BUSINESS SUSTAINABILITY, CORPORATE GOVERNANCE, AND ORGANIZATIONAL ETHICS

Zabihollah Rezaee
with Timothy Fogarty

WILEY

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This book is dedicated to Dr. Rezaee's parents Fazlollah and Fatemeh, sister Monireh, wife Soheila, and children Nick and Rose

and to Dr. Fogarty's wife Susan, son Joe, and daughter Kate.

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Preface

Business sustainability, corporate governance, and organizational ethics are taking center stage in the global business and academic communities. With its accreditation, the Association to Advance Collegiate Schools of Business (AACSB) has noted that these topics are gaining the global acceptance and attention of business schools worldwide. Adequate coverage of these important topics will enable business schools and accounting programs to sufficiently and effectively train competent and ethical students to become future business leaders. Business sustainability focuses on economic, governance, social, ethical, and environmental (EGSEE) performance in creating shared value for all stakeholders. Business sustainability information is now demanded by investors, required by regulators, and reported by business organizations. Organizations worldwide report their integrated financial and nonfinancial sustainability performance in creating shared values for all stakeholders from shareholders to customers, suppliers, creditors, employees, environmental agencies, government, and society. Several professional organizations, including the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), the International Integrated Reporting Council (IIRC), and the Corporate Reporting Dialogue (CRD), have issued numerous sustainability reporting and assurance guidelines to assist business organizations in disclosing their financial and nonfinancial sustainability performance information to all stakeholders. As the book was going through production, the Business Roundtable, On August 19, 2019, announced the adoption of a new Statement on the Purpose of a Corporation, signed by 181 well-known, high-powered CEOs. The Statement indicates “moves away from shareholder primacy” as a guiding principle and outlines in its place a “modern standard for corporate responsibility” that makes a commitment to all stakeholders under stakeholder primacy, and advocates the concept of profit-with-purpose mission for public companies.

Corporate governance is also considered one of the themes of the twenty-first century in determining the roles, responsibilities, and accountability of all corporate gatekeepers from the board of directors to management, regulators, standard-setters, internal auditors, external auditors, legal counsel, and financial advisors and fund managers in contributing and adding value to corporate success and sustainable performance. Organizational ethics encompass the principles and standards of behavior and best practices that guide organizational decision making and provide the framework for individuals within the organization to do the right thing. Increasing expectations around business sustainability, corporate governance, organizational ethics, and accountability for all types and sizes of entities appears to be an international trend. Business schools can serve as a conduit to produce and transfer knowledge about business sustainability, corporate governance, and organizational ethics to ensure a more sustainable future education that contributes to the well-being of society. Business schools worldwide play an important role in preparing the most competent future business leaders who understand corporate governance and business sustainability, and conduct their businesses ethically. Furthermore, these three emerging educational areas of business sustainability, corporate governance, and organizational ethics are aligned with the AACSB’s core values, guiding principles, and the desired dimensions of engagement, innovation, and impact. Thus, these special topics deserve proper attention and coverage in the business and accounting curricula.

This book is the first to present a comprehensive framework of the theory and practice of business sustainability, corporate governance, and organizational ethics education. Currently, more than 450 courses and programs in business sustainability, corporate governance, and organizational ethics are being offered by colleges and universities worldwide and there are more than 200 business sustainability, ethics, and corporate governance research centers at high-profile universities worldwide. More universities are expected to offer stand-alone courses and programs and research centers on business sustainability, corporate governance, and organizational ethics. This book provides students with the knowledge and organizational and personal skills to become successful business leaders, and is intended to be used at both undergraduate and graduate levels. It takes a holistic teaching approach, focusing on the value-adding roles of all participants in the corporate governance process who share the collective responsibility of creating shareholder value; protecting interests of other stakeholders; complying with all applicable laws, rules, regulations, ethics standards, and best practices; and producing reliable, transparent, and high-quality financial information. This book can be used in a three-credit-hour course at the undergraduate, graduate, and/or both levels, as it is designed to develop an awareness and understanding of the main themes, perspectives, frameworks, and issues pertaining to corporate governance, organizational ethics, and business sustainability. Alternatively, different modules of the book can be used individually in a variety of undergraduate and/or graduate accounting and business courses.

This book is a highly pertinent reference for all business schools and other college programs that offer business sustainability, corporate governance, and organizational ethics education, as well as for professionals who need an up-to-date understanding of emerging areas in business. There is currently no other comprehensive book that covers all these emerging and important contemporary issues of corporate governance, organizational ethics, and business sustainability. Straightforward language illustrates theoretical and practical concepts and procedures to aid comprehension of complex corporate governance and business sustainability processes and exposure to a variety of organizational ethics issues that shape corporate culture. The focus is on corporate culture in creating links between business sustainability, corporate governance, and organizational ethics. The next generations of business leaders must understand the importance of ethical conduct, business sustainability, and corporate governance to society and the environment. Organizations of all types (for-profit, not-for-profit), sizes, and complexities (simple operation, multinational) can benefit from comprehensive business sustainability, effective corporate governance, and a robust ethical culture.

