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# FOCUSING ON PERFORMANCE

*Principles for Effective PAO Governance*

PAO Capacity Building Series

IFAC serves the public interest and strengthens the accountancy profession by:

- Supporting the development of high-quality international standards;
- Promoting the adoption and implementation of these standards;
- Building the capacity of professional accountancy organizations; and
- Speaking out on public interest issues.

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## Introduction and Background

Establishing strong governance is crucial for all professional accountancy organizations (PAOs) and helps each organization deliver its mission and vision.

Attention on PAO governance structures and practices continues to increase as its critical role in underpinning well-functioning, sustainable PAO operations becomes increasingly clear. Effective governance is a “make or break” factor for PAOs as they strive to adopt and implement international standards and practices. It is also a key factor in the success of development projects, including those under the IFAC [PAO Capacity Building Program](#). Governance is both necessary to, and a pre-requisite for, a PAO’s overall sustainability (see [IFAC’s PAO Capacity Building Framework](#)).

As a supplement to *Establishing Governance: A Guide for PAOs*, this publication focuses on PAOs’ institutional development. It is not intended to provide detailed practical guidance on how to develop and strengthen governance in PAOs. Instead, this guidance features the *principles* PAOs should follow to enhance their governance

arrangements and a self-assessment tool to encourage continuous improvement.

This publication is also meant to be used in combination with other practical guidance, such as forthcoming work from the Confederation of Asian and Pacific Accountants on governance that is part of its *Maturity Model–Guidance Series*.

While the twelve key principles outlined in [Evaluating and Improving Governance in Organizations](#)

were intended to help professional accountants in business evaluate and improve governance in their organizations, the principles suit all types of entities and remain relevant today. The principles form the foundation and framework of this publication while updating the core contents to enhance application among PAOs.

PAOs are encouraged to consider their local context when taking into account the principles in this publication as each PAO has differing approaches, methodologies, local conditions, and governance arrangements that reflect different influences, cultural and legal backgrounds, and size and membership characteristics.

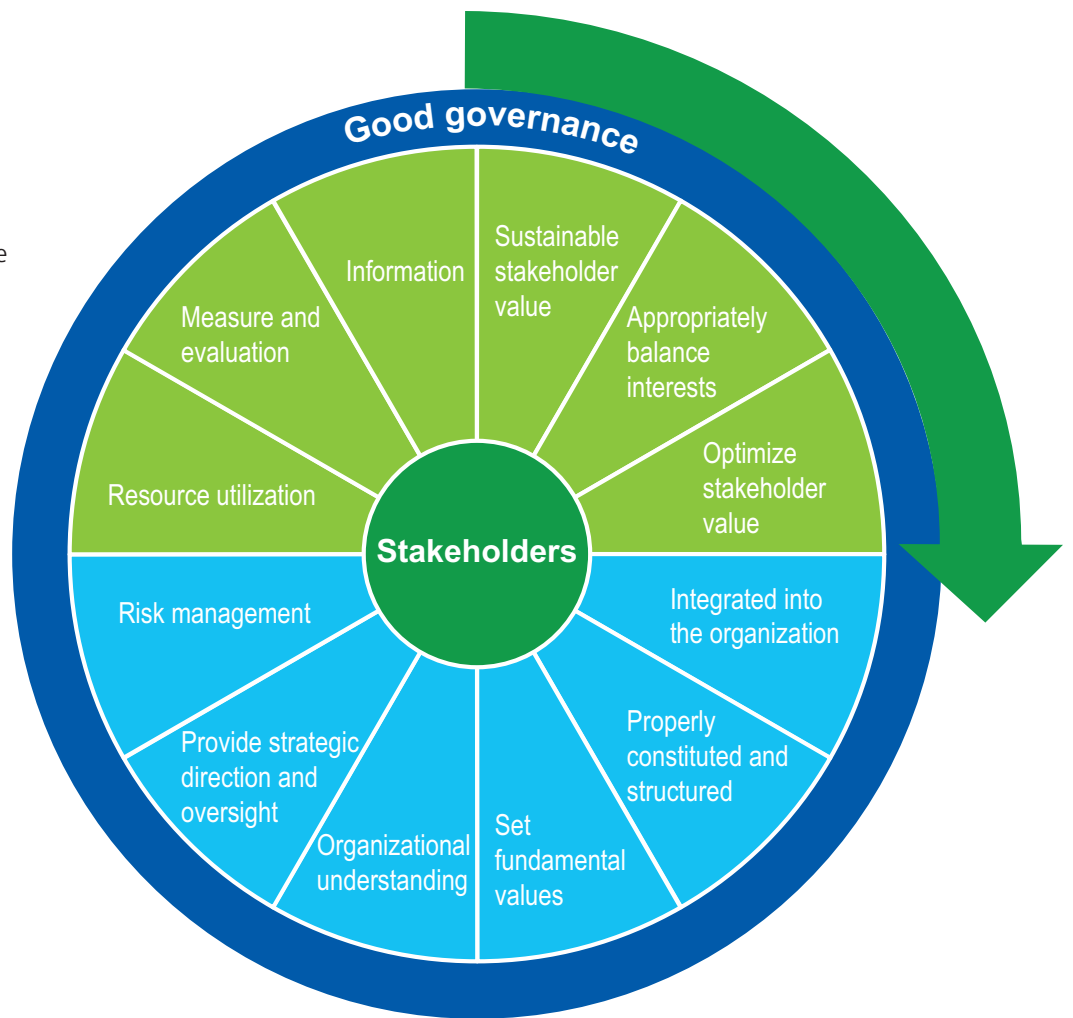
Accountants and their organizations should be committed to ethical values and behaving with integrity. Regardless of the approach or governance model employed, the result should support these hallmarks of accountancy.



