The Institute of
Internal Auditors
Elevating Impact

21 October 2022

To: The Organisation for Economic Co-operation and Development Secretariat and OECD Corporate Governance Committee
Submitted electronically to CorporateGovernance&CorporateFinance@oecd.org

Dear OECD and OECD Corporate Governance Committee:

The Institute of Internal Auditors welcomes the opportunity to comment on the Draft Revisions to the G20/OECD Principles of Corporate Governance. As the President and CEO of The IIA, I am proud to represent a global association of nearly 220,000 members located in 115 countries around the world.

The IIA is the internal audit profession's leader in standards, certification, education, research, and technical guidance throughout the world. We are proud to have the OECD serving on The IIA's International Professional Practices Framework Oversight Council. The Council promotes inclusiveness, transparency, and other qualities important to the multiple stakeholders that benefit from having confidence that the framework, which includes the International Standards for the Professional Practice of Internal Auditing, serves not only internal audit's stakeholders, but also the broader, global public interest.

We congratulate you on the proposed update to the G20/OECD Principles in light of recent evolutions in capital markets and corporate governance policies and practices, particularly the inclusion of the new Sustainability and Resilience chapter on the management of environmental, social and governance risks.

However, we believe that this document must go further than currently proposed to better reflect current corporate governance best practices. We believe that it is critical that the document clarify the roles of internal audit and external, statutory audit and that the Principles include a separate section discussing the purpose, value, ideal structure, and role of an internal audit function. Effective governance is incomplete without a robust internal audit function providing objective assurance and advice, independent from management, to the governing body and management.

The current draft acknowledges internal audit in a few select places, but, elsewhere, it elaborates on "audit" without sufficiently clarifying for readers that it means external, statutorily-mandated audits. Boards have a responsibility for both internal audit and external audit, and corporate governance will benefit with both functions being clearly articulated so a board can maximize the quality of assurance it receives. For example, new language in the draft recommending the audit committee or equivalent body should approve "the appointment, reappointment and compensation of external auditors" is also a duty required of boards regarding the organization's head of internal audit but is not clearly articulated. This approval maintains internal audit's independence from management and ability to provide objective assurance to the board or audit committee and should be clear to followers of the Principles.

The B20 Integrity & Compliance Task Force (I&C Task Force) is one of a growing number of supporters for the role internal auditing plays in effective governance, as outlined in The IIA's Three Lines Model. The Three Lines Model is a principles-based approach that amplifies the need for robust risk management and controls as a fundamental part of governance. The I&C Task Force is following closely the lead of the G20 Anti-corruption Working Group's push for better assurance through internal audit. IOSCO writes in its Report on Good Practices for Audit Committees in Supporting Audit Quality that "a strong internal audit function can contribute to good corporate governance by providing an organisation's directors and audit committee with independent reviews of, and suggestions for, improving the design and operation of the organisation's financial and non-financial control environment, processes for identifying and monitoring risks, and governance processes."

The Three Lines Model helps organizations to identify the appropriate structures and processes that best support the achievement of business objectives to create and protect value for the organization. A recent World Business Council for Sustainable Development paper we collaborated on considers how environmental, social and governance (ESG)-related risks and opportunities should be embedded into the Three Lines processes to ensure efficient and effective risk management and internal oversight. We are working with other international organizations on the governance value of the Three Lines Model, including a new paper with the International Organization of Supreme Audit Institutions (INTOSAI), *Applying the Three Lines Model in the Public Sector*.

The Institute of
Internal Auditors
Elevating Impact

Distinguishing the role of external audit juxtaposed with internal audit and properly explaining and integrating internal auditing into the heart of the OECD corporate governance model will add enormous value for boards and enhance the level of trust and transparency stakeholders' demand. Our proposed language for a new entry, IV.F, is included below along with edits to clarify the existing references to external audit.

In addition, internal audit also plays a key role in the recommendations included in the new Sustainability and Resilience chapter, which calls for sustainability disclosures to be "consistent, comparable and reliable" to provide investors what they need to vote and invest. Implicit in this call for quality information are the internal controls that result in information that is complete, accurate, and timely. Providing assurance over those controls is a role for internal auditors, well-versed in the complete workings of the organization and responsible for controls being effective.

