Brief Contents

Part One  Private Enterprise and Public Trust  1

Chapter 1.  The Free Market System and Business  3
Chapter 2.  Corporate Governance  28
Chapter 3.  Introduction to Business Ethics  60

Part Two  Roles and Responsibilities of Corporate Governance Participants  87

Chapter 4.  Board of Directors’ Roles and Responsibilities  89
Chapter 5.  Board Committee Roles and Responsibilities  117
Chapter 6.  Roles and Responsibilities of Management  152
Chapter 7.  Regulatory Bodies, Standard Setters, and Best Practices  191
Chapter 8.  Internal Auditors’ Roles and Responsibilities  227
Chapter 9.  External Auditors’ Roles and Responsibilities  252
Chapter 10.  Stakeholders’ Roles and Responsibilities  288
Chapter 11.  Roles and Responsibilities of Other Corporate Governance Participants  307

Part Three  Contemporary Issues in Business Ethics and Corporate Governance  321

Chapter 12.  Technology and Corporate Governance  323
Chapter 13.  Corporate Governance in Private and Not-for-Profit Organizations  340
Chapter 14.  Corporate Governance in Transition  361
Chapter 15.  Emerging Issues in Corporate Governance  395
Chapter 4. Board of Directors’ Roles and Responsibilities 89

Introduction 89
Primary Objectives 90
Role of the Board of Directors 90
Fiduciary Duties of the Board of Directors 93
  Duty of Due Care 94
  Duty of Loyalty 94
  Duty of Good Faith 94
  Duty to Promote Success 94
  Duty to Exercise Diligence, Independent Judgment, and Skill 95
  Duty to Avoid Conflicts of Interest 95
Fiduciary Duties and Business Judgment Rules 95
Board Committees 96
  Audit Committee 97
  Compensation Committee 97
  Governance Committee 97
  Nominating Committee 97
  Disclosure Committees 97
  Special Committee 98
Board Models 98
  One-Tier Board Model 98
  Two-Tier Board Model 99
  Modern Board Model 99
Board Characteristics 100
  Board Leadership 100
  CEO Duality 101
  Lead Director 102

Chapter 5. Board Committee Roles and Responsibilities 117

Introduction 117
Primary Objectives 117
Relevance of Board Committees 118
Audit Committee 118
  Definition of the Audit Committee 119
  Audit Committee Relationships with Other Corporate Governance Participants 121
Historical Perspectives on Audit Committees 122
  Audit Committee Principles 124
  Audit Committee Composition 125
  Audit Committee Size 125
  Audit Committee Independence 125
  Member Qualifications 126
  Audit Committee Authority/Resources 127
  Audit Committee Responsibility 127
  Audit Committee Meetings 130
  Audit Committee Agenda 130
  Audit Committee Reporting 131
  Legal Liability of Audit Committees 132
  Evaluation of Audit Committee Effectiveness 133
  Audit Committee Evaluation of External Auditors 133
Compensation Committee 133
  Structure 134
  Responsibilities 134
Chapter 6. Roles and Responsibilities of Management 152

Introduction 152
Primary Objectives 153
Management Responsibilities 153
Operating Process 153
Financial Reporting Process 154
Compliance Process 154
Corporate Officers 155
Chief Executive Officer 155
Chief Financial Officer 157
Corporate Development Officer 157
Chief Risk Officer 158
Chief Internal Control Officer 158

Executive Compensation 159
Components of Executive Compensation 159
Executive Compensation Disclosure 161

Financial Reporting Requirements 161
Small Reporting Companies 163
Financial Reporting Challenges 164

Off Balance Sheet Arrangements Disclosures 165
Aggregate Contractual Commitments 165
Disclosure of Critical Accounting Policies 165
Initial Adoption of Accounting Policies 166
Disclosure of Changes in Existing Accounting Policies 167
Acceleration of Periodic Report Filing Dates and Real-Time Disclosures 167
Non-GAAP Financial Measures 167
Voluntary Changes in Accounting Policies 168
Accounting Pensions and Other Postemployment Benefits 168
Principles-Based versus Rules-Based Accounting Standards 169
Conceptual Framework for Financial Reporting 170
Earnings Management 171
Financial Restatements 172
Convergence in Financial Reporting 175

