HOW THE SEC MAKES RULES BY PROXY WITH SARBANES-OXLEY AND COSO 2.0: A PEDAGOGICAL NOTE

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I. INTRODUCTION

Current business law textbooks oversimplify instruction of administrative law, giving students a misleading picture of how agency rules are made. This oversimplification mischaracterizes systemic realities that future business leaders need to know. Instructors of business law and accounting courses at the undergraduate and graduate levels can augment textbook material and enhance students' operational knowledge through the use of a pertinent and relevant administrative law example. The Security and Exchange Commission's internal control framework requirement for publicly traded companies highlights the real relationship between the US Congress, administrative agencies and the private sector, through a proxy rulemaking process. Therefore, the Security and Exchange Commission's internal control framework requirement provides an example that will aid students learning administrative law.

The following discussion proceeds in three parts. First, a brief history of the Security and Exchange Commission and the Sarbanes-Oxley Act of 2002 is supplied, and the Security and Exchange Commission's use of proxy rulemaking introduced. Second, the proxy rulemaking process is illustrated in detail through the Security and Exchange Commission's adoption of COSO internal control frameworks and the COSO definition of internal control for financial reporting. Third, current textbooks are reviewed, the need for a pertinent and relevant example is established, and an illustrative visual of the relationships between the Security and Exchange Commission, Congress, and the private sector is introduced, relative to the internal control framework / proxy rulemaking example discussed.

II. THE SEC, THE SARBANES-OXLEY ACT OF 2002, AND COSO

Beginning in 2015, the Security and Exchange Commission (hereinafter the SEC) required all publicly traded companies using the internal controls framework COSO 1992 (hereinafter COSO 1.0) to meet the internal controls

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requirements for financial reporting certifications and attestations to move to the revised framework, COSO 2.0, or an equivalent. The SEC has recommended COSO frameworks 1.0 and 2.0 in succession to meet management's internal controls for financial reporting certification requirements under the Sarbanes-Oxley Act of 2002 (hereinafter SOX).

The manner in which the SEC chose to recommend COSO internal control frameworks, frameworks promulgated by a committee sponsored by five private sector organizations, and the adoption of a key COSO definition into SEC rules form an example of proxy rulemaking. Proxy rulemaking highlights the increasingly important and complex relationships between administrative agencies and the private sector, relationships not generally addressed in undergraduate business law textbooks or graduate accounting materials. Using a specific proxy rulemaking example involving the SEC, SOX, and the COSO frameworks enhances instruction of administrative law.

The U.S. Congress passed SOX following the high impact fraud and accounting scandals of Enron in 2001 and WorldCom in 2002. Under codified portions of SOX, management is required to certify internal control effectiveness and external auditors must attest to the same in conjunction with their audits of company financial statements.[1] In order to effectuate oversight of these requirements, Congress granted additional oversight powers to the SEC, an administrative agency it first enabled in the Securities Exchange Act of 1934.[2]

In addition to augmenting the rulemaking authority of the SEC through SOX, Congress created a new entity, a nonprofit corporation named the Public Company Accounting Oversight Board (hereinafter PCAOB).[3] The PCAOB exists to "oversee the audits of public companies in order to protect investors in the public interest by promoting informative, accurate, independent audit reports."[4] The PCAOB is responsible for establishing the specific requirements for internal control attestation, including audits of internal controls over financial reporting by external auditors, and for establishing controls for evaluation and classification of internal control errors.[5] As part of fulfilling the internal control attestation requirements, auditors must test internal controls using a recognized framework.[6] The PCAOB's focus on the public accounting profession is specifically separated

[1] *See* Sarbanes-Oxley Act of 2002, Pub. L. 107–204, title III, § 302, 116 Stat. 745, 777, and Pub. L. 107–204, title IV, § 404, 116 Stat. 789 (2002).
[2] Securities Exchange Act of 1934, 15 U.S.C. §77a (4).
[3] Sarbanes-Oxley Act of 2002, title I, 116 Stat. 745, 750-71.
[4] About the PCAOB, www.pcaobus.org/About/Pages/default.aspx (last visited May 26, 2016).
[5] Diane J. Janvrin et al., *The Updated COSO Internal Control Integrated Framework: Recommendations and Opportunities for Future Research*, 26 J. INFO. SYS. 189, 190 (2012).
[6] *See id.* at 190-91 (Though not explicitly required, the COSO frameworks are recommended by the PCAOB).

in SOX from the business management certification requirement.[7] Though granted rulemaking responsibilities under SOX, the PCAOB is subordinate to the SEC.[8] The PCAOB may develop and draft rules, but is the SEC who ultimately ratifies those rules.[9]

As previously indicated, it is the sole responsibility of the SEC to promulgate rules interpreting management's certification requirements under SOX.[10] These certification requirements caused the SEC to revise previous rules related to certifications, some traceable to the administrative agency's inception.[11] In particular, to effectuate the new required certifications under SOX the SEC needed to provide a clear definition of *internal accounting controls,* a term used in SOX, and a framework pertaining to management's internal controls oversight requirement.

