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OECD Corporate Governance Committee
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OECD PRINCIPLES OF CORPORATE GOVERNANCE DRAFT FOR PUBLIC COMMENT – NOVEMBER 2014

Dear Chair and Members of the OECD Corporate Governance Committee,

The International Federation of Accountants® (IFAC®) values the opportunity to comment on the *OECD Principles of Corporate Governance Draft for Public Comment—November 2014* (the Principles) as prepared by the Secretariat of the OECD Corporate Governance Committee.

Through its current membership of more than 175 professional accountancy organizations in 130 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education. As such, it aims to provide the perspective of the global accountancy profession.

The members of the IFAC Professional Accountants in Business Committee[1] played a central role in the development of this response, as a large part of the constituencies the committee represents are involved in the planning, implementation, execution, evaluation, and improvement of governance in their organizations. In addition, many professional accountants have a responsibility to provide objective and accurate information and analyses to support all of these activities, and may have overall responsibility in governance areas, such as external business reporting. This puts professional accountants in an excellent position to ensure integration of governance throughout an organization—that is, ensuring that it becomes embedded into its very DNA.

General Comments on the Principles

Good governance is fundamental to the effective functioning of the world's capital markets and to organizations in creating sustainable value for their stakeholders.

IFAC strongly believes that the ultimate objective of governance is to ensure the creation of sustainable organizational success and stakeholder value; these are the core elements of every organization that strives to be competitive and sustainable over the long term. Therefore, governance in an organization

1 The Professional Accountants in Business Committee serves IFAC member bodies and professional accountants worldwide who work in commerce, industry, financial services, education, and the public and the not-for-profit sectors. Its aim is to promote and contribute to the value of professional accountants in business by increasing awareness of the important roles professional accountants play, supporting member bodies in enhancing the competence of their members, and facilitating the communication and sharing of good practices and ideas.

should be more than a compliance exercise designed with the sole purpose of satisfying regulatory requirements. Instead, good governance involves giving appropriate attention to both conformance and performance, and is the backbone of the entire organizational cycle of strategic planning, resource utilization, value creation, accountability, and assurance. Such a holistic approach ensures that governance is not “bolt on” but “built in”—integrated into all aspects of an organization.

Overall, IFAC welcomes the enhancements to the Principles as they aim to ensure the continuing high quality, relevance, and usefulness of the Principles and take into account recent developments in the corporate sector and capital markets. However, while the draft Principles contain many proposed revisions, a number of these changes may be interpreted as being somewhat cosmetic—shying away from more fundamental modifications that would arguably enhance the quality, relevance, and usefulness of these Principles.

IFAC believes that a more fundamental revision of the Principles would have a greater impact in ensuring the appropriate implementation, application, and oversight of governance arrangements, both by governments—in enabling/enforcing good governance in their jurisdictions—and organizations—in evaluating and improving their governance arrangements. Significant revisions might encourage the various governance stakeholders to embody and internalize the spirit of the Principles, rather than treating corporate governance as merely a compliance exercise.

The fundamental revisions that IFAC believes are worthy of consideration include:

- more focus on the creation of more sustainable economic, social, and environmental value (as per the OECD’s own mission statement);
- greater clarity about the primary audience;
- a greater focus on desired outcomes; and
- including less detail the Principles, with higher-level discussion supplemented by references to various other national codes specifically focused on the individual corporations.

Consistent with these points IFAC offers the following suggestions.

Expand Objective to Sustainable Economic, Environmental, and Social Performance

Good governance supports building sustainable value in organizations and society. Sustainable value can be defined as the combination of the economic, environmental, and social performance of an organization that determines overall stakeholder value and allows the organization to succeed and prosper in the long term. Sustainable value creation involves considering economic, environmental, and social factors—not only because different stakeholders have different interests, but also because these factors are interdependent. Environmental and social factors can also determine or affect the economic value of an organization.

Responsible leaders ideally should direct their organization’s strategies, operations, and stakeholder communications with a view to achieving sustainable economic, environmental, and social success. In addition to economic performance, environmental and social performance are integral to the sustainability of an organization, which in turn requires a continual commitment from the leadership of the organization and strong and integrated governance practices at all levels.

Additionally, organizations benefit when shareholders and other stakeholders take more interest in the longer-term perspectives of the organization, including holding the board and leadership accountable for overall sustainable performance, not just short-term financial results.

The OECD is well positioned and has a unique opportunity to emphasize this expanded performance objective in the revised Principles.

Better Emphasize Unique Selling Point

A notable challenge for the adoption and use of the Principles is that they appear to be written for several different audiences. For example, some of the discussion is clearly directed toward governments and regulators and what they should be doing to create the appropriate overall governance environments and framework. However, other discussions are more focused on what should happen within, and is in the control of, organizations.

IFAC believes that the OECD Principles are particularly important for policymakers, regulators, and market participants, such as stock exchanges, to create an environment to *enable* good governance in organizations.[2] In contrast, corporations themselves would arguably benefit more from implementing a governance code specifically designated for the individual organization.[3]

Additionally, the Principles are developed, issued, and now revised by an organization (i.e., the OECD) in which governments work together (as stated in the OECD Mission), and by a Corporate Governance Committee that is primarily composed of government or regulator representatives from the 34 OECD member countries. There is very limited involvement in and input from other stakeholders involved in the corporate governance process, such as shareholders, employees, board members, and corporations.

