PRINCIPIA

The Ethics Study

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Special Edition: Ethics & Culture in
the Professional Services sector

Contents

About the research

The Ethics Study is our flagship programme of research on organizational ethics.

First published in 2021, the Ethics Study represents the most extensive global research programme on ethics in business. Informed by conversations with leaders across the world, our research provides unparalleled insight on why and how leaders are seeking to embed ethics and integrity at the heart of their organizations.

For this special edition of the Ethics Study, we have drawn on a decade's experience supporting clients across the professional services sector. During this time, we have worked with firms recovering from crisis to identify and remediate the root causes of ethical failure, and to rebuild stronger, more resilient organizations.

We have also been fortunate to work with leaders proactively seeking to build new approaches ethical leadership and ethical decision-making, to strengthen ethical culture, and to translate purpose and values into innovation and the development of AI and emerging technologies.

We are indebted to our many clients across the sector who have shared their challenges, aspirations, and strategies for the future. While we cannot hope to do justice to every conversation within the scope of this report, we hope that our research provides an instructive perspective on strategies to strengthen ethics and culture across the sector.

Foreword

Professional services firms are facing heightened scrutiny on ethics and integrity.

In the audit sector, high-profile failures have prompted regulators to call for urgent reform to safeguard market integrity.

In consulting, ethical lapses and complicity in widespread harms have begun to draw increased attention to the ethics of the industry.

And global law firms are feeling growing pressure from regulators and industry bodies to pay greater attention to ethical expectations from clients and the public.

Every firm across the sector is facing growing challenges. Competition is fierce and margin pressure intense. Firms face growing challenges in attracting and retaining talent: audit firms report declining interest among graduate job-seekers, while many law firms are struggling to stem a mid-career talent drain. Every ethical misstep makes these challenges harder.

At a systemic level, declining trust presents a significant challenge. A robust audit sector, backed by an efficient market for trusted legal advice and consulting expertise, is essential to the functioning of capital markets and the broader corporate sector. At a time when trust is at a premium, faith in the ethics and integrity of the sector has never been under greater threat.

In this Special Edition of the Ethics Study, the most extensive global research programme on ethics in business, we identify three types of challenge for the professional services sector, and identify how firms can rebuild trust.

We characterize the first set of challenges as "unforced errors", repeated breaches of regulatory or professional standards that continue to attract scrutiny from regulators.

Second, we identify a number of structural pressures inherent in the nature of a professional services partnership, each of which create underlying stresses in the system.

Third, we identify unavoidable tensions and trade-offs: those issues that can never be fully resolved, but require constant vigilance to maintain an appropriate balance between competing goals.

This report outlines the nature of these challenges and showcases leading firms' efforts to address them by reorienting around a clearer conception of societal purpose, values, and commitment to ethics and integrity.

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Ethics & Culture:
What's on the CEO & CHRO agenda?

Ethical culture

- Are our cultural norms and standards distinct from those at other firms?

- Which teams deviate from our cultural norms? Are these outliers susceptible to ethical risk?

- Do we share risk factors with firms that have experienced significant ethical failure?

- How do other firms measure and monitor the health of their culture?

Ethical leadership & decision-making

- Do our leaders understand the evolving expectations of their conduct and decision-making?

- How are shifts in workforce demographics influencing our expectations of leaders?

- What new skills and capabilities should we prioritize in leadership development?

- How can we mainstream discussions of ethics and culture throughout the organization?

Ethics & innovation

- Do we grasp the ethical questions and dilemmas that we face in the coming years?

- Are we incorporating ethics into our approach to new and emerging technologies?

- How do we ensure that our people are prepared to make ethical decisions on the use of AI?

Priorities for action

1. Benchmark the health of your ethical culture

- Ensure that surveys are built on a consistent, validated model of organizational culture.
- Invest in understanding correlations between culture metrics and business outcomes.
- Look beyond averages to understand outliers and microcultures.
- Make it every leader and manager's job to understand the health of their culture.

2. Engage your partners on new expectations of leaders

- Revise codes of conduct to emphasise new, non-negotiable expectations of leaders.
- Illustrate "grey area" ethical dilemmas with real-life examples.
- Share examples of failure, encouraging curiosity and reflection on systemic root causes.
- Reflect heightened expectations in due diligence on leadership appointments.

3. Provide safe spaces for your people to reflect and speak up

- Engage a third party to facilitate regular conversations on ethics and integrity.
- Equip leaders with the hard skills to solicit and receive challenge and dissent.
- Ensure that leaders can engage in dialogue, being transparent about tensions and trade-offs.
- Establish a network of trusted peers to enable people to raise questions and concerns.

4. Audit and strengthen existing approaches to ethical decision-making

- Review recent decisions to assess existing decision-making approaches.
- Engage with leaders to gauge their views on the effectiveness of decision-making.
- Seek independent support to work through the most challenging cases.
- Develop a decision-making framework that provides a structure and common language.

The challenge for professional services firms

Repeated failures to comply with legal and regulatory requirements have put the sector under intense scrutiny. Regulators are intensifying their focus on the role of culture in compliance, demanding that firms identify and address the root causes of failure. But culture and behaviour change initiatives will not succeed unless firms pay attention to the underlying tensions implicit in their business model.
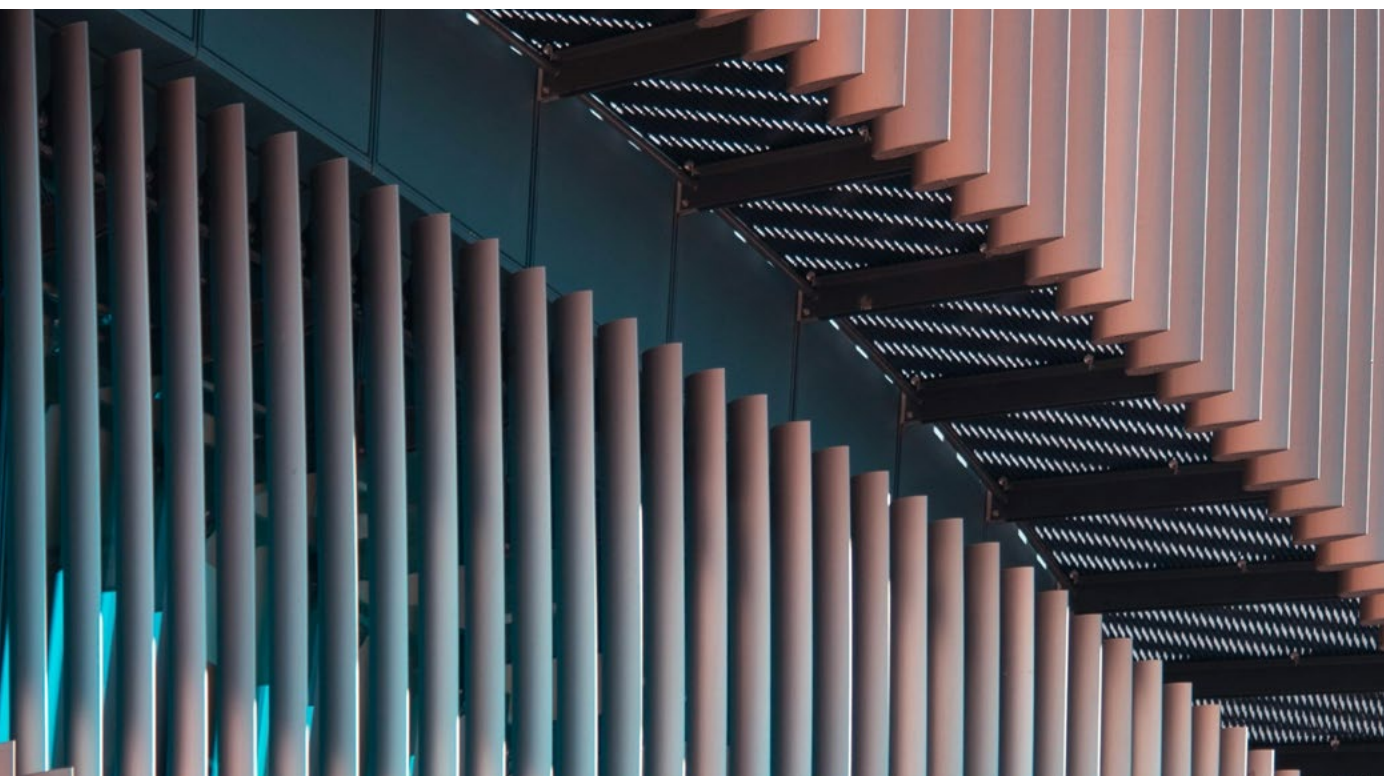
"Unforced errors"

