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# Corporate sustainability after Sarbanes–Oxley linking social–political initiatives and small and medium-sized enterprise resources

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*Received (in revised form): 14th December, 2006*

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## ABSTRACT

**KEYWORDS:** Sarbanes–Oxley, staffing/consulting SMEs, governance, sustainability

*The passage of the Sarbanes–Oxley Act of 2002 in the United States has strengthened corporate governance, albeit at a relatively high cost. This legislation was in response to the collapse of Enron and other high-profile corporations. These catastrophic events brought to light the failures of self-governance in the accounting and investment communities. Sarbanes–Oxley was a political initiative*

*driven by societal demands for reform. As large corporations attempted to comply with the legislation, an opportunity was created for small and medium-sized staffing and consulting companies. Such small and medium-sized enterprises (SMEs) were an invaluable resource to corporations attempting to react quickly and effectively to the new legislation. The success of SMEs in this set of events can serve as a template for the future linking of social–political initiatives, SME resources, and corporate sustainability strategies. The specific conclusions include:*

- Government legislation can strengthen corporate governance and sustainability.
- SMEs (such as staffing/consulting enterprises) play an invaluable role in the sustainability of large corporations.
- With their creativity and ability to adapt quickly to market changes, SMEs are a necessary component of Sustainability Frameworks for regional and national economic development.

*International Journal of Disclosure and Governance* (2007) **4**, 52–58. doi:10.1057/palgrave.jdg.2050043

## INTRODUCTION

The passage of the Sarbanes–Oxley Act (SOX) of 2002 in the United States has strengthened corporate governance, albeit at a relatively high cost. This legislation was in response to

the collapse of Enron and other high-profile corporations. These catastrophic events brought to light the failures of self-governance in the accounting and investment communities.

Sarbanes–Oxley was a political initiative driven by societal demands for reform. As large corporations attempted to comply with the legislation, an opportunity was created for small and medium-sized staffing and consulting enterprises. Such small and medium-sized enterprises (SMEs) were an invaluable resource to corporations attempting to react quickly and effectively to the new legislation. The success of SMEs in this set of events can serve as a template for the future linking of social–political initiatives, SME resources, and corporate sustainability strategies. Corporate sustainability is understood in this paper to refer to a company's ability to generate long-term value through mutually beneficial relationships with its business and socio-political stakeholders.

This paper initially reviews important aspects of Sarbanes–Oxley legislation and how staffing/consulting SMEs aided large corporations to comply. Secondly, the United States small business community of which staffing/consulting SMEs are a subset will be described in more detail. Thirdly, a Sustainability Framework will be presented to illustrate how SMEs can be an effective part of large corporate sustainability. Specific strategies to strengthen this Sustainability Framework will also be explored. Lastly, future research needs will be described.

## **SARBANES–OXLEY AND STAFFING/ CONSULTING SMEs**

### **Every CEO and CFO knows the word 'SOX'**

In response to the financial reporting scandals in 2001 and 2002 at Enron, WorldCom, and other high-profile companies, Congress passed the wide-ranging SOX of 2002 (also known as the Public Company Accounting Reform and Investor Protection Act of 2002). The Sarbanes–Oxley Act, now commonly referred to as SOX, has affected numerous parties associated with public companies including management, audit

committees, independent auditors, lawyers, and security analysts. The Act, among other things,

- Established a five-member Public Company Accounting Oversight Board that oversees audits of the financial statements of public companies through registration, standard setting, inspection and disciplinary programs.
- Requires quarterly and annual certifications by CEOs and CFOs regarding the annual reports and internal controls of their companies.
- Requires board audit committees to include at least one member who is a financial expert.
- Prohibits external auditors from performing certain additional services for audit clients such as financial system designs and implementations.

Penalties for violations of the Act are stiff and can include imprisonment. Congress has sent a message that integrity in financial reporting is a serious matter. Corporate scandals caused the loss of thousands of jobs, billions of dollars in retirement funds, and diminished trust in corporate accounting and reporting practices. The G8 recognised the importance of trust in 2003 when it stated: "Trust and confidence are key ingredients of a well-functioning market economy".<sup>1</sup> It is hoped that the provisions of the Act will strengthen the financial reporting system and by extension the overall US economic system. From this perspective, it can be argued that SOX has the potential of enhancing corporate sustainability by strengthening corporate governance and reporting.

Although specific in its application, the SOX legislation has set an important precedent in corporate governance. One may expect future instances in which political institutions, impelled by societal expectations, place new regulations on business. Such regulations may come in the form of tougher environmental impact rules and community reinvestment quotas. There could be increased disclosure requirements in

the areas of product labelling and verification of compliance with international child labour laws.

### Staffing/consulting SMEs

Staffing and consulting SMEs provided invaluable resources to larger corporations in their SOX compliance efforts. Such SMEs are a subset of a much larger small business community in the United States. The lessons learned from the experience of staffing and consulting SMEs *vis-à-vis* the SOX legislation can serve as a template for the wider small business community. This will be more fully described later in the paper.

