

International Good Practice Guidance

Evaluating and Improving
Governance in Organizations

The Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) approved this International Good Practice Guidance, *Evaluating and Improving Governance in Organizations*, for publication in February 2009.

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This publication was prepared by IFAC's PAIB Committee which serves IFAC member bodies and the more than one million professional accountants worldwide who work in commerce, industry, the public sector, education, and the not-for-profit sector. Its aim is to enhance the role of professional accountants in business by encouraging and facilitating the global development and exchange of knowledge and best practices.

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Preface to IFAC's International Good Practice Guidance

A separate document, entitled [*Preface to IFAC's International Good Practice Guidance*](#), sets out the scope, purpose, and due process of the PAIB Committee's International Good Practice Guidance series to which this guidance paper on governance belongs. It can be downloaded free-of-charge from the PAIB section of the IFAC online bookstore at www.ifac.org/store.

IFAC PAIB COMMITTEE
INTERNATIONAL GOOD PRACTICE GUIDANCE
EVALUATING AND IMPROVING GOVERNANCE IN ORGANIZATIONS
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Evaluating and Improving Governance in Organizations

1. Why the Topic is Important

- 1.1 This International Good Practice Guidance (IGPG) provides a framework and principles-based guidance for the professional accountant in business and their organizations on evaluating and improving governance in organizations. Recognizing that varied organizations and cultures take different approaches to governance, this guidance is based on the premise that certain factors and behaviors can lead to better outcomes and increased stakeholder value across all entities.
- 1.2 Some form of governance has always been present in organizations, but the attention paid to governance issues has evolved with changes in the business environment. Due to recent corporate failures and regulatory responses, governance has again become a priority. Various governance codes have been proposed and implemented on both national and international levels; see Appendix B for some examples.
- 1.3 Although most organizations have a governance structure in place, it is often focused on conformance with regulations. This conformance is of course necessary, but a governance structure should also support an organization's efforts to improve performance. The intention of this IGPG is to help create a balance between performance and conformance, as described in the framework below.
- 1.4 Successful organizations adhere to governance principles, and periodically evaluate results to ensure the continuing effectiveness of their governance systems. Furthermore, governance procedures and practices should be benchmarked against those of successful organizations and the principles outlined in this IGPG. As organizations and their environments change, the governance system must adapt to future opportunities and threats by improving processes and practices.

The Role of the Professional Accountant in Business

- 1.5 As reported in IFAC's 2005 information paper, [*The Roles and Domain of the Professional Accountant in Business*](#), the domain of the professional accountant in business includes – among other things – the following activities:
 1. Providing, analyzing and interpreting information to management for formulation of strategy, planning, decision-making and control.
 2. Measuring performance, recording financial transactions – typically under national or international generally accepted accounting principles – and communicating the results to board and stakeholders.
 3. Managing risk, and providing internal control and business assurance.
 4. Generating or creating value through the effective use of resources (financial or otherwise) through (a) understanding the drivers of value to stakeholders (which may include shareholders, customers, employees, suppliers, communities, and government), and (b) organizational innovation.

- 1.6 These activities, in which the professional accountant in business is engaged, are strongly aligned with the activities included in the definition of governance (see below): (a) providing strategic direction, (b) ensuring objectives are achieved, (c) ascertaining that risks are managed, and (d) verifying the responsible use of resources. The professional accountant in business has a responsibility in all of these activities to ensure that the organization engages in effective and efficient practices. The professional accountant in business has a responsibility to provide objective and valid information and analyses to support all of these activities and, in some cases, may have overall responsibility in areas such as risk management and resource allocation.
- 1.7 IFAC's [*Code of Ethics for Professional Accountants*](#) (see also Appendix A) underpins the role of professional accountants in business in evaluating and improving governance in organizations, for example, in the first paragraph (100.1) which states: "A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest," which is an important element of good governance in organizations.¹ Paragraph 300.5 states that "A professional accountant in business is expected to encourage an ethics-based culture ... that emphasizes the importance that senior management places on ethical behavior." Paragraph 300.16 goes on to state that "Safeguards in the work environment include, but are not restricted to the employing organization's systems of corporate oversight or other oversight structures, [and] the employing organization's ethics and conduct programs." This includes governance frameworks and hence provides the basis for the professional accountant in business' involvement in evaluating and improving governance in their organization.

2. Definitions, Framework, and Key Principles that are Widely Accepted Features of Good Practice

Governance Definitions in the Context of this IGPG

- 2.1 **Governance:** the set of responsibilities and practices exercised by the board and executive management ("the governing body") with the goal of (a) providing strategic direction, (b) ensuring that objectives are achieved, (c) ascertaining that risks are managed appropriately, and (d) verifying that the organization's resources are used responsibly.² This definition reflects both the performance and conformance aspects of governance.
- 2.2 **Conformance:** compliance with laws and regulations, best practice governance codes, accountability, and the provision of assurances to stakeholders in general. The term can refer to (a) internal factors defined by the officers, shareholders, or constitution of an organization, as well as (b) external forces such as consumer groups, clients, and regulators.

