

The Rise and Fall of the superstar CEO: A Case Study

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ABSTRACT

\$150 million! This was the amount of compensation allegedly misappropriated by the CEO of the world's largest automobile manufacturing company (the organization). Born in Brazil to Lebanese immigrants, the CEO found fame and fortune in Paris which led to his superstar status in Japan. Here, not only did he revive a struggling automobile manufacturing company, but he was also the main character in a number of comic books. Unfortunately, he is now languishing a 16 by 10 foot Japanese prison cell with a tatami mat, a toilet in a corner, and the lights always on, awaiting trial for the alleged misdeeds with limited contact with the outside world.

The case discusses the conditions within the organization that contributed to the rise and fall of the superstar CEO. Students are asked to use the Control for Sponsoring Organizations of the Treadway Commission (COSO) framework to assess the control environment of the organization that created the conditions and steps that could be taken to prevent the incident from occurring.

Keywords: COSO, corporate governance, asset misappropriation, compensation, fraud

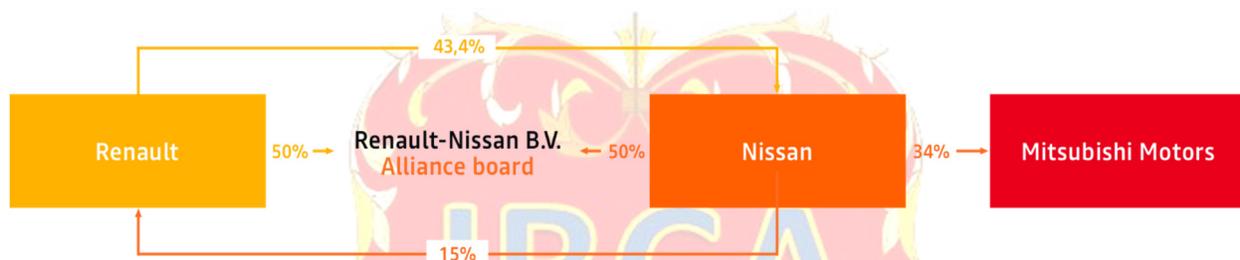
INTRODUCTION

The Alliance

The Renault-Nissan-Mitsubishi Alliance (the Alliance) was formed between several of the top car manufacturers in the world. Created in 1999, the alliance is now the top car manufacturer in the world with over 10.76 million cars sold in 2018. In addition to Nissan, Mitsubishi, and Renault; its brands also include Lada, Dacia, Infiniti, Alpine, and Venucia. These are manufactured in 122 manufacturing plants across the globe, employing approximately 450,000 people.

The Alliance is a strategic partnership that aligns two Japanese companies, Nissan Motors Co Ltd and Mitsubishi Motors Corporation, with the French company, Renault S.A. This unusual Alliance which connects companies from different continents and cultures is formed by a cross sharing agreement as illustrated in Figure 1.

Figure 1: Structure of the Alliance.



Structure

Started in 1899, Renault S.A. is a French multinational automobile manufacturer which is currently jointly owned by the French government, public shareholders, Nissan, and Daimler Pension Trust. During the 1990s, Renault S.A. was facing financial difficulties that including multiple years of unprofitability. In 1997, the company adopted a strategy to try to regain profitability. It initiated a major cost-cutting strategy which proved successfully and returned the company to profitability one year later (1998). This was reflective in the 2.2 million vehicles manufactured by the company, a record number at the time. Production output has since doubled to approximately 4.1 million vehicles as of 2018, the most recent data available.

In 1999, Renault began discussions to purchase Nissan Motor Co, Ltd.(Nissan), the Japanese multinational automobile manufacturer, for approximately \$5 billion. Nissan itself was facing financial difficulties and was on the verge of bankruptcy due to its \$35 billion debt load, a bloated work force, and declining sales from undesirable cars. The potential acquisition was so unpopular that one automobile executive suggested that Renault would be better off "taking \$5 billion, putting it on a barge and sinking it in the middle of the ocean" (Chozick & Rich, 2018).

Despite the financial situation, Renault saw an opportunity to increase its global market share and purchased 33% of Nissan ultimately increasing its share to 43.4%. In order to increase profitability at Nissan, Renault employed the same cost cutting strategy that proved effective in its own organization. To achieve this goal, Renault sent the mastermind behind its cost-cutting strategy to Japan to be the chief operating officer of Nissan. That superstar was Carlos Ghosn (discussed in the next section).

