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Corporate Governance: An Ethical Perspective

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ABSTRACT. This paper discusses corporate governance issues from a compliance viewpoint. It makes a distinction between legal and ethical compliance mechanisms and shows that the former has clearly proven to be inadequate as it lacks the moral firepower to restore confidence and the ability to build trust. The concepts of *freedom of indifference* and *freedom for excellence* provide a theoretical basis for explaining why legal compliance mechanisms are insufficient in dealing with fraudulent practices and may not be addressing the real and fundamental issues that inspire ethical behavior. The tendency to overemphasize legal compliance mechanisms may result in an attempt to substitute *accountability* for *responsibility* and may also result in an attempt to legislate morality which consequently leads to *legal absolutism*. The current environment of failures of corporate responsibility are not only failures of legal compliance, but more fundamentally failures to do the right (ethical) thing.

KEY WORDS: Corporate governance, ethics, legal compliance mechanisms, ethical compliance mechanisms, freedom of indifference, freedom for excellence

Introduction

Over the last two decades, corporate governance has attracted a great deal of public interest because of its apparent importance for the economic health of corporations and society in general. The headlines of the previous 2 years in particular, portrayed a sad story of corporate ethics (or lack thereof): WorldCom, Anderson, Merrill Lynch, Enron, Martha Stewart, Global Crossing, Qwest Communications, Tyco International, Adelphia Communications, Merck, Computer Associates, Parmalat, Putnam, Boeing, Rite Aid, Xerox, ASEA Brown Boveri, Kmart, Swiss Air, and so on. Falling stock markets, corporate failures, dubious accounting practices, abuses of corporate power, fraud, criminal investigations, mismanagement, excessive executive compensation indicate that the entire economic system upon which investment returns have depended is showing signs of stress that have undermined investors' confidence. Some corporations have grown dramatically in a relatively short time through acquisitions funded by inflated share prices and promises of even brighter futures. In others, it seems as if the checks and balances that should protect shareholder interests were pushed to one side, driven by a perception of the need to move fast in the pursuit of the bottom line. While some failures were the result of fraudulent accounting and other illegal practices, many of the same companies exhibited actual corporate governance risks such as conflicts of interest, inexperienced directors, overly lucrative compensation, or unequal share voting rights (Anderson and Orsagh, 2004). In the face of such scandals and malpractices, there has been a renewed emphasis on corporate governance.

Corporate governance covers a large number of distinct concepts and phenomenon as we can see from the definition adopted by the Organization for Economic Cooperation and Development (OECD) – "*Corporate governance is the system by which business corporations are directed and controlled. The corporate*

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governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders and spells out the rules and procedures for making decisions in corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance."[1] From this definition, we see that corporate governance includes: the relationship of a company to its shareholders and to society; the promotion of fairness, transparency and accountability; reference to mechanisms that are used to "*govern*" managers and to ensure that actions taken are consistent with the interests of key stakeholder groups. The key points of interest in corporate governance therefore include issues of transparency and accountability, the legal and regulatory environment, appropriate risk management measures, information flows and the responsibility of senior management and the board of directors. Many companies in the U.S. have adopted legal compliance mechanisms which address ethics or conduct issues in formal documents (Weaver et al., 1999), but much of this activity has been attributed to the 1991 U.S. Sentencing Commission's Guidelines for organizational defendants which prescribe more lenient sentences and fines to companies that have taken measures to prevent employee misconduct (Metzger et al., 1994; Paine, 1994). From an ethical dimension, at a fundamental level, the key issues of corporate governance involve questions concerning relationships and building trust (both within and outside the organization).