Business schools play an important role in preparing the next generation of business leaders, who will experience lifelong training in acting with integrity, upholding the highest level of ethical conduct, and carrying the heavy burden of public trust, as well as being socially and environmentally responsible. The time has come for business schools and accounting programs to renew and revitalize their commitment and education programs in providing business sustainability, corporate governance, and organizational ethics education and in training the most ethical, competent, and socially and environmentally responsible future business leaders. We hope you find this book relevant in educating future business leaders.

Sincerely,

Zabi Rezaee
Tim Fogarty
August 19, 2019

Acknowledgments

We acknowledge rules, regulations, and authoritative reports and guidelines that are cited throughout the book, including the rules, standards, publications, and reports of entities such as the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), the American Institute of Certified Public Accountants (AICPA), the International Federation of Accountants (IFAC), as well as the Global Reporting Initiative, the International Integrated Reporting Council, the Sustainability Accounting Standards Board, the Big 4 and other international accounting firms, the Association to Advance Collegiate Schools of Business (AACSB), and the United Nations Sustainability Development Programs (UNSDP), among other organizations.

We also acknowledge the encouragement and support of our colleagues at The University of Memphis, and Case Western Reserve University. We truly appreciate professors Damon Fleming, Tim Coville, and Brigitte Muehlmann for their invaluable review of business sustainability chapters and seasoned internal audit practitioners, Richard A. Mueller and Alan N. Siegfried, for their insightful reviews of the chapters on corporate governance. Special thanks are due to Professor Sridhar (Sri) Ramamoorti for his generous support and advice throughout the preparation of the book and particularly his review of 13 chapters of Module III on corporate governance. The assistance of our graduate students, Charles Bell, Naomi Riley, Jing Wang, Coumba Khoule, and Sonia Nauhria, is also appreciated. We thank the members of the John Wiley & Sons team for their hard work and dedication, including Susan Cerra for managing the book through the production process, Jean-Karl Martin for marketing efforts, and Sheck Cho for his editorial guidance.

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Introduction

Book Features

Business sustainability, corporate governance, and organizational ethics (BSCGOE) are taking center stage in the global business environment. The revised (January 2019) Association to Advance Collegiate Schools of Business (AACSB International) accreditation standards confirm that these three topics are emerging as areas of focus for business schools worldwide.[1] In today's business environment, multinational corporations are under scrutiny and profound pressure from investors, lawmakers, and regulators, as well as global business counterparts, customers, suppliers, employees, society, and the environment to improve their BSCGOE. These three emerging topics of sustainability, governance, and ethics, when intertwined with the right corporate culture, can set an appropriate tone at the top in promoting competence, integrity, and accountability throughout the organization. The business sustainability practice of focusing on the multiple bottom lines (MBLs) of economic, governance, social, ethical, and environmental (EGSEE) performance is also gaining broad acceptance. Investors demand (through impact investing initiatives), regulators require (through the 2016 European Commission regulations and the 2018 Delaware Act), and business organizations report (more than 45,000 worldwide, according to a 2018 Global Reporting Initiative report) some EGSEE dimensions of sustainability performance.

Growing urbanization, industrialization, and the depletion of nonrenewable resources have necessitated global initiatives and actions to create a more sustainable future. Ever-improving corporate governance, organizational ethics, and accountability in all types and sizes of entities appear to be an international trend. The global investment community is holding public companies responsible and accountable for their business activities and their financial reporting process. As noted above, among the areas that have recently received considerable attention are: corporate governance, organizational ethics, and business sustainability. Institutions of higher education can serve as a conduit to produce and transfer knowledge to create a more sustainable future. Business schools worldwide play an important role in preparing ethical and competent future business leaders who understand corporate governance and business sustainability and conduct their businesses ethically. Further, these three emerging BSCGOE educational areas are aligned with AACSB International's core values, guiding principles, and three vital areas of "engagement, innovation, and impact."[2] Thus, these special topics deserve proper attention and coverage in the business and accounting curricula.

This book is the first to present a comprehensive framework of the theory and practice of BSCGOE by focusing on these three areas of business and accounting education, which are regarded by many as a cornerstone of business education and vigorously promoted by accreditation organizations worldwide (e.g. AACSB International). AACSB International now includes the coverage of BSCGOE in its accreditation standards. Currently more than 450 courses and programs in BSCGOE are being offered by colleges and universities worldwide, as discussed throughout the book. More universities are expected to offer BSCGOE stand-alone courses and programs. The purpose of this book is to present a comprehensive primer on BSCGOE and to provide a framework for business schools and accounting programs by focusing on providing business education that demonstrates "evidence of continuous quality improvement in three vital areas: engagement, innovation, and impact" as dictated by AACSB International.[3]

This book can be used in a course at both the undergraduate and graduate levels, as it is designed to develop an awareness and understanding of the main themes, perspectives, frameworks, and issues pertaining to BSCGOE. Alternatively, different modules of the book can be used separately in a variety of undergraduate and/or graduate accounting and business courses. It provides students with the knowledge and organizational and personal skills to become successful business leaders, and takes a holistic teaching approach, focusing on the value-adding roles of all participants in the corporate governance process who share the collective responsibility of creating shareholder value; protecting the interests of other stakeholders; complying with all applicable laws, rules, regulations, ethics standards, and best practices; and producing reliable, transparent, and high-quality financial information. The participants in the corporate governance process are the board of directors, executives, internal auditors, external auditors, financial analysts, legal counsel, regulators, investing bankers, and other stakeholders.