After the acquisition, each individual company maintained its own board of directors which oversaw the overall goals and strategies of the individual entity. The Alliance had a separate board to oversee collaboration and corporate governance within the companies, including all purchases made by the individual companies. The Alliance's success was derived from using this formation to reduce duplication and improve efficiency. The Alliance's board was comprised of equal number of members from both Renault and Nissan. However, the Alliance itself was dominated by Renault managers giving them more authority in daily operations.

Mitsubishi Motors Corporation joined the Alliance in 2016 when Nissan purchased a 34% controlling interest. At the time, Mitsubishi was recovering from its own mileage cheating scandal involving the overstatement of fuel economy data for some of its minicars in Japan, an issue that existed for 25 years.

THE RISE OF GHOSN

Carlos Ghosn was born in Brazil to Lebanese parents. He moved to Lebanon at six years old where he lived in a middle class neighborhood and completed his secondary school education. He eventually moved to Paris and attended France's most prestigious schools, Lycee Saint-Louis and the Ecole Polytechnique, and studied engineering. His professional career began at Michelin as a low-level employee before he quickly advanced within the company. Only seven years after his graduation, Ghosn was appointed Chief Operating Officer (COO) of Michelin's South American operations, a division that was struggling and reporting consistent losses. By implementing various cost cutting strategies, he completed a turnaround with the division achieving profitability within two years. After the success of this division, he was promoted to COO, then Chief Executive Officer (CEO) of Michelin's North America operations. He served in this capacity for several years before leaving the company in 1996 to accept a position at Renault.

Due to his stellar reputation at Michelin, Ghosn was appointed vice president in charge of several departments at Renault including purchasing, advanced research, engineering and development, powertrain operations, and manufacturing. He was also placed in charge of the company's South America division. It was in this position that he became known for his famous cost cutting strategy. By 1998, two years after joining the company, his cost cutting strategy led Renault back to profitability while producing a record number of vehicles.

When Renault decided it wanted to purchase Nissan and return it to profitability, it already had its superstar on board, Carlos Ghosn. Ghosn's reputation for rebounding businesses had now been solidified and after the acquisition he was appointed COO of Nissan. As COO, Ghosn proposed what was dubbed the "Nissan Revival Plan", a plan centered on eliminating jobs, closing inefficient factories, slashing suppliers, discontinuing unprofitable business units including the space program, and investing in design.

Under this plan, Ghosn promised to return Nissan to profitability within the first year, a goal that was achieved with an after-tax profit of \$2.6 billion. The revival plan quickly turned Nissan into one of the most efficient car manufacturers in the world with a market capitalization that had quintupled, and operating margins that had increased tenfold. Due to this success, Ghosn was promoted to CEO of Nissan in 2001 and set new goals for the corporation that included becoming the biggest car manufacturer in the world.

After continuously increasing Nissan's sales and profit margins, Ghosn was appointed CEO and President of Renault, several years after his initial appointment at Nissan. Ghosn continued to be rewarded for his outstanding performance and contribution to the Alliance. He was elected to the Chairman of the Board of Nissan in 2002, and Chairman of the Board of Renault in 2005. Ghosn was also appointed CEO of Mitsubishi at the time of its 2016 acquisition. Ghosn became the first and only person to simultaneously run two companies on the Fortune Global 500. This was "the type of chief executive who even if you didn't know how to pronounce his name (rhymes with phone), you'd know his products" (Chozick & Rich, 2018).

Under Ghosn's leadership, the Alliance continued to increase sales and by 2018 it reported 10.76 million vehicles sold worldwide, its best performance ever. Ghosn also shared in the Alliance's success and amassed a \$120 million net worth during this period. His compensation drew the attention of political leaders such that in 2015 the French finance minister criticized Ghosn calling his \$8 million salary at Renault excessive. Renault shareholders also raised concerns about Ghosn's pay believing that a salary more than 240 times the minimum pay of the employees is excessive.

Ghosn also became a celebrity in Japan, a rare feat for a foreigner or *gaijin*. He was swarmed by paparazzi, adored by fans seeking his autograph, and consulted by Japanese businessmen on his sense of fashion especially his rectangular sunglasses and custom suits. In 2004, he was awarded a Blue Ribbon Medal by the emperor for his extraordinary contributions, the first foreign business leader to receive such honor. However, he also faced dissent from some members of the policymaking and business community. The "idea of an outsider's bringing free-market capitalism to Japan's quasi-socialist corporate culture jabbed at historical wounds" (Chozick & Rich, 2018).