IFAC is working with PAOs to identify and share their governance experiences and success stories via the [Global Knowledge Gateway](#). Visit the site now for the resources and thought leadership, and subscribe to receive the latest content via email.

# Key Principles of Evaluating and Improving Governance in PAOs

- a. The PAO's board should establish a set of fundamental values by which the organization operates. All those participating in governance should embrace these fundamental values.
- b. The creation and optimization of sustainable stakeholder value should be the objective of governance.
- c. Good governance should appropriately balance stakeholder interests.
- d. The performance and conformance dimensions are both important to optimize stakeholder value.
- e. Good governance should be fully integrated into the PAO.
- f. The PAO's board should be constituted and structured to achieve a balance between performance and conformance.
- g. The PAO's board should understand the organization's business model, operating environment, and how sustainable stakeholder value is created and optimized.
- h. The PAO's board should provide strategic direction and oversight in both the performance and conformance dimensions.
- i. Effective and efficient risk management should form an integral part of a PAO's governance arrangements.
- j. Resource utilization should align with strategic direction.
- k. The PAO's board should periodically measure and evaluate the organization's strategic direction and business operations, and follow up with actions to ensure progress and continued alignment with objectives.
- l. The PAO's board should ensure that reasonable demands from stakeholders for information are met, and that the information provided is relevant, understandable, and reliable.



## PRINCIPLE A

**The PAO's board should establish a set of fundamental values by which the organization operates. All those participating in governance should embrace these fundamental values.**

PAOs must achieve their intended outcomes while acting in the public interest at all times. Acting in the public interest requires PAOs to (a) behave with integrity, demonstrating strong commitment to ethical values, and respecting legislative requirements; and (b) ensure openness and comprehensive stakeholder engagement.

The PAO's board must set the "tone at the top" by defining the organizational values, adopting and implementing the *Code of Ethics for Professional Accountants*, and adhering to these principles as an example of appropriate behavior.

Management and board members should behave with integrity and promote a culture where acting in the public interest is the norm, together with a continuing focus on achieving the PAO's objectives. It should do this by taking the lead in establishing—and living up to—specific values for the PAO and its staff. These values should be communicated, understood, and shared.

