecard system for KPIs ranging from financial ratios to the location of the company's ships. But even as the new performance metrics and reporting systems were being put in place, the company took the bold step of engaging the US-based ratings agency Standard & Poor's (S&P) to assess its corporate governance against global standards, the first Chinese company to do so. That first year S&P gave Sinochem International an overall rating of 5+ and in 2005 the score was upped to 6. Among the 80 factors graded, the company gained 61 positive evaluations, placing it "above the average" against the global benchmark.

The government is still majority shareholder, but Sinochem International has been recognized for its efforts with regard to equal treatment of shareholders, objectivity in information disclosure, and defining the roles and relationship between its board of directors and senior management. A nine-person board consists of three independent directors, three directors who represent the holding company, and three executives drawn from senior management. Li says it is particularly important to win the confidence of the independent directors when making project proposals. As their influence grows they demand ever more detailed information on market opportunities and the associated risks to help them weigh conflicting goals such as safety and environmental considerations over cost.

"Despite our government connection, we have no guarantees in business," Li says. "Most of our customers are third party and we must compete with large foreign companies." There's a growth imperative too. "Over the past two years our growth rate in logistics has been 80%. To maintain this we need funds not just from the share market but also bankers." Last year, for instance, Li negotiated shipping finance with a French bank. "Shipping finance is a very complex and narrow market," he explains. "Local bankers aren't experienced in this area, so we have to turn to foreign banks, and they have very strict evaluation procedures."

Some of the credit for Sinochem International's growth spurt, and indeed for the internal controls that help the company secure loans, can be attributed to two joint ventures with Stolt-Neilsen Transportation Group. The tanker company is listed in Oslo and on Nasdaq, which meant Li and his team have had to master the reporting intricacies of US GAAP. "It's a learning experience," he says. "US GAAP is very complex, very prudent. It's substance over form." But it can't cover every eventuality, he adds. "In daily operations, you still need to depend on professional judgement." ■

Chapter 2
RESPONSIBILITY

While it is true that CFOs play a bigger role on a day-to-day basis, they report that actual day-to-day responsibility for ensuring ethical practice is usually seated elsewhere in the company.

It is commonly assumed that the CFO is the guiding influence when it comes to turning ethical codes into practical action within a company. Given the obvious potential for unethical behavior wherever money is involved, the assumption makes sense. However, the research suggests the role of the CFO is still evolving, and that many CFOs crave clarity on the role that they should be playing.

A clear majority of CFOs see the ethical buck as stopping with the chief executive: some two-thirds of respondents say their CEO holds a degree of overall strategic responsibility. Much strategic oversight is also placed in the hands of chief operating officers, who play a key role in nearly 60% of companies. By contrast, CFOs are charged with strategic responsibility in just 19.1% of companies – which ranks them below company secretaries (35.2%) and chairmen (31.5%). Very often the responsibility borne by these individuals is couched in the context of a special committee or the board as a whole.

While it is true that CFOs play a bigger role on a day-to-day basis, they report that actual day-to-day responsibility for ensuring ethical practice is usually seated elsewhere in the company. Three in ten respondents (30.2%) say that as CFO they hold overall day-to-day responsibility for their company's ethical practice. In the majority of responses, the board, someone assigned on the board, or a special committee is the key protagonist. Some respondents added that day-to-day responsibility was shared by "every employee in the organization".

Even so, most CFOs believe their role is recognized at a corporate level. Just over half (56.2%) say their company considers their role to be very important, and a further 21% claim that their role is seen as vital. A small minority, 3.1%, feel that the role of the senior finance executive on ethical issues is fairly unimportant.

But how much do CFOs care about ethical issues on a personal level? Broadly, CFO self-perceptions are in line with the views of the company they work for. Just over half of respondents (51.9%) say that ensuring an ethical environment is very important to them personally, while for 17.9% it is vital. The attitude of this group is summed up by Daniel Leung of DuPont China. "Perhaps it's because I've been with the company for 25 years, but if a member of my staff was involved in an ethical transgression, I would feel accountable for it too," he says.

Still, one in four (25.3%) describe their role in helping to ensure an ethical culture as being only 'fairly important' to them.

Table 3 The buck stops where?

Allocation of strategic and day-to-day responsibility for ensuring ethical practice in the company

Ethical issue	Strategic responsibility (%)	Day-to-day responsibility (%)
CEO	67.3	5.6
COO	58.6	6.2
Special committee	46.3	35.2
Company secretary	35.2	14.8
Chairman	31.5	21.6
The board as a whole	20.4	59.3
CFO	19.1	30.2
Someone assigned the role on the board	18.5	40.1
Other	5.6	16.0

(Respondents were asked to select all that apply; total equals more than 100%)

Chart 4 CFOs and business ethics – the corporate perspective

Respondents were asked: How important to your company is your role as CFO in helping to ensure an ethical culture within the company?

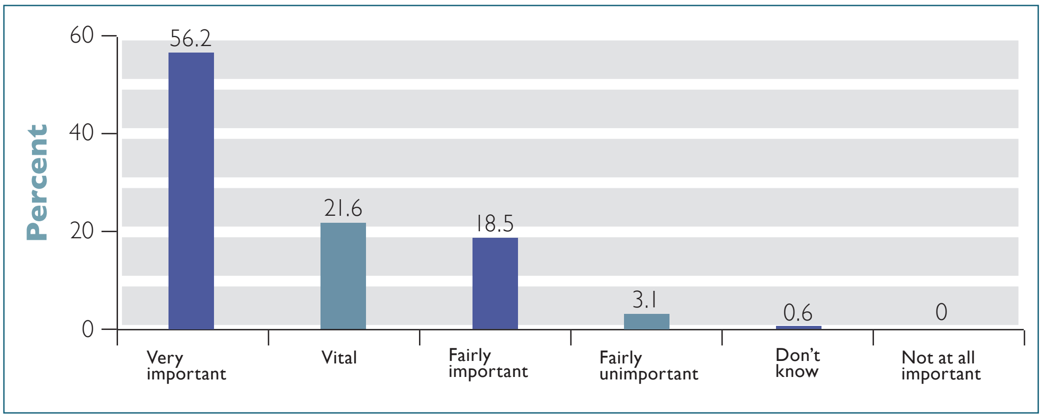
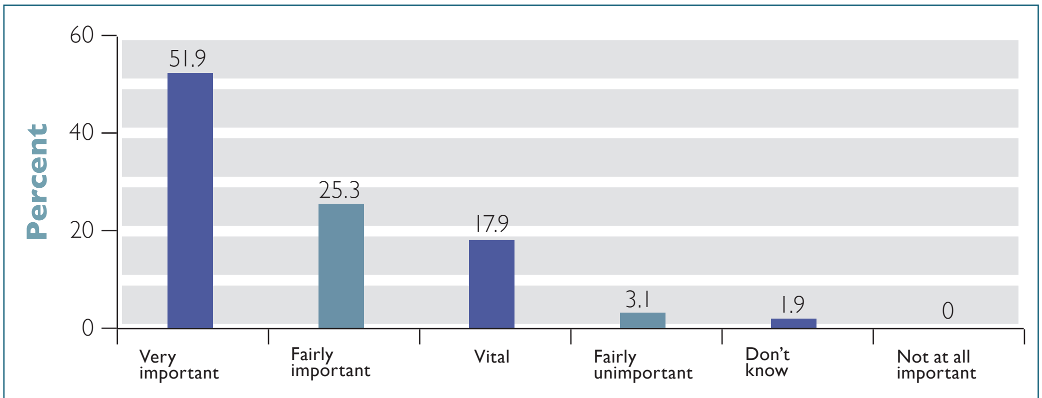


Chart 5 Personal importance – CFOs and business ethics

Respondents were asked: How important to you personally is your role as CFO in helping to ensure an ethical culture within the company?



