MAKING CODES OF CORPORATE CONDUCT WORK:
CONTROL SYSTEMS AND CORPORATE RESPONSIBILITY

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Making Codes of Corporate Conduct Work:  
Control Systems and Corporate Responsibility

Introduction

1. Many companies have implemented programmes that help them to respond to societal concerns about the economic, social and environmental impacts of their activities and to manage their legal risks. Among the many elements of corporate responses to their social and legal environment, the most visible have been their public statements -- codes of conduct -- that commit companies to behavioural norms in a variety of areas. Companies do not limit themselves to the formulation and publication of codes of conduct, but also have developed management systems designed to help them make good on these commitments. Indeed, codes of corporate conduct are often the first step -- and the most visible feature -- of complex systems of control designed to help firms manage business and legal risks. These control systems typically consist of a range of tools including accounting and record systems, training systems, hierarchical controls, production controls, internal incentive systems and both internal and external audits. Management control, of course, is a core function of any company and exists as a separate discipline within the management field. The extension and refinement of this discipline to other fields of business ethics (e.g. environment, anti-corruption, etc.) and its partial merging with legal risk management has been one of the more important developments in the management field of the last two decades.

2. This paper reports on the implementation tools companies use to implement their codes of conduct. It is based on publicly available sources (especially the inventory of codes of conduct described in ANN1), from direct contacts by the Secretariat with firms and NGOs and from the OECD inventory of corporate codes. The paper begins with a discussion covering three areas:

- Managerial approaches to implementing voluntary codes
- Organisations that provide external verification services
- Monitoring or auditing standards

3. After this overview of the organisational and institutional structure of corporate compliance efforts and of the organisations that provide verification services (audit and monitoring), the paper looks at the implications of this for international policy making and proposes several issues for discussion.
Management approaches to implementing voluntary codes -- no “one size fits all” solution

4. This section looks at how firms implement their codes of conduct, using Secretariat analysis of the statements made about implementation in the codes contained in the OECD inventory of 118 individual corporate codes\(^1\). In reviewing the implementation content of these codes, it is worth keeping in mind that the inventory contains firms that are as diverse in many ways as the true “population” of multinational enterprises. Many of the codes in the inventory have been issued by huge, global firms that many thousands of people in dozens of countries (e.g. IBM, Shell). Other issuers are retailers (e.g. H&M, The Gap, Body Shop, C&A, Marks and Spencer) whose names are household words in some OECD countries (but whose retail operations tend to be national or regional). These firms tend to issue labour-oriented codes of conduct that seek to control outcomes of outsourcing via supply chains consisting of tens or hundreds of production sites. Finally, the firms in the inventory straddle all three economic sectors, including several types of primary production, many branches of industry and manufacturing and many services (finance, retailing, consulting etc.). Thus, the implementation challenges these firms face differ in many respects: the types of issues they deal with, the complexity of their operations, the resources they have to spend.

5. The Secretariat has looked at discussions in codes of conduct of various management measures that are used to control outcomes in the areas covered in the codes. These attributes were selected using advice from experts and by looking at the full inventory of codes. They include: internal monitoring, reports to Boards of Directors, use of compliance manuals, whistle-blowing facilities, signatures of directors, training, periodic compliance reviews by managers, employee signatures, external auditing, disciplinary action and external verification. Financial reporting and record keeping (which these firms would normally undertake as part of their overall financial control function) are also counted as an implementation measure when they are explicitly referred to as such in the code. Annex A provides more detailed definitions of these attributes as well as sample texts.

6. The results of this analysis are presented in Figures 1 and 2. These divide up the 118 company codes into 2 sets. The first set -- shown in Figures 1a and b -- covers the 96 company codes that are addressed to the company itself (that is, the code establishes norms for the company’s own behaviour). Figure 2 covers the 22 codes that are addressed to suppliers (that is, firms that are not owned by the company issuing the codes). These codes are mainly issued by retailers and, though they often mention other issues, they tend to focus on core labour standards (child labour, forced labour, working conditions etc.). Figures 1a and b show the frequency of management techniques mentioned in codes making two types of ethical commitment: fighting bribery (44 codes) and environmental stewardship (72 codes)\(^2\). The figures also show the frequency of management practices mentioned in the total sample of 96 company codes. Since it is based on only 22 codes, Figure 2 does not break up the analysis by issue area\(^3\). It shows the percentage of the supplier codes that mention a particular management practice.