¹ In pursuing stakeholder interests (which is the term used throughout this IGPG), professional accountants in business should always be aware of the public interest.

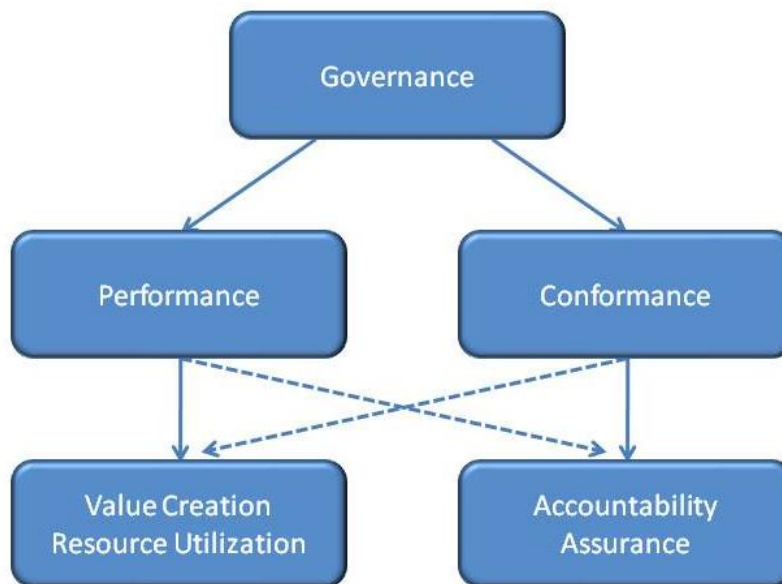
² IT Governance Institute, Board Briefing on IT Governance, 2nd Edition, USA, 2003

- 2.3 **Performance:** policies and procedures that (a) focus on opportunities and risks, strategy, value creation, and resource utilization, and (b) guide an organization's decision-making.
- 2.4 **Stakeholder:** any person, group, or entity that has an interest in an organization's activities, its resources, or output (or that is affected by that output). Stakeholders include regulators, shareholders, debt holders, employees, customers, suppliers, advocacy groups, governments, and society as a whole.
- 2.5 **Shareholder** (stockholder): a holder or owner of shares in a company or corporation. The shareholder plays a formal role in the governance of an organization, and is generally entitled to vote on a variety of issues and to share in the financial results.
- 2.6 **Stakeholder value:** organizational value that is generated for stakeholders by creating, implementing, and managing effective strategies, processes, activities, assets, etc. Sustainable value creation for stakeholders occurs when the benefits to them are greater than the resources that are expended on a consistent and ongoing basis. Value is generally measured in financial terms (as in the case of shareholders), but can also be measured as social or environmental benefit or organizational reputation (as in the case of both shareholders and other stakeholders).
- 2.7 **Enterprise risk management:** the process of planning, organizing, leading, executing, and controlling the activities of an organization to maximize value and minimize the risk of events that diminish value. Enterprise risk management covers all kinds of risks, including risks associated with accidental losses, as well as financial, strategic, operational, and reputational risks (see also the link to the COSO publication on enterprise risk management in Appendix B).
- 2.8 **Risk appetite:** the amount of risk the organization is willing to take in pursuit of its objectives.
- 2.9 **Risk capacity:** the amount of resources the organization is capable of losing before it endangers its own sustainability.
- 2.10 **Governing body:** the person(s) or organization(s) (e.g., a board of directors) with primary responsibility for overseeing (a) the strategic direction of the entity and (b) the accountability of the entity. This includes overseeing the financial reporting process. Governing bodies can be made up of independent and non-independent directors and can have various sub-committees, such as the audit committee, the remuneration committee, and the ethics committee. In some entities in some jurisdictions, the governing body may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. In some cases, the governing body is responsible for approving the entity's financial statements (in other cases management has this responsibility). For a brief consideration of the diversity of governance structures, see Appendix C. In most large organizations, there can be multiple organizational levels, each with specific authority and responsibility for governance. This IGPG uses the term governing body in both respects, that is, the governing body at the top (board of directors or board of trustees), and the lower level governing bodies.

- 2.11 **Fiduciary responsibility:** refers to the responsibility of the governing body to use the resources of the organization — as entrusted to them by the stakeholders — wisely and in a trustworthy manner.
- 2.12 **Business model:** how an organization takes resource inputs and generates value for stakeholders. It represents how an organization undertakes its business. It consists of an organization’s objectives and revenue streams, its strategy, operations, and its various other functions.