(Total may not add up to 100% due to rounding.)

CFOs maintain they are far from sidelined. Just over half claim to be a driver of the process of promoting an ethical culture (50.6%), a similar proportion (54.9%) say they are a driver of implementing and ensuring good ethical practice in senior management decision-making. Slightly fewer CFOs are in charge of communicating reports on ethical behavior internally (43.8%), and externally (33.3%). Most CFOs claim to be at least partly involved in all of these areas.

Table 4 Who's steering?

The role played by CFOs in communicating and implementing good ethical practice within their company.

	Driver of the process (%)	Partially involved (%)	Hardly involved (%)	Process not done (%)
Implementing and ensuring good ethical practice	54.9	40.1	3.1	1.9
Promoting an ethical culture	50.6	43.8	1.9	3.7
Communicating reports on ethical behavior internally	43.8	45.1	6.2	4.9
Communicating reports on ethical behavior externally	33.3	41.4	14.8	10.5

When asked to identify the role they feel they should play in specific activities to promote an ethical culture within their company, CFOs reveal a degree of lack of conviction. True, nearly three quarters (74.1%) agree that they should be at the vanguard when it comes to setting a good ethical example and 50% say they should drive the process for assessing adherence to a code of ethics. But they appear less certain about which particular processes they should drive to help in bringing about an ethical culture.

This is suggested by the finding that more than half of CFOs believe they should be the driver of any number of key measures, from helping establish a code of ethics, to the integration of ethical values into board and senior management decision-making, and on to providing protection for staff who raise ethical concerns. Many also acknowledge the role they can play as a mentor, either through formal channels or informally.

Table 5 The CFO promoting ethical culture

CFOs were asked to what extent they should be directly involved in the following activities in order to promote an ethical culture within a company.

	Should drive the process (%)	Moderate extent (%)	Involved to a low extent (%)	Activity not needed (%)
Set a good ethical example	74.1	21	2.5	2.5
Ensure protection for staff who raise ethical concerns	56.8	35.2	4.3	3.7
Support integration of ethical values into board and senior management decision-making	54.9	37.7	6.2	1.2
Help establish a code of ethics	53.7	40.7	4.3	1.2
Act as an informal mentor for colleagues	51.9	36.4	6.8	4.9
Support assessment of ethical performance or adherence to code of ethics	50.0	43.8	5.6	0.6
Act as an official mentor for colleagues	46.3	38.9	9.9	4.9
Support the inclusion of ethical performance within performance appraisals	43.2	42.6	10.5	3.7
Support the inclusion of ethics as a subject in staff training	42.0	36.4	19.1	2.5
Help establish an ethics hotline or whistle-blowing policy	40.1	33.3	14.8	11.2
Act as an official listener for employees' ethical concerns at work	34.6	46.3	15.4	3.7
Support the appointment of an ethics officer	34.6	34.6	9.9	21

(Totals may not add up to 100% due to rounding.)

Case study: Mulitex Limited
Self regulation rules

Since 1969, Hong Kong-based Mulitex has grown from a shop to a trading company that provides custom garment design and manufacturing services to clients around the world, and makes own-brand items such as Buffalo jeans. Its turnover of US$300m has been boosted by diversification into fashion accessories, toys, and electronics, and operations have been established as far afield as Panama and Dubai. But some things haven't changed: The company is still family-owned and managed. Its founder and chairman is India-born HB Mohinani, who has been doing business in the SAR for close to five decades and remains chairman. The patriarch's fellow board members are his sons Vijay, who presides as director of Mulitex Limited, and Harry, who is a director of Angel Garments (Hong Kong), a joint venture between Mulitex and a Canadian company.

It's a classic local business story: SME makes good. And yet in the current business climate, critics are quick to accuse the region's multitude of family businesses of being opaque and outmoded – ethical wastelands that are holding entire economies back.

Nothing could be further from the truth at Mulitex. "We are not a publicly-listed company, so we don't have an audit committee," explains K Sriram, group manager of internal audit, finance, and accounts. "But we do have a self-regulatory mechanism in place. We hold regular director review meetings and monthly internal compliance reviews. We have a quarterly internal audit cycle and work closely with our external auditors to certify our annual accounts and ensure compliance with local laws and regulations. We are totally transparent with our banks and send them quarterly management reports. It may not be perfect in every respect but it is how we get things done."

Good governance has brought Mulitex longevity in a sector fraught with risk. The booming trade in knock-off goods is one concern. "It happens to Adidas and Nike, so violating a Mulitex trademark is not seen as a big deal," Sriram says. "It's one reason we have been cautious about giving third parties access to our supply chain systems." Also, many of the company's dealings are with companies in poorly regulated developing countries where bribes are a fact of life – from the factory floor to the highest levels of bureaucracy. Mulitex has published a two-page code of conduct, and ethical issues are raised at performance appraisals. "We are not in denial but we train our staff to resist this kind of thing if at all possible," Sriram says.

Much of the company's strength lies in its web of 'sourcing' relationships with factories that offer favorable credit terms, which Mulitex can in turn pass to its own customers. But such links leave any company exposed. "With some suppliers, trust has been built over the course of decades and that works in our favor," Sriram says. "It can work against us also," he says, noting that suppliers may press for favors outside the bounds of good ethical practice and that this must be managed and resisted. To ensure things don't get out of control, checks and balances include unannounced visits to factories for on-the-spot quality control and financial audits.

Internal relationships matter even more. Sriram describes the culture at Mulitex as 'person-driven', with an emphasis on one-to-one interaction. This, he notes, is at odds with the global push for process-driven governance. "In a process-driven environment, what you learn on courses or from textbooks can really be put into practice," he says. "In a person-driven environment it's difficult to get into formal structures and compartmentalization." The company's directors value the loyalty of their staff, and are reluctant to make changes that might smack of heavy-handedness. Sriram sees winning their confidence, and building an open door policy with regards to ethics, as an important part of his role.

The company is working towards a more division-centric, professionalized environment, especially at its headquarters where some 250 people are employed. "We know there are things we can do to take the company to the next level," Sriram says, adding that Mulitex has learned a great deal about best practice in finance from its North American partner. And having been lured from PricewaterhouseCoopers India's risk management practice a year ago, his own appointment – to focus on internal controls that allow the company's CFO to take a strategic view – is symbolic. "I wanted to come out of the fault-finding shell and get into the nuts and bolts of a business." ■

Chapter 3
ETHICAL PRACTICE

Three out every four CFOs insist that ethical matters are routinely taken into account when the board and senior management make decisions.

Some three-quarters of the respondents say their companies have instituted a written code of ethical policies. While a published code of ethics is no guarantee of business integrity, the response suggests a substantial degree of attention to the subject in a comfortable majority of the region's companies.

According to the respondents, senior staff members are required to certify adherence to an ethics policy/code of ethics in nearly 70% of companies, and three out every four CFOs insist that ethical matters are routinely taken into account when the board and senior management make decisions. Importantly, some 54% report that they have a process in place for assessing adherence to their ethical codes or statement of ethical values.

Experts say that in the United States and the United Kingdom, very few companies, probably far less than 10%, are assessing, in a systematic and comprehensive way, how well they are doing in their ethical peromance. It would be interesting to research further what Asian companies are actually doing in this respect. Are CFOs truly satisfied that adherence to the code is good, or have they not yet gotten systematic processes in place for this assessment? One possibility is that, in answering these particular questions, respondents were equating ethics with the act of narrowly complying with the law, rather than seeing it in the context of a broader range of behaviors.