This book is an excellent reference for all business schools and other college programs that offer BSCGOE education, as well as for professionals who need an up-to-date understanding of emerging areas in business. As of now, there is no comprehensive book that covers BSCGOE issues. Unlike existing books that focus on narrow aspects of emerging business issues, this book takes a holistic and integrated approach to BSCGOE. Straightforward language illustrates theoretical and practical concepts and procedures to aid comprehension of complex corporate governance and business sustainability processes and exposure to a variety of organizational ethics issues. This book incorporates emerging corporate governance reforms in the era following the Sarbanes-Oxley Act of 2002 (SOX), including provisions of SOX and the Dodd-Frank Act of 2010 (DFA), global regulations and best practices, ethical considerations, corporate governance principles, sustainability performance, reporting, and assurance. The emerging issues of BSCGOE are integrated into all modules and chapters. The book also includes features, practical examples, and refinements valuable to business students, including the multiple choice and discussion questions at the end of each chapter and case discussions. The focus is on integrating BSCGOE into corporate culture.

Relevance of the Book

Improving BSCGOE in business organizations appears to be a national and international trend in creating a corporate culture of accountability, competence, and integrity. The public, regulators, the accounting profession, and the academic community are also taking a closer look at colleges and universities to find ways to hold these institutions more accountable for achieving their mission of providing higher education with relevant curricula. Business schools play an important and influential role in preparing the next generation of business leaders, who will require lifelong education and training on acting with integrity and upholding the highest level of ethical conduct and the heavy burden of public trust. This next generation of business leaders must understand the importance of BSCGOE, the role of corporations in our society, and the complexity of financial reporting process. Thus, business curricula must promote ethical behavior, professional accountability, and personal integrity. BSCGOE, including accountability, integrity, and transparency, must be integrated throughout the business and accounting curricula.

This book is intended to develop an awareness and understanding of the main themes, perspectives, frameworks, and issues pertaining to BSCGOE. This book aims to prepare students for careers in business leadership, management, and accounting, through the development of skills necessary to be an effective business leader. It presents corporate governance, business ethics, and corporate accountability, along with environmental and social responsibility, from historical, global, institutional, commercial, and regulatory perspectives. This book also acquaints students with the theory and practice of BSCGOE.

Classroom Implications of the Book

The quality and quantity of BSCGOE coverage in business textbooks has been criticized. Critics argue that business education is not adequate in areas such as ethics, corporate governance, organizational judgment, sustainability, accountability, and responsibility, and that it is not providing continuous quality education in these areas. There are several plausible reasons for integrating BSCGOE education into the business and accounting curricula:

- Financial scandals (e.g. Enron, WorldCom, Global Crossing, Adelphia, Qwest) at the turn of the twenty-first century and those post-SOX and the 2007–2009 global financial crisis (e.g. Cambridge Analytica, Volkswagen, Wells Fargo, and Facebook) underscore the importance of vigilant BSCGOE conduct by corporations.

- SOX is intended to improve corporate governance by enforcing more accountability for public companies and requiring adoption of a code of ethics for their executives.
- The concept of business sustainability is advancing from the practice of greenwashing (adding unsubstantiated claims of environmental efforts and benefits to branding) to the strategic imperative of being integrated into corporate culture and the business environment.
- AACSB International standards require business colleges to provide continuous quality education in all three emerging areas of BSCGOE.
- Anecdotal evidence and academic studies suggest that BSCGOE are not properly integrated into business education, and coverage of these issues should be increased.
- Teaching of and research in BSCGOE have been strongly recommended and encouraged.
- There is an inventory of support materials for teaching BSCGOE in the post-Enron and 2007–2009 global financial crisis era. There are sufficient resources (textbooks such as this book, published articles, Internet websites, and videos) to offer a stand-alone course or integrate related modules throughout accounting courses.
- It is easier to obtain administrative support to offer BSCGOE courses in the post-SOX and global financial crisis era. Many business schools have developed innovative strategies for engaging students in the challenges of providing ethical leadership by focusing on both positive and negative examples of everyday conduct in business.
- There is an increasing trend toward incorporation of BSCGOE education into the business curriculum worldwide.
- Accounting programs should integrate the provisions of SOX, addressing business sustainability and corporate governance into the curriculum, as business sustainability and corporate governance have evolved from compliance requirements to a strategic business imperative.
- The National Association of State Boards of Accountancy (NASBA), in its Exposure Draft of Uniform Accounting Rules 5-1 and 5-2 regarding NASBA 150-hour education requirement, emphasized the need for six semester credit hours in ethical and organizational responsibilities. Many states now require ethics education as a prerequisite for taking organization exams such as the CPA exam, which requires academicians to increase the coverage of ethics and ethical issues in the classroom.
- New regulatory reforms and best practices, including SOX and DFA, are intended to improve corporate governance and business sustainability by enforcing more accountability for public companies and requiring adoption of a code of ethics for their executives.
- Investors demand, regulators require, and companies provide information on their EGSEE sustainability performance.
- The American Accounting Association has established the AAA Organizations and Ethics Committee, and promotes coverage of BSCGOE.
- Many universities have designed a capstone course at the senior and graduate level in teaching emerging specialized education areas of BSCGOE.