Harshbarger and Holden (2004) point out that while many of the governance issues that organizations face are not new, the environment in which they confront them is more challenging than ever. For example, United States State and Federal law enforcement has applied significantly increased resources and a more aggressive philosophy toward confrontation of governance lapses, the media spotlight has increased awareness among those constituents directly affected as well as the business community as a whole, shareholder proposals are taken more seriously, and the judiciary has demonstrated its willingness for a more stringent definition of good faith. As well, there are a number of factors that have brought ethical issues into sharper focus, including globalization, technology, and rising competition. Van Beek and Solomon (2004) also note the ability to deliver a professional service will necessarily take place in an environment in which there is an increasing tendency towards individuality, while society as a whole becomes more global. The new realities of corporate governance show that no entity or agent is immune from fraudulent practices[2] and have altered the way companies operate; they have re-defined the baseline for what is considered prudent conduct for businesses and executives (Dandino, 2004).

Legal compliance mechanisms

The difficulty with legal compliance mechanisms is that many abuses that have enraged the public are entirely legal, for example, companies can file misleading accounting statements that are in complete compliance with Generally Accepted Accounting Principles (GAAP). France et al. (2002) point out that laws regulating companies are ambiguous, that juries have a hard time grasping abstract and sophisticated financial concepts (for example, special-purpose entities or complex derivatives), well-counseled executives have plenty of tricks for distancing themselves from responsibilities (Enron and the individual officers all deny they have broken any laws), and the fact that criminal law applies only to extreme cases. As a result, violations are hard to enforce. Based upon in-depth interviews with 30 graduates of Harvard MBA program, Badaracco and Webb (1995) revealed several disturbing patterns. First, young managers received explicit instructions from their middle-manager bosses or felt strong organizational pressures to do things that they believed were sleazy, unethical, or sometimes illegal. Secondly, legal compliance mechanisms (corporate ethics programs, codes of conduct, mission statements, hot lines, and so on) provided little help in such environments. Thirdly, many of the young managers believed that their company's executives were out-of-touch with ethical issues; either they were too busy or because they sought to avoid responsibility. Finally, the young managers resolved the dilemmas they faced largely on the basis of personal reflection and individual values, not through reliance on corporate credos or company loyalty.

Although the accounting profession has always had a strong focus on internal controls, recent spectacular business failures which have undermined auditors' credibility in their reporting function, have eroded public confidence in the accounting and auditing profession. Brief et al. (1997) found that 87% of accountants surveyed were willing to misrepresent financial statements in at least one case when presented with seven financial reporting dilemmas. This has led to new and more stringent applications of standards.[3] The problems of the professions (law, accounting, medicine) which we are witnessing today are not endemic to the industry, they are part of the problems in the wider society: sports, business, government and politics, education, and so on.

In the business world, particularly the world of finance, the many corporate scandals have led to a renewed interest and focus on legal compliance mechanisms. For example, the Sarbanes–Oxley Act[4] (referred to as Sarbox) contains proposals that increases Chief Executive Officers' accountability for financial statements, increases penalty for fraud, makes Chief Executive Officers and Chief Financial Officers sign off financial statements, strengthens the role of the audit committee, and bans several types of non-audit consulting services by outside auditors. Also, auditors are required to give reports to audit committees on critical accounting policies and practices, information on alternative treatments of financial information, and bring to their attention any written communications with management (which could include disagreements as to the presentation of a company's accounts). The key goals of Sarbox are to enhance financial disclosures and auditor independence, improve corporate governance, protect public companies' employees (including whistleblowers) and shareholders, to increase accountability of corporate executives, and to deter and punish fraudulent behavior (Carpenter, 2004). The New York Stock Exchange and Nasdaq listing requirements purport to strengthen Boards' independence (that is, a substantial majority of the Board of Directors should be independent from the sphere of influence of the CEO and senior management of the company, and the Board should be held accountable to shareholders) by requiring a majority of independent directors (that is, there should be no material relationship with the company either directly or as a partner, stockholder or officer of an organization that has relationship with the company), executive sessions, and by tightening the definition of independence. Independence and disclosure can be seen as the main themes of Sarbox.