Governance Framework

- 2.13 As further explained in the principles-based guidance below, the governance framework is composed of two dimensions: the performance dimension and the conformance dimension, which together represent the entire value creation, resource utilization, and accountability framework of an organization.



Governance Framework

- 2.14 In general, the conformance dimension tends to take a historic view, while the performance dimension is more forward-looking. However, by taking a proactive, forward-looking view, organizations can also address many of the risks associated with non-conformance and help ensure that effective measures are in place.
- 2.15 Conformance responsibilities focus on providing assurances to stakeholders:
- Concerning the effectiveness of the identification, prioritization, management, control, mitigation, and reporting of strategic, tactical and operational risks.
 - That the organization is working effectively and efficiently to achieve its strategic and operational goals.

- That the systems generating financial and non-financial information are working within prescribed standards of accuracy and reliability, and that such information reflects the true performance of the organization.
 - That management’s fiduciary responsibilities are being met.
 - That the organization is able to prevent and detect criminal activities such as fraud, money laundering, theft, and misappropriation.
 - That the organization complies with all (other) relevant rules and regulations.
- 2.16 Performance responsibilities focus on strategy, value creation, and resource utilization, and include:
- Establishment of a robust decision-making process, including the determination of risk appetite (see also paragraph I.4). Oversight of strategy implementation and evaluation of the strategy’s ongoing relevance and success.
 - Alignment of business operations and resource utilization with strategic direction and the organization’s levels of risk appetite.
 - Identification of the critical points at which an organization needs to make decisions in response to changing conditions.
- 2.17 Performance and conformance dimensions enhance each other and the organization as a whole, as represented by the dotted line relationships in the above diagram.
- 2.18 Concern that company attention is dominated by compliance at the expense of strategy and performance was confirmed by an independent survey commissioned by IFAC. The report, [*Financial Reporting Supply Chain Survey—Current Perspectives and Directions*](#), issued in 2008, reveals that many respondents believed that organizations and their governing bodies focus too much on compliance, and do not focus enough on matters such as strategy and building a business. The respondents also observed a checklist mentality, leading to governance in name and not in spirit. Respondents recommended a move to a more balanced approach to conformance governance and performance governance.
- 2.19 Also, 27 case studies, undertaken as part of a research project on governance by IFAC and its member body Chartered Institute of Management Accountants (CIMA) and published in 2004 in the report, [*Enterprise Governance: Getting the Balance Right*](#),³ showed that although compliance is necessary to avoid failure, it is not sufficient to ensure success. This demonstrates the need for organizations to ensure that they spend enough time and resources on strategy and performance.

³ This IGPG uses the term “governance” instead of “enterprise governance” to emphasize that the key governance principles apply to a wider circle of organizations than (only) enterprises.

The Key Principles of Evaluating and Improving Governance in Organizations

- 2.20 In developing principles to represent good practice for evaluating and improving governance, the PAIB Committee referred to the findings from the case studies presented in [*Enterprise Governance: Getting the Balance Right*](#), and confirmed by the report [*Financial Reporting Supply Chain Survey—Current Perspectives and Directions*](#):
- A. The creation and optimization of sustainable stakeholder value should be the objective of governance.**
 - B. Good governance should appropriately balance the interests of stakeholders.**
 - C. The performance and conformance dimensions of governance are both important to optimize stakeholder value.**
 - D. Good governance should be fully integrated into the organization.**
 - E. The governing body should be properly constituted and structured to achieve an appropriate balance between performance and conformance.**
 - F. The governing body should establish a set of fundamental values by which the organization operates. All those participating in governance should embrace these fundamental values.**
 - G. The governing body should understand the organization’s business model, its operating environment, and how sustainable stakeholder value is created and optimized.**
 - H. The governing body should provide strategic direction and oversight in both the performance and conformance dimensions.**
 - I. Effective and efficient enterprise risk management should form an integral part of an organization’s governance system.**
 - J. Resource utilization should align with strategic direction.**
 - K. The governing body should periodically measure and evaluate the organization’s strategic direction and business operations, and follow up with appropriate actions to ensure appropriate progress and continued alignment with objectives.**
 - L. The governing body should ensure that reasonable demands from stakeholders for information are met, and that the information provided is relevant, understandable, and reliable.**

3. Practical Guidance on Implementing the Principles

PRINCIPLE A

The creation and optimization of sustainable stakeholder value should be the objective of governance.