In just over two-thirds of these cases, respondents said that independent assurance is sought, a degree of self-scrutiny unusual in any market as the practice of auditing for adherence to ethical codes is still in its infancy – internally as well as externally through third parties – everywhere.*

Knowing how far to take things is an issue for companies. Management at Mulitex in Hong Kong have taken a 'less is more' approach, and kept the company's code of conduct to just two pages. As K Sriram, the company's governance guru explains: "We consciously felt that if we produced a 15-page code of conduct, of 250 staff at our headquarters only three or four would read it – and they would be from the finance department for sure." He wanted a shorter document that would have an impact among all employees, from merchandising managers to logistics clerks. "I don't want a code of conduct that details so much it becomes a box-ticking exercise. You risk diluting the message. It might be theoretically ideal to try to cover every eventuality but to implement it practically is difficult."

Exactly half of the companies surveyed still don't have proper mechanisms in place to protect whistleblowers, although 64.8% of respondents say procedures are in place for looking after staff that raises ethical concerns. Moreover, while 60.5% of companies have introduced ethics-related training for most staff, across the entire sample only 50% of companies say they incorporate ethical issues into staff performance appraisals.

** The Open Compliance and Ethics Group (OCEG), a organization that helps companies align their governance, compliance and risk management activities to drive business performance and promote integrity, released a draft version of its Practice Aid to its Internal Audit Guide: Evaluating a Compliance and Ethics Program in May 2006 For details go to www.oceg.org.*

Table 6 Measures in place to support the practice of good business ethics.

	Yes (%)	No (%)	Don't Know (%)
A written ethics policy/code of ethics/statement of ethical values	75.9	23.5	0.6
Ethical matters routinely considered as part of board and senior management decision-making	75.9	20.4	3.7
Senior staff certify adherence to ethics policy/code of ethics	69.8	27.1	3.1
Providing protection for staff who raise ethical concerns	64.8	27.8	7.4
Training of ethics & ethical practices for all or most staff	60.5	38.3	1.2
Processes for assessing adherence to the written ethics policy/code of ethics/statement of ethical values	54.3	40.1	5.6
Ethical performance included within performance appraisals	50.0	49.4	0.6
An established whistle-blowing policy	48.1	50.0	1.9
An ethics officer or committee	30.9	64.2	4.9

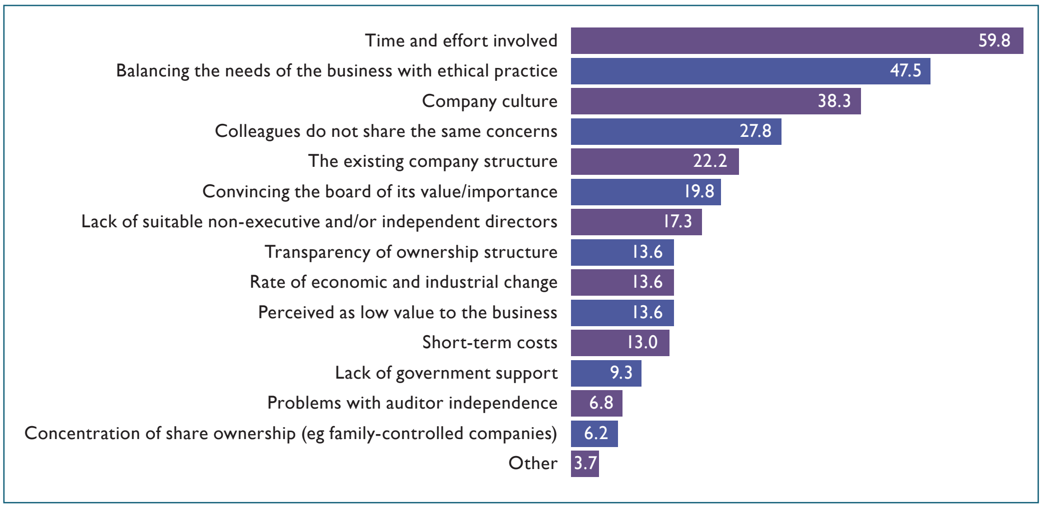
Ethical hurdles

Asked to rank the barriers to developing and improving ethical practices inside their company, CFOs overwhelmingly state that the time and effort involved is the biggest hurdle – nearly 60% of respondents put this among their top three concerns. Somewhat enigmatically, almost half (47.5%) say they struggle to balance the needs of the business with ethical practice and for 38.3% of CFOs company culture is a cause for concern. For some this translates into difficulty convincing the board of the importance of ethical issues, while others labor under an environment where colleagues do not share their concerns.

Relatively few respondents cite characteristics of Asian business that observers might assume would present roadblocks. For instance, just 6.2% blame the concentration of share ownership in family-controlled companies or the transparency of the ownership structure (13.6%). Among those who list other difficulties to those presented in Chart 6 on the next page, several feel that doing business in another culture is a particular challenge. Wong Kwok Foo, CFO of Kärcher Asia-Pacific, a family-owned corporation based in Germany, believes a practical thing CFOs can do is stress the need for company leaders to set realistic targets for staff. "Management goals need to be right," he says. "All managers set aggressive goals – it's natural. But this can lead to risky behavior. If people are under pressure to achieve targets they feel are unreasonable, they will use that to rationalize manipulating the numbers." Indeed, Kwok recalls a case at a cleaning technology company where fraud was perpetrated by a trusted, senior member of staff. "People can change over time," he says. "Suddenly they see fraud as a way to keep their job."

Chart 6 Ethical challenges

Barriers or difficulties faced by CFOs striving to develop and improve ethical practices (%)



(Respondents were asked to select their top three from the list; total equals more than 100%)

Would the extra oversight and regulatory requirements that come with a public listing discourage a family company like Mulitex – which is already feeling the heat of greater scrutiny – from launching an IPO? Sriram says his directors are open to the idea but are well aware of the implications in terms of cost, time, and management focus. "If I go public, I have a huge amount of regulatory compliance, I need to look at my Reuters screen day in and day out for my share price and worry about factors that I very possibly can't control," Sriram observes. "This is how companies get into window-dressing, to keep their share price at a certain level to stay in the good books of the Street. And that's how they get into trouble. At this point in time we wouldn't want to take on that battle."

Case study: Kärcher Asia-Pacific
Polishing its act

Sometimes a company learns its lessons the hard way. Take Alfred Kärcher GmbH, named after an inventor-entrepreneur from the German state of Württemberg, a region that also produced Robert Bosch, Gottlieb Daimler, and Count Zeppelin. In the early 1930s Alfred Kärcher specialized in submersible heating elements and developed a way to improve common industrial and household heating equipment with his 'Kärcher Salt-Bath Furnace'. Although Kärcher the man died in 1959, his company lives on, though he could not have imagined its future. Today Kärcher employs 5,900 people worldwide, and last year recorded revenues of 1.1 bn euros from sales of industrial and domestic cleaning systems. Its products, which range from vacuum cleaners to high-pressure water blasters, have even been used to spruce up monuments such as Mount Rushmore in the US and the temples at Luxor in Egypt.

But success has had its growing pains. Like many German enterprises, Kärcher is famed for its R&D – in 2004, R&D capacity at its head office in Winnenden was literally doubled, and three-quarters of products sold had been developed in the past four years. But in the past, this focus on the future left other areas of the business exposed, especially as the company expanded across the globe. "Accounting fraud was discovered at several subsidiaries," recalls Wong Kwok Foo, Singapore-based CFO of Kärcher Asia-Pacific. "Part of the problem was that different accounting systems were being used at different locations."

The wake-up call was all the more galling for a company that prided itself on being detail-oriented, and Kärcher heard it loud and clear. Over the past five years, tens of millions of euros have been invested in ERP software from fellow German company SAP. The modules were rolled out at headquarters and larger subsidiaries, although smaller subsidiaries that cannot justify the investment continue to use other systems. "The ERP system makes it easier to monitor and affords better transparency," Kwok says. "You don't have to wait for the year-end, you can ask questions faster. It's a deterrent."