Internal Control Reporting and Executive Certifications 176
Internal Control Over Financial Reporting 177
Internal Control Evaluations 178
Section 404 Costs 179
Benefits of Section 404 Compliance 180
Sustainable Section 404 Compliance 180
SEC Interpretive Guidance on ICFR Adequacy 181
Effectiveness 181
Entity-Level Controls 181
Ongoing Monitoring 182
Fraud Risk Considerations 182
Amendments to SEC Rules 182
Enterprise Risk Management 182

Tax Accounting 185
Summary 186
Key Terms 187
Review Questions 188
Discussion Questions 188
Notes 189
### Chapter 7. Regulatory Bodies, Standard Setters, and Best Practices

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>191</td>
</tr>
<tr>
<td>Primary Objectives</td>
<td>192</td>
</tr>
<tr>
<td>Regulations</td>
<td>192</td>
</tr>
<tr>
<td>The Sarbanes-Oxley Act of 2002</td>
<td>193</td>
</tr>
<tr>
<td>Corporate Governance Provisions</td>
<td>200</td>
</tr>
<tr>
<td>Financial Reporting Provisions</td>
<td>200</td>
</tr>
<tr>
<td>Audit Function Provisions</td>
<td>201</td>
</tr>
<tr>
<td>Enforcement of Federal Securities Laws</td>
<td>201</td>
</tr>
<tr>
<td>Provisions Addressing Conduct of Other Individuals</td>
<td>202</td>
</tr>
<tr>
<td>Evaluation of the Sarbanes-Oxley Act</td>
<td>202</td>
</tr>
<tr>
<td>Global Reach of SOX</td>
<td>203</td>
</tr>
<tr>
<td>Securities and Exchange Commission</td>
<td>204</td>
</tr>
<tr>
<td>SEC Activities</td>
<td>207</td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board</td>
<td>208</td>
</tr>
<tr>
<td>PCAOB Responsibilities</td>
<td>208</td>
</tr>
<tr>
<td>PCAOB Standard-Setting Process</td>
<td>210</td>
</tr>
<tr>
<td>Federal Sentencing Guidelines for Organizations</td>
<td>211</td>
</tr>
<tr>
<td>American Institute of Certified Public Accountants</td>
<td>211</td>
</tr>
<tr>
<td>AICPA Roles in the Post-SOX Era</td>
<td>211</td>
</tr>
<tr>
<td>Financial Accounting Standards Board</td>
<td>213</td>
</tr>
<tr>
<td>Government Accounting Standards Board</td>
<td>214</td>
</tr>
<tr>
<td>International Federation of Accountants</td>
<td>214</td>
</tr>
<tr>
<td>Committee of European Securities Regulators</td>
<td>215</td>
</tr>
<tr>
<td>State Influence on Corporate Governance</td>
<td>215</td>
</tr>
<tr>
<td>Corporate Governance and Courts</td>
<td>216</td>
</tr>
<tr>
<td>Corporate Governance and Self-Regulatory Organizations</td>
<td>216</td>
</tr>
<tr>
<td>Best Practices</td>
<td>219</td>
</tr>
<tr>
<td>The Conference Board</td>
<td>219</td>
</tr>
<tr>
<td>American Law Institute</td>
<td>220</td>
</tr>
<tr>
<td>American Bar Association</td>
<td>220</td>
</tr>
<tr>
<td>Institutional Investors</td>
<td>220</td>
</tr>
<tr>
<td>Council of Institutional Investors</td>
<td>221</td>
</tr>
<tr>
<td>National Association of Corporate Directors</td>
<td>222</td>
</tr>
<tr>
<td>Business Roundtable</td>
<td>222</td>
</tr>
<tr>
<td>Public Pension Funds</td>
<td>222</td>
</tr>
</tbody>
</table>