Ironically, Weisul and Merritt (2002) in surveying 1100 college students on 27 U.S. campuses, found that although the students were disturbed by recent corporate scandals (some 84% believed that the U.S. is having a business crisis and 77% think CEOs should be held personally responsible for it), 59% of the same students admitted that they had cheated on a test and only 19% say they would report a classmate who cheated. Although a necessary component of corporate governance, legal compliance mechanisms have clearly proven to be inadequate; they lack the moral firepower to restore confidence and the ability to rebuild trust in the corporation. Termes (1995) compares ethical compliance mechanisms (virtues) versus legal compliance mechanisms (codes) and concludes that the ethical functioning of financial institutions cannot be trusted with the imposition of codes of ethical conduct, but the only way in which companies can be ethical is for people to be ethical. Donaldson (2003) observes that the legalistic (or check-the-box) approach to good corporate governance will not inspire a true sense of ethical obligation and may lead to an array of inhibiting, *politically correct* dictates. He further notes that instead of striving to meet higher standards, corporations would only be inordinately preoccupied with meeting legal obligations under new costs associated with fulfilling a mandated process that could produce little of the desired effect to the detriment of other critical objectives. Consequently, corporations would lose the freedom to make innovative decisions that an ethically sound culture requires.

Ethical compliance mechanisms

Trevino et al. (1999) found that specific characteristics of legal compliance programs matter less than broader perceptions of a program's orientation toward values and ethical aspirations. They found that what helped the most are consistency between policies and actions as well as dimensions of the organization's ethical climate such as ethical leadership, fair treatment of employees, and open discussion of ethics. On the other hand, what hurts the most are an ethical culture that emphasizes self-interest, unquestioning obedience to authority, and the perception that legal compliance programs exist only to protect top management from blame. With respect to the issues of ethical leadership, Collins (2001) examined the character traits of effective business leaders in the culture of 11 companies that transformed themselves from good solid businesses into great companies that produced phenomenal and sustained returns for their stockholders. Every one of the companies he profiled during the critical period in which it was changing from good to great has what he termed *Level 5* leadership which was his top ranking for executive capabilities. Leaders in all companies exhibited the traits of fanatical drive and workmanlike diligence, but Level 5 leaders were also people of integrity and conscience who put the interest of their stockholder and their employees ahead of their own self-interest.

Byrne (2002) points out that following the abuses of recent times, executives are learning that trust, integrity, and fairness do matter and are crucial to the bottom line. Corporate leaders and entrepreneurs somehow forgot that business is all about values and are now paying the price in a downward market with a loss of investor confidence. Byrne (2002) also notes that in the post-Enron, post-bubble world, the realization that many companies played fast and loose with accounting rules and ethical standards and which allowed performance to be disconnected from meaningful corporate values, is leading to a re-evaluation of corporate goals, values, and purpose. What's emerging is a new model of the corporation in which corporate cultures will change in a way that puts greater emphasis on integrity and trust. Such changes would include the diminishing of the single-minded focus on *shareholder value* which measures performance on the sole basis of stock price; the elevation of the interests of employees, customers, and their communities; a reassessment of executive pay to create a sense of fairness; a resetting of expectations so that investors are more realistic about the returns a company can legitimately and consistently achieve in highly competitive markets.

There is little doubt that corporate culture contributed to and is at the heart of the recent scandals and transgressions. Hansen (2004) doubts whether legal compliance mechanisms alone can show the way to business probity and points out the need to ask some basic questions: Are Sarbanes–Oxley and the mandated reforms being made likely to achieve the desired goal? Will our efforts foster a more ethical business environment or is it likely that much of the effort will be directed to formulaic conformity with the appearance of ethical probity? Will corporations be prompted merely to offer empty clichés in their public embrace of integrity (e.g., some corporations might think that rewriting their value statement in a larger font size might somehow translate into a more impassioned ethical commitment)? Hansen (2004) also points out that more explicit recognition of the role of culture in an organization may be forthcoming since the challenge is to ascertain whether a corporation's compliance program is merely a *paper program* or whether it was designed and implemented in an effective manner. A cultural norm that reinforces the importance of compliance is one measure of a real compliance program as opposed to one that merely exists on paper (e.g., Does the company treat employees fairly? Is it honest in its business dealings? etc.).