Corporate Governance

In Japan, it is not uncommon to have a management structure that is powerful and that faces little oversight. For example, in most advanced industrial countries, government oversight requires that the audit committee of a public company be independent of management. In Japan, this is not required. During Ghosn's tenure, Nissan did not have an independent audit committee on the board of directors and the external auditor was directly chosen by the chairman. Another committee that is required in most advanced countries but not in Japan, is a compensation committee that decides the pay for the top executives.

In Japan, it is common for major stakeholders in companies, such as suppliers, to have a position on the board and this was also the case with Nissan. Due to the close relationship Ghosn developed with Nissan's suppliers, these board members were more loyal to the CEO than to the company especially since they were handpicked. By 2018, only three of the nine board members were "truly" independent.

Nissan's board meetings during Ghosn's tenure were often "rubber stamp" meetings in which Ghosn would quickly run through company material and obtain approval for most issues without any descending points of view. These meetings were brief and lasted for less than 20 minutes. An internal audit function was created by Ghosn in the early 2000's but did not have authority to examine dealings of top management.

ISSUES BETWEEN THE ALLIANCE AND ITS CEO

Starting in 2008, cracks began to appear in the relationship between Ghosn and the Alliance, with the companies accusing its CEO of impropriety. A discussion of each event follows:

Investment Losses

Before the global financial crisis of 2008, it was easy to achieve a reasonable rate of return on investments especially since the world economy was performing at historical levels. For instance, from early 2003 until mid-2007, the S&P 500 grew by approximately 70%. Seizing an opportunity to provide executives with additional compensation, Ghosn convinced Nissan's board of directors to establish a fund to provide extra compensation for its executive level employees. The fund invested in foreign exchange futures, a rather risky investment. Ghosn assured the board that the fund was guaranteed to post no losses. However, under the unlikely scenario that losses occurred then Ghosn would personally incur them. The profits from the investment would be paid to the executive-level personnel, including himself. This was a simple way for the company to compensate its executives without having to face the risk of loss on investment.

The financial crisis in 2008, was not favorable to the fund and it incurred an \$80 million loss. According to the funding agreement, Ghosn would personally cover any loss that the fund incurred. However, the company accused him of using corporate funds to pay a Saudi businessman to provide collateral for Ghosn's and the fund's investment losses. Ghosn counter acted that Nissan was actually paying for critical services that substantially benefited the organization.

Improper Payments

Starting in 2011 and continuing for a number of years, Ghosn began to send payments to a business associate in Oman. This business partner also had close ties to Ghosn's own business interests in the Middle East including Good Faith Investments Holding SAL, a private limited company established in Beirut, Lebanon. The associate had an ongoing business relationship with Nissan and was helping the company with its lobbying efforts in the Middle East. As such, the associate was paid numerous times for marketing expenses that related to such lobbying efforts

An internal company review of this relationship noted that some of the payments made were improper and that the funds were diverted to Ghosn or his business interests. Both Renault and Nissan noted that even though the payments were labelled as marketing expenses as is customary, Ghosn authorized some of the transactions instead of the regional director as required by company policy. The companies allege that Ghosn diverted funds to the business associate who then transferred them to Good Faith Investments for Ghosn to use at his discretion. These payments would continue until 2018 and totaled approximately \$30 million. Some of the funds were allegedly used to finance a yacht bought by Ghosn for his wife.

In 2017 and 2018, a Nissan subsidiary made payments totaling \$10 million to an overseas sales agent. This sales agent then transferred \$5 million of these payments to a private investment company controlled by Ghosn. Nissan attests that the payments were made solely to

benefit Ghosn and had no business purpose while Ghosn counteract that they were 100% business related.