Perhaps more crucially, the IT project prompted a reassessment of Kärcher's business processes. The company took the opportunity to harmonize its accounts on international accounting standards, and developed more stringent corporate policies on internal controls. For instance, smaller subsidiaries are now required to have banking instructions signed off at corporate headquarters. An external auditor was brought in to give the new measures the seal of approval. In another effort to regain control, the company has bought out its joint venture partners. Kwok notes: "This has definitely helped us improve our internal controls. The JV partners were less inclined to put money into such efforts."

Despite all the soul-searching, Kärcher has not introduced a corporate code of ethics, though Kwok says more emphasis has been placed on corporate values. "We are trying to create a stronger culture because we understand that can help prevent unethical behavior," he says. Initiatives include greater attention to what Kwok calls "international orientation" to foster a sense of common purpose. If sending key staff to meet their colleagues in Germany sounds simple, it is no less effective for it. Still, Kwok feels that ultimately it is up to senior management at each subsidiary to take responsibility for setting the right ethical tone. In Singapore, for example, orientation for new employees includes discussion about the company's expectations on behavior.

Kwok feels Kärcher's staff in Asia are loyal to the idea of a successful organization that offers them a secure future, rather than any notion that they are part of a family concern. And that's okay. "The advantage of a family business is that the outlook is long term," he says. So far the company's supervisory board, which comprises two family shareholders and three independent directors, has resisted all offers from suitors. The challenge for the management board, which is made up of the global functional heads of finance, production and logistics, and sales and marketing, is to chart a course that is fiscally prudent. "While growing through R&D and acquisitions, the owners prefer not to be too reliant on external financing," Kwok says. "Good working capital management and tight governance are very important to us." ■

Chapter 4
INFLUENCE OF AN ETHICAL CORPORATE CULTURE

The survey participants acknowledge that a good ethical culture has become a requirement in business. It improves a company's relationship with its banks, and with institutional investors.

Common sense and ethical sensibilities

Asked to describe the key benefit of having a strong ethical culture within the company, the region's senior finance executives point to overall reputation and compliance with laws and regulations as areas that are the most affected.

For some the benefits are pragmatic and felt on a daily basis, while others take a wider view. Not surprisingly, some enjoy a 'clear conscience' and confidence that the company will not be caught out. Words like 'accountability' and 'transparency' are mentioned repeatedly, as is 'reputation' and its impact on brand value. "Ethical culture can be regarded as the insurance for successful business," says one CFO. But how do such platitudes manifest themselves within an organization?

"It just makes my life as head of finance easier," says one CFO. "Financial statements will be accurate and mean less time is spent on policing activities performed in the field." Indeed, the impact on employee morale and productivity is noted by many respondents. "A strong ethical culture serves as an attraction for good talent," according to another finance chief. Another adds: "Staff will be more upfront if they discover loopholes in controls that might be taken advantage of by fraudsters."

Another CFO gave voice to the notion that a strong ethical culture makes for a common sense of management direction and clarity on decisions. "There is less conflict within management and more time dedicated to strategic planning," he says. Still another respondent values the "independence from direct superiors' interpretation [of figures]" that his company's governance structure affords. Another CFO offers: "Strong ethics converts to fair and professional management practices, which will enhance shareholder value significantly."

Above all, the survey participants acknowledge that a good ethical culture has become a requirement in business. It improves a company's relationship with its banks, and with institutional investors, who acquire, as one respondent puts it, a "confidence and comfort" with company reports. Asia's CFOs know perfectly well that this is critical for long-term growth and expansion, "especially when dealing with big players in the market who already have a strong ethical culture."

One respondent expressed a distinctly passionate view: "It is the right thing to do! It is a question of principles, not just of pragmatic benefits!"

Table 7 The fruits of good ethics

Respondents were asked to identify, on a scale of 1 to 10 (where 1 is not at all beneficial and 10 is extremely beneficial), the impact of a good ethical business culture on various business issues. (%)

	1	2	3	4	5	6	7	8	9	10
Company's overall reputation	1	1	1	0	2	4	4	16	28	43
Compliance with laws and regulations	1	1	1	1	2	1	7	15	28	43
Gain an edge over competitors	2	3	0	4	4	7	23	19	13	25
Ability to obtain future investment	1	2	2	5	5	5	17	23	15	25
Company's attractiveness as a potential employer	1	2	2	1	6	9	15	21	18	25
Relationships with the investment community	1	2	0	6	2	3	10	29	23	24
Company's attractiveness as a potential supplier	2	2	1	1	4	10	14	26	17	23
Management and staff motivation	1	1	2	1	3	9	15	24	22	22
Company's ranking in analyst reports	1	1	2	1	6	7	15	27	20	20
Business performance	4	2	1	2	3	12	19	27	12	18
Share price	4	3	1	3	10	7	15	24	16	17

The ethical pressure cooker

The growing awareness of business is all well and good, but would Asia's companies invest so much time and effort in the area if they didn't have to? The ethical environment has undoubtedly changed in recent years, but the research suggests an element of good old-fashioned arm-twisting is still required for some companies to promote the place of ethics in the corporate psyche.

Thinking of the Asia-Pacific region as a whole, CFOs were asked to choose what they consider to be the key sources of pressure or drivers for change for the development of good ethical practices. That ultimate authority figure, government, not only ranks among the top three by the largest number of CFOs (46.9%), it is the top choice of a quarter of respondents. Government is followed closely by corporate governance institutes, which make the top three of 46.3% of respondents. These organizations may not wield the weight of law, but clearly they are good at getting their message across. However, they are the single most important driver for just 16.7% of respondents.

Professional accountancy bodies fulfil a similar role. They are considered among the top three drivers by 44.4% of the CFOs in the sample. Furthermore, additional interviews conducted with CFOs as part of the research suggest that they value their accreditation by such bodies, and the opportunities for ongoing learning and development.

The next most popular drivers fall into the category of peer pressure. Nearly one in three respondents point to the example set by top 500 multinational corporations, and almost a quarter say they are influenced by US culture and practice. In line with corporate practice around the world, IBM Singapore, for instance, conducts regular compliance reviews with all its business partners. So has Big Blue ever dropped a supplier or customer because of ethical concerns? "Yes, we have, due to non-compliance with our business guidelines," says Ong Wee Gee. Of course, many companies do not have the power or resources to exert such influence on others in their supply chain.

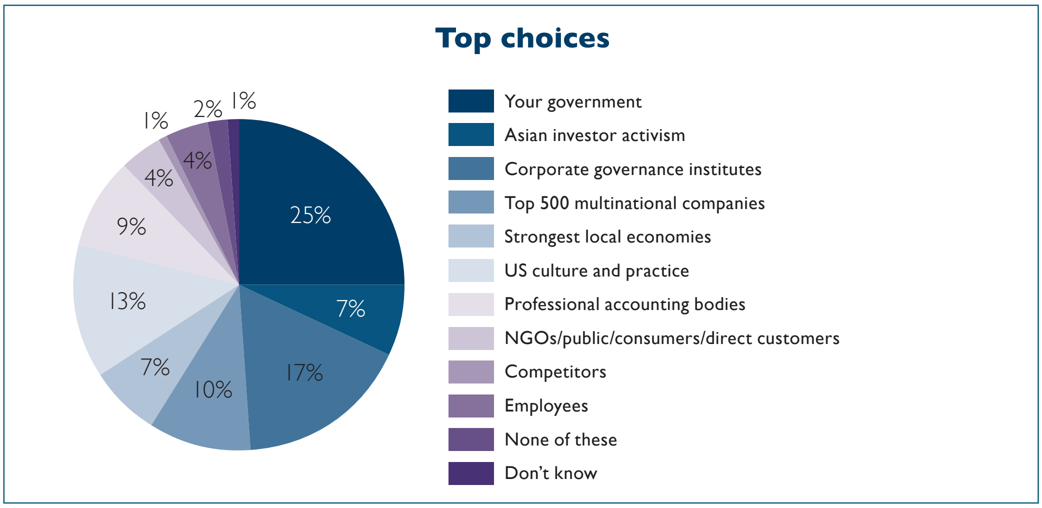
Given that 61.7% of respondents work for Asian companies, it is notable that just 22.2% feel that the region's strongest local economies are among the most potent drivers of change. They barely rate competitors as a force for change. This suggests CFOs seek inspiration from economies and sectors beyond their own.