- A.1 Governing bodies in all types of organization have the (fiduciary) responsibility to use their resources responsibly (see also the governance definition in 2.1) in order to create and optimize sustainable value for their stakeholders. Governing bodies must know and understand the expectations of their stakeholders, particularly with respect to what sustainable value means to them. Stakeholder value can comprise a range of items like good products or services, economic profitability, job security, safety, and other social responsibilities.
- A.2 In for-profit organizations, the primary focus is generally on increasing shareholder value, which generally entails finding the optimal balance between revenue, cost, and risk. However, these organizations should also take into account the needs of other stakeholders.
- A.3 Public sector and not-for-profit organizations differ in various ways from for-profit organizations. Generally, service delivery is addressed primarily from a stakeholder (instead of a shareholder) perspective and is not always easy to measure. These types of organization may satisfy stakeholder expectations by enhancing the environment in which they operate, or by giving back to the community.
- A.4 Rather than short term wealth maximization, sustainable stakeholder value creation and optimization should emphasize the longer term interests of existing and future stakeholders. This perspective can assist in balancing the performance and conformance dimension within the governance framework.
- A.5 The professional accountant in business should help the governing body to identify, understand, and monitor groups of stakeholders, by undertaking stakeholder surveys that provide appropriate decision-oriented information on stakeholder expectations.

PRINCIPLE B

Good governance should appropriately balance the interests of stakeholders.

- B.1 Stakeholder groups have differing, and sometimes conflicting, interests; processes should be established to identify and understand these interests. When making important decisions, the interests of all stakeholders should be appropriately balanced. To balance interests is not necessarily to make them equal.
- B.2 Stakeholders should be encouraged to express their legitimate interests and concerns. Where they express unpopular positions, the organization should ensure that their rights are also taken into account.

- B.3 The key stakeholder group in for-profit organizations is the shareholders. Although they generally have more (legal) rights than other stakeholders, such rights can vary considerably across jurisdictions. Basic shareholder rights generally include the right to (a) obtain relevant materials and information on the organization on a timely and regular basis, (b) participate and vote in general meetings, and (c) elect and remove the board of directors. Shareholders, as their name implies, also rightly expect to share in the results of the organization. The professional accountant in business should be aware of the rights that the shareholders actually have.
- B.4 Although various interests might seem to be in conflict in the short-term, they could be aligned in the longer term. For example, the interests of environmental groups may conflict with the short-term shareholder interests to maximize profits. However, in the long-term it benefits all to balance the various stakeholder interests.

PRINCIPLE C

The performance and conformance dimensions of governance are both important to optimize stakeholder value.

- C.1 Governance affects the entire cycle of planning, resource utilization, value creation, accountability, and assurance of the organization. The two dimensions of the governance framework, performance and conformance, should be appropriately balanced.
- C.2 In many organizations, the conformance aspect of the framework has tended to receive dedicated attention, and generally well-established mechanisms ensure that good governance processes are directed to conformance, for example that the risk management function, internal control, and audit committee, are effective.
- C.3 Many organizations early in their life cycle focus primarily on the performance dimension to get themselves off the ground. These organizations should also pay attention to the conformance dimension before this imbalance yields adverse outcomes.
- C.4 The performance dimension, focusing on strategy and value creation, does not lend itself as easily to a regime of standards and assurance. Unlike the conformance dimension, the absence of the right oversight mechanisms can cause a significant “oversight gap.” Therefore, it is desirable for organizations to implement systems to ensure that appropriate attention is given to the performance dimension, for example by using a strategic scorecard or appointing a strategic oversight committee.
- C.5 Professional accountants in business participate in both performance and conformance activities. For conformance, professional accountants in business are often responsible for meeting regulatory and reporting requirements, and developing control processes. With regard to the performance dimension, professional accountants in business are generally responsible for providing, analyzing, and interpreting information to management for formulation of strategy, planning, decision-making, and control.

PRINCIPLE D**Good governance should be fully integrated into the organization.**

- D.1 Fostering good governance is more than a compliance exercise; governance should permeate all facets of the organization. The governance principles should be taken into account both in setting the organization's objectives (planning), and in all subsequent actions (implementation and review). Governance should be part of the DNA of the organization.
- D.2 The organization as a whole, as well as every individual in it, is responsible for achieving its objectives; everyone has a role in steering the organization toward those objectives. Professional accountants in business should actively promote the integration of governance by demonstrating the benefits to all stakeholders, and by developing, communicating and maintaining a clear map of roles and responsibilities within the organization. Additionally, they should measure and report (to the governing body) on the progress of the integration of governance into the organization.

