



DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS

**QUESTIONS FOR A MULTI-STAKEHOLDER DIALOGUE ON
RESPONSIBLE INVESTMENT IN WEAK GOVERNANCE ZONES**

**Looking through the Lens of
the OECD Integrity Instruments**

Invitation for Input – Deadline 28 February 2005

Investor roles and home and host government responsibilities

1. Do companies have a role in helping to support reform of economic and political institutions in host societies?
2. If companies have such a role,
 - Is this role different in weak governance zones than it would be elsewhere?
 - How are they to tell the difference between positive contributions to the reform process and inappropriate involvement in local politics (which Recommendation II.11 of the Guidelines asks them to avoid)?
 - How are they to distinguish between their own roles and those of host governments, international organisations and home governments (e.g. their diplomatic services, ODA programmes, etc.)?

Investor roles in weak governance host societies

3. Investors in the DRC responded to threatened or actual abuse of political power by cultivating political ties so as to establish a kind of “home made” investment protection. How do efforts of this type affect the development of the rule of law in weak governance host societies?
4. The DRC case study suggests that investors in weak governance host countries have to be well informed about the local political situation and about each other’s activities.
 - What should a company do if obtains information about wrongdoing by private actors or public officials? Should companies be encouraged to bear witness to wrongdoing? Under what circumstances should companies consider that they have whistle-blowing responsibilities?
 - Should their responses be different in weak governance zones than they would be in other investment environments? If so, how?

- If companies have a responsibility to make their knowledge about wrongdoing public, how can they protect themselves against retaliation by host country actors?
5. The DRC case study shows that oil and mining companies provided “monetisation” services that converted the DRC’s natural resource assets into (mainly) financial assets that accrued to state-owned enterprises or to the Treasury at a time when few financial and fiscal controls were in place.
- Does companies’ provision of these services influence the nature of their responsibilities in weak governance host countries? If so, how?
 - How can these companies avoid giving the appearance that they are aiding and abetting people who might be in a position to take advantage of the weak financial and fiscal controls in the host country?
6. Is there any special role that financial companies can play (besides their important and often legally required contribution to helping combat money laundering) in improving the institutional framework in weak governance host countries?

Corporate governance – creating shareholder value with integrity

7. The Disclosure Chapter of the Guidelines encourages companies to apply high standards of financial and non-financial disclosure. Do companies have an extra duty of transparency when investing in non-transparent host countries or are their responsibilities in this area the same in all host countries?
8. OECD societies have valid reasons – grounded in the public interest -- for holding large, publicly-listed companies to higher transparency standards than smaller and/or unlisted companies. The case study of publicly-listed junior mining companies with DRC investments suggests that the juniors have smaller, less open boards than large companies; are less likely to report on company policies, management practices and performance in non-financial areas. The small unlisted mining companies in the case study are found to be less transparent than both large and small publicly listed companies in the financial and non-financial areas.
- Should junior and small unlisted companies be encouraged to use their boards to assign high strategic priority to the ethical management of their investments in weak governance zones? If so, how could this be done (e.g. add board members, create a special committee with access to relevant expertise)?
 - Recommendation II.7 of the Guidelines asks companies “to develop and apply ... management systems that foster a relationship of confidence...” with the societies in which they operate. The Disclosure chapter encourages them to communicate information on “systems for managing risks and complying with laws, an on statements or codes of business conduct”. How do these recommendations apply to small unlisted companies and to junior companies in weak governance zones? Should they be encouraged to adopt internal compliance and external non-financial reporting practices that the case study shows to be common among larger extractive industry companies?
 - Chapter I of the Guidelines acknowledges that small- and medium-sized companies may not have the same capacity to observe the Guidelines as larger enterprises. Is asking the juniors and the small unlisted companies to open up their boards, adopt advanced compliance programmes and engage in extensive non-financial reporting equivalent to asking these companies to act like large publicly listed companies? If so, is this reasonable?

Doing business with weak governance state-owned enterprises (SOEs)

9. The case study shows that many OECD-based companies had joint ventures and other business relations with SOEs in the DRC and suggests that these SOEs' governance rules were weak. OECD and non-OECD experience shows that weak governance SOEs can be a mechanism for lowering public wealth through waste or questionable business practices. Through their joint venture arrangements, OECD based companies provide services and revenues to SOEs.
- Are companies' responsibilities the same when they enter into joint ventures with weak governance SOEs as their responsibilities with stronger governance SOEs?
 - What SOE characteristics should an investor look at when considering whether or not to enter into partnerships with weak governance SOEs and when deciding how such partnerships should be managed?
 - Guidelines Chapter X asks companies to conform "transfer pricing practices to the arm's length principle." Should companies be encouraged to apply this principle when structuring transactions with SOEs, even when it is not required by law or is not a common business practice in the host country?
 - Does Annex Table 1 – drawn from the OECD Corporate Governance Principles and the Guidelines for Managing Conflict of Interest in the Public Sector -- provide a useful list of considerations for identifying weak governance SOEs?
10. Many of the larger multinational enterprises in the DRC mining sector tend to be non-operating shareholders in mixed public/private companies. In this respect their positions and interests are similar to those of the DRC citizens. In addition, large publicly listed companies tend to have significant expertise in corporate governance, involving elaborate and transparent governance practices. The current DRC government has identified SOE reform as a policy priority.
- Should such companies be encouraged to seek to protect the interests of host country citizens (as shareholders in these partially state-owned companies) or are their responsibilities limited to protecting the interests of their own shareholders?
 - Recommendation II.6 of the Guidelines asks companies to "uphold good corporate governance principles", while Recommendation II.3 asks them to "encourage local capacity building through close cooperation with the local community, including business interests". Should large companies be encouraged to share their governance expertise with their SOE partners?