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1. The complete inventory now has 256 codes. 138 of these codes have been issued by something other than an individual company (i.e. by NGOs, by business associations, by intergovernmental organisations).

2. Notice that there is some overlap between the set of bribery codes and the set of environmental codes; that is, some codes mention both issues.

3. This would have meant that some issue areas would hardly have been represented. For example, only two of the supplier codes mention bribery.
Figure 1a. **Implementation in the 96 codes of conduct addressed to the firm itself**

(As a percentage of codes mentioning a particular implementation measure)

Source: OECD

Figure 1b. **Implementation in the 96 codes of conduct addressed to the firm itself**

(As a percentage of codes mentioning a particular implementation measure)

Source: OECD
Figure 2. Implementation measures in the 22 codes of conduct addressed to suppliers 
(as a percentage of codes mentioning a particular implementation measure)

Source: OECD

7. As shown in Figure 1a, 32 per cent of all codes addressed to the company itself discuss implementation in one way or another. However, the bribery codes are much more likely than other codes to discuss management practices: 60 per cent of the bribery codes mention implementation, while only 32 per cent of the environment codes mention it. The bribery codes are about twice as likely as other codes to mention financial records and accounts as an implementation measure and they are also much more likely to mention a range of more specific internal measures. The most common of these tools mentioned in bribery codes are internal monitoring by compliance officers (mentioned in almost 60 per cent of the bribery codes and 30 per cent of the environment codes), whistle-blowing (44 per cent for bribery and 20 per cent for environment). The signing of codes by executive officers, which is one element of hierarchical control, is a feature of 43 per cent of the bribery codes and 20 per cent of the environment codes. Use of compliance manuals (i.e. written training material) is another relatively important implementation tools mentioned in the codes. On the other hand, it is quite rare for these codes -- regardless of the ethical issues they address -- to mention external monitoring as a technique of management control. Only 2 per cent of the 96 codes mention it (5 per cent for the bribery codes and 3 per cent for environment).

4. The reason that the percentages for environment and bribery can be higher than for the total is that there is overlap between the two sets (hence, some environment codes are also bribery codes).
8. The supplier codes in Figure 2 show a different pattern of compliance measures. As noted earlier, these codes tend to focus on labour issues (e.g. child labour, forced labour) raised in connection with retailers’ outsourcing activities. Some of the tools that were relatively important for the codes addressed to the company itself (e.g. compliance manuals and whistle-blowing facilities) are not mentioned in any of the supplier codes. In these codes, the most common measure is threat or “reference to punitive action”. This means that the code threatens some adverse economic consequence if the code is not complied with. About three-quarters of the supplier codes refer to punitive action (most often, termination of contract). Indeed, the overt use of threatening language is an important qualitative difference between the codes addressed to the company itself and those addressed to suppliers.

9. The supplier codes also show relatively heavy reliance on two types of “external” verification. The first -- mentioned by 23 per cent of the codes -- is undertaken by the firm issuing the code (by sending one of its employees to examine conditions in the production site). Hence, this monitoring is “internal” to the outsourcing relationship, but still has some of the difficulties associated with external monitoring. That is, someone from outside the production site must assess on the basis of records, interviews and observation what working conditions at the site are like. The second type is external or third party monitoring, which is also mentioned in 23 per cent of the supplier codes. This is monitoring by an organisation that is “independent” of both the issuing firm and the supplier. Obviously external monitoring is more important in the supplier codes than it is in the codes addressed to the issuing company itself since it is 10 times more likely to be mentioned. However, the codes generally avoid stating in direct terms that third party monitoring will take place. They are more likely to reserve the right to send in either their own employees or third party monitors, as they see fit.