One of the foundational responsibilities of leaders in professional services firms is to equip their organizations to act in accordance with the law, regulatory requirements, and professional standards.

At a minimum, firms are routinely expected to have in place sophisticated systems to ensure that they can reliably discharge their professional duties, as well as managing their responsibilities under "know your customer" (KYC) and anti-money laundering legislation.

But, particularly in highly regulated sectors, compliance with more stringent expectations can be far from simple.

The complexity of regulatory and professional standards, combined with the intricacies of managing compliance across a global network of partners and professionals, creates ample opportunity for "unforced errors" that draw regulatory scrutiny, impair reputation and trust, and can often lead to significant financial penalties.

The audit sector under fire

After a series of high-profile failures in recent years, the audit sector is under particular scrutiny. In the United States, fines levied by the Public Company Accounting Oversight Board (PCAOB) reached new highs in 2023, with enforcement action on audit quality imposing fines totalling nearly $12m.[1] In the UK, the government commissioned the independent Brydon Review into the quality and effectiveness of the audit sector, and have announced the intention to establish a new regulator – the Audit, Reporting and Governance Authority – with greater powers of oversight and supervision.[2]

In addition, the introduction of new disclosure rules by the PCAOB has prompted many of the Big Four audit firms in the US to self-report breaches of independence rules.[3] Data on independence violations is now routinely included in the PCAOB's inspection reports, and despite industry misgivings on the growing complexity of regulations, such breaches will continue to draw unwelcome attention to repeated failings to comply with fundamental regulatory requirements.

Perhaps more damaging for the reputation of audit firms has been the discovery of widespread cheating – or "answer sharing" – among audit professionals on ethics and independence exams required for professional certification. Regulators have uncovered instances going back to 2016 in multiple jurisdictions including the US, UK, Canada, Australia, and Hong Kong, suggesting a practice that had become widespread across the sector. While many firms have tightened their approaches to training and assessment to address the proximate causes of cheating incidents, fewer have fully understood and addressed the underlying root causes that created the cultural conditions in which cheating became endemic.

The role of culture in compliance

The response of the UK's Financial Reporting Council (FRC) underlines an important factor in firms' efforts to address exam cheating and other ethical failures. In a December 2022 letter to firms, the FRC highlighted that "the profession… needs to be vigilant and to seek to continually improve the processes and controls in place in this area. The profession must also strive to maintain a culture of integrity in which the highest standards of professional behaviour are upheld."[4]

The FRC's focus on culture reflects broader awareness among regulators that compliance depends not only on formal systems and controls, but on an environment in which inappropriate and unethical behaviours are identified and addressed: in the United States, the PCAOB announced in December 2023 that they would conduct a deep-dive review into the culture of six leading audit firms as part of routine inspections during 2024.[5]

Despite the clear call from regulators to take action on culture, real change has often been difficult to achieve. The majority of firms now have extensive culture change programmes focussed on the definition of values, or on defining expected behaviours of partners and professionals. But many leaders have been disappointed by the results, describing limited impacts on conduct outcomes, and a continued failure to prevent some of the more egregious ethical failures of recent years.

In the context of the complexity of the sector, and the tensions inherent in the way firms are governed and managed, it is perhaps unsurprising that surface-level initiatives have failed to change behaviour; the surest way to fail to change behaviour is to focus on behaviour itself.

Instead, firms are beginning to look more deeply at the structural factors that influence and shape behaviour, and the tensions and trade-offs they must manage in pursuit of long-term, sustainable success.

The role of culture in driving audit quality

Across the professional services industry, firms are stepping up their efforts to understand the links between culture and business outcomes. In the audit sector, growing regulatory scrutiny is demanding a particular focus on the cultural factors that can drive improved audit quality.

The links between firm culture and audit quality are the subject of growing interest from regulators. Taking their lead from prudential regulators across the financial services sector, many of whom are stepping up their oversight of risk culture and conduct risk, the PCAOB has identified firm culture as an inspection priority for 2024:

Increasing focus on a firm's culture of integrity and audit quality: Audit firms continue to face challenges delivering quality audits as evidenced by (1) the increasing trend of audit deficiencies in recent years and (2) deficiencies identified that have recurred for numerous years. We are interested in why these deficiency trends are not improving and whether audit firms' cultures are playing a role in this failure to improve.

PCAOB, "Spotlight: Staff Priorities for 2024 Inspections", December 2023

In setting its inspection priorities, the PCAOB notes that "to consistently execute quality audits, a firm's senior leadership needs to promote and embrace a culture of integrity and audit quality". While this tone at the top is undoubtedly important, audit quality also depends on a broader set of cultural characteristics that determine to what extent audit professionals possess the required knowledge, skills, mindsets, and attitudes to play their role in driving quality.

Over the last decade, Principia has worked extensively with audit firms across multiple jurisdictions. Our flagship service, the Independent Ethical Culture Assessment, has helped leaders to triangulate insight across quantitative, qualitative and systems maturity analysis to understand the cultural health of the firm, and how culture contributes to priority business outcomes.

Applying Principia's culture assessment methodology to the question of audit quality – including advanced analytics to examine correlations between audit quality and quantitative measures of cultural health through Principia's Ethical Culture Index – pinpoints several cultural factors that will be integral to the sector's efforts to improve audit quality:

Courage in challenging clients & superiors

Many firms have instituted extensive "speak up" programmes that equip people at every level with the confidence and skills to raise a hand with concerns. While these initiatives are often focussed on interpersonal conduct and behaviour, the ability to speak up is particularly important in fulfilling the professional obligations of auditors.