Rather than develop its own definition or framework, the SEC chose to build upon an existing definition and recommend the use of an existing framework, both from the Committee of Sponsoring Organizations (hereinafter the COSO).[12] This action, an administrative agency delegating some of its responsibility to establish standards to an entity in the private sector, is proxy rulemaking.[13] Through proxy rulemaking, the administrative agency retains final decision-making authority while transferring substantive rule drafting power to a private sector third party. In effect, it is similar to the relationship between the PCAOB and the SEC designed by Congress. The differences are in the SEC's selection of a third party private sector participant versus Congressional design, and the funding for each.[14] The use

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[7] *See* Sarbanes-Oxley Act of 2002, title I, § 101(c), 116 Stat. 745, 751-52.

[8] *See* Tammy Whitehouse, *More Hints on Putting COSO Framework to Work*, COMPLIANCE WK., Feb. 2015, at 40 (With the issuance of COSO 2.0, some conflict has arisen between the COSO and the PCAOB, specifically between the two entities differing guidance for auditing and reviewing IT controls, entity-level controls, and management review controls).

[9] *See* Sarbanes-Oxley Act of 2002, title I, 116 Stat. 745, 750-771 (noting that duties and rules of the PCAOB are subject to action or approval of the SEC).

[10] Whitehouse, *supra* note 8, at 40.

[11] Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Securities Act Release No. 33-8238, Exchange Act Release No. 34-47986, Investment Company Act Release No. 26068, 68 Fed. Reg. 36,636 at 36,636 (June 18, 2003) ("We are adopting amendments to our rules and forms under the Securities Exchange Act of 1934 and the Investment Company Act of 1940 to revise Section 302 certification requirements and to require issuers to provide the certifications required by sections 302 and 906 of the Sarbanes-Oxley Act of 2002 as exhibits to certain periodic reports.").

[12] *See infra* notes 30-34, 43 and accompanying text.

[13] *See infra* note 15 (explaining the SEC's relationship to the PCAOB in a similar example of proxy rulemaking).

[14] *See supra* note 3, *infra* note 20, and accompanying text; *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, H.R. 4173 (2010) (Created under SOX, the PCAOB was actually funded under the Dodd-Frank Act).

of COSO frameworks by the SEC forms a pertinent and relevant example of proxy rulemaking, but it is hardly an isolated example, as the SEC has used proxy rulemaking in the past with other entities in the private sector.[15] The fact that this is not an isolated incident of proxy rulemaking impacting business highlights the contention such an example should be used in the instruction of administrative law.

The COSO is a joint initiative of five private sector organizations: the Institute of Internal Auditors, the American Accounting Association, the American Institute of Certified Public Accountants, Financial Executives International, and the Institute of Management Accountants.[16] When it originally formed in 1985, the primary goal of the COSO was addressing challenges arising from a documented increase of fraudulent financial reporting.[17] Today, the COSO is "a voluntary private sector initiative dedicated to improving organizational performance and governess through effective internal control, enterprise risk management, and fraud deterrence."[18] The COSO's Board of Directors is composed of representatives from each of the five sponsoring organizations.[19] The representatives are appointed by their sponsoring organizations and serve terms defined by the same.[20] The mission of the COSO is to "provide thought leadership through the development of comprehensive frameworks and guidance on enterprise risk management, internal control and fraud deterrence designed to improve organizational performance and governance and to reduce the extent of fraud in organizations."[21] Funding for the COSO initially came from its sponsoring organizations.[22] Now, the funding comes through "publication sales and in-kind contributions from project partners, notably PricewaterhouseCoopers and Grant Thornton LLP. Sponsoring organizations cover various costs and services related to administration and the Board of Directors."[23]

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[15] Facts about FASB, http://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1175801855769 ("The SEC has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest.").

Id.

[16] J. Stephen McNally, *The 2013 COSO Framework and SOX Compliance*, STRATEGIC FIN., Jun. 2013, at 1, 2.

[17] David L. Landsittel & Larry E. Rittenberg, *COSO: Working with the Academic Community*, 24 ACCT. HORIZONS 455, 455 (2010).

[18] McNally, *supra* note 16, at 2.

[19] Landsittel & Rittenberg, *supra* note 17, at 456.

[20] *Id.* at 456-47.

[21] COSO website, http://www.coso.org/aboutus.htm (last visited Mar. 29, 2016).

[22] *Id.* at 456.

[23] *Id.* at 456-57.