Management and board members should be driven by their conscience and organizational values to "do the right thing." Incentives could act as an additional motivator. However, incentives can have unintended consequences. The PAO should, therefore, ensure that incentives remain aligned with strategic direction, including any changes.

Stakeholders, including employees, should be able to freely communicate their governance concerns to the PAO's board. Their interests should not be compromised by doing this.

## PRINCIPLE B

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

The PAO's board has the responsibility to use resources responsibly to create and optimize sustainable value for their stakeholders such as their members, regulators, government, press, elected officials, academia, and other organizations. The board must know and understand the expectations of the PAO's stakeholders, particularly with respect to what sustainable value means to them.

Service delivery for PAOs is primarily from a stakeholder perspective and is not always easy to measure. PAOs primarily satisfy stakeholder expectations by providing services that support and enhance the competence and credibility of their members and the environments in which they operate.

Senior staff and volunteers—those involved in scrutinizing the effectiveness of governance—

should help the PAO's board identify, understand, and monitor stakeholder groups via stakeholder surveys that provide appropriate decision-oriented information on stakeholder expectations.

The accountancy profession is a key driver of strong and sustainable organizations, financial markets, and economies. It plays an integral role in achieving the UN's Sustainable Development Goals. PAOs should continue to produce accountants with the relevant skills and awareness to contribute to sustainable and resilient organizations, capital markets, and economies.

By achieving this, PAOs can create stakeholder value derived from various sources, such as relevant certification or accreditation, and continuing professional development offerings, other products or services, financial stability, and PAO activities that support the public interest.

## PRINCIPLE C

### Good governance should appropriately balance stakeholder interests.

PAOs' membership also rightly expects to share in the results of the organization. It is important for PAOs to periodically ask this key stakeholder group about the suitability and quality of its existing services and activities, as well as future needs.

Engagement with the abovementioned stakeholders helps PAOs better understand the objectives and motivations of these groups and align and communicate messages for maximum impact.

Developing formal and informal partnerships with other entities allows PAOs to use their resources more efficiently and achieve their outcomes more effectively. Long-term success and prudent oversight requires the PAO's board to actively consider the legitimate interests and expectations of constituents and stakeholders, and respond to changing expectations, opportunities, and threats that influence future viability.

Communication and consultation methods should be balanced and fair, allowing stakeholders to express their views freely and make informed decisions based on unbiased information. PAO boards may also need to take different stakeholders' needs and requirements into consideration. The PAO's evaluation processes should enable the interests of more vocal stakeholder groups to be balanced with other stakeholders' interests, ensuring that no one group becomes unduly dominant.

Stakeholders should be encouraged to express their legitimate interests and concerns, and PAOs should consider developing appropriate mechanisms and processes to receive and review stakeholder feedback.

Basic member rights generally include the right to obtain relevant materials and information on the organization on a timely and regular basis, participate and vote in general meetings, and elect and remove the board of directors.

## PRINCIPLE D

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

Governance affects the entire cycle of planning, resource utilization, value creation, accountability, and assurance. The two dimensions of the governance framework, performance and conformance, should be appropriately balanced.

In many PAOs, the conformance aspect has tended to receive greater focus; for example, following the constitution and bylaws—particularly for voting processes and managing the board's authority. As PAOs mature, they need to evaluate and improve

their governance to adopt systems that ensure appropriate attention is given to the performance dimension. One example of this is appointing a strategy committee or a planning and finance committee.

While PAOs in general may need to improve their focus on the performance dimension and creation of value for stakeholders, they should also pay attention to aspects of the conformance dimension that may need improvement, such as risk management, nominations processes, and reporting.

## PRINCIPLE E

### **Good governance should be fully integrated into the PAO.**

The governance principles should be considered both in setting the PAO's objectives (planning) and in all subsequent actions (implementation and review). Good governance should be part of the DNA of the PAO.

The PAO, as well as every individual in it, is responsible for achieving its objectives. Everyone has

a role in steering the PAO toward those objectives. PAO staff and volunteers should actively promote governance's integration 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 PAO's board on the progress of the integration of governance into the organization.