This applies within audit teams, through the ability to challenge established perspectives and innovate new ways to fulfil ever-changing regulatory expectations, as well as with clients, through the need to provide robust scrutiny and challenge.

Principia analysis shows a direct correlation between audit quality and people's confidence in challenging superiors: the speak-up skills honed through day-to-day interactions across audit teams are invaluable in fulfilling the duty of the independent auditor.

Psychological safety and the freedom to think differently

A related aspect of firm culture is the degree of psychological safety that people feel in thinking differently and offering alternative perspectives. A topic of increasing interest to regulators, psychological safety is critical in avoiding the groupthink that often afflicts teams made up of people with similar backgrounds and experiences.

For audit firms, these dynamics are particularly relevant. By virtue of the professional requirements among CPAs in the US, for example, graduate recruits into audit teams will often be drawn from a small group of colleges, with a resulting narrowness of social and economic backgrounds. The tendency to think in similar ways can be detrimental to a profession that demands the ability to question and challenge established systems and ways of working, whether with clients or within the audit team itself.

Across the sector, firms are already exploring ways to build people's comfort in challenging consensus and offering new and different perspectives. Many are focussing on embedding the belief that there are no "stupid questions," emphasizing an auditor's professional obligation to probe areas of potential concern until they have a full understanding. For leaders, this will mean role-modelling a willingness to ask awkward questions, as well as demonstrating patience and care in encouraging teams to learn through open dialogue and discussion.

Inclusion & respect

A new and recurring theme in firms' efforts to strengthen the capabilities of audit teams is a focus on inclusion and respect. Closely connected with the intent to build psychological safety, a focus on inclusion means ensuring that every member of the team, whatever their background and beliefs, feels equally welcome among their colleagues, and feels an equal sense of belonging to the firm.

While commitments to inclusion have become commonplace over the last decade, often supported by investment in DEI programs, employee affinity groups, and allyship campaigns, firms are only now beginning to monitor and track the impact on the core metrics of business success. Understanding the connections between people's sense of belonging and their ability to fulfil their professional responsibilities will help firms to ensure that inclusion is not seen as a peripheral activity but as a fundamental foundation in firms' long-term, sustainable success.

The challenge of remote & hybrid working

For every firm seeking to address the underlying cultural factors that influence audit quality, there is an additional challenge.

The transition towards remote and hybrid working has been a challenge for every organization, but its impacts are particularly visible in the audit sector. In an industry that has historically relied on an apprenticeship model in which junior auditors learn "on-the-job", the complexities of pivoting back towards in-person work are creating new challenges in building the skills of the next generation.

Even beyond deficits in technical skills, the loss of the traditional "audit room" culture is also presenting challenges in engaging newly-qualified auditors in understanding how their day-to-day work contributes to the broader objectives and responsibilities of the firm. In our discussions with younger auditors across multiple firms, there is a recurring sense of isolation, with limited visibility on how demanding workloads and highly complex work papers are contributing to broader goals. In this environment, people's sense of purpose and belonging — a core driver of conduct and behaviour — is already under threat.

To address this issue, firms will need to take a more structured approach to apprenticeship, including establishing stronger guidance and parameters on remote and hybrid working. This is unlikely to mean a return to full-time work in the office, but rather a more consistent approach that acknowledges the role of in-person, human interaction in building both technical skills and the broader understanding of auditors' professional obligations and responsibilities.

Towards a stronger audit sector

Efforts towards strengthening professional standards, as well as those targeted at culture and behaviour, show a consistent pattern: a focus on outcomes is rarely successful. Instead, firms need to identify the underlying drivers of the outcomes they seek, whether more agile innovation or more ethical and responsible conduct.

For the audit sector, the beginnings of this understanding are already in place. But further progress will depend on data-driven approaches that track material connections between specific aspects of firm culture and the resulting outcomes, as measured through a sustained improvement in audit quality over time.

Structural pressures

Many of the shortcomings observed among professional services firms in recent years have their origin in structural pressures inherent in the model of a professional partnership. Understanding these pressures is key to understanding the root causes of ethical failure, and to designing cultural interventions and structural changes that can promote ethical, responsible conduct and decision-making.

Cooperation versus competition

At the heart of every professional services firm is an underlying tension between cooperation and competition. Effective client delivery, for example, oftens depends on effective collaboration between different parts of the firm. A thorough audit may require specialist tax advice; reliable legal advice may demand expertise across multiple jurisdictions. But the structure of most firms creates an implicit "tournament" in which regions, member firms, and individual partners are pitted against one another in the race to the top.[6]

The notion of the firm as a tournament also informs analysis of a recurring cultural barrier, the reluctance to challenge peers and superiors.

In an industry where rapid progression is desired and expected – whether through the up-or-out culture of the leading strategy firms, or the race to partner that characterises the careers of mid-career lawyers – personal relationships are critical to success. Despite the efforts of many firms to introduce greater objectivity and transparency into the process, project assignments and promotion decisions are often highly dependent on the patronage of powerful partners and the maintenance of personal networks.

As a result, many firms are dominated by a passive-aggressive, "nice" culture that inhibits frankness and honesty between colleagues, and prevents emerging issues from being properly surfaced and openly discussed.

The challenge of "speak up"

In this environment, it is not surprising that root-cause analysis of ethical failures in the sector has often revealed major shortcomings in people's willingness to challenge and call out poor behaviour or questionable decisions.

Many firms have invested significant time and attention into strengthening a "speak up" culture that encourages people at every level to feel comfortable challenging peers and superiors. Some firms, recognising that the responsibility lies equally with leaders as with their teams, have also instituted training on how to solicit and engage with challenge and dissent.

But a lack of comfort in speaking up is often highly correlated to a lack of faith in the fairness of the systems that govern promotion, progression, and recognition. Without an equal focus on the systemic barriers to professionals calling out bad behaviour by others, poor behaviour will continue to go unchecked.

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Enabling scrutiny in governance

These challenges are particularly acute in structuring effective governance mechanisms. The partnership election model for the appointment of CEOs and Managing Partners may be rooted in a commitment to giving partners an equal voice in electing a first among equals, but have historically encouraged candidates to promote established interests over a commitment to tackling underlying challenges. Reforming leaders have often faced significant barriers to securing a second term in office.

Additionally, many firms are overseen by a board comprised of elected or appointed partners, who are often dependent on the firm's executive leadership team for their own career progression and opportunities. The result is often a supine, quiescent board who fail to exercise effective oversight, and whose authority is overshadowed by the power of the executive.

Recognizing the implications for effective governance, some regulatory jurisdictions have mandated the appointment of independent directors or supervisory boards.

But in an industry in which professional expertise and length of service are highly prized, it can be difficult for independent directors to establish a voice or credibility in challenging leaders who may have served many decades in the same firm.

Added to the challenge that many audit firms have experienced in securing capable independent directors that are permitted to serve under struct independence rules, firms across the sector face a significant challenge in establishing robust governance that can address some of the structural challenges they face.

Tensions and trade-offs

A third set of challenges for professional services firms involve unavoidable tensions and trade-offs that can never be fully resolved, but must be constantly held in balance.