At the core of the current debate over corporate governance is the issue whether managers of corporations should serve the interests of shareholders or the interests of all stakeholders (employees, creditors, suppliers, customers, community, shareholders). This issue is related to a more fundamental question of the nature and purpose of the firm (is it an entity, an aggregate of individuals, a nexus of private contracts?). Two essentially different models of corporate governance can be identified: the model based on the maximization of shareholder value and the model of social responsibility.[5] Ambrosio and Toth (1998), using a natural law ethical framework, show that the latter is more coherent with human nature as the natural law perspective posits the primacy of ethics over politics, law and economics. Economics cannot be divorced from ethics anymore than law, politics, education can (Arjoon and Gopaul, 2003). Natural law ethical theory provides a framework to address the moral dimension of human action, serves as a guide to those directly responsible for corporate governance, judges whether particular corporate actions are consistent with legal obligations, and provides the grounds for a moral critique of existing laws and practices related to corporate governance. The shareholder wealth maximization model deflects attention from the ethical questions and the concern for values. Related to the first principle of natural law ethics (do good and avoid evil) is virtue ethics (be virtuous and avoid vices), which provides more positive principles for the practice of corporate governance.

Legal versus ethical compliance mechanisms

Kleining (1999) observes that despite certain congruities and convergences, there are some very important differences in the character and content of ethical and legal requirements which can help us understand why ethics is accorded a normative primacy in practical affairs and legality is to be judged by reference to ethics (not vice versa). Specifically, law is concerned primarily with conduct and ethical requirements are centrally concerned with reasons, motives, intentions, and more generally with the character that expresses itself in conduct. Ethics therefore is concerned with what we are and not just what we do. Also, law is jurisdictionally limited since what is legitimately required in one state or country may differ from another, whereas ethical values are inclined to be more universal. Kidder (1995) defines ethics as *obedience to the unenforceable*.

Longstaff (1986) argues that an overemphasis on legal compliance mechanisms[6] could be at the expense of ethical reflection since people may have less reason to form their own opinions and take personal responsibility for the decisions they make. This could result in a subtle substitution of *accountability* for *responsibility* and may also result in an attempt to legislate morality, which consequently leads to legalism. Legalism is an approach which emphasizes primarily the strict and precise observance of law while tending to overlook the purpose for which the law exists. Bouckaert (2002) points out the paradox of ethics management is that in creating new regulations to temper opportunistic behavior within and between organizations, the symptoms may be tempered but the underlying roots of opportunism may also be reinforced. Seidman (2004) explains the paradox in that focusing on informed acquiescence often obtains the opposite results, producing ever-increasing bureaucracies designed to enforce compliance with multiplying legal and regulatory requirements which are often met by cynicism, and by the clever employees who attempt to game the system. In addition, violations lead to more bureaucracy resulting in a vicious cycle. The U.S. Sentencing Commission has acknowledged that despite the widespread movement to adopt compliance programs, there was not much evidence that the movement had resulted in *effective* compliance programs (Seidman, 2004). Table I shows the differences between the legal compliance and the ethical compliance approaches.

The current business environment provides an excellent opportunity to establish an organizational culture that goes beyond mere legal compliance.[7] Seidman (2004) observes that in suggesting an organization promote a culture that encourages a commitment to compliance with the law, it is important to understand the nature of what culture is and how it informs human decisions and actions. In other words, you cannot have a culture of compliance unless you have a culture of ethics. Seidman (2004) concludes that the failures of corporate responsibility have been shown to be not only failures of legal compliance, but more profoundly and fundamentally failures to do the right (ethical) thing; the current environment results from a loss of ethical, rather than simply legal footing. Harshbarger and Holden (2004) also agree that as the new realities of corporate governance set in, the substance of the new laws and rules must not be lost in the race to comply with their form. They point out that organizations must make a good faith effort to comply not just with the letter of the law, but with the spirit of the new reforms that recognizes three primary benefits: (1) provides organizations with a stronger measure of an inexpensive insurance mechanism and is a strong mitigating factor in any sanction imposed, (2) more accurate information flows to the top enabling more efficient and effective business decisions, and (3) the imprecise reforms offer business leaders the opportunity to emerge with more well-defined standards (leaders should be embracing this period of reform as an opportunity to institutionalize their systems).