Corporate tax payments into weak governance fiscal systems

11. Do companies that make large tax and royalty payments to weak governance fiscal systems have a role in supporting reform of these systems?
12. If it is agreed that companies have such roles, then:
 - how do these relate to those of other actors, notably host governments and international financial institutions (whose mission is *inter alia* to promote public sector reform)?
 - how can companies most effectively go about supporting reform? Should companies refrain from signing contracts with governments that prohibit them from publishing their payments to host country treasuries? Are there countervailing concerns about business confidentiality that cannot be met through appropriate contracting?
13. Do the questions set forth in Annex Table 2 – which are based on the OECD Best Practices for Budget Transparency -- provide a good basis for identifying weak fiscal systems and areas where reform is needed?

Eradicating bribery of public officials

14. Chapter VI of the Guidelines asks companies to promote employee awareness of and compliance with company policies against bribery and extortion and to adopt management control systems that discourage bribery and corrupt practices. Do participants agree that these recommendations are particularly relevant for investors in weak governance zones, where bribery and corruption is common?
15. Recommendation VI.2 of the Guidelines asks companies to “ensure that remuneration of agents is appropriate and for legitimate services only”. When a company’s agent or other business partner is found to have bribed public officials, is it sufficient for the company to sever its relationship with the agent or should it be encouraged to take additional remedial actions? If so, what kinds of actions would be appropriate?

Table 1. Doing business with state-owned enterprises: Considerations for evaluating integrity risks

<p>Transparency</p> <ul style="list-style-type: none">• Does the SOE disclose financial and non financial information according to international best practices? (CGP)• Does the SOE provide information on all material matters of significant concern for the State as an owner and the general public? (CGP) In the case of extractive industry SOEs – material financial matters would include how successful the company is safeguarding the country's financial interests in its extractive industry wealth. Protection of the interests of people in the vicinity of the extractive industry operations is also of major concern for extractive industries and the SOE might be expected to report on these matters as well.• Does the SOE have efficient internal audit procedures, under the control of and reporting to the audit committee, if this exists, or to the Board itself? (CGP)• Is the SOE subject to an annual independent external audit under the conditions prescribed by the IOSCO Principles for Auditing? (CGP) <p>Nomination and role of the board of directors</p> <ul style="list-style-type: none">• Has the government established a structured and transparent nomination process for SOE boards? (CGP)• Do SOE board members act in the best interests of the company and treat all shareholders equally? (CGP)• Are SOE boards independent from management and any direct political interference? (CGP) <p>Conflict of interest:</p> <ul style="list-style-type: none">• Do members of the SOE board and key executives make decisions and provide advice on the basis of the relevant law and policy and the merits of each case, without regard for personal gain? Are they "disinterested"? (COI)• Have members of the SOE board and key executives disposed of, or restrict the operation of, private interests that could compromise official decisions in which they participate? (COI)• Are members of the board and key executives required to disclose to the board whether they, directly or indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation? (CGP)• Is abusive self dealing by the officers of the SOE prohibited? (CGP)• Have non-executive members been named to the Board who are capable of exercising independent judgement to tasks where there is a potential for conflict of interest? (CGP)

Table 2. Evaluating host country budget systems

- Are the accounting policies that underpin the budget (including any deviations from these policies) publicly available?
- Has the government put in place a system of internal financial controls, including internal audit, in order to assure the integrity of information provided in the reports?
- Do the finance minister and senior officials responsible for producing budget reports effectively assume their responsibilities?
- Is the budget report audited by a “Supreme Audit Institution” in accordance with generally accepted auditing practices?
- Are the audit reports scrutinised by Parliament?
- Does Parliament have the opportunity and the resources to effectively examine any fiscal report that it deems necessary?
- Are all fiscal reports made publicly available (including the availability of all reports, free of charge, on the Internet)?
- Does the finance ministry actively promote understanding of the budget process by individual citizens and non-governmental organisations?

Source: Questions derived from the OECD Best Practices for Budget Transparency.