In 1992, the COSO published and released its initial internal controls integrated framework, COSO 1.0.[24] On May 14, 2013, COSO released an updated version of the internal control integrated framework, COSO 2.0.[25] The framework was updated to "bring it in line with current business practices, especially to reflect the modern uses of technology in business."[26] The SEC has strongly encouraged the use of both COSO frameworks, in succession, to meet management's required oversight for internal controls over financial reporting.[27] In addition, it was through reference to COSO 1.0 that the SEC first developed its definition for *internal controls over financial reporting (ICFR)*.[28] In SOX, Congress used the term *internal controls structure and procedures for financial reporting* in reference to controls that would now require company management oversight and certification.[29] The SEC, through its congressionally granted rulemaking authority, announced that the term *internal controls over financial reporting (ICFR)* would be adopted in the rules and regulations, as such would fulfill Congresses' purpose in using the term *internal controls structure and procedures for financial reporting*.[30] The SEC also determined that term to be an acceptable replacement for the terms *internal controls* and *disclosure controls and procedures*, also used in SOX.[31] The SEC reasoned that:

> The term ICFR is the predominant term used by companies and auditors and best encompasses the objectives of the SOX act. In addition, by using this term, we avoid having to familiarize investors, companies and auditors with new technology, which should lessen any confusion that may exist about meaning and scope of internal controls.[32]

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[24] *See* Management's Report on Internal Control Over Financial Reporting 68 Fed. Reg. at 36,639, footnote 42 (Prior to issuance of COSO 2.0, COSO 1.0 was revised twice, once in 1994 by an addendum which focused on controls for safeguarding assets and once in 1996, addressing financial derivatives).
[25] McNally, *supra* note 16, at 2.
[26] Tammy Whitehouse, *The Many Applications of the New COSO Framework*, COMPLIANCE WEEK, Jan. 2015, at 31; *also* Diane J. Janvrin et al., *supra* note 5, 190 ("The goal of the updated framework is to help organizations develop and maintain a system of internal controls that are adaptable to changes in business and operating environments.").
[27] *See* Whitehouse, *More Hints on Putting COSO Framework to Work*, *supra* note 8, at 40 (referring to remarks by SEC Deputy Chief Accountant Nili Shah on the expected move from the 1992 framework, COSO 1.0, to COSO 2.0).
[28] *See infra* notes 30-34 and accompanying text.
[29] *See* Sarbanes-Oxley Act of 2002, Pub. L. 107–204, title III, § 302, 116 Stat. 745, 777 (2002).
[30] *See* Management's Report on Internal Control Over Financial Reporting 68 Fed. Reg. at 36,640.
[31] *Id.* at 36,638, n35.
[32] *Id.* at 36,640.

The SEC did not invent the term *ICFR*[33]. In fact, the SEC stated in comments to its final rule on Management's Report on Internal Controls Over Financial Reporting that it adopted the term from the COSO.[34]

According to the SEC, adopting a term from a private sector entity focused on building internal control frameworks for managers was appropriate "given the fact that [the SEC] definition will be used for purposes of public management reporting."[35] Furthermore, the SEC felt comfortable adopting a definition from the COSO because that entity's decision-making process, as described by the SEC, demonstrated a measure of procedural due process.[36]

The SEC's final rules addressing the new reporting and certification requirements under SOX require the annual reports of publicly traded companies include an internal controls report by management.[37] Such reports

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[33] *Id.* at 36,640. The SEC defines ICFR as:

> A process designed by, or under the supervision of, the registrant's principal executive and principal financial officers, or persons performing similar functions, and effected by the registrant's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:
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> (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant;
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> (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and
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> (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the registrant's assets that could have a material effect on the financial statements.

[34] *See id.* at 36,639 (noting the COSO definition of internal control: "a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives''. Such processes were, under the original COSO definition, in three categories—effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations).

[35] *Id.* at 36,641.

[36] *Id.* at 36,639 ("COSO undertook an extensive study of internal controls to establish a common definition that would serve the needs of companies, individual public accountants, legislators and regulatory agencies, and to provide a broad framework of criteria against which companies could evaluate the effectiveness of their internal control systems."); *see also* Landsittel et al., *supra* note 17, 457 (regarding COSO's procedural due process: "We work with the SEC and PCAOB to identify areas where practice may be having difficulty in implementing our frameworks. Other initiatives emanate from (1) scanning of the environment to identify current issues affecting the frameworks and need for additional guidance, (2) reviewing research that addresses a need for new or additional guidance, and (3) obtaining direct support from sponsoring organizations.").

[37]Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934; Final Rule,

must include a statement identifying the framework used by management to conduct the required evaluation of the effectiveness of the company's ICFR.[38] The SEC noted that the use of standard, publicly available measures would enhance the quality of the internal control reports and promote comparability of reports of different companies.[39] Though the SEC placed emphasis on the benefits of common standards, it did not mandate use of a specific internal control framework.[40] Instead, the SEC determined characteristics of acceptable frameworks.[41] The SEC now requires that management base evaluation of the effectiveness of ICFR on a framework that is:

- suitable and recognized,
- established by body or group that follows due process procedures, including the broad distribution of the framework for public comment,
- free from bias,
- permits reasonably consistent qualitative and quantitative measurements of the company's internal controls,
- sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of a company's internal controls are not admitted, and
- relevant to an evaluation of internal controls over financial reporting.[42]

The SEC recommended use of the COSO 1.0 framework, stating

> The COSO framework satisfies our criteria and may be used as an evaluation framework for purposes of management's annual internal control evaluation and disclosure requirements. However, the final rules do not mandate use of a particular framework, such

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Securities Act Release No. 33-8810, Exchange Act Release No. 34-55929, 72 Fed. Reg. 35,324 at 35,324 (June 27, 2007) ("Management is responsible for maintaining a system of internal control over financial reporting ("ICFR") that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposed in accordance with generally accepted accounting principles. The rules we adopted in June 2003 to implement Section 404 of [SOX] require management to annually evaluate whether ICFR is effective at providing reasonable assurance and to disclose its assessment to investors.").