Legal compliance mechanisms tend to promote a *rule-based or the stick approach* which corresponds to the *letter of the law* which may not necessarily inspire or instill excellence, whereas, ethical compliance mechanisms promote a *principle-based or the carrot*

TABLE I

Differences in legal and ethical compliance approaches[a]

Factors	Legal	Ethical
Ethos	Regards ethics as a set of limits and something that has to be done	Defines ethics as a set of principles to guide choices
Objectives	Geared toward preventing unlawful conduct	Geared toward achieving responsible conduct
Method	Emphasizes rules and uses increased monitoring and penalties to enforce these rules	Treats ethics as infused in business practice (leadership, core systems, decision-making processes, etc.)
Behavioral assumptions	Rooted in deterrence theory (how to prevent people from doing bad things by manipulating the costs of misconduct)	Rooted in individual and communal values (both material and spiritual)

[a]Adapted from Paine (1996).

approach which corresponds to the *spirit of the law*. Distinguishing between legal and ethical compliance can help to explain why legal compliance mechanisms are insufficient and may not be addressing the real and fundamental issues that inspire ethical behavior. Many legal decisions are made without examining the ethical aspects, especially those that deal with the fear of litigation. This may result in managers who are less practiced at decision-making and more seasoned at relegating every decision to a checklist of rules and regulations rather than relying on some ethical judgement. Ignoring the ethical dimensions of decision-making runs the risk of institutionalizing unthinking behavior (imprudence) and loses sight about what is the right thing to do (Seglin, 2000, Chapter 6). According to Howard (1994), by exiling human judgement, modern law has changed its role from a useful tool to a brainless tyrant as he puts it:

> "...rules, procedures, and rights smothering us are different aspects of a legal technique that promises a permanent fix for human frailty. Dictates are so precise that no one has the chance to think for himself. Procedural layers do away with individual responsibility. Rights are absolute so that choices among conflicting groups never need to be addressed much less balanced. Law be cleansed of human input. All tough choices, and indeed all choices, must be predetermined." (Howard, 1994, pp. 185)

Howard (1994, pp. 173/174) also observes that when humans are not allowed to understand why they are making the decision, they lose their *joy* because modern law tells them that their *duty* is only to comply, not to accomplish; understanding has been replaced by *legal absolutism*. This points to a notion of freedom that depends, at least as much on deciding how to do things as on deciding what to do. Pinckaers (2001) is of the view that legal compliance (*law of duty*) and ethical compliance (*rule of joy*) reflect two types of ethics: (1) *freedom of indifference* which is the source of ethics of obligation and is seen as an external limit imposed on the agent, and (2) *freedom for excellence* which inspires an ethics of happiness and virtue and governs the dynamism and development of a person's faculties of action which tend toward perfection and happiness of the human person. These concepts of freedom also provide the theoretical basis for explaining the different moral or ethical behavior that arises from the legal and ethical compliance approaches that are presented in Table I.

Under freedom of indifference, one loses sight of or is no longer concerned with the bigger picture (the common good or happiness) that would unite all acts in one same intention since each act is viewed as independently governed by obedience to the law. It reduces ethical behavior to cases of conscience (the act of judgement) and presupposes a freedom that can be limited only in its external expression. In this case, ethics loses its formative role and simply becomes a habit of submission to the law. Freedom for excellence, on the other hand, engenders a morality that regards happiness as decisive for the integral ordering of one's life and the formation of one's character.

Freedom for excellence can be compared with an acquired skill in an art or profession as it is the capacity to produce our acts when and how we wish, like high-quality works that are perfect in their domain. Pinckaers (1995) provide comprehensive discussion of these two concepts of freedom.