PRINCIPLE E**The governing body should be properly constituted and structured to achieve an appropriate balance between performance and conformance.**

- E.1 The key issues in establishing the composition of a governing body are: (a) ensuring a suitable percentage of outside, non-executive members who are independent of the organization, (b) the objectivity of members, (c) the appointment and performance evaluation process, (d) the alignment of members' interests with stakeholder interests, and (e) the existence of appropriate governance functions like audit and remuneration committees.
- E.2 Good practice calls for a suitable balance between (a) those members of the governing body who have direct responsibility for the operations and success of the organization (internal, executive members, staff), and (b) those who are responsible only to the stakeholders and are not directly responsible for operations (external, non-executive members).
- E.3 The majority of the non-executive (outside) members of the governing body should also be independent of management, and free from any business or other relationship that could materially interfere with the exercise of impartial judgment. Non-executive members should not have any conflicts of interest that could influence their objectivity, such as realizing personal financial benefit from decisions made by the governing body.
- E.4 To strengthen the structural checks and balances, the roles of chairman of the governing body and chief executive should be separated; ideally, the chairman should be an independent, non-executive member.

- E.5 The governing body as a whole, and all individual members, executive or non-executive, dependent or independent, (a) should take into account and balance all stakeholders' interests, and (b) should therefore exercise objectivity in all their decisions. Non-executive, independent members help to ensure a balance between the various stakeholder interests.
- E.6 The governing body is responsible for ensuring the appropriate mix of its members, ensuring the sufficient representation of both performance and conformance competencies. This can be accomplished by (a) clearly defining the required roles and responsibilities of the chair, the audit committee, etc., and (b) implementing rigorous appointment and evaluation processes based on required competencies, experience (like sector knowledge and operational, financial, and/or legal competency), and on performance.
- E.7 Measures should be taken to ensure that the interests of the members of the governing body remain aligned with stakeholder interests. On the one hand, this means that members should be aware of their governance leadership role ("tone at the top") and all the related responsibilities, as described elsewhere in this guidance document. On the other hand, it means that incentives that might endanger the member's objectivity should be avoided. Periodically, the governing body should reconfirm its adherence to the organization's values, and evaluate the possible existence of incentives that prejudice alignment with stakeholder interests (see also principle J on resource utilization and incentives).
- E.8 The governing body should take explicit responsibility and devote sufficient resources to specific governance functions in the organization, such as (a) overseeing the external reporting and control process, (b) selecting and evaluating the performance of the chief executive officer (CEO), and (c) remunerating the organization's management. The establishment of specific committees for these functions could be helpful. Committees of the governing body with oversight responsibilities, such as an audit committee, should be predominately composed of independent, non-executive members to ensure objectivity. In recent years, there has been a move in some jurisdictions toward adding a strategy committee, to improve strategic direction and oversight in the performance dimension. In many cases, this committee is a preparatory committee for the entire governing body, and not a decision-making committee.
- E.9 The governing body should periodically account to the stakeholders of the organization for how it has carried out its governance responsibilities, and stakeholders should be able to hold governing bodies to account.
- E.10 As important as a proper governance structure is, it should be complemented by appropriate governance processes that ensure that the right people do the right things.

PRINCIPLE F

The governing body should establish a set of fundamental values by which the organization operates. All those participating in governance should embrace these fundamental values.

- F.1 The governing body must set the “tone at the top” by (a) defining the organizational values, (b) developing and implementing a code of conduct, and (c) adhering to these principles as an example of appropriate behavior. A practical approach for doing so can be found in IGPG: [*Defining and Developing an Effective Code of Conduct for Organizations*](#). Examples of organizational values are given in Appendix A.
- F.2 The governing body should clearly communicate the organization’s values to all stakeholders, and ensure that the values are internally understood, accepted, put into practice, and upheld.
- F.3 The organization’s values should be respected by all those involved in its decisions and actions. It is the responsibility of the governing body to make that happen.
- F.4 Participants in governance should be driven by their conscience and organizational values to “do the right thing.” Incentives could act as an additional motivator. However, incentives can produce both good and bad results. The organization should therefore ensure that incentives remain aligned with (changes in) strategic direction.
- F.5 Stakeholders, including employees, should be able to freely communicate their governance concerns to the governing body; their interests should not be compromised by doing this. Many organizations have created a special function to receive and manage such concerns.

PRINCIPLE G

The governing body should understand the organization’s business model, its operating environment, and how sustainable stakeholder value is created and optimized.

- G.1 The governing body should assume a central role in governance, as its primary duty is to manage the organization in the long-term interest of all stakeholders. It is therefore essential that the governing body understands how the organization operates, and the opportunities and risks inherent in the environment in which it operates. Further, the governing body should thoroughly understand how the organization creates and optimizes sustainable stakeholder value, to evaluate whether or not the needs of stakeholders are being met. A number of actions can be taken to facilitate this understanding; these include (a) a rigorous appointment process that ensures appropriate knowledge and experience, orientation, and training of new members of the governing body, and (b) a performance evaluation process that measures competence and achievements in critical areas. Additionally, members of the governing body should have appropriate access to key persons to the organization (e.g., middle management, risk managers, or internal and external auditors), as well as to other sources of information (e.g., operational and other analyses) to keep up their understanding of the organization.