The research suggests investor activism is still a nascent concept in Asia. Just 6.8% of respondents say they feel pressure from investors above all else, which suggests governance and ethical issues pale in comparison to traditional shareholder concern for profit and dividends. At least one CFO wasn't surprised. "I just look at the recent IPO of the Bank of China in Hong Kong, a world record subscription," he said. "Many of the subscribers were institutional investors – Western mutual funds – even though the Western media have been vocal in their criticism of past wrongdoings at the BOC. How come people forgot all that?" But he also regards this as a form of myopia that may apply to investors worldwide. "To me this suggests that whether they are Asian or European or American, investors are really only interested in growth prospects."

Table 8 Key factors exerting pressure or driving the development of good ethical practices

Ethical issue	Percent (%)
Your government	46.9
Corporate governance institutes	46.3
Professional accounting bodies	44.4
Top 500 multinational companies	30.2
US culture and practice	23.5
Strongest local economies	22.2
NGOs/public/consumers/direct customers	22.2
Asian investor activism	21.0
Employees	17.3
Competitors	14.8
None of these	4.9
Don't know	4.3

(Respondents were asked to select their top three choices, in order of importance; total equals more than 100%)



Case study: DuPont China
Pragmatic flexibility

When DuPont started doing business in China the Qing dynasty was in charge and ceremonial gift giving between trading partners was all the rage. Nearly 150 years later the US$28.5 bn diversified chemical sciences giant has invested more than US$600m in wholly-owned and joint ventures in the country and built a headcount of 5,500. But if much has changed in Asia since 1863, some things remain the same. "A lot of business is still done through relationships," observes Daniel Leung, DuPont's regional finance director for Greater China. "The giving and receiving of token gifts is an important part of the culture and generally seen as part of the relationship-building process."

The ethical dilemma this presents to a US-listed multinational is obvious. But DuPont made its start dealing in gunpowder and is well-versed in coping with hazards. To help staff negotiate tricky cross-cultural mores, policies on so-called 'business courtesies' are laid out in a 20-page Business Conduct Guide that is distributed in all 70 countries where the company operates, translated into local languages to ensure the message is clear to all 60,000 employees. As Leung points out: "A black and white approach is just not practical in China. While standards are global, you have to ensure that the local organization understands the standards in the context of the local environment."

The guide covers everything from conflicts of interest to protecting internal controls, reporting integrity, and electronic information. There are detailed standards governing gifts and entertainment of government officials and other business contacts such as suppliers, customers, outside legal counsel, and external auditors. A system of authorization dictates, for instance, that gifts to a government official must meet stringent requirements and be approved by the country head. Gifts, favors, and entertainment may be given only if they fit with local business custom and cannot be construed as a bribe or payoff. They must not violate laws, or be likely to embarrass the company if made public. The guide even stipulates limits to what may be spent on certain occasions. For instance, in China, a cash or non-cash gift may be paid to a customer for a family wedding but it must not exceed 600 renminbi in value. In Hong Kong, a gift worth up to HK$700 may be given for a funeral.

To reinforce the importance of such policies, every employee must complete business ethics training each year. The training consists of (at least) two computer-based modules and typically also at least one face-to-face training session. Leung says each of the courses, delivered over the corporate network, take about an hour to complete. "Staff are given ethical scenarios, such as two guys discussing a rebate or commission, or the manipulation of accounting records," he explains. Throughout the session the employee is asked a series of questions to test understanding, and then given a short test which must be passed to complete the module. Leung says online course delivery and testing makes it easier for DuPont to audit the understanding of ethical practice among staff, and identify areas for development. And the finance director himself is not exempt: Last year Leung was involved in joint ventures and M&A transactions that required a deeper understanding of anti-trust laws, so he took six courses. "Training in such areas is available to all employees who have a need or interest in broadening their understanding," he says.

Leung also sits on an ethics committee for his region, together with his regional president, HR director, legal counsel, and compliance officer. At the center of DuPont's process around business conduct is a department called Ethics and Compliance Central, run out of the company's US headquarters and headed by the vice-president for internal audit, who reports directly to the audit committee. Leung says this structure promotes organization-wide sharing of data on ethical violations, and discussion of ways to improve detection measures and treat the causes. In the Asia-Pacific, for instance, experience has shown special attention should be paid to remote locations or new acquisitions because staff there tend to have less experience of global standards. "It is a matter of building understanding," Leung says. "The same goes for customers and suppliers. The key is good communication – letting them know what your standards are and sticking to them." ■

Chapter 5
ADVICE AND REGULATION

CFOs turn to a variety of sources for information and advice when structuring assurance processes and building in internal controls in order to comply with these new expectations.

Over the past few years, a range of initiatives – public and private – have been launched with a view to improving corporate governance and ethics in Asia. But it is clear that CFOs consider many of these measures to be works in progress, requiring further development to be truly effective.

The Malaysian Code of Corporate Governance, first introduced in March 2000, has been a success in ensuring a high level of compliance with the CG principles and best practices*. In 2004, the government established the Malaysian Institute of Integrity, whose role is to facilitate and execute the National Integrity Plan in both the private and public sectors. Whistle-blowing laws have also been introduced across every sector. The Securities Laws were amended in 2005 to include whistle-blowing provisions for both officers of the companies and external auditors. The Companies Commission of Malaysia is also looking at such provisions.

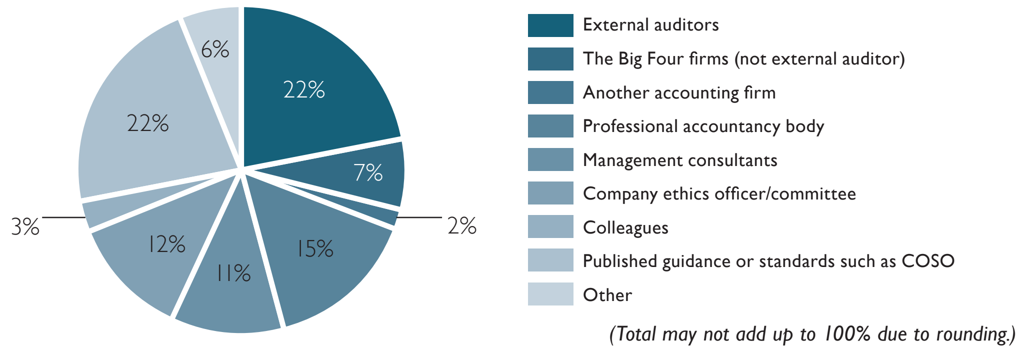
Not to be outdone, Singapore's government launched its Council on Corporate Disclosure and Governance in 2002, to prescribe accounting standards and strengthen the existing framework for reporting practices. And in November 2004 the Hong Kong stock exchange published a final report on its new Code on Corporate Governance Practices, along with a new set of rules requiring issuers to include a 'corporate governance report' in their annual reports. Private efforts include the KPMG-backed Hong Kong Audit Committee Institute, which opened at the end of 2002 to serve as a resource for audit committees and senior management, and groups such as the Minority Shareholders Watchdog Group in Malaysia.

CFOs turn to a variety of sources for information and advice when structuring assurance processes and building in internal controls in order to comply with these new expectations. Perhaps not surprisingly, almost one in four (22.2%) respondents says they turn first and foremost to their external auditor as a trusted guide. Few (6.8%) companies turn to a Big Four firm that is not the external auditor.