For these reasons, IFAC suggests the OECD should more clearly pursue and communicate a set of Principles that are primarily and specifically focused on policymakers, regulators, and market participants (such as stock exchanges) and what they could—and should—do to further enhance governance in their jurisdictions. Such an approach would also better emphasize the "unique selling point" of these Principles: there are many other corporate governance codes specifically directed to corporations, but few (perhaps none) are specifically directed to governments and regulators.

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2 For policymakers, regulators, and market participants such as stock exchanges, it is of course also important to establish good governance in their own organization. To that end they could leverage the *International Framework: Good Governance in the Public Sector* (2014, IFAC and the Chartered Institute of Public Finance and Accountancy), which encourages more effective public governance in public sector entities.

3 The OECD Corporate Governance Secretariat seems to hold similar views according to its statements at this year's ICGN Conference: *"You may know the OECD Principles of Corporate Governance. They are Principles, so not regulation and also not a corporate governance code. They are directed primarily, towards policymakers to create an environment for corporate governance that makes sense. All of these issues come into this overall environment, so we're not only dealing with the companies themselves, but with the overall ecosystem, enabling an environment for corporate governance."*

Focus on Desired Outcomes

Successfully enabling good governance in jurisdictions requires policymakers, regulators, and market participants (such as stock exchanges) to establish and maintain arrangements whereby intended governance outcomes for various stakeholders are defined—in terms of sustainable economic, social, and environmental benefits—and hopefully achieved.

To that end the Principles could be better formulated on a meta level, for example, focused on broad measures or desired outcomes [4] ("what we want to achieve"), rather than including detailed arrangements/prescriptions ("policy inputs") that differ between jurisdictions and become outdated faster than the OECD Principles are likely updated. Furthermore, individual jurisdictions and/or various stakeholder groups could then further determine the interventions necessary to optimize the achievement of these intended outcomes, taking local considerations into account.

Be Less Detailed and Refer to Other Sources

Corporate governance is a "living organism" that evolves due to the changes in both the environment and the perceptions of stakeholders on what comprises good governance. Although one could argue that some of the main principles are timeless, their specific application might change over time. For example, in many areas, the application guidance to the Principles includes text that no longer accurately reflects current good practice, such as in the area of risk management and internal control. Alternatively, the document includes content that will become outdated quickly and soon "lag" good practice due to the rapid developments in corporate governance, such as the Disclosure and Transparency section (Section V of the Principles), as there are many developments in this area.

IFAC believes that there are two options for the OECD to consider in revising the Principles. The OECD might update the text and commit to a rigorous schedule of frequent updates (similar to the other governance codes, such as the International Corporate Governance Network (ICGN) code, which gets updated every year). Alternatively, the OECD might consider revising the Principles so that they are written at a higher level—more focused on desired outcomes and less on detailed implementation guidance to achieve those outcomes (see also our earlier comments). Should this second option be chosen, IFAC believes that this would increase the longevity of the Principles and make them better aligned with the primary audience of policymakers, regulators, and market participants (e.g., stock exchanges), who could then subsequently draft detailed arrangements for corporations within their jurisdiction.

Furthermore, instead of being specific and very detailed in the text itself, the Principles might refer to already existing standards and frameworks, such as the *OECD Guidelines for Multinational Enterprises*. Such an approach would greatly reduce the chance of inconsistencies, especially when these other standards and frameworks are being updated in the future.

With respect to making reference to other sources, IFAC also suggests that the Principles and Annotations might make explicit reference to the sets of standards that are seen as being high quality and internationally

[4] It is relevant to note that the South African King Committee on Corporate Governance has indicated that it is considering updating the King Report on Governance for South Africa (King IV) to make it more focused on desired outcomes, rather than describing in detail all of the necessary input requirements.

accepted. Given the number of jurisdictions around the world that use the standards, IFAC suggests that consideration be given to naming International Financial Reporting Standards (IFRS) for financial reporting, International Standards on Auditing™ (ISAs™) for audit, and the *Code of Ethics for Professional Accountants*™ when discussing auditor independence. Furthermore, it would be appropriate to ensure that disclosures being proposed and described are consistent with the requirements of these high-quality, internationally-recognized standards, for example, with respect to matters such as related party transactions.

Focus on Truly Useful Information

In recent times, there has been a great deal written about the increasing volume of corporate disclosures, and questions raised about the relevance of much of the information being disclosed. The most obvious example is the length of corporations' financial statements and accompanying notes, which for some organizations runs into several hundred pages.

With this in mind, consideration might be given to focusing the disclosure and transparency principle on disclosures and information that are not only material but also truly useful for decision making and informing key stakeholders. For example, information that is prepared solely for regulatory compliance purposes, and requested by regulators, might be better communicated directly to the regulators, or linked to a posting on the organization's website, rather than as part of the organization's public disclosures.

Emphasize Role of the Audit Committee

Over recent years, the role of the audit committee has become more prominent with respect to oversight of an organization's financial and non-financial reporting, external audit relationships, and internal audit arrangements to ensure confidence in all types of performance information. In many jurisdictions the audit committee plays a critical and fundamental role in relation to disclosure and transparency about the organization's financial position and overall performance.

With this in mind, consideration might be given to making explicit reference to the pivotal role of the audit committee with respect to corporate governance in the Principles and to more clearly illustrate that role in the Annotations.

Detailed Comments

IFAC actively participated in the revision of these Principles through its membership of the Business and Industry Advisory Committee (BIAC) of the OECD. Through that channel, IFAC submitted a large number of more detailed suggestions during the revision process. For this reason, this response is limited to key high-level suggestions.

Please do not hesitate to contact us should you wish to discuss any of the matters raised in this letter.

Yours sincerely,

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