- G.2 Professional accountants in business are often at the center of the information management process and should play an essential role in ensuring that the governing body can meet governance requirements. They should, for example, consider what information goes to the governing body and ensure it is fit for purpose.

PRINCIPLE H

The governing body should provide strategic direction and oversight in both the performance and conformance dimensions.

- H.1 Conformance oversight has traditionally been a responsibility of the governing body, often assisted by an audit committee. These responsibilities have not been diminished by adding the performance dimension of governance to the conformance dimension; however, good practice indicates that balanced attention needs to be paid to the value-creating activities of strategy formulation and implementation.
- H.2 Good practice indicates that the governing body might challenge various strategic activities, such as environmental scans and competitive analyses. In some circumstances, the governing body should engage external resources to gather further information. It is essential, however, that the governing body implements processes and procedures to provide both performance and conformance oversight.

PRINCIPLE I

Effective and efficient enterprise risk management should form an integral part of an organization's governance system.

- I.1 Central to the requirements of governance in organizations is a clear relationship between managing risk and fulfilling organizational objectives. Risks can come from many sources, both inside and outside the organization. Enterprise risk management integrates risk management and internal control into decision-making and all subsequent activities at all levels, taking into account strengths and opportunities (performance, see also 2.14), as well as weaknesses and threats. It also assures the governing body and external stakeholders that the organization understands its risks and is actively managing them (conformance, see also 2.13). Good practice in enterprise risk management is essential to organizational success and should facilitate change rather than safeguard a position.
- I.2 In many organizations, risk management and internal control (a) have focused on the prevention of physical and financial loss at an operational level and (b) have been far removed from the decision-making process. Many organizations now recognize that the current environment, characterized by an ever-increasing pace of change, necessitates a more performance-focused approach to risk management and internal control that actually helps decision-makers take more risk. Successful organizations now seek to integrate risk management and internal control into all activities, through a framework of risk identification, risk assessment, and risk response (i.e., mitigating, accepting, avoiding or sharing of risks).

- I.3 Risk is often presented as something that is negative and that should be avoided. However, risk essentially flows from opportunities, and all organizations must react positively to opportunities if they are to survive and to be successful. Since risk is inherent in taking advantage of opportunities, risk should be managed — within risk appetite guidelines as approved by the governing body — and not eliminated.
- I.4 As part of its overall strategy formulation, the governing body should define, internally communicate and maintain the organization’s risk appetite and risk capacity.

PRINCIPLE J

Resource utilization should align with strategic direction.

- J.1 Part of the fiduciary responsibility of the governing body, management, and all other staff is to manage the resources of the organization. This includes both safeguarding these resources (conformance) and ensuring that they are utilized in a manner that enhances stakeholder value (performance).
- J.2 Governing bodies are generally focused on safeguarding an organization’s physical assets, but should also be focused on safeguarding intangibles such as intellectual assets, which have often been given insufficient attention.
- J.3 The governing body should implement processes to review resource allocation periodically, to ensure that the activities that create the greatest stakeholder value are given sufficient resources to be successful. The strategic planning process should include resource planning for new projects, so that when projects are approved, that approval includes the associated resource acquisition and allocation.

PRINCIPLE K

The governing body should periodically measure and evaluate the organization’s strategic direction and business operations, and follow up with appropriate actions to ensure appropriate progress and continued alignment with objectives.

- K.1 What gets measured gets done. Therefore, it is important for the governing body to have a comprehensive performance measurement scheme that evaluates progress against objectives. When setting strategy, decision points and milestones (along with critical success factors) should be identified, so that the governing body can periodically measure performance objectively.
- K.2 Performance measurement tools should be developed that reasonably depict an organization’s strategic direction and progress. Evaluation against objectives should also include an environmental update, to ensure that the conditions (risks and opportunities) present during the planning process have not changed significantly.
- K.3 An organization’s system of enterprise risk management should be regularly evaluated, and corrective action taken if necessary.

- K.4 The governing body should also periodically evaluate the organization's governance structure and performance to (a) ensure its effectiveness, and (b) strive for continuous improvement.
- K.5 The professional accountant in business should assist the governing body in developing, implementing, and maintaining a comprehensive performance measurement scheme. Internal and external auditing can help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of enterprise risk management, internal control, and governance processes.

PRINCIPLE L

The governing body should ensure that reasonable demands from stakeholders for information are met, and that the information provided is relevant, understandable, and reliable.

