

# **OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones**



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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opérant dans les zones à déficit de gouvernance**

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## Foreword

**T**he OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones aims to help companies that invest in countries where governments are unwilling or unable to assume their responsibilities. It addresses risks and ethical dilemmas that companies are likely to face in such weak governance zones, including obeying the law and observing international instruments, heightened care in managing investments, knowing business partners and clients and dealing with public sector officials, and speaking out about wrongdoing.

The Risk Awareness Tool was developed as part of the OECD Investment Committee's follow up to the OECD Guidelines for Multinational Enterprises, a voluntary, government-backed code of conduct for international business. It is non-prescriptive and consistent with the objectives and principles of the Guidelines.

The Risk Awareness Tool has benefited from inputs from business, trade unions and civil society representatives from both the OECD and non-OECD areas. In the next phase, business and stakeholders will work with OECD to identify sources of practical experience in meeting the challenges the Tool addresses.

### **How the Risk Awareness Tool was developed**

The OECD Risk Awareness Tool was developed by the OECD Investment Committee. The Committee benefited from co-operation with other OECD bodies: the Working Group on Bribery in International Business Transactions, the Development Assistance Committee's Network on Conflict, Peace and Development Cooperation, and the Public Governance Committee.

The development of this Tool also benefited from the participation of many other parties, including the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) to the OECD and non-governmental organisations. Sixty four contributions were received during the Web-based consultations. Key inputs were also received from the African and other participants in the "Alliances for Integrity" conference, organised in March 2005 in Addis Ababa, Ethiopia, by the Committee with the New Economic Partnership for African Development, United Nations Global Compact and Transparency International.

The preparatory stages of the development of this Tool received financial support from the government of Belgium and the conference in Addis Ababa received financial support from the government of Sweden.

In the OECD Secretariat, documentation supporting the Tool was prepared by Kathryn Gordon of the Investment Division headed by Pierre Poret, in the Directorate for Financial and Enterprise Affairs. The Division's communication officer is Pamela Duffin.

## Conclusions by the OECD Council, June 2006

**T**he OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones was adopted by the OECD Council on 8 June 2006.

*The Council recalled that the OECD Guidelines for Multinational Enterprises states that the common aim of the adhering governments is to encourage the positive contributions that multinational enterprises can make to economic, environmental and social progress.*

*The Council considered it desirable to raise awareness of the risks multinational enterprises face in weak governance zones and to offer guidance for multinational enterprises in weak governance zones which is consistent with the objectives and principles of the Guidelines.*

*It also recognised that creating the conditions for progress in zones where authorities are unable or unwilling to assume their responsibilities is an important international policy objective and that governments, international organisations and multinational enterprises can each draw on their distinctive competences to contribute to the efforts of strengthening governance in such zones.*

*The Council invited adhering governments to take due account in the context of their policies involving interaction with multinational enterprises in weak governance zones of the OECD Risk Awareness Tool.*

*It recommended, with the support of the OECD, the widest possible dissemination of the Risk Awareness Tool and its active use by multinational enterprises, professional associations, trade unions, civil society organisations, international financial institutions and other stakeholders from both the OECD and the non-OECD area and by non-member governments.*



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## Preface

A weak governance zone is defined as an investment environment in which governments are unable or unwilling to assume their responsibilities. These “government failures” lead to broader failures in political, economic and civic institutions that, in turn, create the conditions for endemic violence, crime and corruption and that block economic and social development. About 15 per cent of the world’s people live in such areas, notably in sub-Saharan Africa.

For international business, weak governance zones represent some of the most challenging investment environments in the world. This *OECD Risk Awareness Tool* aims to help multinational enterprises – including small and medium size enterprises – meet these challenges. There is clearly a demand for such a tool and the business sector itself supports such work. The issue of investing responsibly in weak governance zones has been raised many times with the OECD Investment Committee and the National Contact Points<sup>1</sup> (NCPs) in the context of implementing the OECD Guidelines on Multinational Enterprises. Support for an OECD initiative in this area has come from the G8 – the 2005 G8 Gleneagles Summit Communiqué calls for “developing OECD guidance for companies working in zones of weak governance”.<sup>2</sup>

The *Tool* is based on the premise that a durable exit from poverty will need to be driven by the leadership and the people of the countries concerned – only they can formulate and implement the necessary reforms. Companies play important supporting roles and this *Tool* seeks to raise awareness of these roles and to help companies play them more effectively.

With respect to the role of governments in establishing an appropriate policy framework, the OECD Investment Committee invites all governments to work with it in advancing the shared goal of continuous improvement in public policy. The *Policy Framework on Investment* proposes practical considerations in ten policy areas that help to create the domestic conditions for private investment to flourish (e.g. good public governance and the fight against corruption, equitable and efficient tax systems, human resource development, effective competition policies and improved infrastructure). The *Framework* was developed through an inter-governmental and multi-stakeholder partnership process involving representatives from more than 60 OECD and non-OECD economies. The Investment Committee seeks to

cooperate with all governments – including those representing weak governance zones – with a view to improving the effectiveness of public policy and creating a pathway to sustained economic development and greater well-being for their citizens.