Personal Use of Assets

Both Nissan and Renault accused Ghosn of using company assets for personal use. This includes use of company jets by Ghosn's family, charging the company for personal vacations, and the purchases of several homes. Both entity allegedly that Ghosn used a Dutch corporate entity that he led, Renault-Nissan BV, to finance extra benefits for himself, including acquiring several homes with Nissan money. The homes including a 5,400-square-foot flat in Paris's elegant 16th arrondissement, an apartment in Rio purchased in 2011 for \$6 million, and a salmon-hued mansion on a tree-lined street in Beirut purchased in 2012 for \$8.75 million plus an additional \$6 million in renovations and furnishings

One item that created its own controversy was the joint second wedding and his new wife's 50th birthday party held at the Palace of Versailles complete with a Marie Antoinette theme and extravagant food. Alderman (2009b) reported it as "The black-tie event with 120 guests included actresses in period clothing and powdered wigs welcoming Mr. Ghosn and his second wife, Carole. The reception hall was tended by white-suited waiters and featured tiered golden dishes filled with macarons, and a towering, pyramid-shaped wedding cake made of choux pastry".

The rental cost for use of the Palace and its facility would normally be valued at approximately \$55,000; however, Ghosn did not pay anything. Before the wedding, Renault donated approximately \$2.5 million to the Palace of Versailles under a sponsorship agreement. In return, Renault received the right to rent the Palace for free as long as the value of the rental was less than 25% of the donation. However, the rental applied to corporate events only and not for personal uses such as the wedding. Renault allegedly reported the matter to the French judicial authority even though its own internal investigation cleared Ghosn of any wrong doing.

Other expenses also raised concerns within the Alliance. For instance, Nissan spent \$200 million be a sponsor of the 2016 Rio Olympics, with Ghosn casting himself in the Olympic torch relay. A year later in 2017, he paid a Lebanese artist and friend \$888,000 to create a statue for the entrance of Nissan's Yokohama headquarters.

Compensation

In Japan, salarymen worked at the company with a sense of communal pride almost as important as the salary. In 2008, Japanese law began requiring companies to disclose directors' pay in their annual reports, Nissan's shareholders voted to set an annual cap of about \$27 million on compensation for all board directors combined. Ghosn disagreed with the proposal and made the case to the public that he was underpaid since he made significantly less than his counterparts at other global automakers. In 2017 alone, Ghosn received \$16.9 million (\$8.4 million from Renault, \$6.5 million from Nissan and \$2 million from Mitsubishi) in compensation, an amount approximately 11 times more than the chairman of the world's largest carmaker.

In October 2018, a whistle-blower inside Nissan reported that he had evidence Ghosn was instructing a top aide and board member (the head of Human Resources), and a small group of confidants to effectively create two salary pools for his compensation. One pool would be paid

in the current year and reported in the company's annual report and securities filings. The second pool would be designated as deferred compensation and paid after Ghosn left Nissan. The resulting internal investigation confirmed that Nissan had underreported Ghosn income by in its securities filings from 2009 to 2017. The investigation also found that Ghosn and his aide developed plans to pay Ghosn a further \$124 million in cash and other financial incentives, some as compensation for a future advisory role with Nissan.

THE FALL OF GHOSN

The 2018 internal review by Nissan proved to be the beginning of the end of Ghosn's tenure as CEO. The company accused Ghosn and his top lieutenants of poor leadership, including financial wrong doings and reported them to the authorities. In November 2018, Japanese prosecutors surrounded Ghosn's Gulfstream aircraft after its arrival in Tokyo from Beirut and arrested him on allegations that for years he had withheld millions of dollars in income from Nissan's financial filings. Nissan immediately removed Ghosn immediately as chairman upon his arrest (he was removed from the board by shareholders vote in April 2019. He was released on bail in early March 2019, and re-arrested the same week.

He is accused by Japanese prosecutors of underreporting approximately \$45 million worth of income from 2011 to 2015, and an additional \$36 million from 2016-2018. Afraid that the former CEO would avoid facing his accusers and leave the country, he was asked to relinquish his passport to the Japanese authority. He is now languishing in a 16 by 10 foot Japanese prison cell with a tatami mat, a toilet in a corner, and the lights always on, awaiting trial for the alleged misdeeds with limited contact with the outside world. While he has access to a limited set of books, he has been denied other items, including family photos, a pen and paper, dental floss, and an iPod Nano loaded with music by his favorite artist. He is also not allowed to speak with his family and cannot only communicate with diplomats and his Japanese lawyers. If convicted, Ghosn could face up to 10 years in prison and a fine of up to 10 million Japanese Yen (approximately \$93,000).