## PRINCIPLE F

### **The PAO's board should be properly constituted and structured to achieve balance between performance and conformance.**

The PAO's board and its executive management are responsible for directing the affairs of the PAO, ensuring it is well run, serving the public interest, and delivering value to its stakeholders. The PAO's board should be responsible for ensuring the appropriate balance of performance and conformance priorities.

PAO boards should strive to achieve a representative diversity of skills, gender, and sectors. Depending on the jurisdiction, other factors, such as race, culture, and linguistic diversity, should be taken into consideration as well.

Good practice calls for a suitable balance between (a) those who have direct responsibility for the operations and success of the PAO (e.g., PAO staff members in executive positions—management), and (b) those who are responsible only to the stakeholders and are **not** directly responsible for

operations (e.g., volunteers who are not PAO staff members—board members). Clearly defining the required roles and responsibilities of management, the board chair, and the other board members is critical to achieving a suitable balance between (a) and (b) above.

The PAO's board and all staff should consider and balance stakeholders' interests and exercise objectivity in their decisions. A multi-stakeholder approach to board membership can help ensure a balance between and alignment with various stakeholder interests.

A credible nominations and evaluation processes based on required representation, competencies, experience, and performance will go a long way in achieving an appropriate mix of board members.

In some jurisdictions, it is feasible for PAOs to introduce a board that includes both independent non-executives. Such cases allow for a board structure focused on both strategy and oversight with wider public interest issues.

To strengthen structural checks and balances, the roles of board chair and chief executive should be separated. Ideally, the chair should be an independent, non-executive member.



## PRINCIPLE G

**The PAO's board should understand the organization's business model, operating environment, and how sustainable stakeholder value is created and optimized.**

The PAO's board 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 PAO's board understands how the PAO operates, and the opportunities and risks inherent in its environment. Further, the PAO's board should thoroughly understand how the organization creates and optimizes sustainable stakeholder value to evaluate whether the needs of stakeholders are being met.

To facilitate this knowledge, boards should:

- Follow a rigorous appointment process that ensures appropriate knowledge and experience, orientation, and training of new members of the PAO's board; and
- Conduct performance evaluation process that measures competence and achievements in critical areas.

Additionally, members of the PAO's board should have appropriate access to key personnel (e.g., management staff, external auditors) as well as to other information sources (e.g., operational and other analyses) to maintain their understanding of the organization.

## PRINCIPLE H

**The PAO's board should provide strategic direction and oversight in both the performance and conformance dimensions.**

It is essential that the PAO's board implements processes and procedures to provide both performance and conformance oversight. 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.

It is important to note that, ideally and where feasible, the board should not be involved in operational matters, other than to hold the PAO's committees and officers accountable for implementing their respective roles in line with the strategy.

The PAO's board should periodically report to the PAO's stakeholders (e.g., the members and/or an oversight authority) for how it has carried out its governance responsibilities, and stakeholders should be able to hold governing bodies to account.

Conformance oversight has traditionally been a responsibility of the PAO's board. These responsibilities should not be diminished by adding

the performance dimension of governance. The PAO's board should take explicit responsibility and devote sufficient resources to specific governance functions of the PAO that address both dimensions of the governance framework.

The establishment of specific committees for these functions is typically helpful. Committees of the PAO's board with oversight responsibilities should be predominately composed of board members to ensure objectivity. A strategy committee, such as a planning and finance committee, can improve strategic direction and oversight in the performance dimension. This committee is a preparatory committee for the entire board, and not a decision-making committee.

PAO Board Committee Examples:

- Nominations
- Governance
- Audit
- Planning and Finance
- Public Policy

## PRINCIPLE I

### **Effective and efficient risk management should form an integral part of a PAO's governance arrangements.**

Central to the requirements of governance in PAOs is a clear relationship between managing risk and fulfilling organizational objectives. Risks can come from many sources, both inside and outside the PAO. Effectively managing risk requires that risk management and internal control procedures are integrated into decision-making activities. Further, all activities of the PAO should be analyzed through this lens and the PAO's strengths, opportunities, weakness, and threats consistently considered. It also assures the PAO's board and stakeholders that the organization understands its risks and is actively managing them. Good practice in managing risk is essential to organizational success and should facilitate change rather than safeguard a position.

