

4 January 2015

Secretariat of the OECD Corporate Governance Committee  
[Dafca.contact@oecd.org](mailto:Dafca.contact@oecd.org)

Re: OECD Principles of Corporate Governance Draft for Public Comment

Dear Sir/Madam;

On behalf of the more than 180,000 global members of The Institute of Internal Auditors (IIA), I am pleased to provide our general observations and specific comments on the OECD Principles of Corporate Governance (Principles), which are being revised in 2014/2015 under the auspices of the OECD Corporate Governance Committee. Thank you for the opportunity to provide input.

The IIA applauds OECD's commitment to ensuring the continued quality, relevance and usefulness of the Principles. The current draft prepared by the Secretariat of the OECD Corporate Governance Committee incorporates insightful changes that reflect developments over the last decade affecting both the global corporate sector and capital markets. From our perspective, specific positive enhancements include:

- Allowing for "comply or explain" flexibility, which is consistent with other corporate governance codes. (Paragraph 1)
- Including provisions for the concept of size and proportionality in applying any corporate governance framework. (Paragraph 3)
- Recognizing the important and evolving role stock exchanges and markets play in an overall governance framework. (Paragraphs 8-10)
- Addressing the important and increasingly influential role institutional shareholders play, and the criticality of their willingness and ability to participate in making governance structures accountable. (Paragraph 45)
- Recognizing the important role proxy advisors play in influencing corporate governance. (Paragraph 53)
- Addressing a "comply or explain" stance on separating the role of CEO and Board Chair. (Paragraph 90)

In addition, we see opportunities to incorporate foresight into the Principles to reflect anticipated developments in the corporate sector and capital markets. These include:

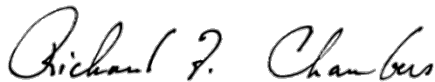
- Providing additional attention to the call for corporate integrated thinking as a way to best benefit the investment community over the long-term. Manifested in the promulgation of integrated reporting, this would include emphasizing the importance of assurance on reported data.
- Clarifying the both complimentary and separate roles internal and external audit have in providing assurance to the board and shareholders.

More details and comments are provided in Attachment A.

The Principles developed by the OECD are essential to ensuring effective corporate governance and we believe strongly that internal auditing, operating in accordance with the International Standards for the Professional Practice of Internal Auditing, is a cornerstone of good governance. Given the relatively short time this exposure has been publicly available for comment, on behalf of our global membership and the internal audit profession as a whole, we respectfully request an invitation to participate in a discussion to elaborate on how strong, independent and objective internal auditing is central to good corporate governance.

Thank you again for the opportunity to provide our observations on the Principles. Please contact Stacy Mantzaris, IIA's Managing Director of Global Advocacy, if you have any questions about this response and/or would like to schedule a time for us to either meet in person or via conference call. Ms. Mantzaris can be reached at [stacy.mantzaris@theiia.org](mailto:stacy.mantzaris@theiia.org) or +1-407-937-1290.

Best regards,

A handwritten signature in cursive script that reads "Richard F. Chambers".

Richard F. Chambers, CIA, QIAL, CGAP, CCSA, CRMA  
President and Chief Executive Officer

## V. Disclosure and Transparency

### A. Disclosure should include, but not be limited to, material information:

#### 2. Company objectives and non-financial information

##### Paragraph 77

Comment: In this paragraph sustainability and integrated reporting are briefly mentioned. However, much has progressed since the issuance of the OECD Code in 2004. Recent global financial crisis brought new insights into factors that are more than financial or tangible in nature that determine the value of an organization.

As identified in the King Code of Governance for South Africa 2009 (King III): "*A key challenge for leadership is to make sustainability issues mainstream. Strategy, risk, performance and sustainability have become inseparable; hence the phrase 'integrated reporting' which is used throughout this Report.*"<sup>1</sup> King III specifically requests organizations to provide integrated report that delivers a holistic and integrated representation of the company's performance. Further, in South Africa, integrated reporting is now mandatory for publically traded companies on the Johannesburg Stock Exchange.

In addition the International Integrated Reporting Council's 2013 launch of the International Integrated Reporting Framework has brought additional attention to the power and relevance of integrated reporting. The practical value of integrated reporting is resulting in a global movement towards increased adoption.

Given these developments around integrated reporting as a more holistic way of thinking and reporting on performance and long-term value creation, there is a great opportunity to provide additional forward looking insights. Taking a predictive stance, we suggest adding guidance on the integration of financial and non-financial reporting and the importance of assurance on the reported data.

### B. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial reporting.

Comment: As mentioned above a linkage to sustainability and integrated reporting principles provides forward thinking insights to the Principles.