Published guidance and standards, such as those issued by COSO, are influential too. COSO is a voluntary private sector organization that promotes better financial reporting through business ethics, effective internal controls, and corporate governance. It was formed in 1985 by professional bodies in the US, but now translates its publications into languages such as Chinese, Japanese, and Korean.

Chart 7 Sources of advice

Where do senior finance executives turn for information and advice on corporate governance and ethical issues, specifically as they apply to assurance processes and internal controls?



(Total may not add up to 100% due to rounding.)

** CG Survey Report 2004, Nottingham University Business School, Malaysia Campus, and the Minority Shareholders Watchdog Group.*

The in-depth interviews highlighted the importance of professional accreditation to many CFOs across the region. One example is Li Dun, CFO of Sinochem International. Now based in Shanghai, he earned his stripes during a stint in Singapore. "I graduated from a Chinese university in 1993. What we learned then is very different to what I learned in Singapore. They gave me training not just in professional skills but also in ethical areas. In my opinion if you want to have good ethics in the company, the leader must set the example to staff, and one way of doing this is to follow the requirements of a professional body."

Li encourages his staff to take courses as he did, but says this would be easier if China had a powerful professional group of its own. "Accountants are responsible for executing the system. They need the support and backing of a body of some kind." He is hopeful that the introduction of new accounting standards in China in January 2007 – which are expected to be closely modeled on IFRS but take a tougher approach on asset impairment, much like US GAAP – will be the catalyst for the creation of an influential organization.

Sarbanes-Oxley and all that

Only a fifth of CFOs surveyed work for companies that are based or listed in the United States. Yet almost half (47.5%) of the respondent base believe that the Sarbanes-Oxley Act has had a positive global effect on business ethics. CFOs at non-US companies in Asia note that American customers or supply chain partners are asking them to provide a new level of transaction documentation, which encourages discipline within their own finance departments.

In light of the leadership scandals that befell Enron, Worldcom, and others, Section 302 of the act requires the CFO and CEO to certify their company's financial statement, and also that they have evaluated internal controls within the previous 90 days. Section 404 famously requires each annual report to contain an internal control report that includes an assessment of the effectiveness of the internal control structure and procedures for financial reporting, and requires that the external auditor attest to and report that assessment by management.

Roughly a quarter of CFOs believe the controversial 2002 law's impact has been restricted to American firms and their subsidiaries. If this is still the case, things look set to change. Already, elements of Sarbox are finding their way into national codes across the Asia-Pacific region, while in a preemptive strike, some companies are cherry-picking the aspects that they consider to be best practice, even if they are not legally required to do so.

On the power of external forces such as pressure from investors, non-executive directors, the media, or NGOs to promote the influence of the national code on ethical practice, CFOs remain unconvinced.

At least for the moment, Asian CFOs are urging stronger government involvement despite the prospect of a higher cost of compliance. A robust 69.8% of survey respondents say that stronger enforcement by regulators is needed. More than half (52.5%) feel that at the very least, their national code would benefit from the inclusion of more explicit references to ethics. A sizeable minority of 37% would welcome stiffer criminal penalties.

And Asian CFOs not only welcome a strong government stance, but also suggest that their national codes could show more teeth. Only a quarter (24.7%) believe that their country's national code for corporate governance is comprehensive enough.

Chart 8 Government influence on governance

Survey participants were asked to rate, on a scale of 1 to 10 (where 1 is not at all influential and 10 is extremely influential), to what extent ethical practice within their company is influenced by a national code(s) of governance.

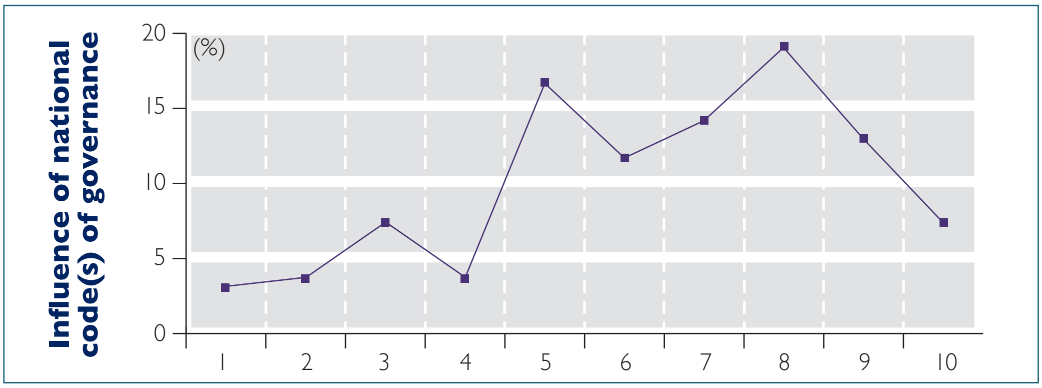


Chart 9 The impact of Sarbanes-Oxley

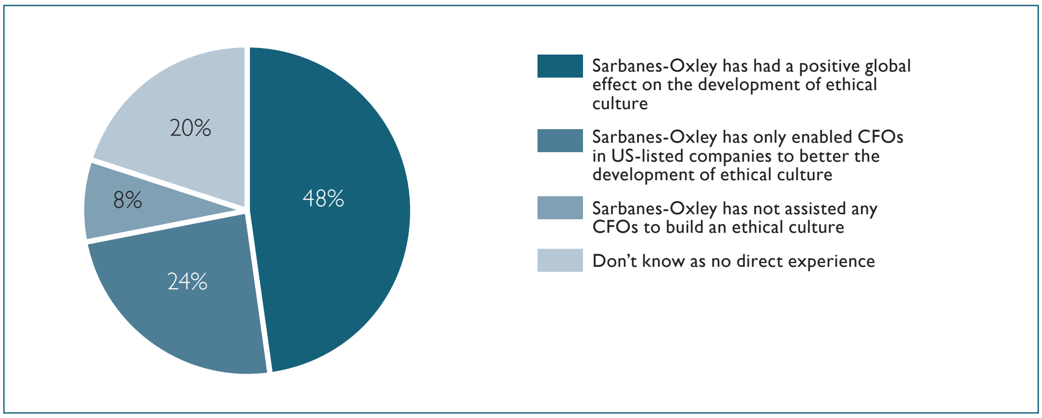
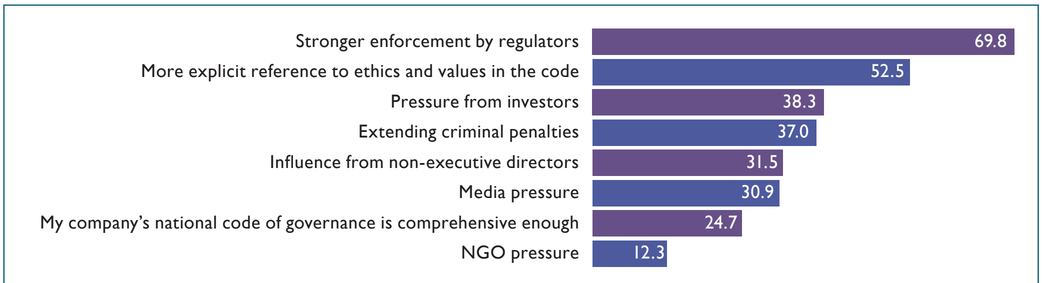


Chart 10 Boosting the national code

Factors that CFOs believe could help to improve the influence of the national code(s) of governance on their company's ethical practice (%)



(Respondents were asked to select all that apply; total equals more than 100%)

Case study: Tanjong
Sending the right message

If a website offers a window into a company's self-perception and attitude towards its stakeholders, Malaysian power generation, gaming, and leisure group Tanjong is a paragon of transparency and control. Incorporated in London in 1926 as Tanjong Tin Dredging, the company took a dual listing on the Kuala Lumpur Stock Exchange (KLSE) and London Stock Exchange (LSE) in 1991 following the purchase of Pan-Malaysia Pools, and clearly takes its fiduciary responsibilities very seriously.

"The single biggest impetus for ensuring an ethical culture has been the support and recognition of our continuing work in this area by our institutional investors, researchers, and the regulators," says CFO Gerard Nathan. "Our investors have in particular been appreciative and this is reflected in our share price over the past five or more years, as well as the high quality of the funds that have held a significant interest in the group."

Indeed, many constituents of the LSE's prestigious FTSE 100 index could learn a thing or two about investor relations from Tanjong, which states its values and aspirations for corporate governance right upfront. As well as explaining the role of the board and board committees, including the terms of reference of the company's audit committee, the website explains the company's systems for internal control. Pie-charts illustrate the percentage of issued shares by location, and by category, and the percentage of shareholders by category. Dashboard-style presentation of financial results is user-friendly and there is even a diagram that explains the company's approach to risk management. It's comprehensive and easy to digest.

And in case anything is unclear, there is an email link to the company's senior independent director, Leong Wai Hoong. Indeed, great stock is placed in the accessibility and involvement of the board, which was reconstituted a few years ago in response to the so-called Higgs Report of 2003, which addressed the role of independent directors. Tanjong's board now has five members, comprising four non-executive directors, two of whom (including the chairman) are independent; and one executive director. The directors have access to the group internal audit manager and the company secretary, and may also take independent professional advice at the group's expense.

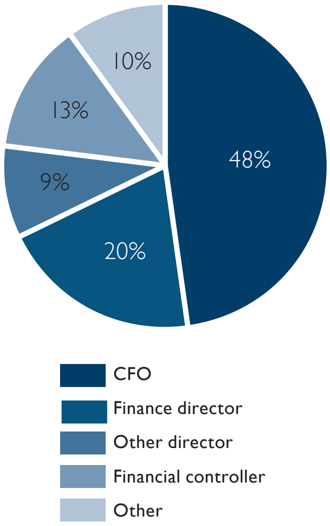
Of course, a jaunty website is meaningless if its mantras ring hollow. Nathan says Tanjong, which earned revenues of more than 3 bn ringgit last financial year, takes a three-pronged approach to governance. Shareholders want reassurance that the financial data they receive is sound, and can be used as the basis for wise investment decisions; for them, a strong reporting framework must be in place. The board must be confident that tight systems set the tone for control consciousness and ethical conduct, and that monitoring and detection measures are effective. The executive team counts on a strong risk management framework that will identify, evaluate, treat, and report internal and external risks.

"For governance and ethics to be potent, it is important that all the moving parts are functioning well, not just control procedures but also the overall control environment, monitoring efforts, and risk management processes," Nathan says. Practical measures include workshops for line managers to instil in them risk and control consciousness, leading to the completion of risk registers for core business activities. There are supporting procedures for the reporting and resolution of actions contravening a board-approved Statement of General Business Principles and Human Resources Policies and Procedures. Procedures also exist for mitigating exposures to losses arising from material fraud or accounting error. The company's cross-cultural heritage serves it well: In addition to adhering to the Malaysian Code of Corporate Governance, Tanjong has incorporated into its approach the recommendations of the UK Combined Code of the Principles of Good Governance and Code of Best Practice.

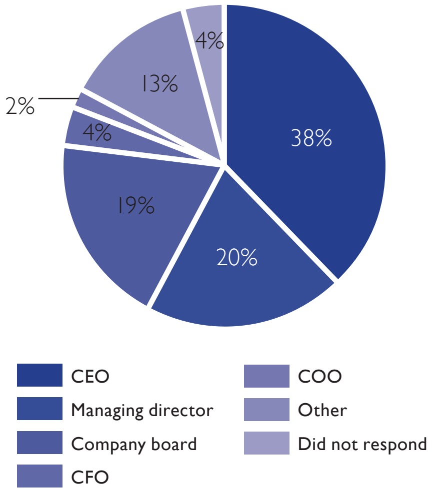
Even so, Nathan remains realistic. "Any system of internal control can provide only reasonable and not absolute assurance against material misstatement or loss," he says. "The cost of controls should not therefore exceed the expected benefits." ■

SNAPSHOT OF SURVEY RESPONDENTS

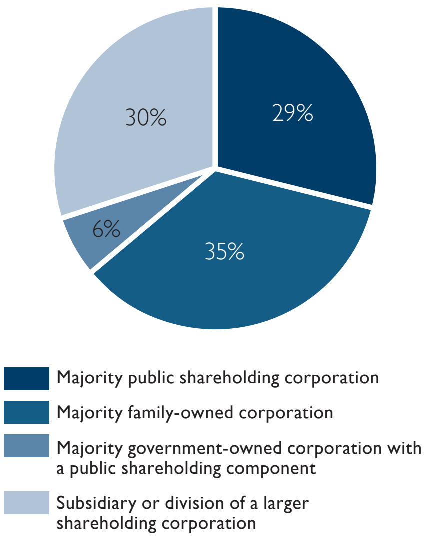
Survey respondents by job title



Who do the survey respondents report to?

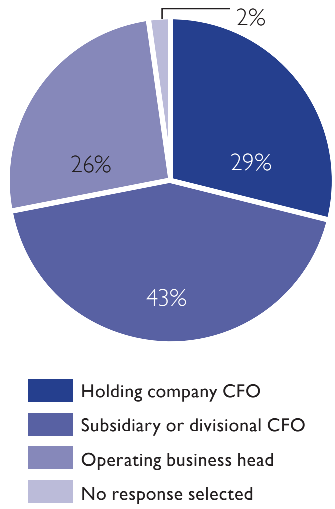


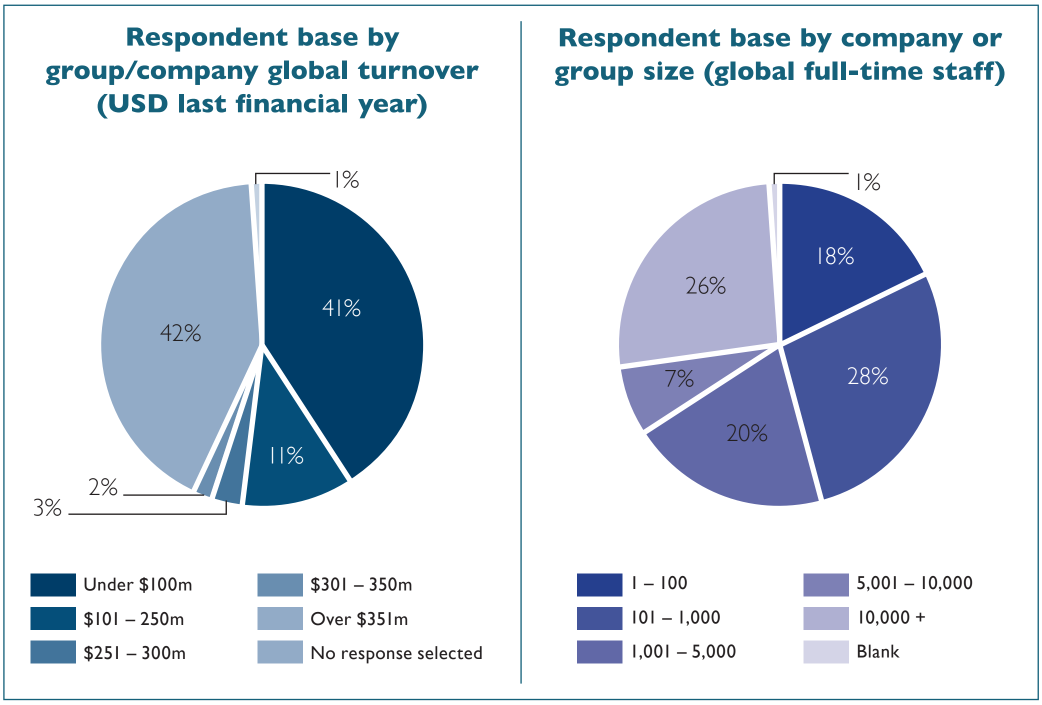
Respondent base by company structure

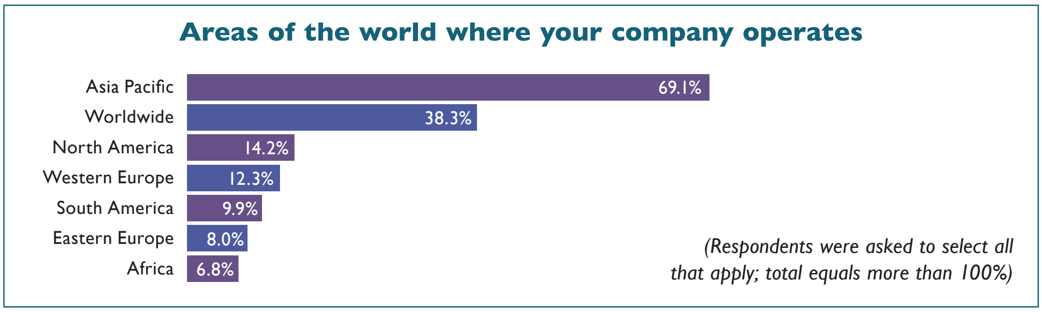


Note: Over one-third of respondents come from family-owned enterprises.

Respondents who selected "subsidiary or division of a larger shareholding corporation" personally report to




Respondent base by group/company global turnover (USD last financial year)
1%
41%
42%
11%
2%
3%
Under $100m
$101 – 250m
$251 – 300m
$301 – 350m
Over $351m
No response selected
Respondent base by company or group size (global full-time staff)
1%
18%
26%
7%
28%
20%
1 – 100
101 – 1,000
1,001 – 5,000
5,001 – 10,000
10,000 +
Blank


Areas of the world where your company operates
Asia Pacific 69.1%
Worldwide 38.3%
North America 14.2%
Western Europe 12.3%
South America 9.9%
Eastern Europe 8.0%
Africa 6.8%
(Respondents were asked to select all that apply; total equals more than 100%)

ACCA'S PERSPECTIVE

Business ethics contribute towards shareholder value

An overview by ACCA (the Association of Chartered Certified Accountants)

There has been a resurgence of interest in ethics in reaction to the corporate governance scandals of the beginning of the decade.

Global drivers for change

Governments around the world are now well aware of the need for trust in capital markets. The United States learned the hard way how fragile trust can be and responded with the Sarbanes-Oxley Act which, among other things, requires senior financial management of US-listed companies to have ethical codes and for management and auditors to report on the effectiveness of internal controls over financial reporting. This has resulted in wholesale review and documentation of policies and procedures.

Little research has been carried out on ethical practice in companies and the role accountants play. Partly this is because interest in the subject is relatively new and partly because ethics is one of those soft areas where it is hard to make objective judgement. One important piece of research was published by the Institute of Business Ethics in the UK. This found that there was a strong correlation between companies which have established ethical codes and a number of measures of corporate financial performance, suggesting strongly that good ethics is the right thing to do not just because it is the right thing to do: it also makes for successful business.

Good ethics are vital to good corporate governance. Company boards too are now becoming much more aware of the need to have the right ethical culture. The culture of an organization is probably the most important aspect of its system of internal control, and it is the foundation for other internal controls. Management may set out the policies and procedures which it wants followed, but it is the corporate culture which determines when they are followed, amended or ignored.

Large companies listed in the US, since Sarbanes-Oxley, have seen a proliferation of new policies and procedures, but anecdotal evidence suggests that this may be breeding a culture where employees become frustrated with the amount of new rules and feel inclined to ignore the ones they see as unhelpful to getting the job done. And as everyone knows, Enron had an impressive code of ethics. ACCA favors a principles-based approach to business ethics, to provide business with a 'moral compass' by which to navigate.

The role of the finance professional

The accounting profession globally has taken steps to enhance the importance of ethical behavior and decision-making. The International Federation of Accountants (IFAC) has launched a revised code of ethics based on a set of fundamental principles to be adopted by individual accountancy bodies. ACCA has already revised its own code of ethics for its members to be consistent with the IFAC standard. These codes are about accountants' professional ethics.

Business ethics is a different, but related, matter. Accountants in business, particularly at board or at top management level, are often regarded as the keepers of the ethical conscience of their organizations. As well as following their own professional codes of ethics, accountants set an ethical example to others.

Business ethics and the CFO

It is against this background that ACCA has worked with CFO Asia Research Services to find out what CFOs in Asian companies think about ethics in their companies and what roles they have in promoting an ethical culture.

The findings make for fascinating reading. Of particular significance is that not only are business ethics seen to be an increasingly important issue in the region, CFOs are playing an increasing role in taking responsibility for their application in their companies. CFOs say that they are finding it a challenge to balance the needs of the business with the need to ensure an ethical culture. However, in spite, or perhaps because, of this, most CFOs would like to see more explicit reference to ethics in their national codes of corporate governance, with stronger enforcement.

Theoretically, the US Securities and Exchange Commission rules which give effect to Sarbanes-Oxley require companies and their auditors to assess the ethical environment. There is, however, no generally accepted approach to doing this and it is not just about documentation. Not surprisingly, this important subject tends to be given less attention than it deserves by companies and their auditors. Interestingly, over half the respondents to this survey say they have processes in place for assessing adherence to their company's code of ethics. This is a higher percentage than we would have expected and it would be interesting to research further and learn more about what companies are doing.

The challenge of living up to one's ethical values is evident from the survey findings. For nearly 40%, company culture is a cause for concern. Boards set the values and standards for their organizations and we believe that in future boards will insist on knowing how well their companies are living up to these. This goes beyond simply complying with rules: the reputation and the future of the company and individual board members are at stake.

ACCA and ethics

ACCA's students and members agree that an enhanced emphasis on ethics is appropriate in the interests of integrity and promoting professionalism. A global survey of members revealed that 'upholding ethical standards' is one of the most important competencies for modern professionals. In a survey of 12,000 of ACCA's students, nearly three-quarters agreed that professional ethics and integrity are the single-biggest challenge in the global accounting profession today.

ACCA's new professional qualification, to be introduced in 2007, will adopt a unique focus on ethics. It will include a paper in the final level, called the Professional Accountant, which will concentrate on professional values, ethics, and governance. Students will also need to complete an online module on ethics, which will present them with challenging real-life ethical dilemmas to consider. And the practical experience requirements will emphasize the importance of ethics to the well-rounded accountant and finance professional. This is further emphasized by the requirement for all ACCA members to undertake continuing professional development, in which they confirm on an annual basis that they are keeping their skills and knowledge up to date, including in the area of ethics.

ACCA also works with governments, regulators, and standard setters around the world to help them put in place regulatory and governance structures which follow best practice. ACCA is also working with the accounting profession, through its involvement in bodies such as the International Federation of Accountants, the Asean Federation of Accountants and the Confederation of Asia Pacific Accountants. It also champions transparency and sustainability reporting through the Global Reporting Initiative.

Conclusion

The findings of this survey are consistent with the work that ACCA has undertaken in the area of business ethics. ACCA is encouraged to see that CFOs in the Asian region share the belief in the increasing importance of ethics at work. This provides a platform for professional accountants in the region to develop business ethics as a driver to enhance shareholder value – and this research provides a valuable insight into current practice, a basis on which to develop best practice in the region.

www.accaglobal.com/ethics