Effective risk management better enables a PAO to achieve its objectives, while operating successfully, efficiently, ethically, and legally. The PAO's board should ensure that the organization has effective risk management arrangements in place. This should include:

- Defining the PAO's risk management strategy, approving the limits for risk taking, where feasible, and determining the criteria for internal control;
- Integrating the process for managing risk into the PAO's overall governance, strategy, and planning, management, reporting processes, policies, values, and culture;
- Regularly reviewing key strategic, operational, financial, reputational, and fraud risks and then devising responses consistent with achieving the PAO's objectives and intended outcomes;
- Engaging staff in all aspects of the risk management process;
- Monitoring and reviewing the risk management framework and processes on a regular basis, with the results reported to the PAO's board and/or its audit committee; and
- Reporting to stakeholders on the effectiveness of the risk management system, for example, through an annual governance statement, including, where necessary, plans to address significant issues.

## PRINCIPLE J

### **Resource utilization should align with strategic direction.**

Part of the fiduciary responsibility of the PAO's board is to oversee management of the organization's resources. This includes ensuring both safeguarding of these resources (conformance) and utilization of these resources in a manner that enhances stakeholder value (performance).

In addition to protecting physical assets, management should also focus on safeguarding intangibles, such as intellectual assets or non-financial capitals, which are often given insufficient attention yet are the key drivers of stakeholder value.

Integrated thinking is a precursor to integrated reporting, which has the potential to change the way a PAO thinks about creating and sustaining value (see principle L).

Integrated thinking leads an organization to focus on the variety of information and decisions that impact its potential success. Such thinking promotes a better understanding of the financial and human resources needed to enable this success, and which should therefore be optimized through the organization's business model.

The PAO's board should review resource allocation periodically to ensure 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 the approval of new projects includes the associated resource acquisition and allocation.

## PRINCIPLE K

**The PAO's board should periodically measure and evaluate the organization's strategic direction and business operations, and follow up with actions to ensure progress and continued alignment with objectives.**

What gets measured gets done.

Therefore, it is important for the PAO's board 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 PAO's board can periodically measure performance objectively.

Performance measurement tools should be developed that reasonably depict the PAO'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.

The PAO's board should regularly evaluate the organization's governance arrangements and performance to ensure its effectiveness and strive for continuous improvement.

## PRINCIPLE L

**The PAO's board should ensure that reasonable demands from stakeholders for information are met, and that the information provided is relevant, understandable, and reliable.**

Good governance requires the PAO's board to oversee the organization's disclosures, including financial and non-financial reporting, to ensure that stakeholders receive relevant, understandable, and reliable information. This reporting should include (a) a historical perspective of the PAO's performance for the period covered by the report, and (b) information that would allow stakeholders to assess the PAO's future performance.

Stakeholders usually recognize that financial reporting alone cannot satisfy all information needs and continue to seek more and different information of relevance. This includes information on strategy, governance, risk management, human resources, and approach to broader sustainability issues, including environmental and social issues. Some PAOs have adopted integrated reporting to improve organizational management and stakeholder engagement, as well as demonstrate leadership.

This responsibility for reporting oversight should include assurances that the PAO's board has reviewed the risk management and internal control systems to ensure their effectiveness. This type of oversight is usually guided by an audit committee.

Non-financial reports specifically provide an opportunity to present perspectives on the underlying potential and prospects for the PAO. The report should include information on how effective the PAO has been in meeting its strategic objectives, and how it has managed its resources.

There must be consistency between financial and non-financial information, as well as between

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internal and external information, presented in each period. PAOs are encouraged to include all of these types of information in one integrated report that links past performance with future expectations. The information from one reporting period should also be consistent with information from the next, especially for those items that can materially affect performance and value creation, to the extent that they continue to be relevant to the PAO's success.