Staffing/consulting SMEs include a wide range of businesses including:

- individual consultants;
- aggregators that organise and place independent consultants on projects;
- consulting corporations and partnerships that employ full-time consultants;
- staffing or 'temporary agencies' that place temporary, contract, and 'on-call' staff.

Statistics focussed specifically on temporary and contract workers indicate that their services are spread across the sectors shown in Figure 1.

The staffing/consulting industry continues to expand. Driving this expansion is demand from both employers and temporary employees themselves as illustrated in Figure 2.

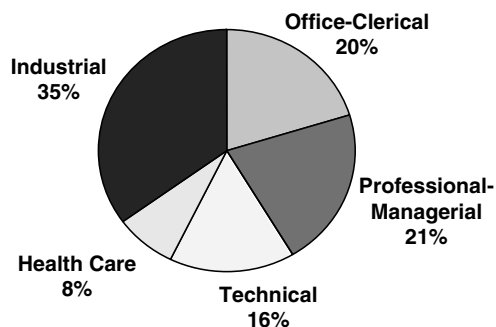


Figure 1: Temporary and contract workers by occupation

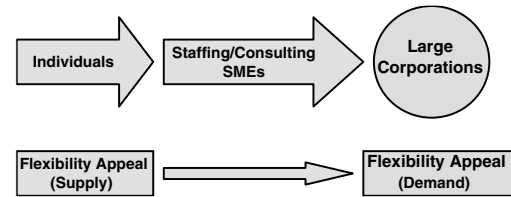


Figure 2: Staffing/consulting SME supply chain

### Appeal of flexible staffing to individuals

Approximately two-thirds of temporary employees report that flexible work time is important to them.<sup>2</sup> This includes people desiring more time at home with families and semi-retired persons seeking part-time opportunities in the workplace. Flexible or temporary staffing opportunities allow workers to earn money while looking for jobs. Some people enjoy such working arrangements so much that they are 'permanently' working as temporary or flexible staff.

### Corporate demand for flexible staffing

Most CEOs say that flexibility and adaptability to change are the major keys to staying competitive.<sup>3</sup> The use of temporary staff is apparently good for large companies as noted in a study published in *Decision Sciences* magazine. According to the study:

'Increased reliance on contingent (ie temporary/part-time) labor ... is associated with superior subsequent performance ... [and] no increase in systematic risk'.<sup>4</sup>

### Flexible staffing statistics

Staffing/consulting firms (both large and SMEs) employed nearly three million temporary and contract workers *per day* in 2004. This represented nearly two per cent of the entire US workforce. Over two-thirds of temporary workers accepted full-time positions as a result of working for the staffing companies.

According to the American Staffing Association's 2004 Annual Economic Analysis of the

Staffing Industry, approximately 90 per cent of global corporations use staffing companies. The main reasons that companies use temporary and contract workers are:

- to fill in for absent employees;
- to provide extra support during busy seasons;
- to staff special short-term projects.

This latter point was especially evident in staffing to comply with SOX.

### **Macroeconomic benefit of flexible staffing**

The benefit of flexibility in the workforce was noted by Federal Reserve Board chairman Alan Greenspan at the European Banking Congress in 2004:

‘Flexibility, as history persuasively shows, enables an economic system to better absorb and rebound from shocks. In the United States, for example, real output contracted very little during our most recent cyclical episode despite having been subjected to a number of shocks: the bursting of the technology bubble, the terrorist attack of September 2001, and the corporate governance scandals...Presumably, the rise in product and labor market flexibility in the United States and in a number of other countries over the past quarter-century is continuing to pay off’.<sup>5</sup>

Staffing/consulting SMEs can contribute to the labour market flexibility mentioned by Alan Greenspan.

### **Staffing/consulting SMEs and SOX**

Although corporate scandals led to the eventual demise of Arthur Andersen, one of the largest accounting firms in the world, the resultant SOX legislation actually created a bundle of new work for the remaining large accounting firms, sometimes referred to as the ‘Big 4’.<sup>6</sup> Section 404 of SOX required certifications on the internal controls of public companies. It required a small army of auditors, accountants,

and consultants to analyse and audit risks and controls across the sprawling divisions of public companies.

As a result of the increased workload, a significant amount of work was created for staffing/consulting companies. The work was spread across two fronts: first, the assessment and documentation of internal (“SOX”) controls and secondly, the auditing of those controls. The SMEs provided their services to the Big 4 accounting firms or directly to the large corporations. Within the large corporations, services were delivered at the divisional level for risk assessment and documentation tasks and to Internal Audit departments to assist in audit procedures. Figure 3 below illustrates the flow of work provided by the staffing/consulting SMEs.

The main point to emphasise is that this invaluable work performed by SMEs was a direct result of a social-political initiative (SOX). The demand for SME talent was so intense that there were constant advertisements seeking experienced individuals who could work on contracts. Many of the individuals working on temporary or contract bases ended up working full-time for the large corporations.

### **SMALL BUSINESS IN THE UNITED STATES**

The staffing/consulting SME industry is a subset of the much larger small business community in the United States. A small



*Figure 3: SME staffing/consulting support of corporations with SOX compliance*



business is defined by the US Small Business Administration (SBA) as an independent business with less than 500 employees. The SBA estimates that there are 17,000 large business and over 20 million small businesses in the United States. Small businesses have a substantial influence on the US economy<sup>7</sup>.