A CALL TO ACTION

Students are asked to respond to the following questions:

1. The "tone at the top" is considered a key component of an organization's corporate governance process. Use the fundamental principles within the control environment component of the Committee of Sponsoring Organizations of the Treadway Commission (or COSO) framework to discuss:
 - i. The organization's commitment to integrity and ethical values
 - ii. The Board of Directors' independence from management
 - iii. The structures, reporting lines, and appropriate authorities and responsibilities established by management in the pursuit of objectives
 - iv. The organization's commitment to attract, develop, and retain competent individuals
 - v. The organization's ability to hold individuals accountable for their internal control responsibilities

[Note: Use Appendix A to answer each of the above in terms of both the *design* and *operating* effectiveness of the control environment primarily at Nissan. Be sure to

indicate using “n/a” if the case does not provide adequate information to address a specific principle]

2. What is your overall assessment of the control environment within Nissan and the Alliance that created the opportunity for financial wrongdoing?
3. Did Nissan’s board of directors adequately fulfill its oversight responsibilities?
4. The CEO claims his innocence and attributes the challenges to external forces trying to undermine his authority. Do you believe that the CEO is responsible for his own downfall?

Interested faculty may contact the authors for a copy of the teaching note

EPILOGUE

In January 2019, Ghosn severed his relationship with Renault resigning as its chairman and chief executive. In mid-2019, after spending 108 days in jail, Ghosn was released on a \$13 million bail and as part of the agreement forbidden from leaving Japan. He gave a statement noting that “I am innocent, and totally committed to vigorously defending myself in a fair trial against these meritless and unsubstantiated accusations” (Tabuchi, 2019).

In September 2019, Ghosn reached a settlement with the Securities and Exchange Commission over allegedly false financial disclosures, paying a \$1 million civil penalty and agreeing to a 10-year ban from serving as an officer or director of a public company. The SEC had charged Ghosn and others with concealing more than \$140 million in compensation and retirement benefits.

On December 30, 2019, Ghosn was photographed in Lebanon after apparently escaping Japan. His ability to leave Japan while under close monitoring and without a passport is still unknown. However, the speculation was that Ghosn had escaped in a box designed for musical instruments a private jet. On January 2, 2020, Interpol issued an international arrest warrant for Ghosn but Lebanon remained silent on whether it will cooperate with the request.

Meanwhile in Lebanon, Ghosn has vigorously defended his conduct while at the helm of Nissan and Renault. Instead, he accused certain Nissan personnel of organizing a coup against him to prevent any further combination with Renault, a longtime objective of Ghosn. Chozick & Rich (2018) noted that as Ghosn “sought to integrate Nissan’s operations more closely with Renault, maybe connecting them permanently, the relationship was getting shaky. Some Nissan executives, engineers and marketing staff began to resent what they saw as Renault’s unfairly piggybacking on Nissan’s technology, research and brand strength...”

He also accused the Japanese government of injustice and didn’t hold back in his comment to the Lebanese press,

I am now in Lebanon and will no longer be held hostage by a rigged Japanese justice system where guilt is presumed, discrimination is rampant, and basic human rights are denied, in flagrant disregard of Japan's legal obligations under international law and treaties it is bound to uphold. I have not fled justice - I have escaped injustice and political persecution. I can now finally communicate freely with the media, and look forward to starting next week. (Sommerville, 2019)

In May 2020, two Americans, a father and son, were arrested in Massachusetts for aiding Ghosn in escaping from Japan to Lebanon.

Meanwhile, the former CEO is a ‘free’ man living out a luxurious life in Lebanon.

The business outlook has deteriorated at both Renault and Nissan due to both impact of the leadership changes and Covid-19. In May 2020, Renault announced an 80% sales decline for the month of April. As a result, it announced a major cost cutting measure which will result in an 8% world-wide work force reduction (15,000 jobs), and withdrawal from China. Renault will also reduce its marketing and research and development costs, and halt expansion of factories in Romania and Morocco. Meanwhile, Nissan reported a loss for the fiscal year ending in March 2019 of 671 billion yen, or \$6.3 billion. It announced factory closures in Indonesia and Spain and a one-fifth reduction in the number of cars produced.



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Appendix A: The COSO Framework – Control Environment

COSO Component – Control Environment	Related Principle	Comment on the design or existence of this principle within the organization	Comment on the operating effectiveness of this principle within the organization
	i. The organization demonstrates a commitment to integrity and ethical values.		
	ii. The board of directors (BoD) demonstrates independence from management and exercises oversight of the development and performance of internal control.		
	iii. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.		
	iv. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives		
	v. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives		