



# Building an Ethical Culture

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# Learning Objectives

- State the relationship between financial success and company ethics.
- Describe how motivations behind company ethics has changed according to the Journal of Accountancy research article from 2014
- Describe the structure of the AICPA Code of Professional Conduct, as well as the different categories of practitioners that are addressed within it

# Learning Objectives

- State the four steps to the Conceptual Framework approach and how it related to the AICPA Code of Professional Conduct
- Define the concept of social responsibility and how it relates to company ethics
- List activities that may be used to create a sense of social responsibility within an organization.

# What is Company Culture?

- Peter Messana, CEO of Searchspring, (Forbes, 3/11/2022): *"Anything that relates to customs and norms that naturally form within a company."*
- Indeed (7/22/2022): *"A set of shared core values and practices that define an organization, both internally for employees and externally as part of its public image."*
- SHRM (4/1/2023): *"consists of shared beliefs and values established by leaders and then communicated and reinforced through various methods, ultimately shaping employee perceptions, behaviors and understanding."*

# Why have ethical culture?

- Gunthorpe (1998) “found that upon the announcement that a firm is under investigation or has in some way engaged in unethical behavior, a statistically significant negative abnormal (excess) return is found. This suggests that firms are indeed penalized for their unethical actions.”
- Renneboog (2019) says found that “consistent with investors paying a price for ethics, SRI funds in many European and Asia-Pacific countries strongly underperform domestic benchmark portfolios by about 5% per annum, although UK and US SRI funds do not significantly underperform their benchmarks.”
- Margolis (2011) found that “except for the effect of revealed misdeeds on financial performance, none of the many contingencies examined in the literature markedly affects the results.”

# A few observations....

- **It is difficult to measure a company's level of ethics. You can do it through surveys, but this really comes down to perceived ethics – not actual ethics.**
  - It is probably the best you can do in research, but still....
- **The studies in this area mostly use stock price as the gauge to financial success (because it is widely available and measurable). Other variables may not be as readily apparent.**
  - For example, lost contracts, lost customers, and lost key employees are difficult to measure for research purposes – yet these could be relevant dependent variables, if the company has poor ethical practices.

# Relationship Between Ethics & Financial Success

Academic studies have been mixed in regard to how ethics influences a company's success

There is some evidence that perceived ethical companies have a higher stock price\*\*

\*\*Long, D. M., Wann, C., & Brockman, C. (2016). Unethical business behavior and stock performance. *Academy of Accounting and Financial Studies Journal*, 20(3), 115.

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# So why have an ethical culture?

- There is at least some empirical evidence from research that investors care about it – markets demand higher stock prices.
- When a company gets caught not being ethical, it usually affects them negatively in the press, public perception, etc.
- If companies want to expand, they need to attract talent. Unethical practices would seem to make that tougher....



# So can you really create ethical culture?

- If company culture is shared beliefs, then presumably each person within the organization plays a part in that culture.
- On some level, it is how the people within the organization are naturally wired... but it can also be influenced.
- Changing perceptions would seem to take time, so it is likely to be gradual and organic – not really direct or prescriptive.

# Does ethics change?

- Core values may not change.... But the situations we apply them in do.
- Key workplace issues now are not the same as they were 10 years ago.
- So the key tenants of our ethical culture need to be able to withstand the test of time.

# Social Responsibility

- Cambridge Dictionary - *"the practice of producing goods and services in a way that is not harmful to society or the environment."*
- Penn State University – *"covers the relationship between corporations (or other large organizations) and the societies with which they interact"*
- Collins Dictionary – *"the incorporation of ethical elements, such as the public interest and environmental concern, into the planning of business strategy"*

# Companies are trying to create a sense of Social Responsibility

- Volunteer Days → Elephanteering!
- Allowing people to give PTO for social causes

*Does your company do anything to create a sense of social responsibility?*

# AICPA Code of Professional Conduct

- New Format – December 15, 2014
  - 1 – Members in Public Practice
  - 2 – Members in Business
  - 3 – Other Members



# AICPA Code of Professional Conduct

- Conceptual Framework:
  - Identify Threats
  - Evaluate Threats
  - Identify Safeguards
  - Apply Safeguards



# Case Study

*You are the Controller of a small company in your hometown. Your company is undergoing its first financial statement audit. You find out from the CFO that a family friend is the audit partner in charge of the engagement.*

*Is this situation addressed by the AICPA Code of Professional Conduct?*

*Are there any ethical problems with this arrangement? If so, what?*

# Case Study – Conceptual Framework Approach

- 1. Identify Threats** – There is a threat that the auditor may not be objective and independent in giving their opinion.
- 2. Evaluate Threats** – How close is the auditor with the Controller? How long have they known each other? In what capacity have they known each other?