Small businesses:

- employ half of all private sector employees;
- supply more than 23 per cent of the total value of federal prime contracts;
- employ 41 per cent of high-tech workers (such as scientists, engineers, and computer workers);
- produce 13–14 times more patents per employee than large patenting firms.

The last two metrics above hold important implications for future economic and corporate sustainability. The technology sector is important for many countries seeking an edge in global economics. Further, the payback in terms of patentable ideas is very favourable for small businesses.

### SUSTAINABILITY FRAMEWORK

Figure 4 presents a framework of how SMEs contribute to large corporation sustainability. As described above, staffing/consulting SMEs can offer extensive talent to large corporations in areas such as accounting/finance and research. Other SMEs contribute by selling technology solutions. For example, automobile companies, large builders, and energy companies are increasingly pressed to exhibit more eco-friendly behaviour. SMEs in the cleantech industry are developing solutions to meet some of these social–political expectations. As evidence of this trend, California’s cleantech industry<sup>8</sup> attracted almost \$500m in venture capital in 2005, a 36 per cent increase over 2004. Many of the recipients of this funding were SMEs. Sustainability policies and frameworks should include small business as an important component for achieving success.

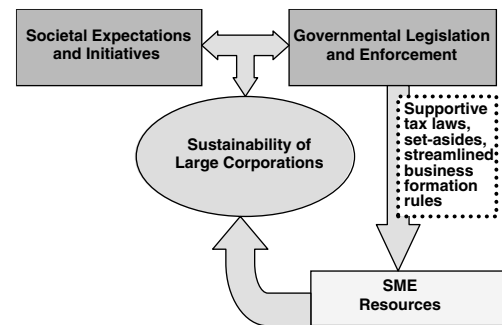


Figure 4: A sustainability framework incorporating SME support of large corporations

### Strategies to strengthen the sustainability framework

Each player in the above framework can take actions to strengthen the overall system. Following are examples of such actions for large corporations, SMEs, and governments.

#### Large corporations

Large corporations can take greater advantage of SME resources by

- streamlining information security clearances for temporary workers;
- developing training courses designed specifically for short-term workers on corporate culture and communication protocols;
- training managers in the effective use of flexible staffing;
- building more alliances with SME research/technology enterprises.

As noted previously, small businesses house enormous abilities to produce patentable ideas and technology.

#### SMEs

SMEs can take strategic actions such as

- supporting small business political initiatives such as healthcare reform;
- joining (or forming) industry groups that focus on SMEs and how SMEs can tap into the large corporation supply chain;

- devoting resources to stay abreast of regulatory requirements and other issues facing large corporations;
- developing expertise in responding to corporate Requests for Proposal.

### **Governments (regional, national, local)**

Governments can promote corporate sustainability by

- enacting supportive tax laws and providing small business set-asides in government contracts;
- reviewing laws and procedures governing SME formation and operations;
- measuring the impact of cross-border temporary worker programmes (a hot topic in the United States);
- streamlining regulatory reporting requirements for SMEs;
- devising affordable options for SMEs to provide health insurance for their employees (a major issue within the small business community in the United States);
- investing in adult education.

This latter item can be accomplished through a variety of formats. Focusing efforts on local markets is most advisable. For example, workers losing their jobs due to coal mine closures in West Virginia may require different training than that of software engineers who lose their jobs to off-shore providers.

### **FUTURE RESEARCH OPPORTUNITIES**

As this paper has suggested, helping SMEs to support large corporations is an important component of sustainability at many levels of analysis. Strategists could benefit from future research such as

- measuring how many services and products are provided to large corporations by SMEs on local, regional, and national levels;
- evaluating roadblocks that large corporations face in using SMEs, such as computer

network security and protection of intellectual property rights;

- quantifying the main business obstacles faced by SMEs such as high healthcare costs;
- developing additional tools to measure and manage SME reputation risk and the linkage to social capital development<sup>9</sup>.

### **CONCLUSION**

The SOX legislation was a political initiative driven by societal demands for reform in response to the staggering losses attributable to corporate accounting and financial reporting scandals. The Act was designed to strengthen corporate governance, the financial reporting system and by extension the overall US economic system. From this perspective, it can be argued that SOX enhances corporate sustainability.

As large corporations wrestled with SOX compliance, an opportunity was created for staffing/consulting SMEs. Such SMEs were an invaluable resource to corporations attempting to react quickly and effectively to the new legislation. The success of SMEs in this set of events can serve as a template for sustainability frameworks linking social-political initiatives, government legislation, SME resources, and large corporations.

The Sustainability Framework presented in this paper suggests that all stakeholders (citizen groups, nongovernmental organisations (NGOs), government, and SMEs) can contribute to large corporation sustainability. Furthermore, SMEs have been shown to be key providers of solutions to wider social issues such as environmental sustainability through cleantech technologies currently being developed. Bold leadership using insightful research can simultaneously improve corporate sustainability and help build a sustainable society.

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