10. Thus, this analysis shows that there is no “one-size-fits-all” approach to implementation and that firms need to tailor implementation measures to the type of commitment and to their own circumstances. In some areas, external verification may not be used because it might not be very useful -- for example, in areas where infractions may be unobservable to anyone except the direct parties to a transaction. This is likely to be the case in the bribery and competition areas, where wrongdoing often involves elaborate accounting and institutional subterfuges co-ordinated between several wrongdoers. Audits by outsiders, designed to ensure high quality records and accounting systems, can only eliminate the easier forms of wrongdoing in these areas. A wider portfolio of management techniques is needed to prevent more concerted and sophisticated wrongdoing. That is why some of the management systems addressing bribery and other types of economic crime (e.g. ECS 2000) emphasise the importance of high quality financial accounts and record keeping but also of various internal measures including whistle-blowing facilities, internal compliance and hierarchical controls. When dealing with these management issues, businesses often hire outside consultants who engage in external assessment rather than external verification. That is, they provide an expert judgement about whether the mix of measures taken by the firm is adequate and appropriate to control the risks of wrongdoing (rather than trying to verify whether or not wrongdoing is taking place).

11. In contrast, retailers that are trying to respect core labour standards in their outsourcing operations cannot use many of these internal measures, especially since they do not own their outsourcing sites. Also some of them probably wouldn’t work anyway. For example, whistle blowing is recognised to

5. The following is typical of the language adopted in the codes. For example the following language appears in the code of a general retailer: “Suppliers and their subcontractors must make their facilities available at all times for inspections by [company name] representatives or independent inspection firms retained by [company name].” In this study, this language resulted in this retailer’s code being scored for both “internal monitoring” (because the company’s “representatives” might inspect the site) and for “external monitoring” (because “independent inspection firms” might become involved).
be less of an option in a context where workers are in an inherently weak position. Such workers may be extremely poor and not supported by a social safety net and therefore may be less able to risk a cut in earnings if their employers “punish” whistle blowing. Also, they may not be protected by the transparency and external monitoring afforded by formal worker representation. In such situations, external verification may be one of the few realistic options. However, even external verification in such situations is also often difficult because record keeping may be rudimentary, interviews with employees may be coloured by employee fears of retribution and the firm may be on “best behaviour” for the inspection.

12. In determining the mix of measures they use to implement their codes, firms balance cost, effectiveness and the perceived cost of failure to comply with their own codes or with the law. Many outside parties, looking at firms’ voluntary efforts, have expressed a strong preference for external verification and are sceptical that firms can effectively monitor their own activities. However, a more comprehensive look at firms’ compliance and implementation techniques underscores the fact that no single implementation measure -- including external monitoring -- will be adequate to ensure compliance in all the areas covered in corporate codes. Governments themselves have recognised the inherent limitations of external monitoring (even when done by public authorities) and, in some areas, are making firms’ own internal measures the first line of defence in public regulatory and legal enforcement strategies. Each compliance and implementation measure has advantages and disadvantages, uses and misuses. Effective compliance and implementation will generally involve a complex mix of measures tailored to the issue at hand. Firms, governments, and NGOs are still in the process of learning about which mixes work best for different types of compliance problems.

Organisations that provide external verification services

13. A number of organisations provide external verification services. These include global auditing firms, more specialised external monitoring firms and NGOs, firms specialising in ISO quality certifications that have recently been branching out into ISO environmental certifications, security and specialised risk assurance firms. The Box quotes from a more detailed description of these organisations provided by “Businesses for Social Responsibility (BSR)”, a business association that specialises in helping firms design and implement social responsibility programmes.

14. Three points to note about this industry are:

- The best known firms in the industry are the long established accounting and audit firms (e.g. KPMG, Price Waterhouse). These firms benefit from client relationships formed during decades of experience in business services. They see this new line of business as a potential growth sector that would complement their recent moves to become full-service advisors covering not just financial audit but also legal, economic and technical consulting. The interest of diversification into other lines of business is being made more acute by the fact that their traditional business services -- accounting and audit -- are in a “declining” sector (that is, growing at slightly less than the rate of GDP growth).

- A number of smaller (but nevertheless multinational) firms also provide such services (e.g. Bureau Veritas and SGS). They offer a range of business services, especially quality (ISO 9000) certifications. For them, moving into other types of certifications appears to be a

6. The incorporation of ISO 14001 (the private environmental management standard) into the EU environmental enforcement and reporting framework is a good example of this.

natural extension of their more long-standing activities. They have managed to establish strong reputations and to position themselves among the industry leaders.