[38] Management's Report on Internal Control Over Financial Reporting, 68 Fed. Reg. at 36,654.

[39] *Id.* at 36,642.

[40] *Id.* at 36,642.

[41] *Id.* at 36,642.

[42] *Id.* at 36,642.

> as the COSO framework, in recognition of the fact that other evaluation standards exist outside of the United States, and that frameworks other than COSO may be developed within the US in the future, that satisfy the intent of the statute without diminishing the benefits to investors.[43]

III. PERTINENCE & RELEVANCE

For purposes of evaluating the quality of examples in current administrative law texts and review materials and assessing the usefulness of the internal controls framework / proxy rulemaking example advocated here, the terms relevance and pertinence are both used, each with a distinct meaning. Pertinence speaks to the usefulness of the example to business students, and relevance refers to efficacy of the specific law example in illustrating multiple administrative law concepts.

A. *Defined*

These definitions differ from those generally given to the terms in literature promulgated by the PCAOB and from the SEC's use of relevance in determining requirements for an internal controls framework.[44] Nor does relevance, as used here, have the same meaning as in the legal field of evidence. The terms as used here are consistent with the definitions discussed in information systems literature, wherein clear distinctions between the two are made. Generally, pertinence is recognized as having a more personal, subjective quality than relevance; it has also been termed "subjective utility."[45] A pertinent document is one the user finds useful because it has

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[43] *Id.* at 36,642; *see also id.* at note 67 (Mentioning two other frameworks which would satisfy requirements of the final rules, *The Guidance on Assessing Control* from the Canadian Institute of Chartered Accountants and the *Turnbull Report* from the Institute of Chartered Accountants in England and Wales).

[44] *See* Myojung Cho et al., *Two conflicting definitions of relevance in the FASB Conceptual Framework*, 29 J. ACCT. PUB. POL'Y 604, 605 (2010) (Describing two conflicting definitions of relevance, one in FASB Concept Statement No. 2 and the other in Exposure Draft, Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Report Information. Both definitions define relevance as a form of pertinence, the first specifically as "the pertinence of the chosen economic phenomenon" and the second as "the pertinence of accounting information to decisions". Note that both these definitions focus on substantive content of information. By contrast, the definitions constructed for use here delineate relevance and pertinence with different goals and audiences); *supra* note 42 and accompanying text.

[45] D. A. Kemp, *Relevance, Pertinence and Information System Development*, 10 INFO. STORAGE RETRIEVAL 37, 37 (1973).

bearing on his particular situation, while the relevance of the document is something which can be agreed by several people expert in the particular field of interest.[46] Relevance and pertinence are therefore distinct, the first capable of public, objective assessment, the second driven by private, subjective assessment.[47]

The pertinent viewpoint is determined from the perspective of the student using the material, i.e. what specific example of administrative law would best meet the information needs of the student. As previously discussed, the general definition of pertinence emphasizes private, subjective assessment. Neither of these attributes is practically obtainable in their purest sense, as a determination of absolute pertinence would require assessment of the administrative law example by every individual student before the example could be taught. Therefore, the viewpoint applied for determination of pertinence in this instance is collective, and the pertinence of an administrative law example is the measure of how applicable the example will be to the students' education and future careers.

In the evaluation of business law and accounting texts, the relevant viewpoint for determining the subjective quality of relevance is the pool of textbook authors. Generally, the authors agree on what aspects of administrative law should be taught, and any variation between the texts stems from the amount of detail the authors wish to present. Given the subjective expert view of the textbook authors, a relevant example for illustrating administrative law is one which demonstrates the maximum number of common aspects.

The assessment qualifications applied to examination of the proposed COSO proxy rulemaking example and current Business Law and Accounting texts are:

> *Pertinence* – The usefulness of the example to business students. Does the example highlight information the students will use in their future management and / or accounting careers? Specifically, does it include identification of different regulatory stakeholders they are likely to encounter and work with and rules and regulations that will govern their actions?
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> *Relevance* – A relevant example illustrates multiple principles of administrative law, including enabling legislation and rulemaking by the administrative agency.

[46] *Id.* at 37.
[47] *See id.* at 37.