The organization of the book provides maximum coverage and flexibility in choosing the amount and order of materials on BSCGOE. This book is organized into four distinct but interrelated modules:

Module	**Title**	**Chapters**
I	The Free Enterprise System and Financial Markets	1–3
II	Business Sustainability: Practice, Research, and Education	4–10
III	Corporate Governance: Practice, Research, and Education	11–23
IV	Organizational Ethics: Practice, Research, and Education	24–30

The 30 chapters of this book are organized into four modules. Module I consists of three chapters that introduce the free enterprise system and capital markets, public trust and investor confidence in financial and nonfinancial information, and the relevance of BSCGOE in promoting reliable information and market efficiency. Module II includes Chapters 4–10, which present business sustainability and its importance, the five dimensions of business sustainability (EGSEE), sustainability reporting and assurance, and sustainability research and education. In Module III, Chapters 11–23 provide the emergence of corporate governance, a framework for the discussion of the important functions of corporate governance (including oversight, management, compliance, the advisory function, auditing, and monitoring) as well as integrating corporate governance into accounting research and business curricula. Module IV includes Chapters 24–30, which present the importance of business and organizational ethics, workplace ethics, and trends in ethics research and education.

Chapter objectives, summaries, objective questions, essential terms, discussion questions, essays, and cases are provided in each of the 30 chapters of the book.

Module I: The Free Enterprise System and Financial Markets

This introductory module presents the framework for the book in integrating BSCGOE, including the fiduciary duties and ethical responsibilities of all corporate gatekeepers, into the business and accounting curricula. Students will learn about the role of business sustainability and corporate gatekeepers – from directors to executives, auditors, regulators, legal counsel, financial advisors, and investors – in promoting effective corporate governance and sensible organizational ethics. Corporate governance has been the main theme of the twenty-first century and business sustainability is transforming from branding and greenwashing to a business strategic imperative. In recent years, investors demand, regulators mandate, and business organizations worldwide report their sustainability information in all five EGSEE performance dimensions. Thus, sustainability education covering all five sustainability performance dimensions should be integrated into business curricula.

Module I consists of three introductory chapters providing a synopsis of the free enterprise system, the role of corporations in society, and an introduction to BSCGOE. Discussion of global BSCGOE makes the book attractive to corporations, business schools, and professionals worldwide. The book can be easily used in the educational and training programs of business schools and organization organizations. Other professionals, such as management accountants, internal auditors, corporate legal counsel, financial institutions, and financial analysts who provide accounting, auditing, legal, and financial services to corporations should find this book relevant and helpful to their professional assurance services and activities.

Module II: Business Sustainability: Practice, Research, and Education

The concept of business sustainability is advancing from greenwashing and branding to a strategic imperative, as stakeholders, shareholders (particularly institutional investors), and investor activists demand, global regulators require, and business organizations worldwide report their sustainability performance in all five dimensions of EGSEE. A decade ago fewer than 50 companies released sustainability reports; now more than 15,000 global public companies report on the sustainability dimensions of performance, risk, and disclosure. This module presents sustainability research, education, and practice by focusing on the discussion of both financial economic sustainability performance (ESP) and nonfinancial governance, social, ethical, and environmental (GSEE) sustainability performance in creating shared value for all stakeholders. In today's business environment, global businesses are under close scrutiny and profound pressure from lawmakers, regulators, the investment community, and their diverse stakeholders to focus on both ESP and GSEE dimensions of sustainability performance, reporting, and assurance. Traditionally, organizations have reported their performance on economic affairs. Their focus on only financial results has become outdated and irrelevant. In recent years, stakeholders, global organizations, and the public have increasingly demanded information on both financial ESP and nonfinancial GSEE key performance indicators (KPIs), and in some cases ethics have been integrated into the other four components. The primary theme of this module is on the examination of business sustainability and accountability reporting and their integration into strategy, governance, risk assessment, performance management, and the reporting process; research opportunities in business sustainability; and the integration of business sustainability into business curricula. Module III also highlights how people, business, and resources collaborate in a business sustainability and accountability model.