- There is still no agreement among the various users of these services as to which organisations are most qualified to be performing them. As can be seen from BSR’s description of the big auditing firms (whose employees, according to BSR, may not necessarily well qualified to be interviewing workers from developing countries for labour standards violations in developing countries), there is some distrust of the large, established firms. This is even more pronounced in other parts of the NGO community, where many suspect that the for-profit firms in the sector are not really independent of the firms that hire them. The business community, however, is concerned that some of the NGOs that provide monitoring services are using standards that have not been subjected to wider public scrutiny.

15. Thus, one shortcoming of external verification is that it tends to transfer some of the voluntary codes’ problems of credibility (“you can’t let the fox guard the hen-house”) into problems of credibility of the auditor or monitor. However, this shortcoming is very much a function of the state of institutional development for this type of service. This shortcoming would be addressed, at least in part, if auditing or monitoring standards, similar to those that have been developed for financial auditing, existed in other areas. As the next section will show, such standards are being worked on in some areas, but none of the proposed standards (with the possible exception of ISO 14001, an auditable standard for environmental management systems) have achieved widespread acceptance by the business and NGO communities.

Monitoring or auditing standards

16. Financial auditing is the most developed form of external monitoring of enterprise activity. Its institutional structure has been in development for over a hundred and fifty years. One of the main functions of this institutional structure is to define the set of steps and statements that make up the audit. The objective of an audit is:

… to enable the auditor to express an opinion on whether a statement (financial, environmental, social report) is prepared, in all material respects, in accordance with an identified reporting framework.

17. This quote underscores how formal the auditing process is. Auditors deliver strictly delimited statements about whether a statement adheres “in all material respects” to “an identified reporting framework”. Auditing is quite a circumscribed activity and users of financial information tend to be aware of the strengths and shortcomings of the standards and frameworks that underpin the audited information. Accounting and auditing standards and the understanding of how they work are important parts of the business sector’s intangible capital that generally takes years to accumulate.

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8. For example, formal auditing in Britain can be dated to the creation of the Comptroller General of the Exchequer in 1834 and to the creation in 1870 of the “English Institute” (an association of auditors), which was granted a royal charter as the ICAEW in 1880. The American Institute of Public Accountants was formed in 1887. Both of these are private, self-regulated associations.

9. This text is adapted from International Federation of Accountants Handbook, 1999. The Handbook refers only to financial auditing.
18. A main purpose of auditing standards is to remove discretion from the auditor so as to increase
the credibility of the audit. This means that, after undertaking standard steps to verify pre-agreed aspects
of a firm’s management procedures and of the information it proposes to publish, the auditor can make
standardised statements about the adherence (or lack thereof) of these things to a given quality standard.
This standardisation enhances the credibility of the auditor’s services because it reinforces its claim to be
acting independently of the firm being audited. It also makes it easier for every one involved in the
process -- the firm being audited, the audited company and the users of the information produced by the
audit -- to determine whether the audit has been done competently and according to established norms.

19. In the absence of such standards -- that is, if everything were to be decided on a case by case
basis -- then the auditor (or monitor) could be pressured to use auditing and reporting practices that shed a
flattering light on the firm. These pressures would be even stronger if, as is often the case, the firm doing
the monitoring is being paid by the firm being monitored or audited. The auditor thus may have a strong
commercial interest in developing an ongoing business relationship with the firm being audited. Even in
financial accounting, where auditing practices benefit from a long tradition, extensive standardisation and
other safeguards, the independence of auditors is called into question from time to time.\(^{10}\)

20. For many of the societal concerns that are publicly debated in recent years, such standards do not
exist. In some of the areas, however, attempts to develop them are being undertaken by governments,
 firms and NGOs. Some of the interesting initiatives include:

- Global Reporting Initiative (GRI). This initiative has developed guidelines for sustainability
 reporting by firms (that is, a reporting framework is being developed that includes economic,
 social and environmental issues). The GRI guidelines are now being tested internationally
 using pilot firms from a number of OECD countries (e.g. Japan, the Netherlands, Sweden,
 United Kingdom, and United States). For the time being, it is unclear whether this will
develop into a useful reporting framework for firms and for potential users of information on
 sustainability. GRI is a co-operative arrangement involving corporations, business
 associations and NGOs and has received some funding from the United Nations.