Finally, the Investment Committee takes note of the interest of companies, NGOs and trade unions in the development of this instrument, the contributions they have made to its development and their continuing interest in its use. The Committee also expresses its desire to work with them to promote the use of this *Tool* and, in particular, to continue to work with them to develop a more extensive resource guide for companies wishing to identify sources of practical experience in meeting the challenges this *Tool* is intended to address. It suggests using the *Risk Awareness Tool* in the OECD dialogue with non-member countries.

### **Notes**

1. National Contact Points are government offices (sometimes involving participation by business, trade union and NGO representatives) that located in each of the 39 countries adhering to the *OECD Guidelines for Multinational Enterprises*. They are charged with promoting the OECD Guidelines among multinational enterprises operating in or from the country in question.
2. The 2005 G8 Gleneagles Summit Communiqué, paragraph 10c of the African Statement.

# 1. Introduction

The mission of the OECD Investment Committee is to enhance the contribution of investment to growth and sustainable development. The Committee recognises that attracting private investment – both domestic and international – and creating effective institutions of public and private governance will lay the groundwork for durable improvements to the well being of citizens in weak governance zones.

Creating the conditions that permit this to happen is primarily the responsibility of governments. A recurrent theme of the OECD Investment Committee’s work on the *OECD Guidelines for Multinational Enterprises* (“the *Guidelines*”) – a government-backed, voluntary code of conduct for international business – is that corporate responsibility goes hand-in-hand with government responsibility. “Weak governance zones” are defined as investment environments in which governments cannot or will not assume their roles in protecting rights (including property rights), providing basic public services (*e.g.* social programmes, infrastructure development, law enforcement and prudential surveillance) and ensuring that public sector management is efficient and effective.<sup>1</sup> These “government failures” lead to broader failures in political, economic and civic institutions that are referred to as weak governance.

The broader institutional failures create situations which pose many ethical dilemmas and challenges for companies. As companies themselves often note, weak governance zones represent some of the world’s most difficult investment environments. In addition to the usual financial and business risks encountered in all investment environments, weak governance zones pose ethical dilemmas and present risks that stem directly from government failure – *e.g.* widespread solicitation, extortion, endemic crime and violent conflict, abuses by security forces, forced labour and violations of the rule of law. Through its development of this *Risk Awareness Tool*, the OECD Investment Committee seeks to help companies in weak governance zones face these dilemmas and risks by calling to their attention to the guidance contained in OECD instruments and the findings of the broad-based consultations the Committee has conducted on this issue.<sup>2</sup>

International instruments provide various types of guidance that is of potential interest to many actors, including governments and companies. In particular, these instruments can help companies by setting forth agreed concepts and principles for business conduct. The evolving framework of international instruments provides guidance in such areas as respecting human rights, combating corruption, disclosing information and protecting the environment. In some cases, these instruments are addressed directly to companies (as with the *OECD Guidelines for Multinational Enterprises*). In others, they create obligations for governments to translate the concepts and principles into national law (as with the *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*), which in turn alters the legal obligations of companies. Companies should obey the law and observe established international concepts and principles in their global operations, including in weak governance zones. Some international instruments deal with public sector management issues. Indeed, OECD instruments of this type cover a wide range of public sector issues (e.g. management of budget systems or of conflict of interest in the public service). While addressed to governments, these instruments may also be useful for companies in weak governance zones as aids for identifying and understanding risks that arise from government failures. It is in this spirit – helping companies understand weak governance investment environments – that the present *Risk Awareness Tool* makes use of these public sector instruments.

The principal distinction between investments in weak and in stronger governance host countries lies not in differences in the concepts and principles that apply to managing them, but in the amount of care required to make these concepts and principles a reality. The “heightened risks” encountered in weak governance zones (e.g. in relation to corruption, human rights abuses and violations of international law) create a need for “heightened care” in ensuring that the company complies with law and observes relevant international instruments.

The Committee recognises that its efforts are only one of many international initiatives seeking to help people living in weak governance zones to get on the path of successful economic development.<sup>3</sup> The Committee aims to add value by basing its contribution on its experiences with the *OECD Guidelines* and on established OECD expertise. The *Tool* is non-prescriptive and consistent with the objectives and principles of the *Guidelines*.

The *Tool* has benefited from two sets of consultations conducted by the Committee. The first set (December 2004 to March 2005) included: 1) face-to-face discussions with invited experts; 2) an electronic discussion open to all interested parties; 3) an international conference held in Addis Ababa (jointly

sponsored with NEPAD, Transparency International and the UN Global Compact) that involved more than 70 participants representing African business, trade unions, NGOs and governments.<sup>4</sup> A second (web-based) consultation on the first draft of the *Tool* was held in late 2005. It attracted written comments from 50 business, trade union, NGO and academic participants from both the OECD and non-OECD area.<sup>5</sup>

The *Tool* proposes a list of questions that companies might ask themselves when considering actual or prospective investments in weak governance zones. The questions cover the following topics:

- I) Obeying the law and observing international instruments
- II) Heightened managerial care
- III) Political activities
- IV) Knowing clients and business partners
- V) Speaking out about wrongdoing
- VI) Business roles in weak governance societies – a broadened view of self interest