# Case Study – Conceptual Framework Approach

## 3. Identify Safeguards –

- Company rules regarding conflicts of interest
- Company Code of Ethics
- Board of Directors or Audit Committee Influence

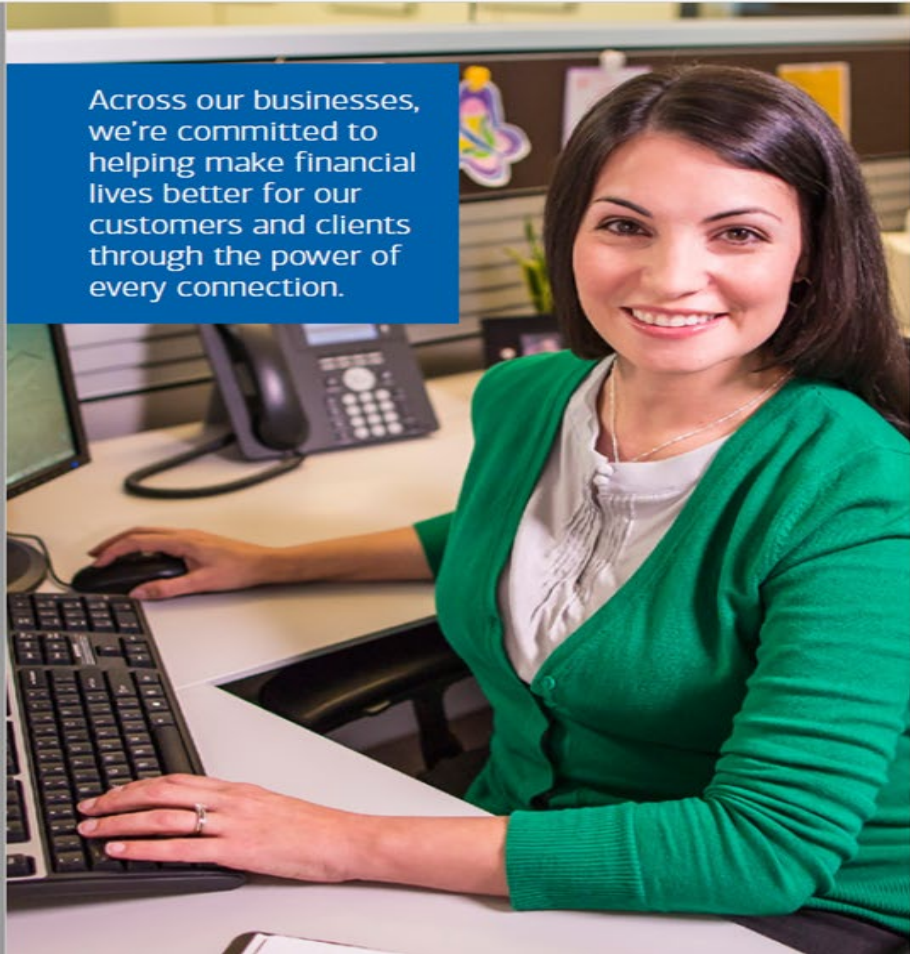
## 3. Apply Safeguards – Probably would apply nearly all of these.

# Discussion

*So the place to begin building your ethical culture is by figuring out your core values and how those are unique. How can you reinforce your core values? How do they show up in everyday situations? Is there a way to celebrate them?*



# Bank of America Values Statement



Across our businesses, we're committed to helping make financial lives better for our customers and clients through the power of every connection.

## Bank of America values

### Our values

Across our businesses, we're committed to helping make financial lives better for our customers and clients through the power of every connection.

Our values guide and inspire how we work together to serve our customers and clients, our shareholders and each other, helping us realize our purpose. To do this, we must:

### Deliver together

We believe in the importance of treating each customer, client and teammate as an individual and treating every moment as one that matters. We strive to go the distance to deliver with discipline and passion. We believe in connecting with people person-to-person, with empathy and understanding. We believe everything we do for customers, clients, teammates and the communities we serve is built on a solid business foundation that delivers for shareholders.

### Act responsibly

We believe that integrity and the disciplined management of risk form the foundation of our business. We are aware that our decisions and actions affect people's lives every day. We believe in making decisions that are clear, fair and grounded in the principles of shared success, responsible citizenship and community building.

### Realize the power of our people

We strive to help our employees reach their full potential. We believe that diverse backgrounds and experiences make us stronger. We respect every individual and value our differences—in thought, style, culture, ethnicity and experience.

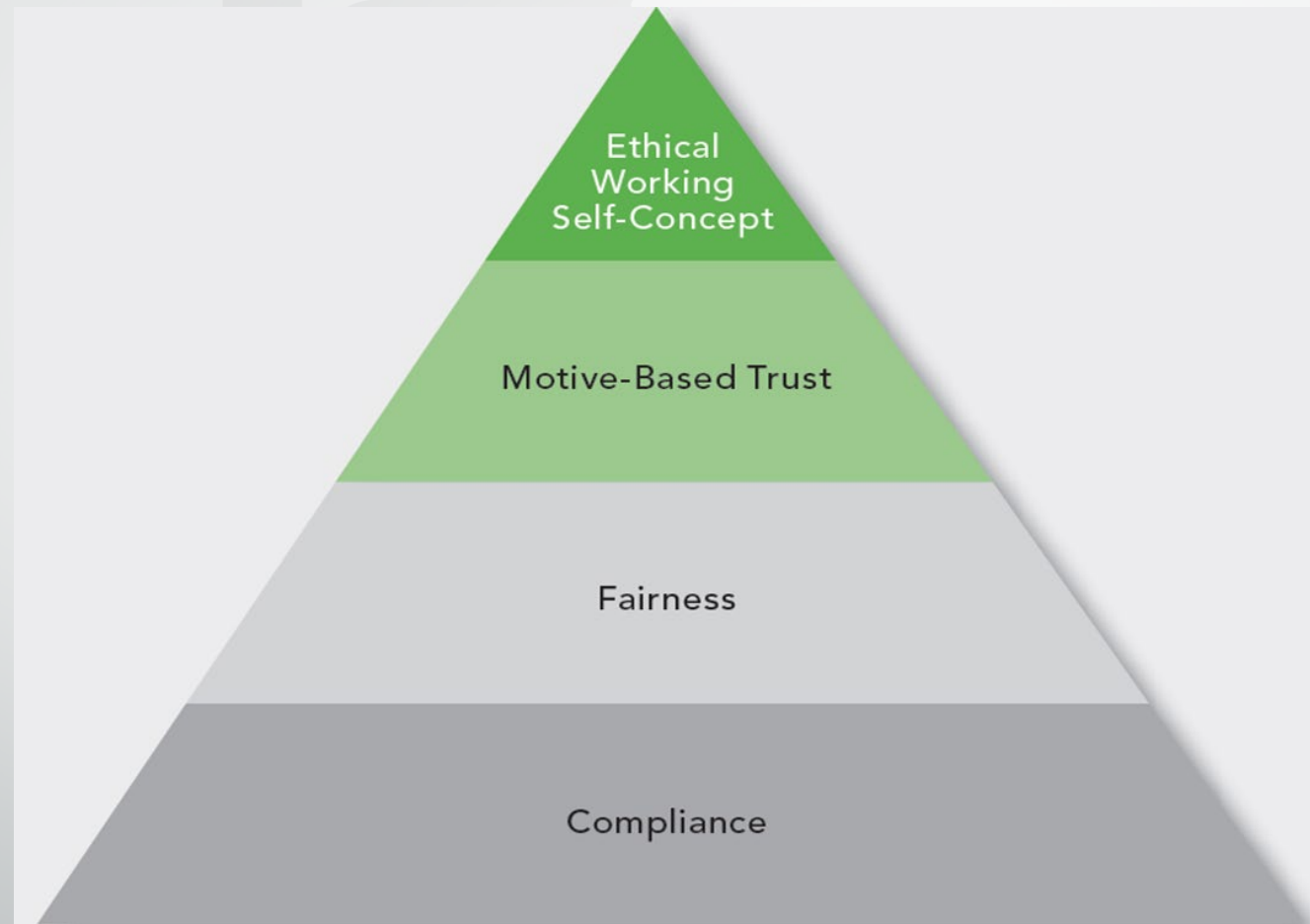
### Trust the team

We believe that the best outcomes are achieved when people work together across the entire company. We believe great teams are built on mutual trust, shared ownership and accountability. We act as one company and believe when we work together, we best meet the full needs of our customers and clients.