Risk versus reward: the tragedy of the commons

For many firms, the most visible and highly-charged tension is the primacy of revenue, growth, and profitability over other objectives. In a partnership model, risks and rewards are unevenly distributed between individuals and the firm. A decision to accept a questionable client, for example, or to under-price and under-resource a client engagement in order to meet revenue and profitability targets, creates outsize risks for the reputation of the firm. But when these risks materialise, the penalty that falls on individual partners is often minimal.

Similarly, a root cause of many instances of ethical failure — and one cited by almost every firm in its analysis of the exam cheating issue — is the feasibility of expectations on people across the firm.

At senior levels, an arms race between firms has produced a pressure-cooker atmosphere in which partners and directors are held to increasingly ambitious financial targets.

At more junior levels, pressure on revenue and profitability filters down through the ranks, producing unreasonable expectations of productivity. Associates in many firms report expectations to generate utilization rates consistently in excess of 100%, with numerous accounts of utilization and client chargeability rates being used to determine those at risk of redundancy and year-to-year headcount reductions.

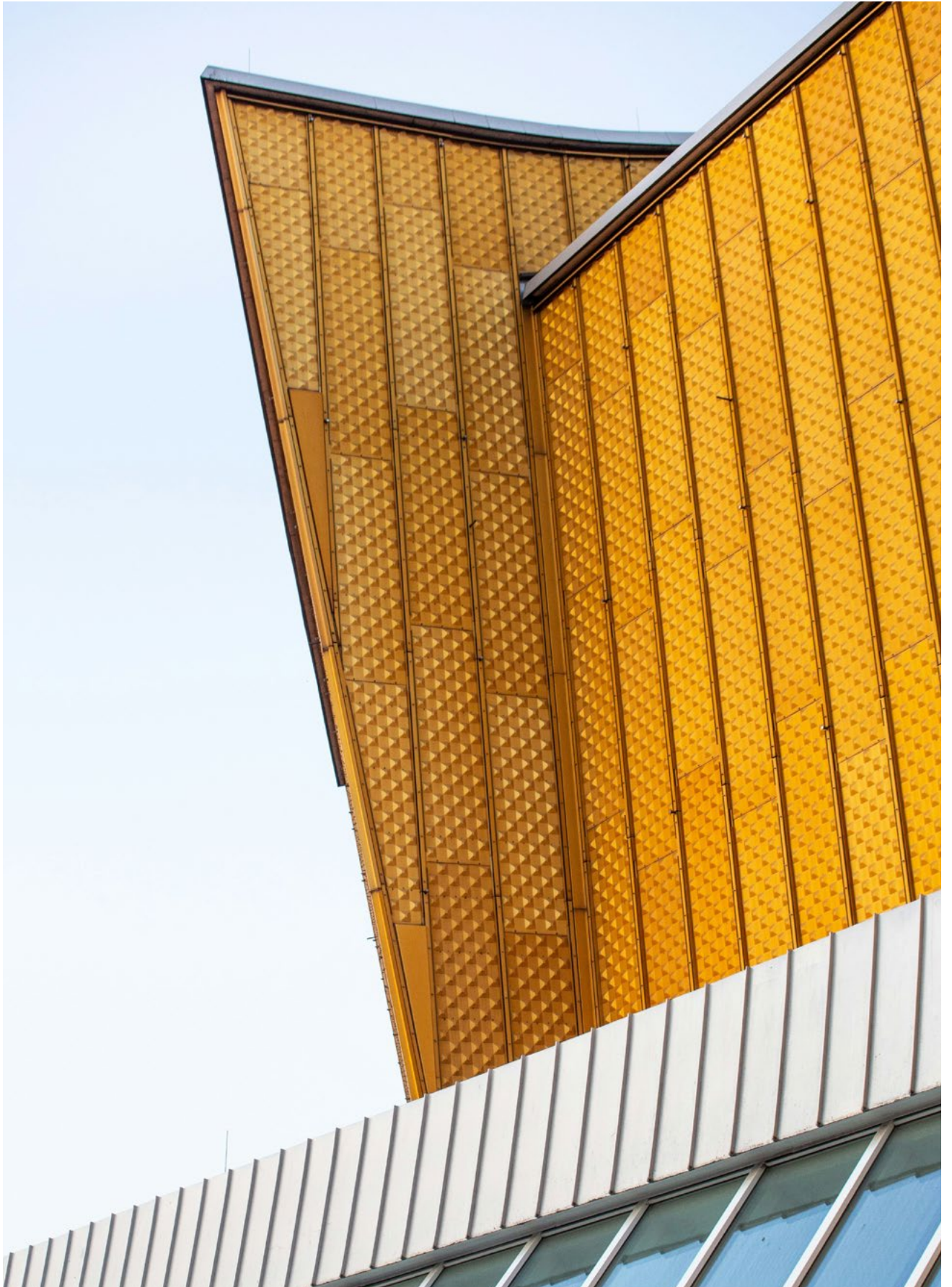## The feasibility of expectations

For an individual partner seeking to ensure the quality of client delivery, the timely provision of urgent advice, or the thoroughness of an audit opinion, the incentives are clear; for the firm and the sector as a whole, a generation of burnt-out partners and professionals with no time to rest and reflect is a recipe for failure.

At a time when the number of new entrants to the accounting profession is at its lowest level for nearly two decades, firms face a talent squeeze exacerbated by retirements and growing pressure on engagement margins. This pressure can often create unfeasible expectations of audit professionals, particularly during audit "busy season".

Professionals who are time-pressured or burned out are sometimes tempted to take shortcuts that breach conduct guidelines, or contravene the spirit — if not the letter — of the law. Often this is motivated by a desire to 'just get the task done' for their team or their client. Excessive time pressures also reduce the amount of time and bandwidth that partners and directors can spend with their teams to reinforce cultural and ethical norms through example and active discussion.

In many professional services firms, it is the audit business that experiences these pressures most acutely, raising the importance of measures that can address these pressures and maintain the integrity and trustworthiness of the sector.

But these tensions exemplifies the dilemmas faced by leaders in the sector. How much growth is too much? To what extent should leaders "tap the brakes" in boom times, comprising their ability to ride the inevitable downturn? And how can firms maintain quality and competitiveness while living up to growing expectations from clients, regulators, and the public?

Strengthening ethics and culture: the way forward for the professional services sector

It is one thing to understand the risks and opportunities that define the ethical landscape. It is another – often harder – task to know how to act. In last year's Ethics Study, two thirds (65%) of survey respondents identified the complexity of implementation as one of the greatest barriers to building an ethical organization.

Most leaders feel they have invested significantly in ethics in the past few years, but that there is a growing urgency to reimagine what 'good' looks like. They speak about the pressure of rising expectations and scrutiny, and the complexity of navigating tensions between different ethical commitments. All see the clear requirement to maintain and strengthen the basics of ethical conduct and culture to avoid risk. More varied is the appetite to position ahead of the curve and build new and leading capabilities, but a growing number of leaders see ethics as a source of competitive advantage – and are initiating acts of leadership that set them apart.