Further commentary on terms appearing in bold type can be found in the Annex (*Glossary of Selected Terms*). Finally, it should be noted that the *Risk Awareness Tool* does not create new obligations on companies, but are provided by the OECD to be used by companies in the context of their own assessment procedures when investing in weak governance zones. In addition, the questions do not alter the text and the commentary of the *OECD Guidelines for Multinational Enterprises*. While the *Risk Awareness Tool* cannot be used as a basis for bringing specific instances, NCPs and interested parties might use it as a complementary source of information and ideas when confronted with the issue of responsible investment in weak governance zones (as they could with other OECD and non-OECD texts dealing with relevant subjects).<sup>6</sup>

## Notes

1. The work of the Development Assistance Committee's Fragile States Group characterises "fragile states" as governments that have low will and/or capacity to address their citizens' basic needs. Thus, the terms fragile and weak governance zones define very similar investment environments.
2. Numerous consultations have been held by the OECD Investment Committee since investments in weak governance zones were first raised in issue was first raised in early 2001. They have included consultations with business, trade unions and NGOs from the OECD and non-OECD regions. They also involved other OECD bodies and international financial institutions. A summary of the most recent series of consultations can be found at: [www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines) or in Annex 6 of the 2005 Annual Report on the *OECD Guidelines for Multinational Enterprises*.

3. For example, other initiatives are being undertaken in the OECD, the United Nations and adhering governments. The Development Assistance Committee has several initiatives that complement this risk management tool, including the DAC Guidelines on Helping Prevent Violent Conflict and its development of the DAC Principles on Engagement in Fragile States. The UN Global Compact has published the *Business Guide to Conflict Impact Assessment and Risk Management* (June 2002). The Extractive Industries Transparency Initiative, which promotes transparency on the revenue side of budget systems so as to facilitate more effective use of extractive industry revenues in weak governance host countries, complements and reinforces this risk management tool.
4. A summary of the findings of the consultations can be found in the Chair's Report for the 2005 Annual Meeting of the National Contact Points. [www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines).
5. See [www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines) for a compilation of written contributions.
6. The *OECD Guidelines for Multinational Enterprises* were adopted in June 2000 by the OECD Council Meeting at Ministerial Level. The Council Decision of June 2000 is a binding decision in which adhering governments make commitments in relation to *Guidelines* implementation. The Decision gives guidance about the specific instances procedure. The *Guidelines* text and implementation procedures were negotiated and agreed to as an integral package. Therefore the specific instances procedure can only be conducted with reference to the text of the *Guidelines*.

## 2. Obeying the Law and Observing International Instruments

Companies have the same broad responsibilities in **weak governance zones** that they do in other investment environments – they are expected to comply with their legal obligations and to observe other **relevant international instruments** covering such areas as human rights, the fight against corruption, labour management (including observance of core labour standards) and environmental protection. Because legal systems and political dialogue in weak governance zones (almost by definition) do not work well, international instruments that provide guidance on acceptable behaviours are particularly useful in these contexts. Companies will want to reflect carefully on what law and relevant international instruments mean for their operations, accounting for the specificities of their sector, operating environments and business strategy.

### Questions for consideration

#### General

- Is the **company** confident that, in this investment environment, it will be able to put in place business policies and processes that will allow it to obey applicable laws and to observe **relevant international instruments**, including the *OECD Guidelines for Multinational Enterprises*? If the answer to this question is no, what conclusions does the **company** draw for its investment strategy?
- How can the **company** inform itself about and assess the impacts (positive and negative) of its investment on the host country?
  - ❖ Does the **company** seek to involve stakeholders, especially local actors, in this process?
  - ❖ What steps does the **company** take to avoid situations where it might aggravate existing problems (e.g. human rights abuses, violent conflict, corruption in state-owned enterprises)?
  - ❖ What steps does it take to mitigate any negative impacts?
- Can the **company** use and contribute to the development of international standards for business conduct that are relevant for its operations in weak

governance zones? These standards are likely to cover such areas as human rights, management of security forces (e.g. the *Voluntary Principles on Security and Human Rights*) combating corruption (e.g. the *International Chamber of Commerce's Rules of Conduct and Recommendations on Combating Extortion and Bribery* and *Transparency International's Business Principles for Countering Bribery: TI Six Step Process*) and promoting transparency and accountability of both public and private actors (e.g. the *Extractive Industries Transparency Initiative*)?<sup>1</sup>

### **Human rights and management of security forces**

- What measures does the company take to respect the human rights of those affected by its activities consistent with the host government's international obligations and commitments?<sup>2</sup>
- Is the company well informed about the relevant principles covering business and human rights?
- What steps does the company take to assess the host country's ability and willingness to respect human rights? Does it use heightened care when answering such questions as:<sup>3</sup>
  - ❖ Do the host government, other important political bodies and non-state actors respect human rights? Do non-state actors impair the enjoyment of human rights?
  - ❖ If the country is experiencing armed conflict, do the parties to the conflict respect **international humanitarian law**?
  - ❖ Does the host government fully control its territory? If not, what is the human rights situation in areas outside of effective government control and is **international humanitarian law** respected if there is armed conflict?
  - ❖ What do external evaluations of the government's record in respecting human rights and **international humanitarian law** indicate?
  - ❖ What steps are the host government, international organisations and other actors taking to improve the current situation?
- How can the company manage investments for which impact assessments show serious problems for respecting human rights and other obligations? Does company policy make it clear that business should be conducted without impairing others' enjoyment of human rights?
- What steps can the company take to ensure that it is able to pursue resolution of disputes through dialogue or other peaceful means?
- What steps can it take to ensure that its management of resettlement operations and of project impacts on local peoples (including indigenous



peoples) does not impair enjoyment of human rights or act as a catalyst for conflict?