- L.1 Good governance requires the governing body to oversee an organization's disclosures, including financial and non-financial reporting, to ensure that stakeholders receive relevant, understandable, and reliable information. This reporting should include both (a) a historical perspective of the entity's performance for the period covered by the report, and (b) information that would allow stakeholders to assess the entity's future performance.
- L.2 This responsibility for reporting oversight should include assurances that the governing body has reviewed the enterprise risk management and internal control systems to ensure their effectiveness. This type of oversight is usually guided by the audit committee.
- L.3 Non-financial reports specifically provide management and the governing body with the opportunity to present their perspective to readers on the underlying potential and prospects for the organization – its long-term sustainability and the quality of its earnings. The report should include information on how effective the organization has been in meeting its strategic objectives, and how it has managed its resources.
- L.4 Reports presented to stakeholders should only include material information. Items are material if they would affect stakeholder decisions. Caution should be exercised to ensure that the reader is not overwhelmed with details that are more appropriate for management decisions.
- L.5 There must be consistency between financial and non-financial information, as well as between internal and external information, presented in a given period. These four elements should be included in one integrated document that links past performance with future expectations.
- L.6 The information from one reporting period should be consistent with information from the next, especially for those items that can materially affect performance at the strategic level, to the extent that they continue to be relevant to an organization's success.
- L.7 The presentation style of stakeholder reports should be sensitive to the fact that not all stakeholders are financial professionals. Complex issues should be explained and

illustrated, for example by using charts, tables and graphs, so that they can be easily understood by all interested readers, and not just by those with technical expertise in accounting.

- L.8 Financial and non-financial reports are unique to each organization. Care must however be taken to ensure that such reports do not become marketing tools. These reports should be written in an even-handed, balanced way – negative results should be included, rather than just glossed over. Disclosure of all relevant information should also be ensured.
- L.9 The governing body is responsible for (a) reviewing and questioning the procedures and practices that are involved with providing external stakeholder information, and (b) ensuring that the principles of integrity, accountability, and transparency govern these processes.
- L.10 Professional accountants in business play an important role in providing, analyzing, and interpreting information for formulation of strategy, planning, decision-making, and control. They also participate in performance measurement and communication to the governing body and stakeholders. This includes the financial recording of transactions and subsequent reporting to stakeholders under national or international generally accepted accounting principles.

Examples of Organizational Values/Principles

In the private sector, the fundamental values/principles can be defined as:

- Integrity: steadfast adherence to a strict moral or ethical code. Governing bodies should foster integrity in their organization through their leadership, strategy, policies, information, and culture.⁴
- Accountability: responsibility to stakeholders.
- Transparency (openness): disclosure of information is seen as the basis for the confidence that needs to exist between a business and its stakeholders.
- Other examples of organizational values/principles are: ethical and responsible decision making, due care, truth, and trust.

In the public sector, the fundamental values/principles can be defined as:

- Integrity: comprises both straightforward dealing and completeness. It is based on (a) honesty and objectivity, and (b) high standards of propriety and probity in the stewardship of public funds and resources, and management of an entity's affairs. It depends on the effectiveness of the control framework, and on the personal standards and professionalism of the individuals within the entity. It is reflected both in the entity's decision-making procedures, and in the quality of its financial and performance reporting.
- Accountability: the process whereby public sector entities, and the individuals within them (a) are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and (b) submit themselves to appropriate external scrutiny. It is achieved with a clear understanding by all parties of those responsibilities, and with clearly defined roles and through a robust structure. In effect, accountability is the obligation to answer for a responsibility.
- Transparency (openness): is required to ensure that stakeholders can have confidence in (a) the decision-making processes and actions of public sector entities, (b) the management of their activities, and (c) the individuals within them. Openness through meaningful consultation with stakeholders and communication of full, accurate, and clear information leads to effective and timely action, and stands up to necessary scrutiny.

The UK-based standing Committee on Standards in Public Life set out seven principles of public life: Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty, and Leadership, commonly known as the Nolan Principles. See the IGPG on [Defining and Developing an Effective Code of Conduct for Organizations](#) for an example.

The fundamental principles in IFAC's [Code of Ethics for Professional Accountants](#) are: integrity, objectivity, professional competence and due care, confidentiality, and professional behavior.

⁴ Based on the description of integrity in *Reporting with Integrity*, published by IFAC member body Institute of Chartered Accountants in England and Wales (ICAEW) in 2007.

They are focused on professionals, and specifically on professional accountants (performing a professional service), and their organizations. A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest a professional accountant should observe and comply with the principles of this *Code of Ethics for Professional Accountants*.

Appendix B

Resources

This list of resources is not intended to be exhaustive. Use the IFAC KnowledgeNet at www.ifacnet.com to search IFAC and many of its member body websites.