Obviously, much needs to be done in this area, including covering the following important topics:

- Introduction to business sustainability performance
- Financial and nonfinancial dimensions of business sustainability
- Measurement, recognition, auditing, and reporting of sustainability performance
- Roles and responsibilities of key players in accountability/sustainability reporting
- Best practices in sustainability performance, reporting, and assurance
- Integration of business sustainability and accountability reporting into business and accounting curricula
- Research opportunities in business sustainability

Module III: Corporate Governance: Practice, Research, and Education

The pervasiveness of financial scandals and the related loss of billions of dollars of shareholder wealth have received a considerable amount of attention from regulators and standard-setters. In the wake of financial scandals, corporate governance, accountability, and ethical conduct remain significant issues. Corporate governance's role in restoring public trust and investor confidence in corporate America has become a mandate of the capital markets. New regulatory initiatives and reforms affecting corporate governance have broadly defined the roles, responsibilities, and accountability of all corporate governance participants (the board of directors, executives, internal and external auditors, financial advisers, legal counsel, and investors) in achieving high-quality, reliable financial reports. The achievement of corporate governance effectiveness requires the development of a framework that encompasses all participants and processes and coordinates their functions toward gaining public trust and investor confidence and creating sustainable shareholder value. The module provides this framework by examining oversight, managerial, compliance, internal auditing, advisory, external auditing, and monitoring functions of an effective corporate governance. Module III, by taking an integrated approach to corporate governance, addresses three fundamental questions raised pursuant to these scandals and related regulations: (1) What role and functions should corporate governance fulfill in the twenty-first century organization? (2) What are the regulatory requirements and best practices of corporate governance? (3) What functions and practices make corporate governance effective?

Corporate governance has evolved from its traditional role of focusing on primarily business and shareholder issues, such as growth and profitability, to a modern role of emphasizing long-term shareholder value creation, stakeholder value protection, and addressing public and stakeholders issues (including pollution, insider trading, equal employment opportunities, and customer satisfaction). Effective corporate governance cannot be achieved merely from compliance with applicable laws, regulations, and rules. Rather, it is achieved by the commitment to doing the right thing, to observing moral and ethical principles and professional conduct, and to accepting accountability. Effective corporate governance is required for the efficient functioning of the financial markets to attract and retain capital. The corporate governance concepts, principles, guidelines, regulatory requirements, functions, and best practices presented in this module focus primarily on public companies, although they may well apply to all entities (whether for-profit or not-for-profit or private companies planning to go public in the future). It presents a road map for various functions of corporate governance designed to create shareholder value while protecting the rights of other stakeholders.

This book presents the essential and fundamental concepts of corporate governance with a keen focus on an integrated approach that addresses fiduciary duty and professional responsibilities of all financial market participants. Corporate governance has moved from purely internal managerial issues and decisions to broad strategic and reporting issues concerning the board of directors, the audit committee, executives, internal auditors, external auditors, legal counsel, financial analysts, investment bankers, governing bodies, investors, and other stakeholders. The suggested integrated approach to corporate governance assists corporations in demonstrating that they do in fact hold themselves to high standards of professional accountability, integrity, ethical conduct, and honorable behavior that exceed all required applicable laws, regulations, and rules. This module is intended to enhance the corporate governance regulations and practices that should already be in place and provide an integrated approach toward an effective corporate governance structure that aids in regaining public trust and investor confidence in corporations and creates a corporate culture of profit-with-purpose.

Module IV: Organizational Ethics: Practice, Research, and Education

Ethics in the generic sense is based on a combination of individual and/or family values, moral principles, religious beliefs, cultural norms, and best practices. An individual's values are derived from moral principles taught or instilled in him or her, whereas an individual's choices are the actions taken to do what is right or wrong. Organizational ethics is a specialized study of moral righteousness and proper corporate culture. An appropriate code of ethics that sets the right tone at the top of any organization in promoting ethical and professional conduct and establishing the moral structure for the entire organization is the backbone of proper organizational ethics.

Corporate culture and compliance practice should provide incentives and opportunities to maintain organizational honesty, fairness, and transparency. Attributes of an ethical corporate culture or an integrity-based culture refer to employee responsibility, freedom to raise concerns, and managers modeling ethical behavior and expressing the importance of integrity. The company's directors and executives should demonstrate through their actions as well as their policies a firm commitment to ethical behavior throughout the company and a culture of trust within the company. Although the right tone at the top is very important in promoting an ethical culture, actions often speak louder than words. The 2007–2009 financial crisis was partially caused by a number of ethical lapses made by both organizations and individuals involved in the mortgage markets, including mortgage originators, financial intermediaries, and mortgage borrowers. These lapses collectively contributed to the financial crisis, resulted in the global economic meltdown, and have threatened the sustainability of individuals, businesses, and governments. The crisis and related financial scandals have caused policymakers, regulators, and ethics advocates to question to what extent ethics and corporate culture affect the business process. Another question posed is whether ethics performance should be reflected in overall corporate reporting. This module addresses these and other ethics related questions in the context of organizational ethics.