- Weak governance zones often present extremely serious security risks and companies will want to be particularly vigilant in managing security risks in these environments. Governments have the primary role in maintaining law and order and respecting their human rights obligations. Nevertheless, companies have an interest in ensuring their security management practices are consistent with the promotion of human rights. Do company policies reflect good practice in the management of relations with public<sup>4</sup> and private<sup>5</sup> security services (as set forth, for example, in the *Voluntary Principles on Security and Human Rights*)? In particular:
  - ❖ How does the company intend to protect employees and physical assets from threats related to violent conflict and from extortion and other criminal activities (*e.g.* theft, armed robbery, kidnapping)?
  - ❖ Can the company manage security in ways that also promote human rights? Can the company be confident that its management of security for employees and physical assets is not at the expense of the security of local populations?
  - ❖ Has the company identified and analysed the security risks that may exist in its operating environments? Does it follow good practice in making conflict impact assessments (possibly using tools developed by various international initiatives)?<sup>6</sup>
  - ❖ Does the company consult regularly with public security in the host country, home and host governments and local communities about the impact of their security arrangements?
  - ❖ What steps does the company take to review the background of its security providers? Is the company confident that its security management arrangements do not inadvertently support or finance armed groups who may be responsible for human rights abuses or violations of **international humanitarian law**?
  - ❖ What policies does the company have for recording and reporting credible allegations of human rights violations? How does it plan to protect the security and safety of the sources of such information?

### **Combating corruption and money laundering**

- What steps can the company take to refrain from, directly or indirectly, offering, promising, giving or demanding a bribe or other undue advantage to obtain or retain business or other improper advantage?
- Do company policies make it clear that business that cannot be conducted without recourse to corruption or money laundering should not be

conducted at all? Do company policies commit employees to respect the letter and the spirit of anti-corruption and anti-money laundering laws?

- What steps does the company take in order to refrain from using subcontracts, purchase orders or consulting agreements as a means of channelling payments to public officials, to employees of business partners or to their relatives or business associations?
- What steps does the company take to ensure that remuneration of agents is appropriate and for legitimate services only?<sup>7</sup> Are lists of agents employed in connection with transactions with public bodies and state-owned enterprises kept and made available to competent authorities?
- When relevant, does the company comply with **international standards for combating money laundering**? In particular, does the company observe the *Financial Action Task Force's* recommendations on customer due diligence and record keeping; on reporting of suspicious transactions and compliance; and on other measures to deter money laundering and terrorist financing?<sup>8</sup>
- If the company has dealings with business partners that are registered in offshore locations, what steps does it take to ensure that these partners are not involved in money laundering, bribery and other illicit financial activities? (For example, does the company look into the reputation of the business partner, does it request disclosure of corporate and ownership information; does it ask the partner to provide the rationale for the offshore registration?)<sup>9</sup>

## Notes

1. The Extractive Industries Transparency Initiative (EITI) is one example of such an initiative. The OECD Investment Committee has associated itself twice with the EITI. See Archive Document 1 in the 2005 Chair's Report of the Annual Meeting of the National Contact Points and Archive Document 1 of the 2003 Chair's Report.
2. This question draws on recommendation II.2 of the OECD Guidelines. The commentary to this recommendation states that: "while promoting and upholding human rights is primarily the responsibility of governments, where corporate conduct and human rights intersect enterprises do play a role and thus MNEs are encouraged to respect human rights, not only in their dealings with employees, but also with respect to others affected by their activities, in a manner that is consistent with host governments' international obligations and commitments (paragraph 4 of Commentary).
3. The Human Rights and Business Project of the Danish Institute for Human Rights is developing a diagnostic tool called Human Rights Compliance Assessment to help companies detect potential human rights violations caused by the effect of their operations on employees, local residents and all other stakeholders. This tool may be accessed at <https://hrca.humanrightsbusiness.org>.

4. Companies may wish to consult the Voluntary Principles for Security and Human Rights. Under the heading “interactions between companies and public security”, the Voluntary Principles offer guidance on: security arrangements, deployment and conduct of public security; consultation and advice and responses to human rights abuses. See [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org) for more information.
5. Companies may wish to consult the Voluntary Principles for Security and Human Rights. Under the heading “Interactions between companies and private security”, the Voluntary Principles recognise that it may sometimes be necessary to engage private security providers as a complement to public security when governments are unable or unwilling to provide adequate security. See [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org) for more information.
6. A number of such resources are available to companies (see Appendix 2). They include the *UN Global Compact Business Guide for Conflict Impact Assessment and Risk Management*; and material provided by the Conflict Prevention and Reconstruction Unit of the World Bank ([www.worldbank.org/conflict](http://www.worldbank.org/conflict)) See also International Alert’s *Conflict–Sensitive Business Practice: Guidance for Extractive Industries* ([www.international-alert.org](http://www.international-alert.org)).
7. A number of services are available to help companies to do this. For example, TRACE is a non-profit membership association that specializes in anti-bribery due diligence reviews and compliance training for international commercial intermediaries (sales agents and representatives, consultants, distributors, and suppliers). TRACE member intermediaries are “pre-vetted” partners for multinational corporations seeking to do business with entities that share their commitment to transparent and ethical business practices. See [www.traceinternational.org](http://www.traceinternational.org).
8. The *Forty Recommendations of the Financial Action Task Force on Money Laundering* contain, *inter alia*, recommendations for financial institutions and non-financial businesses (*e.g.* real estate and casinos) and professions (*e.g.* legal and accounting). The recommendations cover such areas as: customer due diligence and record keeping; reporting of suspicious transactions and compliance; and other measures to deter money laundering. The *Forty Recommendations* can be accessed at: [www.fatf-gafi.org](http://www.fatf-gafi.org).
9. See Appendix 3: (Due diligence and offshore companies) of the International Association of Oil and Gas Producers’ Guidelines on Reputational Due Diligence.



### 3. Heightened Managerial Care

Business responsibilities are broadly the same in **weak governance zones** as in other countries – they are expected to identify and develop investment opportunities, obey home and host country laws and observe the international instruments that are relevant for their operations. However, the heightened risks encountered in weak governance zones create a need for **heightened managerial care** – covering information gathering, internal procedures, relations with business partners (including agents, joint venture partners and subsidiaries) and use of external legal, auditing and consulting services – in order to ensure compliance with legal obligations and observance of international standards.

#### Questions for consideration

##### Policies

- Are the concepts and principles that underpin relevant laws and **relevant international instruments** embedded in the company's business culture and policies (see Section II for further consideration of company policies on human rights, international humanitarian law and combating corruption)?
  - ❖ How does the Board of Directors (or other body with ultimate responsibility for the investment) promote these concepts and principles?
  - ❖ Do company policies adequately communicate the implications of relevant laws and international instruments for the company's business practices?
  - ❖ Is more detailed guidance provided to employees that are likely to be directly confronted with difficult situations?
- What steps does the company take to encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the *OECD Guidelines*? Does the company use **heightened care** to promote the application of these principles to the company's subsidiaries, joint ventures, agents, suppliers and sub-contractors and other business partners in **weak governance zones**?

**Management systems**

- What steps does the Board of Directors take to ensure compliance with company policies, the law and **relevant international instruments**?
  - ❖ Are senior management and members of the Board of Directors visibly and actively committed to ensuring that investments in weak governance zones are managed in accordance with company policies, with the law and with **relevant international instruments**?
  - ❖ For investments in weak governance zones, does the Board make additional resources available for implementing its policies and for complying with the law and with **relevant international instruments**?
  - ❖ Does the Board use **heightened care** in ensuring that the company establishes and maintains **adequate internal company controls**, especially for investments in weak governance zones?
  - ❖ Does the audit committee of the Board (or other relevant body) conduct regular independent reviews of compliance with company policy, the law and with **relevant international instruments**, especially for investments in weak governance zones?
- Does the company use **heightened care** in putting in place the management systems and **adequate internal company controls** that will allow it to manage the heightened risks of operating in weak governance zones? In particular, what steps has the company taken to ensure that:
  - ❖ It implements good management practices (for example, those described in various international initiatives)<sup>1</sup> in its business activities across the globe, but uses **heightened care** to offset the heightened risks encountered in weak governance zones?
  - ❖ Employees at all levels – from senior executives to field workers – understand the implications for their work of company policies, of relevant laws and of the **relevant international instruments**? In particular, do employees assigned to weak governance zones receive special assistance when facing the challenges of conducting business in these difficult environments (*e.g.* special training on how to tell the difference between solicitation and extortion; or advice on when not to engage in transactions because of excessive risks of being associated with human rights abuses, corruption or other criminal activities)?
  - ❖ Employee management practices (*e.g.* promotion, compensation, employee evaluation, disciplinary actions and **internal audit**) create genuine incentives for employee compliance with company policies and the law and for observance of **relevant international instruments**?

- ❖ Hiring practices filter out potential employees who are unable or unwilling to comply with the law and to observe company policies and **relevant international instruments**?<sup>2</sup>
- ❖ Employees are confident that, if they lose business because they comply with company policies, **relevant international instruments** or with home or host country law, they will be supported by their supervisors and will not suffer adverse consequences?
- ❖ Employees know where to turn to for help (for example, to hotlines or whistle-blowing facilities) when dealing with violations of the law or non-observance of company policies and **relevant international instruments**?
- ❖ Does the company refrain from discriminatory or disciplinary action against employees who make *bona fide* reports to management or, as appropriate, to the competent authorities, on practices that contravene the law, the *OECD Guidelines* or company policies? How does the company follow up on *bona fide* reports on such practices?

### **Reporting and disclosure of information**

- Does the company ensure that timely, regular and reliable information is disclosed regarding its activities, structure, financial information and performance? Is the information disclosed for the enterprise as whole and, where appropriate, along business lines or geographic areas?<sup>3</sup>
- Does the company apply high quality standards for disclosure, accounting and audit for its operations in weak governance zones?
  - ❖ Does the company use **heightened care** to ensure that its financial statements relating to activities in weak governance zones are subject to **adequate independent external audits**?
  - ❖ Does the company use **heightened care** to ensure that the **arm's length principle** is applied in valuing transactions with **related companies**, especially when those transactions relate to activities in weak governance zones?
  - ❖ Does the company use **heightened care** in disclosing information about sensitive transactions (such as those involving **high-level governmental and political figures**, offshore entities, security forces or agents in weak governance zones)?
- Does the company cooperate with other companies, with home and host governments and with international financial institutions (for example, by participating in the *Extractive Industries Transparency Initiative*) in providing

for full disclosure of benefit streams from its investments (e.g. royalties, taxes, signature bonuses, and payments in kind) to host governments?

- What steps does the company take to provide easy and economical access to published information and, when necessary, to make information available to communities that do not have access to print or electronic media?

## Notes

1. Many management system standards and guidelines exist to assist companies put in place appropriate management practices. For example, Transparency International's "Six Step" process for developing and implementing a no-bribes policy involves: 1) adoption of a no bribes policy by boards and senior management; 2) plan implementation (e.g. review legal requirements; identify company specific risks); 3) develop anti-bribery programmes; 4) implement programme; 5) monitor; and 6) evaluation of performance by Board of Directors and senior management. See also the International Chamber of Commerce's rules of Conduct and Recommendations on Combating Extortion and Bribery: 2005 Edition ([www.iccwbo.org/policy/anticorruption/iccfccd/index.html](http://www.iccwbo.org/policy/anticorruption/iccfccd/index.html)).
2. See also Section V of this risk management tool on "Knowing clients and business partners". The International Association of Oil and Gas Producers' Guidelines on Reputational Due Diligence provide guidance for companies on due diligence procedures for hiring employees (as well as for selecting and managing business partners such as agents, contractors, etc)? This includes the identification of "red flags" – that is, characteristics of individuals or transactions that signal that the company should be particularly vigilant in looking into the relationship with the employee or business partners. The Guidelines are available at: [www.ogp.org.uk/pubs/356.pdf](http://www.ogp.org.uk/pubs/356.pdf).
3. The Global Reporting Initiative (GRI) is a multi-stakeholder process and independent institution whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. These Guidelines are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products, and services. See [www.globalreporting.org](http://www.globalreporting.org) for more information.



## 4. Political Activities

In all societies, business can play legitimate and useful roles in the political process. However, if companies use political activities to gain access to improper advantages, they might violate home or host country laws or fail to observe international standards.

**Weak governance zones** are characterised by institutional shortcomings that prevent the public and private sectors from playing their respective roles effectively. These shortcomings include: absence of workable systems for promoting public and private sector ethics; excessive discretionary powers for public officials at all levels of government; absence of rules-based frameworks for investment protection; and lack of adequate tendering procedures and of financial and managerial controls in all parts of the public sector (including state-owned enterprises).

Companies in **weak governance zones** often find it necessary to forge political alliances with **high level governmental and political figures** in order to protect their investments from heightened threats of direct or indirect expropriation. These threats arise from inadequate checks on the powers of political actors – in effect, companies, through their political activities, create an informal system of investment protection that compensates for the lack of rules-based protection of their rights.

### Questions for consideration

#### **Involvement in local politics**

- What steps can the company take to ensure that it abstains from **improper involvement in local political activities**?
- What steps can the company take to ensure that it refuses to make illegal contributions to candidates for public office or to political parties or to other political organisations? Do its contributions fully comply with public disclosure requirements?
- What steps can the company take to ensure that its political activities in weak governance zones do not aid and abet criminal and/or corrupt activities or exacerbate conflict?

- How can the company use **heightened care** in managing relations with **high level governmental and political figures** (e.g. by providing for board-level approval for and monitoring of these relations)?
- How can the company use **heightened care** in seeking to ensure that charitable contributions and sponsorship programmes are not used for illegitimate purposes?
- What steps can the company take to refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation and financial incentives among other issues?
- What steps can the company take to enhance the transparency and perceived legitimacy of its political activities (e.g. through partnerships with legitimate citizens groups or business associations)?

***Dealing with public officials with conflicts of interest***

- What steps can the company take to identify **conflicts of interest** associated with **public officials** with whom it has political or business relations?
- What is the company's policy for dealing with the **risks** associated with its political and business relations with **public officials** that may give rise to **conflicts of interest**?
- How does the company use **heightened care** in managing "**at risk**" **situations for conflict of interest** (an example would be negotiation of the terms of a public/private joint venture involving a company and a public official whose private capacity interests create conflicts with his public duties)?

## 5. Knowing Clients and Business Partners

In **weak governance zones**, companies face heightened risks of entering into relationships with employees, clients or business partners that might damage business reputations or give rise to violations of law or to other **abuses** (e.g. of human rights). Companies in weak governance zones have an interest in using **heightened care** in managing these risk and several business associations have issued guidelines for helping companies to do this.<sup>1</sup>

### Questions for consideration

- Has the company used heightened care in informing itself about possible roles in host country criminality, **corruption** and violent conflict of people with whom it may have business or political relations?
- How does the company use **heightened care** to ensure that it does not, through its business relations, facilitate criminality, corruption and/or human rights abuses or contribute to fuelling violent conflict (e.g. through **heightened care** in the collection of information, selection of employees and business partners, contracting practices, assessment and resolution, documentation and follow-up monitoring)?<sup>2</sup>
- Does the company use **heightened care** to not be party to misuse of transactions channelled through off-shore financial centres and/or involving corporate vehicles (corporate forms that allow individuals or organisations to hide their identity and their involvement in transactions)?<sup>3</sup>

### Notes

1. See, for example, the *Wolfsberg Standards on Anti-Money Laundering* ([www.wolfsberg-principles.com](http://www.wolfsberg-principles.com)) and the *Guidelines on Reputational Due Diligence* published by the International Association of Oil and Gas Producers. ([www.ogp.org.uk/pubs/356.pdf](http://www.ogp.org.uk/pubs/356.pdf)).
2. See the *Guidelines on Reputational Due Diligence* published by the International Association of Oil and Gas Producers. The Guidelines provide information on all aspects of managing relationships with employees and business partners.
3. See *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (OECD 2001) for a detailed discussion of this issue.



## 6. Speaking out about Wrongdoing

Information about wrongdoing (including crimes and **abuses** such as human rights violations, private or public corruption) can be especially valuable in weak governance host countries, which have few institutions (*e.g.* a free press, well developed legal and auditing institutions, active and free trade unions and civil society) that can collect and channel information (since, in the absence of protection of basic rights, these activities are risky). In the course of analysing or managing investments in weak governance zones, companies sometimes acquire such information and share it with home or host governments, international organisations or the media. Although foreign companies may be more capable of protecting themselves than most citizens in weak governance zones, the risks of speaking out in such environments are serious and real – they include threats to the physical security of employees and assets and threats of expropriation. It is useful for companies in weak governance zones to consider the costs, benefits and risks of speaking out or sharing information – their analysis will depend on the specific situation in the host country, the nature of the wrongdoing in question and channels available for communicating such information.

### Questions for consideration

- If a company envisages making an investment that is likely to put it in a position of frequently knowing of and having to remain silent about serious wrongdoing that is directly or indirectly related to its presence in the country, has it considered associated **risks** (*e.g.* the legal implications of complicity in wrongdoing, damage to its reputation and to its internal business culture)?
- What channels exist for sharing information or speaking out about wrongdoing? Does the host government have a whistle-blowing or ombudsman facility? Could the company use whistle-blowing and ombudsman facilities made available to it by host governments and by international organisations?<sup>1</sup> Could it use diplomatic channels? Are behind-the-scenes discussions with host country actors likely to be useful?
- What are the likely benefits, costs and risks for various elements of impacts of a company decision to share information about wrongdoing with the

public or with relevant government authorities or international organisations?

- What costs or risks would this involve for the company's owners, employees and other stakeholders?
- Could the company envisage forming partnerships with other companies, business associations, international organisations, trade unions or civil society organisations in order to lower the risks of reprisals for passing on information about wrongdoing?

### **Note**

1. Several such facilities exist. For example, the World Bank investigates fraud and corruption allegations about World Bank staff and the project it funds. It accepts complaints from its Staff and from the public by email, telephone and paper mail. The email address for submitting complaints is: [investigations\\_hotline@worldbank.org](mailto:investigations_hotline@worldbank.org). Companies that have encountered corruption practices or that have been victims of bribe solicitation can report this information to the "Bribery Hotline" maintained by the US Department of Commerce's Trade Compliance Centre or at [www.mac.doc.gov/tcc](http://www.mac.doc.gov/tcc).

## *7. Business Roles in Weak Governance Societies – A Broadened View of Self Interest*

The business costs of “government failures” and of associated problems of rights violations (including investors’ rights), violence and corruption are large – they include direct costs and missed opportunities. Individual companies and the business sector as a whole might therefore find it in their broad self interest – as important members of weak governance host societies – to help these societies get on the path of institutional reform. However, the roles they can usefully play in this area are not always well defined and there may be risks associated with business engagement in this area.

A durable exit from poverty and insecurity will need to be driven by the leadership and people of the countries concerned: host country actors – including citizens, politicians and civil servants – have the primary responsibility for reforming institutions in weak governance zones. International organisations and home country governments can play important supporting roles.

OECD consultations on possible roles for companies in promoting institutional reform in weak governance countries revealed mixed views. Some consultation participants welcomed such involvement, noting that multinational enterprises are relatively powerful actors in weak governance host societies and that they might be better placed to advocate reform than most of the citizens of these countries. Some participants underscored the risks for companies of being seen as associated with or even complicit with a weak governance regime – it may be prudent for companies in weak governance zones to be seen as making credible efforts to promote better policies and practices in both the public and the private sectors. Others were strongly opposed to political advocacy by companies, fearing that it would inevitably deteriorate into inappropriate involvement in local politics.

When discussing how companies can support weak governance host countries’ efforts to enact institutional reform, consultation participants generally agreed on the importance of partnership. Multinational enterprises can help by working in partnership with host country business and professional associations, trade unions and civil society organisations. They

also noted the potential usefulness of partnerships involving international organisations, home governments and international business, trade union and civil society organisations (the *Extractive Industries Transparency Initiative* was cited by many as a good example of international, multi-stakeholder partnership for promoting fiscal reform and transparency).