We support the global movement for better governance and share in the OECD's goal of strengthening corporate sector resilience. We would appreciate any opportunity to further discuss this goal. Please don't hesitate to contact me or Mat Young, Vice President of Global Advocacy, Policy, and Government Affairs, at mat.young@theiia.org, if The IIA can be of further assistance. Thank you for your consideration of our views.

Sincerely,

Anthony J. Pugliese, CIA, CPA, CGMA, CITP
President and Chief Executive Officer
The Institute of Internal Auditors, Global Headquarters

The Institute of Internal Auditors
Elevating Impact

The Institute of Internal Auditors

Recommended Changes

to the Draft Revisions to the G20/OECD Principles of Corporate Governance.

p. 8

9. The Principles do not intend to prejudice or second-guess the business judgement of market participants, board members, internal auditors, and management. What works in one or more companies or for one or more investors may not necessarily be generally applicable. Companies vary in maturity, size and complexity. There is therefore no single model of good corporate governance. However, the Principles set out clear guidance for the achievement of intended outcomes and suggest some common elements that underlie good corporate governance. The Principles build on these common elements and are formulated to embrace the different models that exist.

10. For example, they do not advocate any particular board structure and the term "board" as used in the Principles is intended to embrace the different national models of board structures. In the typical two-tier system, found in some countries, "board" as used in the Principles refers to the "supervisory board" while "key executives" refers to the "management board". In systems where the unitary board is overseen by an internal audit or's body, the Principles applicable to the board are also, mutatis mutandis, applicable. As the definition of the term "key executive" may vary among jurisdictions and depending on context, for example concerning remuneration or related party transactions, the Principles leave it to individual jurisdictions to define this term in a functional manner that meets the intended outcome of the Principles. The terms "corporation" and "company" are used interchangeably in the text. Throughout the Principles, the term "stakeholders" refers to non-shareholder stakeholders and includes, among others, employees, creditors, customers, suppliers and affected communities.

p. 16

II.B. Shareholders should be sufficiently informed about, and have the right to approve or participate in, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of a substantial portion

GLOBAL HEADQUARTERS | 1035 Greenwood Blvd., Suite 149 | Lake Mary, FL 32746 USA | Phone: +1-407-937-1111 | Fax: +1-407-937-1101

of ~~all or substantially all~~ corporate assets, that in effect result in the sale of the company.

p. 17

II.C.4. Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, external reporting, the audit committee, the financial statement audit, the company's internal governance mechanism, and the role of internal audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

In order to encourage shareholder participation in general meetings, many jurisdictions have improved the ability of shareholders to place items on the agenda through a simple and clear process of filing amendments and resolutions, and to submit questions in advance of the general meeting and to obtain replies from management and board members. Shareholders should also be able to ask questions relating to the external audit report, external reporting, the audit committee, the financial statement audit, the company's internal governance mechanism, and the role of internal audit. Companies are justified in assuring that abuses of such opportunities do not occur. It is reasonable, for example, to require that in order for shareholder resolutions to be placed on the agenda, they need to be supported by shareholders holding a specified market value or percentage of shares or voting rights. This threshold should be determined taking into account the degree of ownership concentration, in order to ensure that minority shareholders are not effectively prevented from putting any items on the agenda. Shareholder resolutions that are approved and fall within the competence of the shareholder meeting should be addressed by the board.

p. 32

IV.A.9. Governance structures and policies, including the extent of compliance with national corporate governance codes or policies and the process by which they are implemented.

Companies should report their corporate governance practices and such disclosure should be mandated as part of the regular reporting. Companies should implement corporate governance principles set, or endorsed, by the regulatory or listing authority with mandatory reporting on a "comply or explain" or similar basis. Most jurisdictions publish a national report reviewing adherence to the code by publicly traded companies as a good practice to support effective disclosure and implementation of "comply or explain" codes.

Disclosure of the governance structures and policies of the company, including, in the case of non-operating holding companies, that of significant subsidiaries, is important for the assessment of a company's governance and should cover the division of authority and responsibilities between shareholders, management, and board members. Companies should clearly disclose the different roles and responsibilities of the CEO and/or chair and, where a single person combines both roles, the rationale for this arrangement. It is also good practice to disclose the articles of association, board charters and, where applicable, committee structures and charters.

p. 33

IV.C. An annual audit should be conducted by an independent, competent and qualified external auditor in accordance with high-quality international auditing standards in order to provide reasonable assurance to the board and shareholders that the financial statements represent fairly, in all material respects, the financial position and financial performance of the company.

In addition to the external auditor's opinion stating whether the financial statements represent fairly, in all material aspects, the financial position and financial performance of a company, the external auditor's report should also include an acknowledgement that the financial statements are the responsibility of the company's management. In some jurisdictions, the external auditors are also required to report on the company's corporate governance. In the performance of this work, external auditors should consider relying upon any complementary work performed by internal auditors when the internal auditors have completed their work in conformance to global standards for the profession of internal auditing.

The independence of external auditors and their accountability to shareholders and the public interest should be required. Moreover, the IOSCO Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence states that, "standards of auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, that addresses at least the following threats to independence: self-interest, self-review, advocacy, familiarity and intimidation". Monitoring threats to external auditor independence should be a shared responsibility between the audited company, its audit committee or an equivalent body, and the external auditor.

The audit committee or an equivalent body should ~~provide oversight of the internal audit activities and should also~~ be charged with overseeing the overall relationship with the external auditor including the appointment, reappointment and compensation of external auditors, as well as approving and monitoring the nature of non-audit services provided by the external auditor to the company. Provision of non-audit services by the external auditor to a company can significantly impair their independence and might involve them auditing their own work or present other threats to independence. To deal with the skewed incentives which may arise, the disclosure of payments to external auditors for non-audit services should be required in accordance with a regulated definition of audit-services and non-audit services. Examples of other provisions designed to promote auditor independence include, a total ban or severe limitation on the nature of non-audit work which can be undertaken by an external auditor for their audit client, periodic communications to the audit committee discussing the nature, timing and fees of the non-audit work (including the approval of such work), mandatory rotation of external auditors (either partners or in some cases the audit company), a fixed tenure for external auditors, joint audits, a temporary ban on the employment…

Continued p. 34

….of an ex-auditor by the audited company and prohibiting external auditors or their dependents from having a financial stake or management role in the companies they audit. Some countries take a more direct regulatory approach and limit the percentage of non-audit income that the external auditor can receive from a particular client or limit the total percentage of external auditor income that can come from one client.

Further, to improve external auditor independence and audit quality, a system of audit oversight and audit regulation plays an important role. Consistent with the Core Principles of the International Forum of Independent Audit Regulators (IFIAR), the designation of an external audit regulator, independent from the profession, and who, at a minimum, conducts recurring inspections of audit companies undertaking audits of public interest entities, is one example among other important factors that support high-quality audits that serve the public interest. In addition, regulators should have a comprehensive and effective range of disciplinary measures/sanctions at their disposal to address any breaches of professional or statutory duties by an external auditor or an external audit company in a proportionate manner.

Finally, an issue which has arisen in some jurisdictions concerns the pressing need to ensure the competence of the external audit profession. A registration process for individuals employed by external audit companies to confirm their qualifications is considered good practice or required in some jurisdictions. This needs, however, to be supported by ongoing training and monitoring of work experience to ensure appropriate levels of professional competence and scepticism.

The Institute of Internal Auditors
Elevating Impact

IV.F. Boards should consider the establishment and on-going support of an independent, properly resourced, and qualified internal audit function with a direct line reporting to the board, an audit committee, or an equivalent body as an essential practice.

The internal audit function plays a critical role in a company's success as well as its ability to report on financial or other disclosures. It does so by providing objective assurance, independent from management, on the internal controls and operations of the company as well as strategic advice, consulting services, and risk mitigation to management and the board. Internal auditors are uniquely positioned to examine their companies holistically, with a far broader mandate than that of external auditors, and their roles and responsibilities should be clearly articulated through dialogue and a written internal audit charter agreed upon by both the board and the Chief Audit Executive (CAE). CAE describes the role of a person in a senior position responsible for effectively managing the internal audit function in accordance with the internal audit charter and global internal auditing standards.