Notes

1. Association to Advance Collegiate Schools of Business (AACSB) (2019). Accreditation standards. https://www.aacsb.edu/accreditation/standards/accounting.
2. Ibid.
3. Ibid.

Abbreviations

AAA	American Accounting Association
AACSB	Association to Advance Collegiate Schools of Business
AAER	Accounting and Auditing Enforcement Releases
AASHE	Association for the Advancement of Sustainability in Higher Education
ABA	American Bar Association
ACCA	Association of Chartered Certified Accountants
ACFE	Association of Certified Fraud Examiners
AICPA	American Institute of Certified Public Accountants
AI	Artificial Intelligence
AIDB	Accountancy Investigation and Discipline Board
AIM	Alternative Investment Market
AIMR	Association for Investment Management and Research
AJCA	American Jobs Creation Act
ALI	American Law Institute
ARC	Accounting Regulatory Committee
ASB	Auditing Standards Board
ASBE	Accounting Standards for Business Enterprises
ASC	Accounting Standards Council
ATS	Alternative Trading System
BCBS	Basel Committee on Banking Supervision
BOD	Board of Directors
BRC	Blue Ribbon Committee
BRT	Business Roundtable
BSCGOE	Business Sustainability, Corporate Governance, and Organizational Ethics
BSP	Board Service Providers
CAE	Chief Audit Executive
CalPERS	California Public Employees' Retirement System
CAM	Critical Audit Matters
CAO	Chief Analytics Officer
CARA	Credit Agency Reform Act
CAQ	Center for Audit Quality
CCAR	Comprehensive Capital Analysis and Review
CCDG	Corporate Disclosure and Governance Committee
CCEO	Chief Compliance and Ethics Officer

CCGG	Canadian Coalition for Good Governance
CCO	Chief Compliance Officer
CD&A	Compensation Discussion and Analysis
CDO	Corporate Development Officer
CD&A	Compensation Discussion and Analysis
CDSB	Climate Disclosure Standards Board
CED	Committee for Economic Development
CECO	Chief Ethics and Compliance Officer
CERES	Coalition for Environmentally Responsible Economies
CESR	Committee of European Securities Regulators
CFA	Chartered Financial Analyst (Institute)
CGC	Corporate Governance Committee
CGO	Chief Green Officer
CGR	Corporate Governance Report
CGMA	Chartered Global Management Accountants
CHRM	Chief Human Resources Manager
CII	Council of Institutional Investors
CIO	Chief Information Officer
CIMA	Chartered Institute of Management Accountants
CPA	Certified Public Accountant
CL	Corporate Library
CLO	Chief Legal Officer
CMO	Chief Medical Officer
COO	Chief Operating Officer
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CSR	Corporate Social Responsibility
CRC	Carbon Reduction Commitment
CRCO	Chief Risk and Compliance Officer
CRO	Chief Risk Officer
CSR	Corporate Social Responsibility
CSRA	Certified Sustainability Reporting Assurer
CSO	Chief Sustainability Officer
DENR	Department of Environment and Natural Resources
DERA	Division of Economic and Risk Analysis
DFA	Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
D&O	Directors' and Officers' Insurance
DII	Defense Industry Initiative on Business Ethics and Conduct
DJIA	Dow Jones Industrial Average
DIT	Defining Issues Test
DoJ	Department of Justice

EAAC	Ethics and Accountability Advisory Committee
EALIC	European Association for Listed Companies
EBR	Enhanced Business Reporting
EC	European Community
EFRAG	European Financial Reporting Advisory Group
EGSEE	Economic, Governance, Social, Ethical, and Environmental
EMS	Environmental Management Systems
EPA	Environmental Protection Agency
EPB	Environmental Protection Bureau
ERISA	Employee Retirement Income Security Act
ERM	Enterprise Risk Management
ESC	European Securities Committee
ESG	Environmental, Social, and Governance
ESOP	Employee Stock Ownership Plan
ESP	Economic Sustainability Performance
ESPP	Employee Stock Purchase Plan
ETN	Electronic Trading Networks
EU	European Union
EUIMC	European Union Internal Market Commission
EVA	Economic Profit or Economic Value Added
FASB	Financial Accounting Standards Board (US)
FCPA	Foreign Corrupt Practices Act
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FEI	Financial Executives International
FFIEC	Federal Financial Institutions Examination Council
FPI	Foreign Practice Issues
FRAANK	Financial Reporting and Auditing Agent with New Knowledge
FRB	Federal Reserve Bank
FRSC	Financial Reporting Standards Council
FSB	Financial Stability Board
FSF	Financial Stability Forum
FSG	Federal Sentencing Guidelines
FSOC	Financial Stability Oversight Council
GAAP	Generally Accepted Accounting Principles (US)
GAAS	Generally Accepted Auditing Standards
GAO	Government Accountability Office (formerly the General Accounting Office)
GASB	Governmental Accounting Standards Board
GATS	General Agreement on Trade in Services