### C. An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material aspects.

##### Paragraph 95

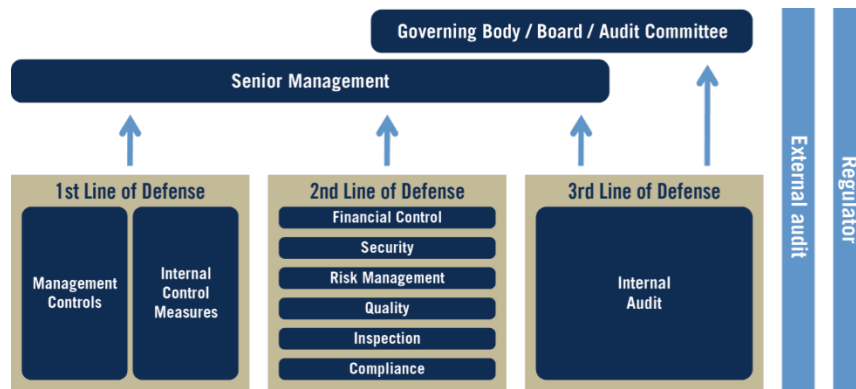
Comment: A clear distinction should be made between both the complimentary and separate roles internal audit and external audit have in providing assurance to the board and shareholders. Suggest adding a paragraph focused on the benefits of a dedicated internal audit function that conforms to the International Standards for the Professional Practices of Internal Auditing

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<sup>1</sup> King Code of Governance for South Africa 2009, The Institute of Directors in South Africa, P. 12.

(Standards)<sup>2</sup> in supporting audit committees by evaluating the efficiency and effectiveness of governance, risk management, and internal control processes. In addition it should be noted that internal audit is also well positioned to provide assurance around integrated reporting.

The audit committee or governing body should seek assurance from various sources within and outside of the organization. Internal to the organization, The IIA, the Federation of European Risk Management (FERMA), and others have recognized the “Three Lines of Defense” model pictured below as a benchmark for describing responsibilities over risk management and control.



As the third line of defense, the internal auditing function provides assurance on the effectiveness of governance, risk management, and internal control to the organization’s audit committee or an equivalent body, including the manner in which the first and second lines of defense operate. External audit sits outside the organization’s structure and is considered by some as an additional line of defense.

The audit committee or an equivalent body provides oversight of the internal audit function including monitoring independence and objectivity as well as quality by ensuring adherence to the Standards.

Paragraph 96

Comment: It is important to clarify what is meant by the “audit profession.” Is this meant to be external audit, internal audit, or both?

Paragraph 98

Comment: Consider noting that best practices, as well as some exchange listing requirements, suggest the disclosure of relevant corporate governance information, including board and committee charters, on company websites.

**VI. The Responsibilities of the Board**

**C. The board should apply high ethical standards. It should take into account the interests of stakeholders.**

Paragraph 106

Comment: Suggest adding the word monitoring to the first sentence: “The board has a key role in setting **and monitoring** the ethical tone of a company. . .”

<sup>2</sup> For additional information on the International Standards for the Professional Practice of Internal visit The IIA’s website at [www.globalIIA.org](http://www.globalIIA.org).

Comment: The last sentence added to this paragraph is good information regarding tax planning strategies, but seems misplaced in this paragraph. Suggest adding another paragraph to address board oversight of the tax planning strategies.

#### Paragraph 107

Comment: Disclosure of the Code on the company's internal and external websites is a good practice. Suggest including this practice in this paragraph.

### **D. The board should fulfill certain key functions, including:**

#### **6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.**

#### Paragraph 114

Comment: The text, as written, may imply to some that internal audit has direct responsibility for financial controls, which is not the case. It is management, as part of the first line of defense, who has this responsibility. Internal Audit, as the third line of defense, should review the completeness, effectiveness, and proper functioning of these controls, and provide assurance to the board of same.

To clarify, a distinction should be made between the roles and responsibilities over risk management utilizing the "Three Lines of Defense" mentioned earlier (reference comments under Paragraph 95) as a benchmark. This model serves to break down silos for risk management and control processes to integrate and coordinate activities among:

- First line of defense operational managers who own and manage risks.
- Second line of defense functions that oversee risks, such as risk management and compliance functions.
- Internal audit, the third line of defense, which provides independent assurance on the effectiveness of governance, risk management, and controls.

In addition, it would also be necessary for the board to oversee internal control systems covering financial and non-financial reporting. (Reference comments under Paragraph 77)

We respectfully request that the wording of this particular paragraph be clarified.

#### **7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance within the law and relevant standards. Large companies should be encouraged to put in place and internal audit function and an audit committee of the board to oversee the effectiveness and integrity of the internal control system.**

Comment: It is critical for more than just "large" companies to have an internal audit function and audit committee. In addition, "large" needs to be better defined. Suggest providing additional clarification on what types of companies would benefit from an internal audit function and audit committee including listed companies, companies with revenues greater than a particular amount, or with staff greater than a certain number, etc.

**E. The board should be able to exercise objective independent judgment on corporate affairs.**

**2. Boards should consider setting up specialized committees to support the full board in performing its functions, particularly in respect to audit, but, depending upon the company's size and risk profile, also in respect to risk management and remuneration. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.**

Paragraph 127

Comment: Suggest adding "internal auditor" to the sentence that reads, "... have established independent audit committees with powers to oversee the relationship with the external auditor **and internal auditor** and to act in many cases independently."