The board should provide oversight of the internal audit function including the appointment, reappointment and compensation of the CAE.

Beyond traditional financial disclosures and tax compliance, internal auditors' insights, expertise and focus on risk, defined as those things which impact the ability of the organization to meet its objectives, should be leveraged to assist management and advise the board on a wide array of matters, including: climate- and sustainability-related disclosures; social and governance issues; culture; diversity, equity, and inclusion (DEI); strategy; fraud, waste, and malfeasance; cybersecurity; and data governance (privacy & security), among others.

Failure to establish an independent internal audit function should be considered a material risk to the company and boards who do not establish and support an on-going internal audit function should be required to explain annually to shareholders their reasoning for not doing so and by which mechanisms the company obtains assurance over internal operations and reporting. Furthermore, legislators, regulators, and stock exchanges should consider whether they should mandate the establishment of independent internal audit functions for publicly traded companies as necessary mechanism to protect the public interest. Where governments have laws and regulations regarding the establishment of and certification by management of a companies' internal controls, those governments should consider whether any company's internal control framework can be considered sufficiently effective without an independent internal audit function.

When establishing and evaluating an internal audit function, boards should ensure that their internal auditors are following globally accepted internal auditing standards and that staff, in particular the CAE, hold appropriate certifications or other credentials, and/or have other on-going professional training which ensures sufficient competency to perform their roles.

Unlike the external auditing profession, governments have generally accepted a self-regulatory model for internal auditors, given that their obligations are principally to the board rather than to shareholders. In that spirit, governments should avoid restrictions on the use of globally recognized certifications or other credentials that would impede the successful in-country or cross-border practice by highly qualified members of the internal auditing profession. Governments also should avoid unnecessary burdens such as government-mandated registries that do not advance the public interest, although they may find it valuable to require membership in a country's internal auditing professional membership association or professional body or a globally recognized internal auditing membership association.

In some cases, companies opt to outsource their internal audit function. In those situations, the board should carefully review the engagement to avoid conflicts of interest. Audit companies providing external audit services should never be allowed to provide outsourced internal audit services to the same client.

Given the expertise and experience of the internal audit function, external auditors may consider it appropriate in certain circumstances to rely on internal auditors' work. Where there is ambiguity, lawmakers and regulators may wish to work with stakeholders to provide additional clarity on when this is appropriate.

p. 35

V. Responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, the active engagement of an internal audit function independent from management, and the board's accountability to the company and the shareholders.

Together with guiding corporate strategy, the board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. In order for boards to effectively fulfill their responsibilities, they must be able to exercise objective and independent judgement. Another important board responsibility is to oversee the risk management and internal controls systems and systems mechanisms designed to ensure that the corporation obeys applicable laws, including relating to tax, competition, labour, environmental, equal opportunity, data privacy and digital security, and health and safety. In some countries, companies have found it useful to explicitly articulate the responsibilities that the board assumes and those for which management is accountable. In fulfilling these responsibilities, the internal audit function also has a critical role to play in partnership with management and the board.

p. 37

V.D.2. ~~Reviewing and assessing risk management policies and procedures.~~ Determining risk management policy and the company's acceptable level of risk.

Oversight of the company's risk management is an area of major importance for boards and is closely related to corporate strategy. It involves oversight of the accountabilities and responsibilities for managing risks, specifying the types and degree of risk that a company is willing to accept in pursuit of its goals, and how it will manage the risks it creates through its operations and relationships. The board's oversight, with the support and counsel of the internal audit function, thus provides a crucial guidance to management in handling risks to meet the company's desired risk profile.

pp. 37-38

V.D.3. Monitoring the effectiveness of the company's governance practices and making changes as needed.

Monitoring of governance by the board includes continuous review of the internal structure of the company to ensure that there are clear lines of accountability for management throughout the organisation. In addition to requiring the monitoring and disclosure of corporate governance practices on a regular basis, at least in summary form, many countries have moved to recommend, or indeed mandate, self-assessment by boards of their performance, as well as the assessment of the performance of their committees, individual board members, the chair and the CEO.