In this report, we have built on the findings of the Ethics Study to offer a deeper dive into how leading professional services firms are approaching the ethical challenges they face. We have drawn on many conversations with firms across the sector, as well as our own experience working with leaders to determine which issues to lead on, live up to their ethical commitments, and integrate action and ethics and culture across the entire organization through a single 'golden thread'.

1. Actively manage your ethical culture

Why?

Ethical culture underpins conduct and decision-making at every level of the firm. It is the cultural environment that can support professionals to recognize ethical issues in their day-to-day work, and to act appropriately.

But ethical culture has often been perceived to be amorphous or intangible. While many firms have instituted some form of engagement or culture survey, few have identified the most meaningful predictive metrics that can provide a quantitative, evidence-driven foundation to monitor the health of ethical culture.

How?

Leaders should start by making the concept of "culture" concrete, identifying the specific drivers that support ethical conduct and decision-making. This understanding should then flow through into two distinct areas of responsibility.

The first sits at the centre – often with HR and People teams – and requires the development of measurement and monitoring approaches that go beyond the traditional annual engagement survey. Firms are increasingly adopting sophisticated analytics-based solutions that can provide an up-to-date perspective on the strength of ethical culture, and provide insight into the strengths and weaknesses in each part of the firm. By identifying the culture metrics that are most highly correlated with business outcomes – from revenue growth and profitability to the incidence of audit quality issues or professional misconduct – leaders can heighten their focus on the most material drivers, and build the data required to serve as an early-warning system for emerging ethical risk.

KPMG Australia, for example, has adopted Principia's Ethical Culture Index to monitor the health of ethical culture, identify strengths and vulnerabilities, and track the impact of culture change initiatives (see "Assessing & Strengthening Ethical Culture").

The firm routinely includes selected ECI metrics in the firm's Impact Plan Scorecard to demonstrate tangible progress on priorities related to conduct and culture.[7] The scorecard tracks employee sentiment on questions such as "People can challenge their leaders without fearing negative consequences" and "People can report unethical practices without fear of any negative impact", indicators critical to understanding the strength of ethical culture.
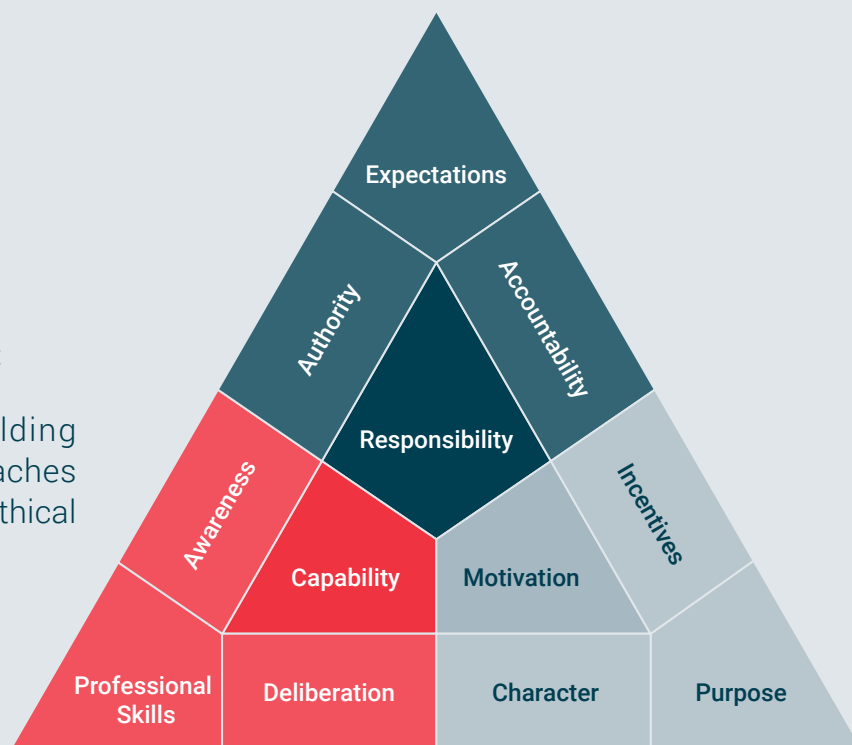
The second responsibility is distributed across every partner and manager across the firm, and requires every individual to take accountability for their role in building and maintaining a strong ethical culture. While regulators have typically focussed on "the tone at the top", the tone in the middle is equally important. Experience shows that while the CEO and senior partners are critical in setting expectations, the most influential factor in shaping day-to-day conduct and behaviour is the example set by first-line leaders and managers. In an increasingly complex landscape, translating abstract expectations into concrete action depends on demonstrating ethics in action.

HR and People teams can support this endeavour through providing timely, actionable insight on the health of ethical culture, together with practical interventions that enable leaders to address emerging risks. Culture change does not have to be the product of annualised, organization-wide transformation, but can take flight in targeted, team-level conversations.

Equipping leaders with a common language to talk about ethics in day-to-day interactions is a critical first step. Both from an interpersonal and a business perspective, leaders can engage their teams to understand what good looks like, and where risks may emerge. For many leaders, signalling the openness to talk about ethical risks and dilemmas can send an important signal to their teams, that professional ethics is not simply a question of black-and-white compliance – or good versus evil – but a constant balancing act that requires deliberation and judgement.

Assessing & Strengthening Ethical Culture

Many firms are now building more sophisticated approaches to assess and strengthen ethical culture across the firm.

Principia's Ethical Drivers Model identifies the core elements of the ethical organization. Drawn from three decades of academic research, the model pinpoints the cultural factors required to align conduct and decision-making with purpose, values, and ethical commitments. The Ethical Drivers Model and its employee survey tool, the Ethical Culture Index, provide a powerful diagnostic to assess the critical drivers of ethical culture and conduct.

Principia's Ethical Culture Index (ECI) is one such approach. Drawn from three decades of academic research on the drivers of organizational behaviour, the ECI identifies the elements required to consistently reinforce ethical conduct in line with established purpose, values, and commitments.

Based on a quantitative employee survey, and integrating qualitative elements through interviews and focus groups, the ECI provides a powerful diagnostic to assess and enhance the critical drivers of ethical culture and conduct, tracking the strength of ethical culture across three key drivers: Responsibility, Capability, and Motivation.

Responsibility

For an effective ethical culture, individuals must have clearly-understood responsibilities for their role in helping the firm to meet its ethical obligations and commitments.

Authority: The ECI examines the strength of *authority* structures, looking at the clarity of ownership for decisions, leaders' openness to challenge, and the ability of people at every level to raise concerns or offer alternative perspectives. In our Professional Services sector benchmark dataset, incorporating a global sample of nearly 500 companies across the accounting, audit, consulting, and legal professions, one of the lowest-scoring dimensions of ethical culture is people's confidence in challenging superiors.

In a sector where personal relationships are paramount, firms need to pay particular attention to creating an environment in which people who speak up are not only listened to, but respected and valued.

Expectations: Second, the ECI looks at the clarity and feasibility of *expectations* with respect to conduct and decision-making, and the effectiveness of leadership communications on ethics and integrity.