- The ISO 14000 series of environmental standards includes ISO 14001, an auditable standard
 for environmental management systems. It was issued in 1995 by ISO, a private,
 international standards setting organisation. ISO 14001 has attracted considerable attention
 and many thousands of certifications by firms. It is reasonably well accepted by the business
 community (though not all businesses think it is well suited to their needs) and by NGOs.
 However, this standard only concerns environmental management practices and commitment
 to continuous improvement. A firm could have poor environmental performance (measured
 for example, in terms of industry benchmarks for energy efficiency or effluents) and still be
certified for ISO 14001.

- SA 8000 and ECS 2000: SA 8000 is an auditable standard for human rights in the workplace.
 It was issued by the Council for Economic Priorities, a US-based NGO. ECS 2000, issued by
 a private group located in a Japanese business school, covers various aspects of business
 ethics but concentrates mainly on bribery and other types of economic crime. Both standards
 have attracted considerable attention, but they have not yet gained as much acceptance by the
 business community as ISO 14001.

\(^{10}\) Empirical studies of the auditor-client relationship do suggest that it is at times influenced by commercial
 considerations. Of course, standardisation and other disciplines (e.g. the risk of litigation against auditors
 by users of reports they have audited) limit the extent to which this can take place.
21. This analysis has implications for the feasibility of implementing international policies in many issue areas. Policies covering several jurisdictions often rely on good faith of participating actors for enforcement. However, it should be acknowledged that the sufficient detail and precision of the policies, which would serve as a guide for enforcement mechanisms in which external monitoring plays an important role, is also necessary. Such developments would require the involvement of experts in each of the subject areas and would be quite time consuming. ISO 14001 took many experts several years to develop in the International Organisation for Standardisation. The Guidance document for auditing SA 8000 is 67 single spaced pages long and it covers only a small portion of the issues among numerous public concerns

11. In particular, SA 8000 covers child labour, forced labour, workplace health and safety, freedom of association and collective bargaining, discrimination, disciplinary practices, working hours, compensation and labour-related management systems. This Guidance document only addresses audits of indoor workplace; at the time a publication of the Guidance document currently in use, a separate document pertaining to agricultural production sites was being written. Guidance Document for Social Accountability SA 8000 Version 1999-I. March 1999.
Firms providing external monitoring can be divided into four categories:

1. Global accounting firms;
2. Monitoring firms;
3. Forensic and investigation firms; and
4. Quality assurance or quality registrar firms.

**Global Accounting Firms:** Several large accounting firms offer external monitoring services globally by using auditors in various parts of the world. While these auditors have experience reviewing wage and hour records, they have been criticised by some advocacy groups for lacking the experience and skills to interview workers effectively and to examine factories for health and safety violations.

**Monitoring Firms or NGOs:** As monitoring of workplace conditions has grown in importance, several firms and NGOs focusing exclusively on workplace monitoring have been created in the past few years. Many of these firms, based in the United States, have staff or affiliates in exporting countries around the world and focus their efforts specifically on inspecting work sites for code of conduct violations.

**Quality Registrar or ISO Certification Firms:** Building on the platform established by the International Standards Organisation (ISO), a non-governmental organisation established to promote the development of voluntary standards that govern quality and environmental impacts, several quality registrar or quality certification firms have started performing workplace monitoring on codes of conduct and human rights issues. Many of these firms already visit and certify factories against ISO standards and several have begun to expand their services to include workplace assessments relating to codes of conduct and human rights.

**Forensic and Investigation Firms:** Other organisations currently providing external monitoring services include those from the forensic and investigation industry. Forensic and investigation firms typically use a network of professionals to investigate allegations of impropriety or perform due diligence assessments of potential or existing suppliers’ ability to comply with codes.