B. *Pertinence Assessed – Information Needs of Future Managers & Accountants*

Management and Accounting were selected as the featured career fields for determining pertinency because management is a broad category encompassing different business specialties, and the accounting / auditing industry specifically is expected to enjoy above average job growth in the next ten years. According to the Bureau of Labor Statistics, the projected percent change in employment for Accountants and Auditors through 2024 is eleven percent, markedly above the projected average growth rate of seven percent.[48]

Since the internal control framework / proxy rulemaking example focuses in part on a framework future managers need to know, the example is pertinent to business students generally. For accounting students, the SEC proxy rulemaking by COSO example, particularly if accompanied by a useful visual, would address several topics included in preparation for the Certified Public Accountant (CPA) exam, thereby making it a highly pertinent example. All four sections of the CPA Exam test knowledge of the SEC, SOX, PCAOB, or the COSO 2.0 framework.[49] In addition to testing those specific concepts, the REG (Regulation) section of the CPA exam also tests material on administrative law.[50]

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[48] Bureau of Labor Statistics, U.S. Department of Labor, Occupational Outlook Handbook, 2016-17 Edition, http://www.bls.gov/ooh/ (last visited May 10, 2016)
Accountants and Auditors, https://www.bls.gov/ooh/business-and-financial/accountants-and-auditors.htm (expected growth – 11%. Average growth rate is 7%);
Top executives – http://www.bls.gov/ooh/management/top-executives.htm (expected growth – 6%. Average growth rate is 7%);
Administrative services managers - http://www.bls.gov/ooh/management/administrative-services-managers.htm (expected growth – 8%. Average growth rate is 7%);
Financial managers – http://www.bls.gov/ooh/management/financial-managers.htm (expected growth – 7%. Average growth rate is 7%);
Computer and Information Systems Managers – http://www.bls.gov/ooh/management/computer-and-information-systems-managers.htm (expected growth – 15%. Average growth rate is 7%).

[49] *See* BOARD OF EXAMINERS, INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, CONTENT AND SKILL SPECIFICATIONS FOR THE UNIFORM CPA EXAMINATION (2015).
AUD (Auditing and Attestation) – COSO §II.F.1., PCAOB §VI.B.2.
FAR (Financial Accounting and Reporting) – SEC §I.A.1., SEC Reporting Requirements §I.D.
REG (Regulation) – SEC enabling legislation (references).
BEC (Business Environment and Concepts) – Sarbanes-Oxley Act of 2002 (references).

[50] *Id.* at §II.B. – Agency, §II.C. – Government Regulation of Business.

C. *Relevance Assessed – Proxy Rulemaking & Administrative Law*

By virtue of the SEC's proxy rulemaking, the relationships between SOX, the SEC and private sector COSO demonstrate a number of administrative law concepts, all while illuminating realities of private sector involvement in modern administrative law. This makes an administrative law example crafted from those relationships highly relevant to administrative law instruction. The internal control framework / proxy rulemaking example discussed features two entities created through enabling legislation (SEC and PCAOB), rulemaking authority of an administrative agency and an administrative agency looking to the private sector for definitional terms and frameworks, making it a relevant example.

IV. CURRENT ADMINISTRATIVE LAW INSTRUCTION

To examine how administrative law is currently presented in Business Law textbooks, a sample of four books was taken. To be in the sample each text had to be in, at a minimum, its third edition. Two different textbook publishers were sampled. In addition, it was confirmed that three of the textbooks had been used by current Business Law faculty at West Texas A&M University as the primary text for Business Law classes within the past three years.[51] Selected textbooks were analyzed to determine if they addressed administrative law and how each introduced the concept, with emphasis either on the need for future business leaders to know rules and regulations or on the power of administrative agencies as a fourth branch of government. Textbooks were also examined to see if they discussed either the SEC or SOX.

[51] PAGNATTARO, MARISA A., ET AL., THE LEGAL AND REGULATORY ENVIRONMENT OF BUSINESS (17th ed. 2016); KUBASEK, NANCY K., ET AL., DYNAMIC BUSINESS LAW: THE ESSENTIALS (3rd ed. 2015); CHEESEMAN, HENRY R., LEGAL ENVIRONMENT OF BUSINESS: ONLINE COMMERCE, BUSINESS ETHICS, AND GLOBAL ISSUES (8th ed. 2016).

Exhibit A: Table – Textbooks Analyzed

Text (Edition/ Publisher)	Administrative Law Chapter / Section	Emphasis: Rules and Regulations	Emphasis: 4th Branch	SEC / SOX
Legal & Regulatory Environment of Business (17th / McGraw Hill)[52]	X[53]	X[54]		X[55]
Dynamic Business Law (3rd / McGraw Hill)[56]	X[57]	X[58]		X[59]
Legal Environment of Business (8th / Pearson)[60]	X[61]		X[62]	X[63]
Business Law (16th / McGraw Hill)[64]	X[65]	X[66]	X[67]	X[68]