# So if I just regurgitate the AICPA Code of Professional Conduct onto a pamphlet, I am building ethical culture?

- Of course not.... You have to make it personal.
- **Think for a minute....** How does your code of ethics affect how you conduct business? Could you tell your employees about this somehow? How about your vendors? How about your investors?

# SHRM: Four Building Blocks of Ethical Culture



(SHRM Foundation, 2013)

# Exercise

- Take 2 minutes:
- If you were writing a code of ethics for a company from scratch, what would the key elements be? How would you start?





# Writing a Code of Ethics From Scratch

# What Influences Employee Behavior?



ORGANIZATIONAL  
BEHAVIOR

- Just having a Code of Ethics really doesn't do much.... It needs to be a living document.
- Tone at the top matters
- Day to day interactions matter
- Building trust among employees matter



# Highlights of Ethical Research – Journal of Accountancy Article (June 1, 2014)

- 1980s and 1990s companies were primarily motivated to have an ethics and compliance program to show that they were socially responsible and to guide employees' behavior
- Today's companies are more motivated by “doing the right thing” and by legal compliance

# Highlights of Ethical Research – Journal of Accountancy Article (June 1, 2014)

- Having Codes of Ethics is not enough to reduce opportunistic behavior by a manager or to increase investor confidence
- What is needed to accomplish both goals is to have managers publicly sign a statement that they will personally adhere to the code of ethics

# Key Takeaways about Employee Behavior

- If managers personally adhere to the code of ethics, employees likely will as well.
- The Code of Ethics needs to be a living document
  - Ethics committees
  - Ethics Hotlines
- A constant emphasis on doing the right thing can be powerful

# Building Trust in Organizations

- 1) Trust with generosity
- 2) Be patient & flexible
- 3) Be dependable
- 4) Be consistent
- 5) Be open



(Psychology Today, 2014)

# Building Trust in Relationships

- 1) Say what you mean, and mean what you say
- 2) Be vulnerable — gradually
- 3) Remember the role of respect
- 4) Give the benefit of the doubt
- 5) Express your feelings functionally, especially when it's tough
- 6) Take a risk together
- 7) Be willing to give as well as receive

(Psychology Today, 2018)

# Ethical Communication Builds Trust

- **Ethical Communication involves:**
  - Transparency
  - Congruence between words and actions
- **Ethical communication may be difficult to practice in high-stress situations, such as when employees are at odds with each other**

# Discussion

***What are the things that you can do right now to build an ethical culture?***

***What are the barriers to this?***

## Key Takeaways

Building an ethical culture is an iterative and constant process

Code of Ethics should be a living document

Code of Ethics should be part of a company's identity



# Review Question #1

**Which of the following is correct in regard to the relationship between ethics and financial success?**

- a) There is some evidence of positive correlation between ethics and stock price
- b) There are several academic studies showing strong positive correlation between ethics and financial success
- c) There are several academic studies showing strong negative correlation between ethics and financial success
- d) Ethics and financial success has never been the subject of academic study

# Review Question #1

***Answer choice A is correct. Academic studies on the relationship between ethics and financial success have shown mixed results, but there is some evidence of a positive relationship between perceived ethics and stock price.***

# Review Question #2

According to the Journal of Accountancy article from June 2014, which of the following is correct?

- a) Just having a code of ethics will reduce opportunistic behavior within a company
- b) Today's companies are not motivated by legal compliance when it comes to ethical practices
- c) Managers personally adhering to a code of ethics may lead to reduced opportunistic behavior and increased investor confidence
- d) Today's companies are more motivated to adopt a code of ethics, in order to guide employee behavior

## Review Question #2

***Answer choice C is correct. Just merely signing a code of ethics is not enough. By signing a code of ethics, managers show their commitment to ethics – which can result in reduced opportunistic behavior and increased investor confidence.***

# Review Question #3

**A section of the AICPA Code of Professional Conduct that is intended for those in public practice will begin with the number:**

- a) 1
- b) 2
- c) 3
- d) 4

# Review Question #3

***Answer choice A is correct. For those in public practice, sections will begin with a 1.***

# Review Question #4

Which of the following is NOT a step in the AICPA Conceptual Framework Approach?

- a) Identify Threats
- b) Identify Safeguards
- c) Score Risks
- d) Evaluate Threats

## Review Question #4

***Answer choice C is correct. While we are told to evaluate threats, we are not told specifically that we need score risks. Presumably, less formal methods may be used to evaluate threats.***



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