The presentation style of stakeholder reports should be sensitive to the fact that not all stakeholders are accounting 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.

The PAO's board is responsible for (a) reviewing and questioning the procedures and practices that are involved with providing stakeholder information and that support reporting, and (b) ensuring that the principles of integrity, accountability, and transparency govern these processes.

Care must be taken to ensure that reports do not become marketing tools. Reports should be written in an even-handed, balanced, and candid way. Disclosure of all relevant information should also be ensured either in the report or online.

# Focus on Performance, and Don't Forget Conformance

The principles of good governance exist within a framework comprised of two dimensions: the performance dimension and the conformance dimension, which together represent an organization's entire value creation, resource utilization, and accountability framework.

In general, the conformance dimension takes a historic view while the performance dimension is more forward-looking. By taking a proactive, forward-looking view, PAOs can address many of the risks associated with non-conformance and help ensure that effective measures are in place to successfully achieve the organization's objectives.

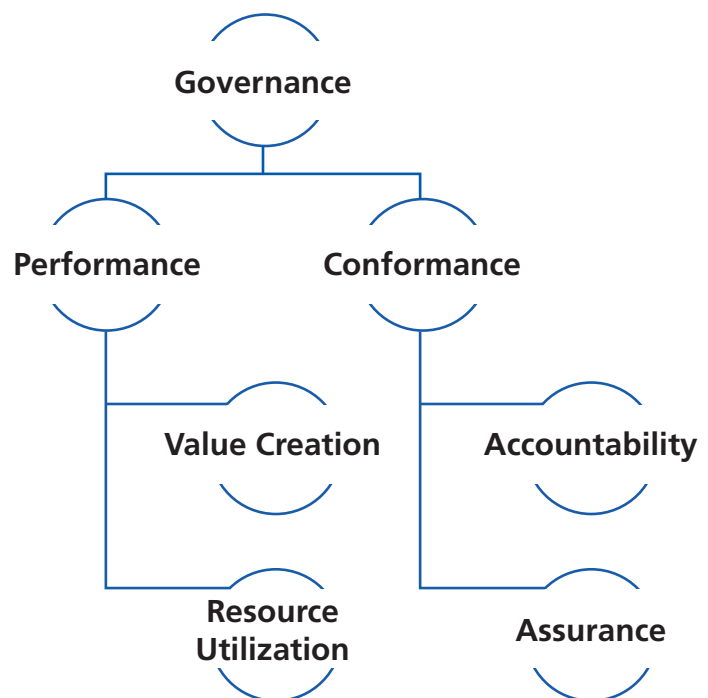
Conformance responsibilities focus on providing assurances to stakeholders that:

- There is effective identification, prioritization, management, control, mitigation, and reporting of strategic, tactical, and operational risks.
- The PAO is working effectively and efficiently to achieve its strategic and operational goals.
- 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 PAO.
- Management's fiduciary responsibilities are being met.
- Criminal activities such as fraud, money laundering, theft, and misappropriation can be prevented and detected.
- The PAO complies with all other relevant rules and regulations.

Performance responsibilities focus on strategy, value creation, and resource utilization, and include:

- Establishment of a robust decision-making process, which involves an approach to the management of risk that supports decision making and reduces uncertainty associated with achieving objectives (for more information, see [From Bolt-on to Build-In: Managing Risk as an Integral Part of Managing an Organization](#)).

- 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 a PAO needs to make decisions in response to changing conditions.



## APPENDIX: Self-Assessment Tool—Is Your PAO Addressing All the Principles?

This self-assessment tool is based on the [Plan-Do-Check-Act \(PDCA\) Cycle](#) model, which is a four-step continuous improvement cycle based on the scientific method of proposing a change in a process, implementing the change, measuring the results, and taking appropriate action.