Paine (1996) identifies an organizational integrity-based stratagem that is more comprehensive and broader than the legal compliance strategy, to encourage and support an ethical corporate culture. Four challenges which must be met before an organizational integrity approach can work are: (1) developing an ethical framework, (2) aligning practice with principles, (3) overcoming cynicism, and (4) resolving ethical conflicts. In order to create an ethical compass or a framework for integrity, Paine (1994) also suggests a useful starting point is to begin by answering some questions to four fundamental sources of responsibility: (1) What is the organization's fundamental reason for being – its ultimate aim (*purpose*)? (2) Who are the constituencies to whom the company is accountable and on whom it depends for success? What are their legitimate claims and interests (*people*)? (3) What is the organization's authority and ability to act (*power*)? and (4) What are the organization's obligations or duties, as well as its guiding aspirations and ideals (*principle*)?

Conclusion

Failure in corporate governance is a real threat to the future of every corporation. With effective corporate governance based on core values of integrity and trust (reputational value),[8] companies will have competitive advantage in attracting and retaining talent and generating positive reactions in the marketplace—if you have a reputation for ethical behavior in today's marketplace it engenders not only customer loyalty but employee loyalty. Effective corporate governance can be achieved by adopting a set of principles and best practices. A great deal depends upon fairness, honesty, integrity and the manner in which companies conduct their affairs. Companies must make a profit in order to survive and grow, however, the pursuit of profits must stay within ethical bounds. Companies should adopt policies that include environmental protection, whistle blowing, ethical training programs, and so on. Such compliance mechanisms help develop and build corporate image and reputation, gain loyalty and trust from consumers, and heighten commitment from employees. Ethical compliance mechanisms contribute to stability and growth since they instill confidence; management, leadership, and administration are essentially ethical tasks. There is also a need to integrate law and ethics so that companies will be able to navigate gray areas and stay on the right side of the law, even in situations where the rule of law is ambiguous or where they might otherwise have been unaware that a law applies (Seidman, 2004).

Ethics is truly an essential ingredient for business success and it will continue to serve as the blueprint for success in the 21st century. Many of our traditional role models have fallen, and so it is more important for us to set a strong ethical example for future generations. We are in danger of breeding a whole generation of moral stutterers who are imprudent and who are abdicating their responsibility to carefully think through the ethical dimensions of their actions. Some answers to the following questions can serve as a basis for future research endeavors: Were the recent scandals in the U.S. and elsewhere the result of corporate greed and collusion, or were companies driven by market forces which they were unable or unwilling to resist? Do we need a radical overhaul of corporate governance and codes or can companies be relied upon to regulate themselves? Are businesses collectively contributing to the failures of corporate responsibility, albeit unwittingly or through ignorance? Do the solutions lie outside liberal capitalism?

Perhaps it is most appropriate to close with the following remark which succinctly captures the aspects of corporate governance as discussed in this paper:

> "An adequate corporate strategy must include non-economic goals ... An economic strategy is humanized and made attainable in a living organization by deciding on the character the company is to have, the values it espouses, and its relationships to its customers, employees, communities, and shareholders. The personal values and ethical aspirations of the company leaders, though probably not specifically stated, are implicit in all strategic decisions ... Al-

though codes of ethics, ethical policy for specific vulnerabilities, and disciplined enforcement are important, they do not contain in themselves the final emotional power of commitment. Commitment to quality objectives – among them compliance with law and high ethical standards – is an organizational achievement. It is inspired by pride more than the profit that rightful pride produces. Once the scope of strategic decision is thus enlarged, its ethical component is no longer at odds with a decision right for many reasons.'' (Kenneth Andrews, 1989, pp. 10/11)

Notes

[1] OECD April 1999, http://www.encycogov.com/WhatIsGorpGov.asp.