Our benchmark suggests that while firms have made significant progress on outlining expectations of conduct and behaviour, there remains work to be done in ensuring that people are not exposed to pressures — whether through financial targets, time pressures, or resource scarcity — that make these expectations unfeasible.

Accountability: Last, *accountability* examines the degree to which misconduct or unethical behaviour is discovered, investigated, and resolved through appropriate sanctions. In this area, our sector benchmark suggests growing confidence that firms uncover and investigate misconduct appropriately, but people still have concerns on the fairness of resolution and sanctions. In particular, there is a widespread feeling across the sector that unethical behaviour by "rainmaker" partners may be overlooked. Concerns over fairness also reflect a widespread reluctance to speak openly about sanctions, with associates in one firm referring to the phenomenon of "alien abductions" when partners would suddenly leave the firm with no explanation.

Capability

Once decision-making responsibilities are defined, people must also have the relevant capabilities to discharge those duties appropriately.

Professional Skills: The ECI quantifies perceptions of *professional skills* and expertise across the firm, looking at how the firm recruits, trains, and brings together people with the right skills for the job at hand.

This is one of the highest-scoring drivers in our sector benchmark, with most believing that their organization performs well across each of these dimensions.

One concern that is sometimes aired is the degree to which leadership appointments are genuinely based on merit, rather than personal relationships, political dynamics, or reward for long service.

Awareness: The ECI also examines people's level of ethical *awareness*, the degree to which they understand the impact of their decisions and behaviours. This is one of the lowest-scoring drivers in the sector benchmark, underlining the need for continued focus on ensuring that partners and professionals have the appropriate understanding of how ethics and integrity is relevant to their day-to-day role and decisions. In particular, the benchmark highlights two areas for attention. First, the ability to build teams with a diversity of viewpoints and perspectives, enabling them to avoid groupthink, challenge consensus, and anticipate ethical questions and dilemmas. And second, the commitment to openly discussing things that go wrong, and building the institutional memory that can raise people's awareness of ethical risks and potential missteps.

Deliberation: Last, the ECI looks at people's capabilities in ethical *deliberation* to resolve highly-charged questions and ethical dilemmas. The benchmark suggests that this is an area that requires further work to properly embed ethical decision-making capabilities across the firm. This is the focus of many current initiatives, particularly among L&D teams seeking to move beyond compliance-focussed ethics training and towards engagement with real-world scenarios that demand deliberation and judgement. Our experience suggests that this is often best achieved through live, leader-led sessions that encourage people to confront and analyse ethical grey areas in their own area of practice, and avoid the notion that ethical dilemmas have an easy solution that is simply waiting to be discovered.

Motivation

Incentives: Understanding whether people across the firm are motivated to act ethically – or whether there are factors that encourage irresponsible behaviour – depends on assessing the structure of *incentives*. This includes "hard" incentives such as compensation and bonus schemes, as well as "softer" factors such as the qualities that are recognised and valued by the firm.

This is the lowest-scoring driver in our sector benchmark, suggesting that shifting expectations on ethical conduct and behaviour have not yet been embedded into the systems that govern performance management, progression, and compensation.

Character: The ECI also examines the firm's efforts to shape the *character* of its people through cultivating common values and behaviours, and the role of principles in shaping a sense of collective responsibility for ethics and integrity. For the most part, the benchmark shows that people are positive about their working environment and their relationships with colleagues, but often believe that more could be done to embed a sense of individual and collective ownership for upholding the values and principles of the organization.

Purpose: Finally, the ECI quantifies the strength of common *purpose*, understanding to what extent the firm's purpose is clearly defined and embedded as a foundation for ethical conduct and decision-making. The sector benchmark shows that this is one of the weakest drivers for many firms, with a poor understanding of the purpose of the firm itself, and of the connection between the firm's purpose and individuals' day-to-day role. Purpose is also a demonstrably powerful driver of conduct and behaviour: our work with one firm in the United States showed that people's understanding of the connection between their role and the firm's purpose was the single most accurate predictor of conduct outcomes.

2. Develop widespread employee engagement with ethics

Why?

Leaders in every sector are clear that rules alone are insufficient to support ethical conduct and decision-making. The strength of an organization's ability to act ethically is dependent on the extent to which people understand broader expectations and are equipped to make judgement calls when the right thing to do is not clear.

Across the professional services sector, leaders identify a need to enable people across the firm to identify the ethical issues in their work, and to understand the expectations of their conduct and decisions. Building ethical awareness through a deeper understanding of the reasons behind professional standards and the behaviours expected by the firm can help professionals to take ownership of their behaviour, without the need to resort to a "zero tolerance" approach dominated by threats and sanctions.

How?

A growing number of firms across the sector are investing in learning and development programmes that go beyond the "box-ticking" approach of many traditional ethics and compliance programmes.

EY's Global Code of Conduct draws on the shared values of the firm to provide an ethical framework to guide the decisions of people at every level. Anchored in the firm's purpose, values, and ambition, the code emphasises individual responsibility and accountability for structured, reflective decision-making when faced with complex and challenging choices. In the US, the firm recently established a new C-level role of Chief Ethics and Compliance Officer, responsible for developing a culture of compliance and a focus on integrity.[8]

KPMG hosts a global Values Week that brings together more than 260,000 colleagues from across the world to spotlight examples of the firm's values in action. The global focus is supported by Values Immersion sessions led by local leaders that provide guidance and practical exercises to help their people to live the values of the firm in real-world situations, empowering them to use their own judgment and discretion to navigate ethical grey areas.[9]

Similarly, many firms are beginning to create dedicated spaces for open discussion on ethical dilemmas and challenges, with a focus on anticipating grey-area decisions, learning from past failures, and reinforcing a culture where people feel encouraged to speak openly about challenging ethical issues.

In 2023, KPMG Australia rolled out its ethical decision-making framework to all partners and professionals, providing an easy-to-use, evidence-based, and standardised approach to making ethical decisions. The framework equips KPMG's people to recognise an ethical issue, identify options, and reach an informed decision informed by the firm's values and ethical commitments. In addition, more than 200 of the firm's most senior leaders participated in a facilitated workshop to provide hands-on practical experience with the framework and enable them to role model ethical decision-making to their teams. At the same time, the firm also launched its Ethics Champions Network, a network of trusted employees that provide colleagues with access to peer support and guidance on ethical decision-making.[10]

3. Develop new people leadership skills and behaviours

Why?

Rising expectations of business demand leaders with qualities that have not necessarily always been at the top of the list in professional services: empathy, authenticity, and emotional intelligence.

In a sector where experience and technical expertise have typically been the most highly-prized attributes, people now expect leaders to be visible role models for a values-driven organization in which the *how* is as important as the *what*. Throughout the firm, younger professionals are looking to partners to proactively build an environment where it feels safe to raise an ethical concern, challenge a mainstream opinion, ask for help, or admit a lapse in judgement.

How?

Ethical leadership is increasingly a focus for talent teams across the sector. Many firms are establishing forums for leaders to listen to the perspectives of different groups and constituencies across the firm. In the era of remote and hybrid work, which has reduced the opportunities for serendipitous exchanges beyond individuals' team, function, or peer group, these forums have become particularly important in equipping leaders to engage with alternative opinions and perspectives.