Gen Re	General Reinsurance Corporation
GHG	Greenhouse Gas
GIIN	Global Impact Investing Network
GMI	Governance Metrics International
GNDI	Global Network of Directors Institute
GSEE	Governance, Social, Ethical, and Environmental
IAASB	International Auditing and Assurance Standards Board
IAEP	Internal Auditing Education Partnership
IAI	Institutional Accredited Investors
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICFR	Internal Control Over Financial Reporting
ICGN	International Corporate Governance Network
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
IIX	Impact Investment Exchange
IIRC	International Integrated Reporting Council
IMA	Institute of Management Accountants
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPOs	Initial Public Offerings
IPTF	International Practices Task Force
IRRC	Investor Responsibility Research Center
IRRCI	Investor Responsibility Research Center Institute
IRS	Internal Revenue Service
ISA	International Standard on Auditing
ISAE	International Standards on Assurance Engagements
ISO	International Standardization Organization
ISOs	Incentive Stock Options
ISS	Institutional Shareholder Services
IT	Information Technology
KPIs	Key Performance Indicators
LEED	Leadership in Energy and Environmental Design
LID	Lead Independent Director
LLA	Limited Liability Agreement
LDN	Lead Director Network
MBLs	Multiple Bottom Lines
MD&A	Management Discussion & Analysis

MFDF	Mutual Fund Director's Forum
MNCs	Multinational Corporations
NACD	National Association of Corporate Directors
NASBA	National Association of State Boards of Accountancy
NASD	National Association of Securities Dealers
Nasdaq	National Association of Securities Dealers Exchange (US)
NBS	National Bureau of Statistics
NCCG	National Committee on Corporate Governance
NCEO	National Center for Employee Ownership
NGOs	Nongovernmental Organizations
NGP	National Greening Program
NHRI	National Human Rights Institution
NIRI	National Investor Relations Institute
NPO	Not-For-Profit Organization
NPV	Net Present Value
NRSROs	Nationally Recognized Statistical Rating Organizations
NSE	National Stock Exchange
NYSE	New York Stock Exchange
OCC	The Office of the Comptroller of the Currency
OECD	Organisation for Economic Co-operation and Development
OFHEO	Office of Federal Housing Enterprise Oversight
OLA	Orderly Liquidation Authority
OPEB	Other Post-Employment Benefits
OPERS	Ohio Public Employees Retirement System
ORA	Office of Risk Assessment
PBGC	Pension Benefit Guaranty Corporation
PCAOB	Public Company Accounting Oversight Board (US)
PEEC	Professional Ethics Executive Committee
PPF	Professional Practices Framework
PRI	Principles for Responsible Investment
PSLRA	Private Securities Litigation Reform Act
QAR	Quality Assurance Review
QIB	Qualified Institutional Buyers
RAC	Regulation Analyst Certification
RAFS	Restoring American Financial Stability Act of 2010
RDT	Resource Dependence Theory
ROA	Return On Assets
RFD	Regulation Fair Disclosure
RI	Residual Income
ROSC	Reports on Standards and Codes (World Bank)
RPT	Related-Party Transactions

S&P	Standard & Poor's
SAB	Staff Accounting Bulleting
SAG	Standing Advisory Group
SARs	Stock Appreciation Rights
SARA	Superfund Amendment and Reauthorization Act
SAS	Statement on Auditing Standards
SASB	Sustainability Accounting Standards Board
SBA	State Board of Administration
SDGs	Sustainable Development Goals
SEC	Securities and Exchange Commission (US)
SFAS	Statement of Financial Accounting Standards
SIF	Social Investment Forum
SMEs	Small and Medium-Sized Enterprises
SMILE	Sustainable Management and Investment Guideline
SOX	Sarbanes-Oxley Act of 2002
SPPIA	Standards for the Professional Practice of Internal Auditing
SRI	Socially Responsible Investing
SROs	Self-Regulatory Organizations
SSBI	Spencer Stuart Board Index
SSCM	Sustainable Supply Chain Management
SVA	Shareholder Value Added
TBL	Triple Bottom Line
TCJA	Tax Cuts and Jobs Act
TSE	Tokyo Stock Exchange
TSX	Toronto Stock Exchange
TSR	Total Shareholder Returns
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNEP	United Nations Environment Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNGC	United Nations Global Compact
UNSDGs	United Nations Sustainability Development Goals
USSC	US Sentencing Commission
WBCSD	World Business Council for Sustainable Development
WEF	World Economic Forum
WFE	World Federation of Exchanges
WTO	World Trade Organization
XBRL	eXtensible Business Reporting Language
XML	Extensible Markup Language
XSB	XBRL Standards Board