[52] PAGNATTARO, MARISA A., ET AL., *supra* note 51.
[53] *Id.* at 444-70.
[54] *Id.* at 446 ("The direct day-to-day legal impact on business of the rules and regulations adopted and enforced by these agencies is probably greater than the impact of the courts or other branches of government … the administrative process at either the state or federal level regulates almost every business activity.").
[55] *Id.* at 537-542.
[56] KUBASEK, NANCY K., ET AL., *supra* note 51.
[57] *Id.* at 54-74.
[58] *Id.*at 55 ("As a business owner or manager, you will need to be aware of regulations that affect your business. In addition to learning about laws passed by Congress, you will also need to know about rules passed by administrative agencies.").
[59] *Id.* at 118-19, 496.
[60] CHEESEMAN, HENRY R., *supra* note 51.
[61] *Id.* at 55-57.
[62] *Id*. at 55 ("Because of their importance, administrative agencies are informally referred to as the fourth branch of government.").
[63] *See generally id.*
[64] MALLOR, JANE P., BUSINESS LAW: THE ETHICAL, GLOBAL, AND E-COMMERCE ENVIRONMENT (16th ed. 2016).
[65] *Id.* at 1270-1303.
[66] *Id.* at 1272 ("Today's businesses operate in a highly regulated environment. The administrative agency serves as a primary vehicle for the creation and enforcement of modern regulation.").

Of the business law textbooks reviewed, all had either an administrative law chapter or section and all mentioned the SEC and SOX at least once, though not always in the administrative law chapter or section.[69] All either emphasized the need for business students to know how administrative agencies make rules and regulations that impact businesses or deemed administrative agencies so important that they should be named the fourth branch of government.[70] One text did both.[71]

Though these texts deemed it important to teach business law students the rudiments of administrative law, none offered a single, relevant example that was also pertinent to the students. For example, one text began its administrative law chapter with a case introduction about the EPA but then jumped to a historic synopsis of administrative law history featuring the Interstate Commerce Commission.[72]

In addition to a lack of relevance and pertinence in examples currently used, the textbooks presented misleading language and sparse visual aids. Regarding language, one text claimed that "administrative law consists of the substantive and procedural rules created by administrative agencies …"[73] As seen by the internal control framework / proxy rulemaking example, such a statement does not accurately describe the realities of rulemaking or the relationships that exist between administrative agencies and the private sector.

V. USE OF VISUALS IN ADMINISTRATIVE LAW INSTRUCTION

Only one of the Business Law textbooks reviewed offered a visual explanation of relationships between groups that influence and impact administrative law. This figure, titled Powers of Administrative Agencies, shows each of the three traditional branches of government giving some form of power to administrative agencies.[74] The visual makes a fair attempt at showing one facet of the relationships between administrative agencies and other branches of the government, but by excluding the private sector from the relationship diagram it loses pertinence.

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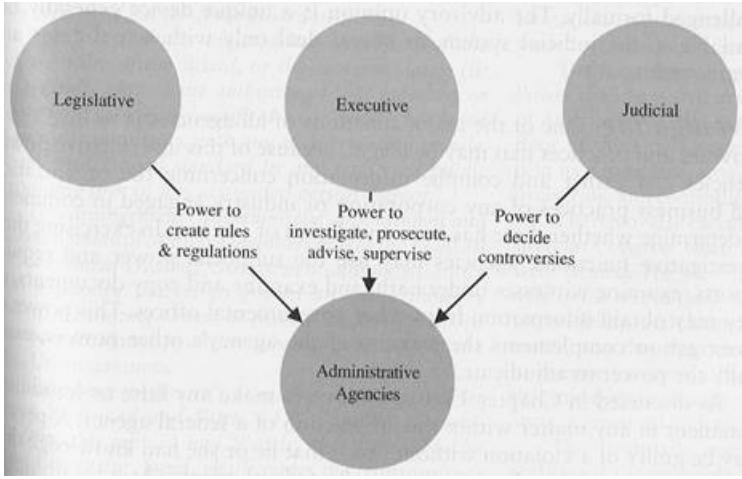
[67] *Id.* at 1272 ("The inflows of administrative agencies has become so sweeping that they are sometimes referred to as the "fourth branch" of a government that officially consists of three branches (legislative, executive, and judicial).").
[68] *See generally id.*
[69] *Supra* notes 53, 55, 57, 59, 61, 63, 65, 68.
[70] *Supra* notes 54, 58, 62.
[71] *Supra* notes 66, 67.
[72] KUBASEK, NANCY K., ET AL., *supra* note 51, at 54-55.
[73] *Id.*at 55.
[74] PAGNATTARO, MARISA A., ET AL., *supra* note 51, at 449, Figure 15.1.