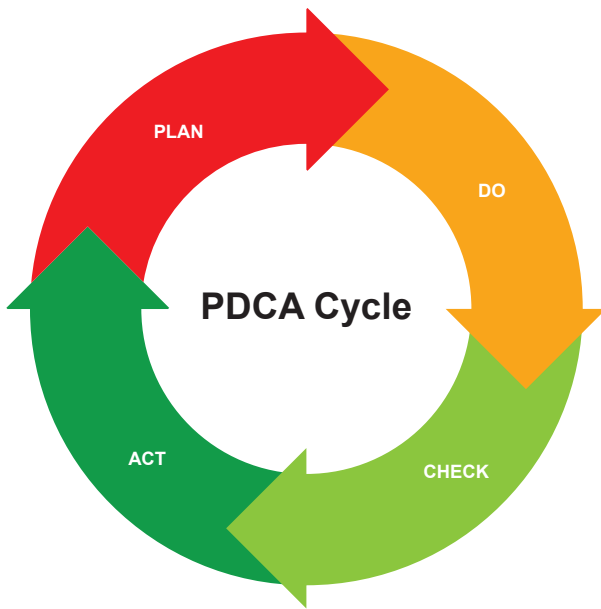
The [IFAC Member Compliance Program](#) uses a PDCA cycle-based approach to assess the status of a PAO’s fulfillment of the [Statements of Membership Obligations](#) (SMOs). IFAC’s approach employs a six-step continuous improvement cycle:







- *Not Active* for PAOs that are not fulfilling SMO requirements
- *Consider* for PAOs considering how to fulfill the requirements
- *Plan* for defining a plan to fulfill the requirement
- *Execute* for demonstrating its implementation of the plan
- *Review & Improve* for fulfilling its obligation and checking results to identify and apply improvements
- *Sustain* for maintaining well-established ongoing processes to fulfill relevant obligations.

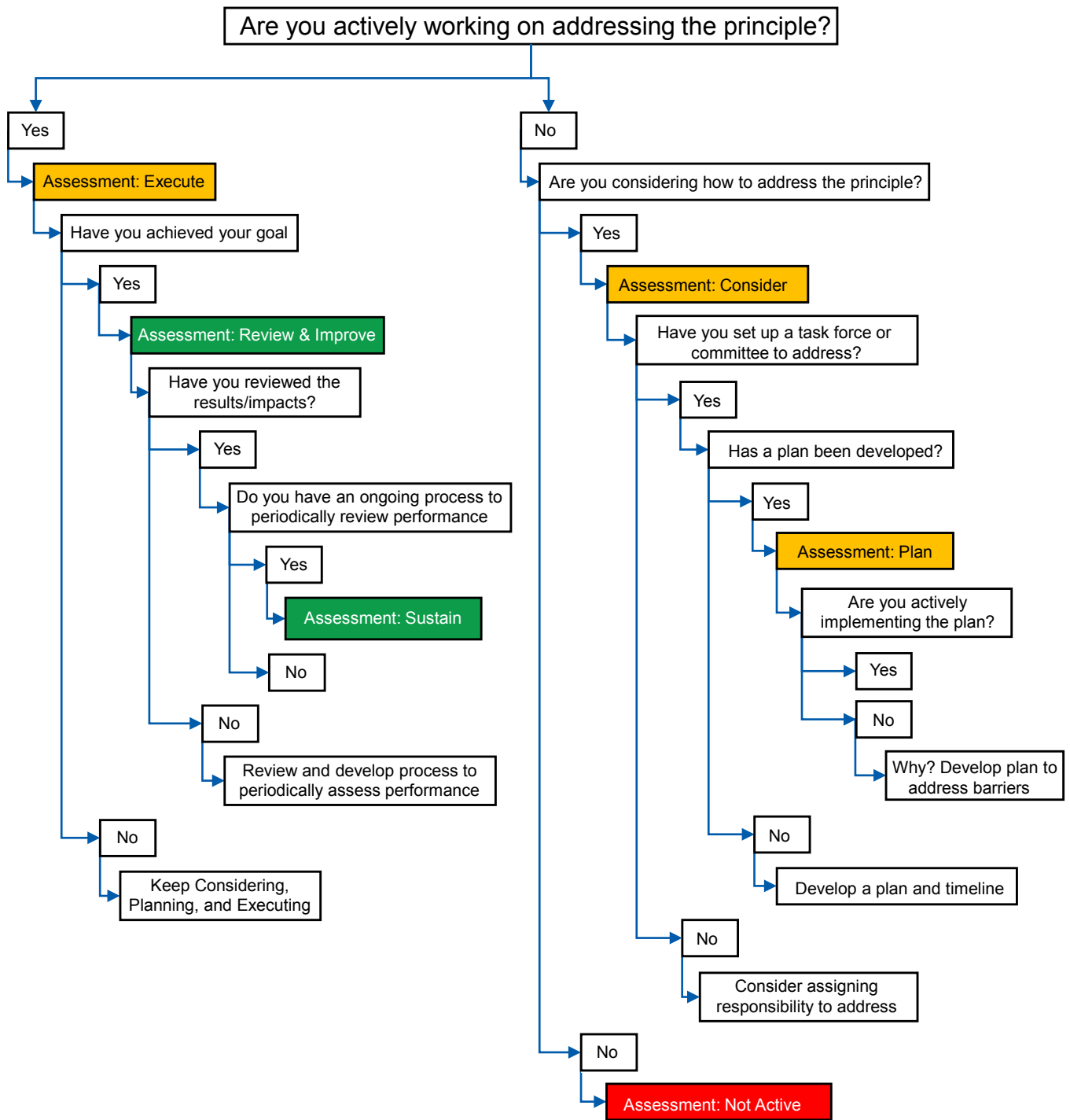
The tool below is included to encourage continual improvement for PAOs in considering the governance principles. The cycle begins at *Not Active* for PAOs that are not considering the governance principle and ends at *Sustain* for PAOs maintaining well-established ongoing processes to periodically review performance. PAOs should refer to the legend below while completing the self-assessment for each of the governance