[www.bsr.org/resourcecenter](http://www.bsr.org/resourcecenter)
Annex A

Definition of Attributes Used in Analysis of Bribery Texts

Record keeping and financial reporting: Codes mention attempts to set forth quality standards for record keeping and reporting. Example:
“…employees shall …comply with all accepted accounting standards, practices rules, regulation and controls …. Ensure that all entries are promptly and accurately recorded and properly documented --- no entry will intentionally distort or disguise the true nature of any transaction.”

Compliance discussed: Codes mention implementation of or compliance with codes of conduct, other than record keeping and financial reporting. Examples:
“[Company’s name] “Ethical Business Conduct” and related procedures constitute company wide standards of conduct. This procedure provides an overview of the [Company’s name] ethics and business conduct program and employees’ responsibilities.”
“As a condition of doing business with [Company’s name], each and every factory must comply with this Code of Vendor Conduct.”
A code of conduct has a section titled “Maintaining Compliance”.

Codes signed by Executive Officers: A code is signed by the board of directors, the chairman of the board, the president or other top officers. This often takes the form of a signed message to employees as a foreword to the code text, or it can be a signature on the code document itself. Codes are not scored for this attribute when the code text merely says that the chairman or board of directors adopted the code.

Internal monitoring mentioned: Codes mention that the company monitors or has a compliance/implementation system for its own company codes of conduct. Codes addressed to suppliers or other business partners are not scored for this attribute. Example:
“The structure includes the Corporate Responsibility Committee of the Board of Directors and the Leadership Committee, which have oversight responsibility; the Compliance Council, whose duties include education, monitoring and response; and all employees of the Company.”

Existence of whistle blowing facility: Codes mention the company ombudsman, with clear indication of where to contact this person, e.g. address, telephone number and EM address. Example:
“Call the [company’s] Human Resources hotlines at 1-800-xxx-xxxx to report any possible violations of law or other violations of the Code of Business Conduct.”

Appointed compliance officer or committee: Codes mention company appointment of compliance officers or committees to execute compliance programmes. Example:
“… we have established a “Corporate Compliance Committee” to oversee our compliance efforts and ensure that the Company has necessary policies and systems in place to train employees in their legal responsibilities, monitor compliance and correct any deficiencies in compliance programs.”
Use of compliance manuals: Codes mention the existence of compliance manuals, or themselves look like manuals (give thorough guidance on what to do under certain circumstances, or have Questions and Answers). Examples:

“Many of the statements made here are backed up by detailed policies and procedures. These are available on the internal policy and procedure web-site at: [internet address given]”

“‘Handle a Concern’ explains the many ways you can get a policy question answered, or report a concern or possible violation”. ‘What to Watch Out For’ lists some of the things that may indicate a policy problem.”

Reference to disciplinary actions: Codes mention that the companies will take disciplinary actions in the case of non-compliance with the codes. Example:

“Failure to act in compliance with the Code is likely to result in disciplinary action against both the employee committing the breach and others who condone it.”

Report to the Boards of Directors: Codes mention that the Boards of Directors receive reports on compliance activities. Example:

“The Committee will report annually through the Managing Director to the Board of Directors.”

Training for compliance mentioned: Codes state explicitly that employees will be trained in code implementation or monitoring. Examples:

“Each operating group and division will establish a training program. The program will be designed to ensure that all employees have an awareness of the [Company’s name] Integrity Statement and the standards of conduct and legal requirements that are relevant to their work at a level of detail appropriate to their job functions.”

Signature by employees: Codes have a section in which employees are requested to sign that they have read the codes and will comply with them. Example:

“This booklet contains an acknowledgement to sign as a statement of your personal commitment to integrity. It’s a way for each of us to pledge to uphold the principles of high ethical standards and to comply with all company policies.”

Monitoring suppliers: Codes mention that the companies monitor activities of their suppliers and business partners, as opposed to monitoring their own activities (internal monitoring). Example:

“[Company’s name] intends to monitor compliance with our Partnership Guidelines and to undertake on-site inspection of partners’ facilities.”

Periodic review by managers: Codes mention that it is the task of managers to monitor compliance and conduct periodic reviews. Example:

“Management is responsible for instituting regular reviews of compliance…..”