- IFACnet is the global, multilingual search engine developed by IFAC and its member bodies to provide accountants and others with access to global resources and information. IFACnet can be accessed free-of-charge at <http://www.ifacnet.com>.
- To provide professional accountants in business with greater access to global resources and information, IFAC launched a “relevant links” page where users can share links to websites and documents on topics of interest. Users can post links, “tag” them to multiple categories, and include a description. These links can be sorted by topic, name, or most recently posted. This free resource is available at http://www.ifac.org/PAIB/relevant_links.php.
- IT Governance Institute, *Board Briefing on IT Governance*, 2nd Edition, USA, 2003
- The IFAC report *Enterprise Governance: Getting the Balance Right* (IFAC/CIMA 2004) specifically focused on governance failures and what must be done to ensure that things go right.
- In November 2005, IFAC published *The Roles and Domain of the Professional Accountant in Business*. The purpose of this paper is to define the term “Professional Accountant in Business” and to provide an understanding of the roles and responsibilities that professionals in these positions occupy in business.
- The Organisation for Economic Co-operation and Development (OECD) published the *OECD Principles of Corporate Governance: 2004*. They are intended to assist governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance.
- The United Nations Conference on Trade and Development (UNCTAD) issued in 2006 the *Guidance on Good Practices in Corporate Governance Disclosure*. The purpose of the guidance is to help those responsible for preparing company reports to produce disclosures on corporate governance that address the major concerns of investors and other stakeholders.
- Through the following website, the European Corporate Governance Institute is making available the full texts of corporate governance codes, principles of corporate governance, and corporate governance reforms, both in Europe and elsewhere. http://www.ecgi.org/codes/all_codes.php.
- In 2006, the PAIB Committee published *Internal Controls — A Review of Current Developments*. This information paper reviews current developments and some of the latest thinking in the area of internal control.

- In 2007, IFAC published an IGPG on [*Defining and Developing an Effective Code of Conduct for Organizations*](#). This IGPG helps organizations to encourage an ethics-based culture, and to define and develop a code of conduct. It also refers to the most significant resources in this area.
- The report [*Financial Reporting Supply Chain: Current Perspectives and Directions*](#) (IFAC 2008), presents the results of a study focused on whether financial reporting has improved in recent years.
- In 2008, IFAC member body, the Institute of Chartered Accountants of Scotland (ICAS) issued guidance on the principles of governance and how these may be applied in a private company as it develops: [*Avoiding the Pitfalls in Running a Private Company: A Practical Guide for Directors*](#).
- In 2004, the UK based Office for Public Management (OPM) and the Chartered Institute of Public Finance and Accountancy (CIPFA) published, [*The Good Governance Standard for Public Services*](#), prepared by the Independent Commission for Good Governance in Public Services. It builds on the Nolan Principles for the conduct of individuals in public life, by setting out six core principles of good governance for public service organizations. It shows how these should be applied if organizations are to live up to the standard and provides a basis for the public to challenge sub-standard governance.
- Deloitte maintains the Center for Corporate Governance that contains resources for boards, as well as for audit, compensation, and other committees. See www.corpgov.deloitte.com.
- The global website of Ernst & Young offers perspectives on topics like corporate governance, risk and control, see www.ey.com/global/content.nsf/International/Issues_and_Perspectives. Ernst & Young also has a website specifically focused on audit committees, which can be accessed from the same webpage.
- KPMG has established an Audit Committee Institute with resources for audit committees. See www.kpmg.com/aci.
- PricewaterhouseCoopers (PwC) provides resources to strengthen governance and regulatory compliance. See Today's Challenges at www.pwc.com.
- The Committee of Sponsoring Organizations of the Treadway Commission (COSO) has published *Enterprise Risk Management—Integrated Framework* (2004) that expands on internal control and provides key principles and concepts — like “risk appetite” — on the broader subject of enterprise risk management. A summary can be downloaded at www.coso.org/Publications/ERM/COSO_ERM_ExecutiveSummary.pdf.

Appendix C

The Diversity of Governance Structures

Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example:

- In some jurisdictions, a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board (a “two-tier board” structure). In other jurisdictions, both the supervisory and executive functions are the legal responsibility of a single, or unitary, board (a “one-tier board” structure).
- In some entities, the governing body includes positions that are an integral part of the entity’s legal structure, for example, company directors. In others, for example some government entities, a body that is not part of the entity is charged with governance.
- In some cases, some or all of the members of the governing body are involved in managing the entity. In others, the governing body and management have different memberships.

In most entities, governance is the collective responsibility of the governing body. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee. When governance is a collective responsibility, a subgroup such as an audit committee (or even an individual) may be charged with specific tasks to assist the governing body in meeting its responsibilities. Alternatively, a subgroup or individual may have specific, legally identified responsibilities that differ from those of the governing body.

It is important (a) that all functions covered by the expression “governance” be exercised by an appropriate person or body, (b) that there is clarity on governance matters for all in the organization and its stakeholders, and (c) that undue concentrations of influence are avoided.



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