Importantly, these exchanges cannot be one-way. While most leaders are increasingly aware of the need to avoid "broadcast" mode, they must also avoid the temptation to simply listen without engaging and taking action. To generate productive engagement, leaders must be seen to engage in genuine dialogue, being honest about tensions and trade-offs, and – where necessary – advocating for unpopular positions and decisions.

Both in these forums and in routine team meetings, firms are also strengthening their expectations of leaders to facilitate open discussions and debates on ethical issues. After a significant ethical issue in its audit practice, one US firm mandated every office managing partner to begin monthly town hall meetings with an example of an ethical dilemma that they had faced. By sharing examples of "grey area" decisions – with an emphasis on those where they felt genuinely conflicted, or even regretful of the decision they made – partners were encouraged to demonstrate openness and humility in the face of complex ethical challenges. The impact was immediate, with an upsurge in people's willingness to discuss ethical issues, seek advice and guidance, and admit to mistakes.

Firms are also embedding new expectations by strengthening their approach to leadership appointments. While leadership performance evaluations have often included an element of 360° feedback, more and more firms are making conduct expectations more explicit, and paying greater attention to behavioural factors in determining candidates for promotion, progression, and election to the partnership, as well as in determining partner performance and compensation. In the UK, KPMG has introduced a balanced scorecard for all partners which measures performance across four pillars including Building Trust.[11]

Importantly, regulators are increasingly stepping up their attention on the quality of leadership and its implications for firms' ability to act ethically and responsibly. The Solicitors Regulation Authority (SRA) has recently issued updated guidance on firms' obligations regarding the workplace environment, setting out the potential for enforcement action should leaders be shown to have created an environment in which unethical behaviour can flourish, or where staff cannot raise concerns.[12]

4. Define why, when, and how to take a stand

Why?

Growing expectations on business to take a stand on social, political, and sectoral issues have created significant challenges for leaders.

In the professional services sector, many of these expectations come from a young, socially-engaged workforce looking for their employer to reflect their values and priorities. While these expectations include workplace issues such as diversity, equity, and inclusion, they also incorporate questions on the firm's public stance on controversial issues.

While some have embraced a higher-profile role for corporate leaders in shaping the public debate, others feel that they have unwittingly created unachievable expectations to exert their influence on every passing issue.

Increasingly, leaders are looking to move beyond a reactive approach by defining those issues on which the firm will take a public position. This may often involve disappointing expectations: not all expectations are reasonable and some will be conflicting, so leaders are increasingly seeing the need to define clearly where they will take a lead in line with the company's purpose and commitments.

How?

Professional services firms are increasingly seeking to define those issues on which they can have a material impact, and those which will have a material impact on their business. As a major employer – the Big Four firms alone employ more than 1.5m people worldwide – the sector should reasonably be expected to have well-developed positions on diversity, equity, and inclusion, and to have commitments to building a safe, supportive, workplace for all.

Other areas of focus follow naturally from firms' professional expertise. The legal sector has an important role to play in shaping future legislation and regulation, and in providing advice – both solicited and unsolicited – to executive and legislative authorities. Similarly, by virtue of its role in safeguarding the integrity of capital markets, the audit sector may be expected to have a well- evidenced position on corporate governance, and a voice in shaping governmental and regulatory approaches to guidance and supervisory priorities.

Leading law firm Baker McKenzie organizes its environmental, social, and governance goals according to prioritised Sustainable Development Goals (SDGs). By linking the firm's activities and impact to relevant SDGs, Baker McKenzie ensures that the firm focusses its efforts on the most material impacts of its business, and prioritises issues on which it can have the most influence. By focussing its efforts, the firm look to strengthen and consolidate performance year on year.[13]

Other positions may arise from exposure to specific issues, or from individual conviction on the influence that a high-profile firm can have. Professional services firms have historically focussed attention and resources on issues ranging from social mobility to deforestation. But the essential role of leaders is to establish parameters by which firms can deploy their influence and expertise most effectively, and to ensure that decisions are made in a way that reflects more than simply individual preference or preoccupation.

To help the firm focus its efforts on the most material topics, Deloitte has established its World Impact Council. With members drawn from the global board and executive committee, as well as more junior members of the firm selected from the firm's participants in the One Young World program, the council seeks to identify the most relevant risks and opportunities that shape Deloitte's approach to environmental, social, and governance issues.[14]

As part of its broader commitment to responsible business, leading global law firm Clifford Chance publishes its materiality matrix that identifies the topics that are most important to stakeholders, and those with the greatest significance for Clifford Chance itself. The results inform the firm's reporting priorities, as well as efforts to embed responsible business practices across every part of the firm, led by its new Responsible Business Board.[15]

For every firm, a clear ethical stance gives leaders a coherent position from which to meet, respond to – and in some cases reject – expectations from others, and to ensure that efforts are properly focussed on the most salient and material issues.

5. Build awareness of ethical issues on the horizon

Why?

In recent years, fast-moving events such as the COVID-19 pandemic and the Russian invasion of Ukraine each posed fundamental questions for professional services firms. Thinking about the future enables organizations to anticipate ethical challenges and to build capabilities for reacting quickly to the unexpected. While traditional risk management approaches can address known risks and issues, creative thinking is increasingly required to enable leadership teams to "think round corners", identifying the pressures that may confront the sector and the firm in the coming years.
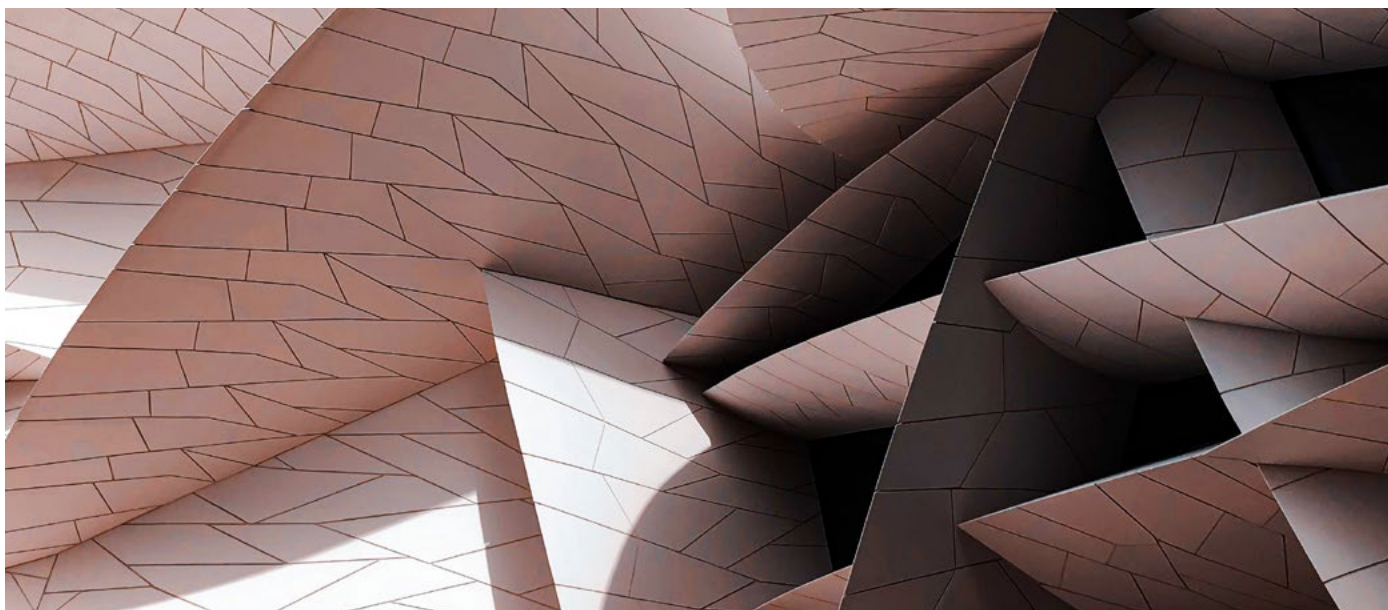
How?