[2] Marshall Cogan (the founder, controlling shareholder, CEO and Chairman of the Board of Directors of Trace Holdings International) over a period of 15 years, took some $40m from the company through a number of self-dealing transactions while the officers and directors stood by idly. Trace ultimately entered into a Chapter 7 bankruptcy proceeding and the trustee subsequently filed a suit against Cogan and the Trace officers and directors. The court held for the trustee, citing the directors' utter failure to exercise their legal duties to act on behalf of Trace's shareholder and creditors, and went so far as to impose liability on Trace officers who were not part of the board, but who had the authority to preempt Cogan's misappropriations (Dandino, 2004). Martha Stewart was also recently convicted and was found guilty of conspiracy, making false statements and obstruction of justice. Her ex-stockbroker, Peter Bacanovic was also convicted of similar charges.

[3] In January 2003, AIMR and its Disciplinary Review Committee sent a letter to all AIMR members reminding them of their obligations under the Code and Standards requesting, ''*If you become aware of unethical conduct by a fellow member, please let us know. If you are unsure about the membership status of an investment profession, file a complaint and we will make that determination … we cannot act without knowledge of a violation and we cannot act against those who are not AIMR members. You can help us acquire that knowledge, and we encourage you to take a more active interest in ensuring that AIMR members abide by the Code and Standards (www.aimr.org).*''

[4] The Sarbanes–Oxley Act of 2002 (signed into law on July 30), the most radical reform of corporate governance since the Great Depression of the 1930s, has a number of major ramifications on large businesses: banning loans to directors and officers; disgorging compensation already paid to CEOs and CFOs in cases of financial misconduct; directing CEOs and CFOs to personally certify their familiarity with reports, legal compliance, material accuracy, and disclosures to the public and to the audit committee; requiring the audit committee to preapprove outside auditors and avoid some non-audit services such as consulting; rotating the responsible partner reporting directly to the audit committee and avoiding conflicts and coercion; requiring the audit committee to have sole authority over auditors and consist of only non-management directors; establishing protections for whistle-blowers and disclosing the identity of financial experts on the committee and board; calling for attorneys to report violations by their corporate clients and, if there is no action, to report violations to the SEC directly. It also calls for additional or accelerated SEC filings, reviews, and disclosures; corporate disclosure of a code of ethics governing conduct of management and financial personnel; and extensively increased SEC enforcement and penalties (Jacobs, 2004). The Act defines the code of ethics as necessary standards to promote: ''(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships, (2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issue, (3) compliance with applicable governmental rules and regulations (Carpenter, 2004).''

[5] In practice, many firms adopt the model of social responsibility. There is a push for what is called ''The Triple Bottom Line'' model of the firm – economic, social, and environmental – which has been gaining recognition in the business community due to pressure of the recent scandals. This effort has been pioneered by the Global Reporting Initiative (GRI – www.globalreporting.org).

[6] The Economist (2004, p. 15) observed that many people are concerned about the proliferation of new business regulations used to prevent recurrence of business scandal, but over-regulation may not be the right answer. A recent study by a World Bank team (The Economist, 2004, p. 16) also reveals that the poorest countries have the most rules which make returns from entrepreneurial risk-taking unattractive and provides an avenue for corruption. The same study also concluded that over-regulation can scare away foreign capital.

[7] A speech given by Commissioner Cynthia Glassman on Sarbanes–Oxley's lesson for Broker Dealers, October 17, 2003, captures this aspect: ''*As we move past Sarbanes–Oxley and the requirements, rules and regulations that*

have come in its wake, it's essential that corporate boards look beyond the letter of the law and be ever mindful of the spirit of the reforms. By determining what makes up the moral DNA of the company and establishing a culture that puts ethics and accountability first, a company and its Board are less likely to fall into the common trap of mere compliance – where simply identifying a new line of legally acceptable behavior and how to maneuver the loopholes that accompany it passes for a commitment to reform.'' The Commission's *Ad Hoc* Advisory Group recommended a focus on corporate culture and the dispositive role culture plays in getting more respect for the law.

[8] There seems to be a shift in focus away from compliance towards ethics as corporate reputation and reputational value become more central. A survey of 2000 public and private companies, conducted by Aon, an American insurance company, found that the single biggest risk or business hazard was *reputational risk* (The Economist, 2004, p. 14).

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