Exhibit B: Figure – The Power of Administrative Agencies[75]

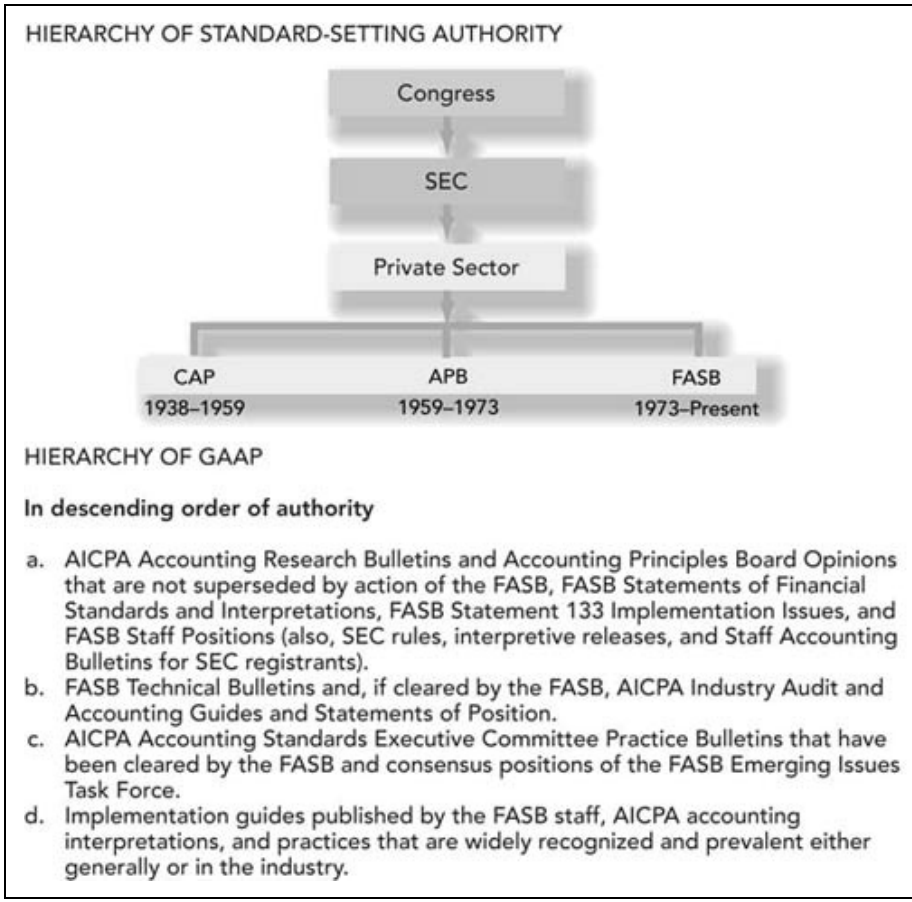


Another visual on the subject, found in an intermediate accounting text and shown below, illustrates a hierarchy of some of the entities involved a different example of proxy rulemaking by the SEC, but does not clearly illustrate the flow of information between the associated entities.[76]

[75] *Id.* at 449, Figure 15.1

[76] J. DAVID SPICELAND ET AL., INTERMEDIATE ACCOUNTING, Chapter 1 (Ebook, 4th ed. 2007) ("Congress gave the SEC the responsibility and authority to set accounting standards, specifically for companies whose securities are publicly traded. The SEC has delegated the task to various private sector bodies (currently the FASB) while retaining its legislated authority.").

Exhibit C: Figure – Accounting Standard Setting[77]



Regarding the usefulness of visuals generally, the visualizer-verbalizer learner hypothesis, long a standard of educational practice, emphasizes that some students are better at processing words and some are better at processing pictures.[78] Well-constructed visuals can drive the learning process for visual learners. In addition, a good visual can benefit learners who best

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[77] *Id.*; *see also* "The Hierarchy of Generally Accepted Accounting Principles," Proposed Statement of Financial Accounting Standards, (Norwalk, Conn.: FASB), April 28, 2005.
[78] *See* Richard E. Mayer & Laura Massa, *Three Facets of Visual and Verbal Learners: Cognitive Ability, Cognitive Style, and Learning Preference*, 95 J. EDUC. PSYCHOL. 833 (2003) (Arguing that the visualizer-verbalizer hypothesis should form the base for a detailed framework analyzing learning on three facets, cognitive ability, cognitive style, and learning preference).

comprehend material presented in either a sequential format or with a global, "big picture" view.[79]

Because of the presence of visual learners in the classroom and the current lack of pertinent and relevant visual examples in the instruction of administrative law, students would benefit by a flow chart showing the chronological progression of information, laws, and regulations related to the internal control framework / proxy rulemaking example. Moreover, a flow chart organized by *swimlanes* would increase the impact of a single visual by adding an additional layer of information.

Swimlanes are a feature of many Business Process Management Notation (BMPN) flowcharts, where they allow for the presentation of collaborative (global) processes from a role-based perspective.[80] The swimlanes system shows the viewer who the key stakeholders are by placing each stakeholder in a separate lane.[81] As applied in Exhibit D below, *swimlanes* show the separate processes performed by the Legislative Branch, the Executive Branch, and the Private Sector. Process flow arrows traveling between the *swimlanes* illustrate the relationships between the parties at the same time they power the chronological record of the administrative law process.