Leading firms are beginning to adopt best practices from other industries, such as the energy and technology sectors, in employing futures methods to anticipate future developments and trends.

These methods focus on broadening leaders' horizons to consider not just what is likely, but what is possible in the development of the sector over decades, including defining issues, potential disruptions, and factors that may be critical to navigating a shifting competitive environment while safeguarding integrity and trust.

Working with futures experts and specialist facilitators, boards and leadership teams are increasingly setting aside time to step out of the day-to-day to consider events that may result in rapid, radical change, or "black swan" events that may force leaders in rapid responses on highly-charged issues.

Hypothetical scenarios can test the agility of leaders' responses, as well as identifying areas of consensus and disagreement on how the organization should respond. As leaders build the muscle of anticipating and responding to complex dilemmas, firms are laying the foundations of a more agile, consistent, and transparent response to future volatility.

There is also an important role for industry and professional associations to examine the future of their sectors, and the implications for firms and individual practitioners. In 2022, the International Bar Association's Legal Research & Policy Unit launched the Gatekeepers Project, a consultative exercise to examine the future of lawyers' ethical responsibilities and obligations.[16] The project will seek to answer emerging questions on the core values of the legal profession, and address growing critiques on the relevance of existing professional guidance and standards.

Next steps for leaders

Across the sector, the complexity of the challenge on ethics and culture can make it challenging to know where to start. And in complex global firms, finding the right levers to drive change is not always easy. Drawing on a decade's experience supporting professional services leaders, we identify four immediate actions:

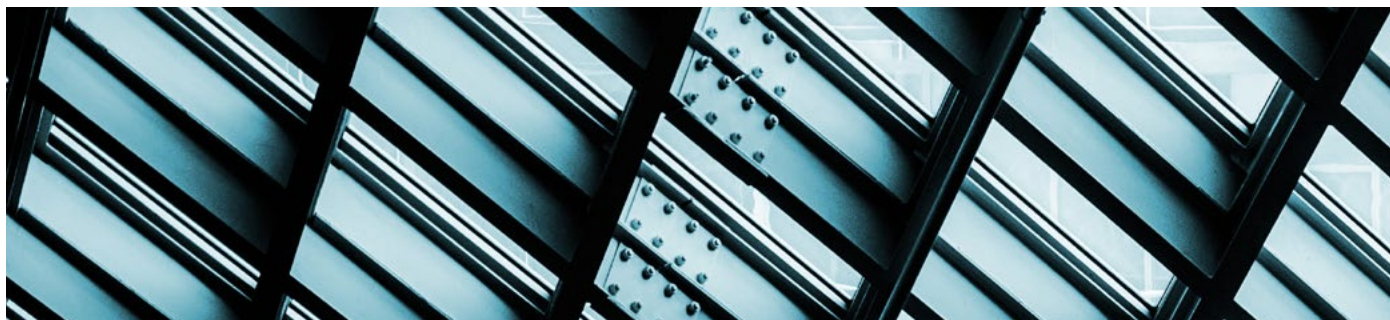## 1. Benchmark the health of your ethical culture

The health of your culture will determine the extent to which your people are able to act ethically and responsibly. But for most firms, existing culture data is not fit for purpose: data tends to be patchy and fragmented across multiple surveys, with limited understanding of the connections between culture and business outcomes. To address this challenge, leaders should:

- Ensure that surveys are built on a consistent, validated model of organizational culture that incorporates the material factors that influence conduct and decision-making.

- Invest time in understanding the most material correlations between culture metrics and business outcomes, enabling greater focus on the most predictive indicators.

- Look beyond averages to understand outliers. Microcultures are a source of risk for every firm; be systematic in identifying and addressing them.

- Make it the job of every leader and manager to understand the health of their culture, paying attention to shifting dynamics and taking responsibility for change.

2. Engage your partners on new expectations of leaders

Expectations on leaders are changing fast. But without a clear expectation to change, many partners will continue to do what has made them successful in the past. Leadership development programmes must be coupled with unambiguous expectations and individual accountability for conduct and decision-making.

- Revisit codes of conduct to emphasise non-negotiable expectations of leaders that go beyond the black-and-white of regulatory compliance and professional standards.

- Engage partners through real-life examples of ethical dilemmas, illustrating the ethical grey areas that leaders must navigate through exercising moral judgement.

- Share examples of misconduct and ethical failure, encouraging curiosity and reflection on systemic root causes as well as the actions of individuals.

- Reflect heightened expectations on conduct and behaviour through more stringent due diligence for partner election and leadership appointments.

3. Provide safe spaces for your people to reflect and speak up

Too often, honest conversations only take place in the aftermath of a crisis. Proactively building a speak-up culture in which people can share emerging concerns, or contribute new ideas, can provide opportunities to identify the early signs of impending failure.

- Engage an independent third party to facilitate regular conversations on ethics and integrity. People will rarely share their experiences and emotions as frankly in-house.

- Equip leaders with the hard skills to solicit and receive challenge and dissent, as well as in how to engage constructively in highly-charged or emotional conversations.

- Ensure that leaders do not get stuck in "listen-only" mode. Leaders must engage in genuine dialogue, being honest about ethical tensions and trade-offs.

- Establish a network of peers (such as an Ethics Champions network) to enable people to informally raise questions or concerns and seek guidance from trusted colleagues.

4. Audit and strengthen existing approaches to ethical decision-making

Decisions with an ethical dimension are often the most challenging for Boards and executive teams. Many teams lack a common language to debate ethical issues constructively, and highly-charged issues can exacerbate challenging dynamics that already exist among the team.

- Review examples of complex or "highly-charged" decisions to ascertain the effectiveness of existing decision-making approaches.

- Engage individually with leaders to understand their views on the effectiveness of decision-making, including the inclusiveness of the process.

- Seek independent support to work through the most challenging cases, paying attention to interpersonal and group dynamics that may be heightened under pressure.

- Develop a decision-making framework that provides a structure and common language to debate ethical issues, bringing agility, consistency, and transparency to decisions.

Footnotes

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Acknowledgments

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