principles.

The self-assessment tool seeks to measure the qualitative differences that make good governance a continual and self-correcting process.









Status	Governance Self-Assessment Legend
 Sustain	PAO maintains well-established ongoing processes to periodically review performance. In fulfilling the principle, PAO considers, plans, executes, reviews, and improves as part of an ongoing commitment to continuous improvement.
 Review & Improve	PAO has recently achieved its goal and is reviewing the results/impacts to apply improvements.
 Execute	PAO is actively implementing the plan.
 Plan	PAO has a defined plan with specific timeline to implement the plan.
 Consider	PAO is considering the principle.
 Not Active	PAO is not considering the principle.



Principles	Sustain ■	Review & Improve ■	Execute ▲	Plan ▲	Consider ▲	Not Active ●
<b>Principle A:</b> The PAO's board should establish a set of fundamental values by which the organization operates. All those participating in governance should embrace these fundamental values.						
<b>Principle B:</b> The creation and optimization of sustainable stakeholder value should be the objective of governance.						
<b>Principle C:</b> Good governance should appropriately balance stakeholder interests.						
<b>Principle D:</b> The performance and conformance dimensions are both important to optimize stakeholder value.						
<b>Principle E:</b> Good governance should be fully integrated into the PAO.						
<b>Principle F:</b> The PAO's board should be constituted and structured to achieve a balance between performance and conformance.						
<b>Principle G:</b> The PAO's board should understand the organization's business model, operating environment, and how sustainable stakeholder value is created and optimized.						
<b>Principle H:</b> The PAO's board should provide strategic direction and oversight in both the performance and conformance dimensions.						
<b>Principle I:</b> Effective and efficient risk management should form an integral part of a PAO's governance arrangements.						
<b>Principle J:</b> Resource utilization should align with strategic direction.						
<b>Principle K:</b> The PAO's board should periodically measure and evaluate the organization's strategic direction and business operations, and follow up with actions to ensure progress and continued alignment with objectives.						



Principles	Sustain 	Review & Improve 	Execute 	Plan 	Consider 	Not Active 
<p><b>Principle L:</b> The PAO's board should ensure that reasonable demands from stakeholders for information are met, and that the information provided is relevant, understandable, and reliable.</p>						

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