MODULE I

The Free Enterprise System and Financial Markets

CHAPTER 1

The Free Enterprise System, Financial Markets, and Corporate Culture

1. Introduction

This chapter presents the importance and dynamics of relationships between capital markets and businesses as influenced by corporate culture, perceived by stakeholders (including investors), and transformed through business sustainability, corporate governance, and organizational ethics. Corporate and accounting scandals at the turn of the twenty-first century and the global 2007–2009 financial crisis eroded public trust and investor confidence in corporate America and in its financial reports. Several initiatives and reforms, including the Sarbanes-Oxley Act of 2002 (SOX), the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and the Securities and Exchange Commission (SEC) rules and regulations related to their implementation, as well as listing standards of national stock exchanges, corporate governance best practices, and business ethics guidance, were established to restore investor confidence in public financial information. These reforms and standards are a continuous process creating new measures and practices for public companies and their directors, officers, accountants, auditors, legal counsel, financial analysts, investing banks, and others to effectively fulfill their responsibilities and discharge their accountability. Impactful corporate culture, robust business environment, effective corporate governance, integrated business sustainability, enforceable accountability and compliance system, and informed organizational ethics can improve a corporation's strategic plan, decisions, actions, and the reliability of its financial reports, as well as the efficiency of capital markets and the nation's prospects and growth. This chapter provides an introduction to and background for a plan for business sustainability, corporate governance, and organizational ethics presented throughout the book.

Learning Objectives

- Learn about the free enterprise system and business.
- Understand the role and responsibility of business in society.
- Understand the primary goal of corporate governance.
- Exemplify the importance of reliable and transparent financial information.
- Be aware of the effect of corporate governance on investor confidence.
- Present various definitions of corporate governance.
- Provide an overview of corporate governance reforms.
- Introduce business ethics.
- Provide an overview of costs and benefits of corporate governance reforms.
- Address the impacts of corporate governance reforms on accountability.

2. The Free Enterprise System

The free enterprise system is a bedrock principle of the US economy, and its capital markets are the backbone of the system. Understanding the free enterprise system and its contribution to continuous economic growth in the United States is important in assessing the global competitiveness of US financial markets. The free enterprise system has made US financial markets the world's largest, deepest, and safest marketplaces, as well as home to the world's largest financial institutions. The US free enterprise system has transformed from

> A system in which our businesses were generally owned and controlled by small groups of people … to a system in which our businesses are owned by public investors … The US has achieved this widespread participation by maintaining high quality disclosure standards and enforcement policies that protect the interests of public investors.[1]

The free enterprise system in the United States has been developed and promoted with a keen focus on creating jobs and wealth, enabling growth, fostering innovation, rewarding initiatives and risks, and using resources effectively. This widespread and global investment by individual and institutional investors has been accomplished by, and will continue to prosper from, investors receiving reliable and useful financial information in making sound investment decisions. The free enterprise system promotes healthy and constructive competition among business organizations without much government interference. This is also referred to as capitalism, or the free market. In this type of system, investors are enabled to invest their money whenever and wherever they wish and to take as much risk as they can tolerate as well as to pursue whatever career they desire.[2]

The liquidity, integrity, safety, efficiency, transparency, and related dynamics of capital markets are vital to the nation's economic welfare and growth, since the markets act as signaling mechanisms for capital allocation. The capital markets have been vibrant because investors have confidence in them and are able to obtain, analyze, and price securities based on the information provided about public companies and the economy. Information is the lifeblood of capital markets. Without such trusted information being available, stocks would be mispriced, capital markets would be inefficient, scarce resources (capital) would be inefficiently used and allocated, and the level of economic growth that we currently see would not be possible. Capital markets provide public companies with opportunities to raise capital to establish or expand their businesses as well as to finance their investments and other public projects while enabling investors to put their capital to work.[3] Their efficiency, liquidity, and integrity depend on their "ability to obtain, digest, and price securities derived from information about companies and the economy."[4] Thus, the safety and soundness of our financial markets are also influenced by proactive, smart, scalable, and cost-effective regulations that require adequate and fair financial information disclosures, and their prosperity and vibrancy depend on investor confidence in public financial and nonfinancial information.

Businesses play an important role in creating capital markets that are safe, efficient, and as competitive as possible, which ensures economic growth, low costs of capital, entrepreneurship, innovation, and job creation. Businesses allow people to optimize their time and resources. With businesses present in the economy, individuals are able to consume more goods and services than they could ever produce on their own. It would be impossible to build your own house, car, or cellphone or to produce your own movie to watch at leisure in any reasonable amount of time. Because of businesses, the prices of goods and services decrease while the quantity and quality increase.[5] Capital, provided by investors to public companies, is the lifeblood of markets. Thus, protecting investors, who provide the most cost-effective capital, is essential to the survival and competitiveness of capital markets. More than 150 million Americans have provided capital to the markets through their private investments and/or their pension and mutual funds, and companies have therefore had access to sufficient funding at the lowest cost of capital possible worldwide.

Investors must not only be encouraged and rewarded for investing in the capital markets but also be protected through appropriate regulations, effective corporate governance, and optimal market mechanisms. The preservation of the integrity, reputation, and efficiency of capital markets is the responsibility of all