### Chapter 8. Internal Auditors’ Roles and Responsibilities

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>227</td>
</tr>
<tr>
<td>Primary Objectives</td>
<td>228</td>
</tr>
<tr>
<td>Internal Auditing Function and Corporate Governance</td>
<td>228</td>
</tr>
<tr>
<td>Internal Auditors as Assurance Providers</td>
<td>230</td>
</tr>
<tr>
<td>Internal Auditors as Consultants</td>
<td>230</td>
</tr>
<tr>
<td>Trend and Relevance of Internal Auditors</td>
<td>231</td>
</tr>
<tr>
<td>Authorities and Responsibilities of Internal Auditors</td>
<td>232</td>
</tr>
<tr>
<td>Authority</td>
<td>232</td>
</tr>
<tr>
<td>Responsibility</td>
<td>235</td>
</tr>
<tr>
<td>Internal Audit Outsourcing</td>
<td>236</td>
</tr>
<tr>
<td>Audit Committee Relationship with Internal Auditor</td>
<td>236</td>
</tr>
<tr>
<td>Internal Auditors’ Role in Internal Control</td>
<td>238</td>
</tr>
<tr>
<td>Institute of Internal Auditors</td>
<td>240</td>
</tr>
<tr>
<td>Determinants of Effective Internal Audit</td>
<td>243</td>
</tr>
<tr>
<td>Best Practices</td>
<td>244</td>
</tr>
<tr>
<td>Internal Audit Performance</td>
<td>245</td>
</tr>
<tr>
<td>Internal Audit Framework</td>
<td>246</td>
</tr>
<tr>
<td>Internal Auditing Education</td>
<td>246</td>
</tr>
<tr>
<td>The Internal Audit Opinion on Internal Controls</td>
<td>247</td>
</tr>
<tr>
<td>Summary</td>
<td>247</td>
</tr>
<tr>
<td>Key Terms</td>
<td>248</td>
</tr>
<tr>
<td>Review Questions</td>
<td>249</td>
</tr>
<tr>
<td>Discussion Questions</td>
<td>249</td>
</tr>
<tr>
<td>Notes</td>
<td>250</td>
</tr>
</tbody>
</table>

### Chapter 9. External Auditors’ Roles and Responsibilities

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>252</td>
</tr>
<tr>
<td>Primary Objectives</td>
<td>253</td>
</tr>
<tr>
<td>External Auditing and Corporate Governance</td>
<td>253</td>
</tr>
<tr>
<td>External Auditor Responsibilities</td>
<td>255</td>
</tr>
<tr>
<td>Auditor Competency</td>
<td>256</td>
</tr>
<tr>
<td>Audit Failures and Audit Quality</td>
<td>257</td>
</tr>
</tbody>
</table>
Public Company Accounting Oversight Board 258
  Registration and Inspection of Public Accounting Firms 259
  PCAOB Auditing Standards 260
  PCAOB Enforcement Investigations 267
Audit Committee Oversight of External Auditors 267
  Appointment, Compensation, and Retention of Auditors 268
  Preapproval of Audit Services and Permissible Nonaudit Services 268
  Review of Independent Auditor Plan for the Integrated Audit 269
  Review and Discussion of Financial Reports 269
  Monitoring the Auditor’s Independence 270
  Auditor Rotation Requirement 270
  Independent Auditor Communication with the Audit Committee 272
Auditor Independence 273
Consolidation and Competition in Public Accounting Firms 276
Integrated Audit Approach 277
  Audit Strategy 277
Audit of Defined Benefit Pensions 279
Auditor Liability Limitation Agreements 279
Summary 283
Key Terms 284
Review Questions 284
Discussion Questions 285
Notes 286

Chapter 10. Stakeholders’ Roles and Responsibilities 288

Introduction 288
  Primary Objectives 289
Shareholders 289
  Shareholder Monitoring 291
  Shareholder Proxy Process 294
  Security Class Actions 295
Institutional Investors 295
  Institutional Investors’ Monitoring 296
  Governance of Institutional Investors 298
Mutual Funds 298

Improving the Oversight Function 299
  Chief Compliance Officer 299
  Code of Ethics 299
Hedge Funds 300
Investor Activists 300
Employee Monitoring 300
  Employee Ownership 301
  Employee Roles in Corporate Governance 302
  Employee Class Actions 303
Summary 303
Key Terms 304
Review Questions 304
Discussion Questions 304
Notes 305

Chapter 11. Roles and Responsibilities of Other Corporate Governance Participants 307

Introduction 307
  Primary Objectives 307
Legal Counsel 308
  Communication with Legal Counsel 309
SEC Rules of Professional Conduct for Lawyers 310
Responsibilities of Legal Counsel 311
Financial Advisors 312
  Securities Analysts 313
  Standard I: Information Flow 315
  Standard II: Analyst Conduct 315
  Standard III: Corporate Communication and Access 316
  Standard IV: Reviewing Analyst Reports or Models 316
  Standard V: Issuer-Paid Research Reports 316
Investment Banks 316
Summary 318
Key Terms 318
Review Questions 319
Discussion Questions 319
Notes 319