In addition to the immediate learning benefits of the visual, there is an added benefit to using *swimlanes* and BPMN notation. BMPN, first released in May 2004, has gained wide acceptance as a standard for constructing visual models of business processes.[82] It is even used in conjunction with COSO 1.0 / 2.0 to meet the frameworks' internal control requirement of documenting business processes.[83] The notation is so common in the accounting field that BPMN diagrammatic process mapping is now included in many accounting information systems texts.[84] In addition, use of the notation will make the example more pertinent to Information Systems

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[79] *See contra* J. Efrim Boritz, et al., *The Effect of Business Process Representation Type on Assessment of Business and Control Risks: Diagrams versus Narratives*, 27 ISSUES IN ACCT. EDUC., 895 (2012) (Claiming that use of flowchart visuals has a negligible effect on student learning. However, the authors made no efforts to separate their test groups before the experiment into visual-verbalizer or other recognized cognitive categories. Therefore, based on the results presented no conclusions can be drawn about the effectiveness of flowchart visuals in instruction of visual learners).

[80] Ryan K.L. Ko, et al., *Business Process Management (BPM) Standards: A Survey*, 15 BUS. PROCESS MGMT. J. 744, 757 (2009).

[81] *See id.* at 757-58.

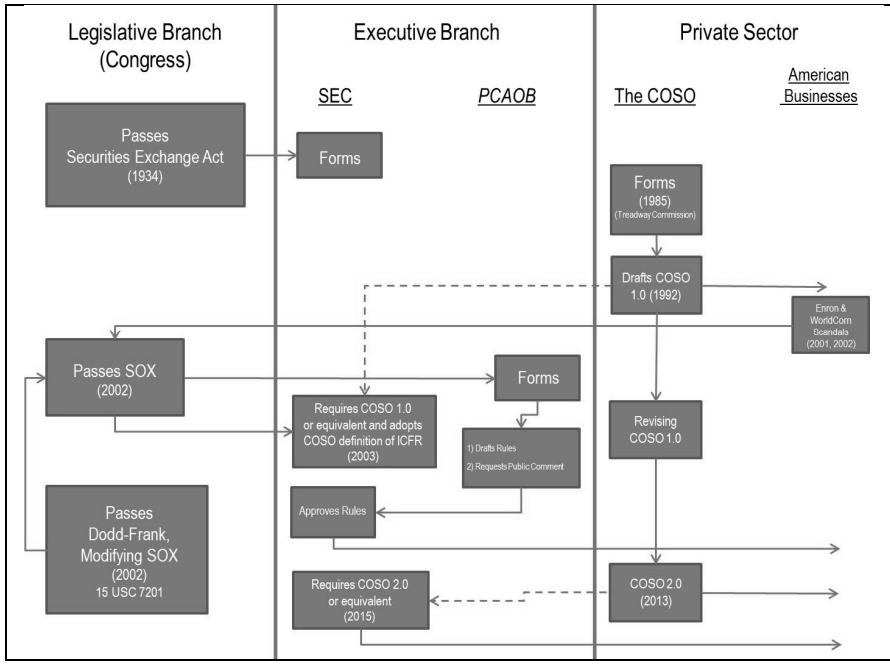
[82] *Id.* at 756.

[83] *See* Kenton B. Walker, *SOX, ERP, and BPM: A Trifecta That Can Make Your Business Run Better*, STRATEGIC FIN., Dec. 2008, www.thefreelibrary.com.

[84] J. Efrim Boritz, et al., *The Effect of Business Process Representation Type on Assessment of Business and Control Risks: Diagrams versus Narratives*, 27 ISSUES ACCT. EDUC. 895, 903 (2012).

business majors, students hoping to enter an industry seeing above average employment growth.[85]

Exhibit D: Figure – SEC, SOX & COSO Flowchart



Entities featured in the flowchart here are the US Congress (legislative branch), the SEC and PCAOB (administrative agencies under the executive branch), the COSO, and American Businesses (private sector). PCAOB is italicized to show it is different from the SEC, specifically that it is subordinate to the SEC.[86] The swimlane format could be adapted to show an example involving the legislative branch, executive branch, and judicial branch. The current flowchart could also be adapted to illustrate other proxy rulemaking examples, such as the SEC's required use of GAAP.[87]

The visual can be presented by course instructors either chronologically or by process. Chronologically, the action in the flowchart moves from top to bottom. If the focus is on information flows, note that because rules and frameworks from the private sector are not binding on the administrative

[85] *Supra* note 48.
[86] The subordination of the PCAOB to the SEC is also noted with an information flow from the PCAOB to the SEC, after rules are drafted but before the rules are approved.
[87] *Supra* note 15.

agency, process flows from the private sector to the agency are shown as dashed lines.

VI. CONCLUSION

The SEC interacts with private sector groups like the COSO through proxy rulemaking, a process by which the administrative agency delegates some of its responsibilities to a third party. An example featuring a proxy rulemaking example, such as that involving the COSO internal control frameworks, is both pertinent and relevant in the instruction of administrative law. A flowchart with BPMN diagrammatic process *swimlanes* presents the internal control framework / proxy rulemaking example both chronologically and with process flows, offering a strong visual representation of this pertinent and relevant example of proxy rulemaking.