Routine assessment of the company's governance practices by the internal audit function can assist boards in these monitoring responsibilities.

p. 39

V.D.7.

In fulfilling its control oversight responsibilities, it is important for the board to establish an anonymous whistleblowing policy in order to encourage the reporting of unethical/unlawful behaviour without fear of retribution. The existence of a company code of ethics should aid this process which should be underpinned by legal protection for the individuals concerned. A contact point for employees who wish to report concerns about unethical or illegal behaviour that might also compromise the integrity of financial statements should be offered by the audit committee or by an ethics committee or equivalent body.

V.D.8. Ensuring the integrity of the corporation's accounting and reporting systems for disclosure, including the independent external audit, and that appropriate systems of control are in place, in compliance with the law and relevant standards.

The board should demonstrate a leadership role to ensure that an effective means of risk oversight is in place. Ensuring the integrity of the essential reporting and monitoring systems will require that the board sets and enforces clear lines of responsibility and accountability throughout the organisation. The board will also need to ensure that there is appropriate oversight by senior management. ~~Normally,~~ As discussed in section IV.F., this should include~~s~~ the establishment of an internal audit function ~~system~~ directly reporting to the board. It is considered good practice for the internal auditors to report to an independent audit committee of the board or an equivalent body which is also responsible for managing the relationship with the external auditor, thereby allowing a co-ordinated response by the board.

It should also be regarded as good practice for this committee, or equivalent body, to review and report to the board the most critical ~~accounting~~ policies which are the basis for financial and non-financial reports.

p. 41

V.E.2. Boards should consider setting up specialised committees to support the full board in performing its functions, in particular the audit committee – or equivalent body – for overseeing disclosure, internal controls, risk management systems for financial and non-financial risks, and audit-related matters including internal auditors' work. Other committees, such as remuneration, nomination or risk management, may provide support to the board, depending upon the company's size, structure, complexity and risk profile. Their mandate, composition and working procedures should be well defined and disclosed by the board which retains full responsibility for the decisions taken.

Where justified in terms of the size and structure of the company and its board, as well as the company's sector or level of development, the use of committees may improve the work of the board. In order to evaluate the merits of board committees it is important that the market receives a full and clear picture of their purpose, duties and composition. Such information is particularly important in the many jurisdictions where boards are required to establish independent audit committees with powers to oversee the work and relationship with both the internal and external auditor. Audit committees, working closely with the internal audit function, should also ~~be able to~~ oversee the effectiveness and integrity of the internal control system.

p. 42

Other committees may be established to advise the board on additional issues. Some boards have created a sustainability committee to analyse in particular climate-related risks. The establishment of other committees, such as a technology committee, may also be considered by the board. Such a committee may advise on the management of digital security risks as well as on the company's digital transformation. Ad hoc or special committees can also be temporarily set up to respond to specific needs or corporate transactions. Disclosure need not extend to specific committees set up to deal with, for example, confidential commercial transactions. When established, committees should have access to the necessary information to comply with their duties, receive appropriate funding and engage both internal audit functions and outside experts or counsels.

p. 44

Several jurisdictions have oriented their capital market policies to foster a greener and more resilient corporate sector. In doing so, such policies may aim to also preserve access to capital markets by preventing prohibitively high costs of listing a company while still ensuring that investors have access to the information necessary to allocate capital efficiently to companies. Investors, directors, internal auditors, and key executives must also be open to a constructive dialogue on the best strategy to support the company's sustainability and resilience. A company that takes account of stakeholder interests may be better able to attract productive employees, support from the communities in which it operates, and more loyal customers.

p. 49

VI.D.5. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and to the competent public authorities, and their rights should not be compromised for doing this.

Unethical and illegal practices by corporate officers may not only violate the rights of stakeholders but also be detrimental to the company in terms of reputational effects. It is therefore important for companies to establish an anonymous whistleblowing policy with procedures and safe-harbours for complaints by employees, either personally or through their representative bodies, and others outside the company, concerning illegal and unethical behaviour.