### Questions for consideration

- Does the company use its influence on political actors positively, not only to negotiate immediate conditions for their investment, but also to avert conflict and to promote broader reform? In particular, where possible, does the company promote:
  - ❖ Observance of international and host country law and policies and of **relevant international instruments**?
  - ❖ The development of the rule of law and the protection of rights (including property rights)?
  - ❖ Improvements in public security in line with internationally agreed principles?
  - ❖ The adoption of public sector ethics programme covering such areas as solicitation, conflict of interest and political contributions?
  - ❖ The development of laws and policies that support efficient markets and an effective public sector (including the development of competition policy, competitive and transparent tendering and appropriate reform of regulation and of the state-owned enterprise sector)?
  - ❖ Transparency and consultation in the adoption and implementation of law and public policy and in the political process? Does this include easy and economical access to government information on policies that affect business or other interested parties?
- In what ways does the company use its partnerships with host governments (joint ventures, concessions and delegated management contracts) to advocate respect for widely-accepted good policy practices (e.g. in the areas of fiscal policy, public sector ethics including avoidance of conflict of interest, governance of state owned enterprises and respect by state owned enterprises of principles of corporate conduct compatible with the *OECD Guidelines*)?
- Companies should comply with the tax laws and regulations of all countries in which they operate. In weak governance zones, **weak fiscal systems** are one symptom of broader government failures. Companies that make large tax payments into governments with **weak fiscal systems** may want to assess possible **risks** (e.g. of damage to reputation) associated with making payments into fiscal systems that cannot control revenues or channel



expenditures in a financially and politically accountable way. If such **risks** are deemed to be substantial, the company might want to ask itself the following questions:

- ❖ Is it possible for the company to engage constructively with host country institutions with a view to encouraging reform to fiscal policies and practices?
- ❖ What are the benefits, costs and risks associated with engagement on this issue for the company's owners and for other people affected by its operations?
- ❖ If the company does engage on this issue, how can it organise its activities so as to maximise benefits and reduce risks of reprisals (*e.g.* by forming partnerships with host country, regional or international civil society organisations)? by forming partnerships with home governments and international organisations for promoting more transparent and accountable fiscal policy (*e.g.* through participation in the *Extractive Industries Transparency Initiative*)?
- Does the company encourage capacity building through close cooperation with the local community, consistent with the need for sound commercial practices?
  - ❖ In managing its relations with host country business partners – especially with weak-governance state-owned enterprises – does the company support and uphold good corporate governance principles and apply good governance practices?
  - ❖ Does the company participate in and support development of host country professional and business associations, chambers of commerce and other institutional supports for a constructive role for business in host societies?
  - ❖ Does the company work with local communities, the host government, business and professional associations, trade unions, and NGOs to promote human rights (including labour rights), good governance and sustainable development?



## APPENDIX I

## Glossary of Selected Terms

**Abuses.** Abuses are acts that are excessive or improper when evaluated using widely accepted international concepts and principles for business conduct (see **Relevant international instruments**). Such abuses might not be offences (criminal or otherwise) in all jurisdictions.

**Adequate internal company controls.** According to the OECD Revised Recommendation on Combating Bribery (Article V) these practices should include:

- the development of standards of conduct;
- the company's management processes and controls are subject to adequate **internal audit** procedures, including the creation of monitoring bodies, independent of management, such as audit committees of boards of directors and supervisory boards;
- provision of channels from communication of and protection for, persons not willing to violate professional standards of ethics under instruction or pressure from hierarchical superiors.

**Adequate independent external audit.** External auditors lend credibility to published financial statements and are fundamental to public confidence in the reliability of these statements. In this context, independence means that auditors are free of any influence, interest or relationship that might impair professional judgement. Adequate standards for ensuring the independence of external auditors permit them "to provide an objective assessment of company accounts, financial statements and internal controls" (quote from OECD Revised Recommendation on Combating Bribery; V. B.ii.).

**Arm's length principle.** This valuation principle is commonly applied to commercial and financial transactions between **related companies**. It says that transactions should be valued as if they had been carried out between unrelated parties, each acting in his own best interest. This is an important concept in the *OECD Transfer Pricing Guidelines*.

**“At risk” situations for conflicts of interest.** The *OECD Guidelines for Managing Conflict of Interest in the Public Service* identify “at risk situations” as:

- “Outside” appointments – The appointment of a public official on the board or controlling body of, a community group, a professional or political organisation, another government entity, a government-owned corporation, or a commercial organisation which is involved in a contractual, regulatory, partnership or sponsorship arrangement with their employment organisation.
- Contracting – The preparation, negotiation, management or enforcement of a contract involving a public organisation.
- Gifts and other forms of benefits – Offering of traditional or new forms of gifts or benefits.
- Additional employment – Public officials engage in ancillary (“outside”) employment while retaining their official positions.
- Activity after leaving public office – A public official who is about to leave public office may negotiate an appointment or employment or other activity which creates a potential for conflict of interest with their employing organisation.
- “Inside information” – Using information collected or held by public organisation which is not in the public domain or information obtained in confidence in the course of official functions.

**Company.** The *Risk Awareness Tool* uses the term “company” throughout, but has potential application to a broad range of organisations and organisational forms. These include partnerships; companies that are listed on stock exchanges; companies that are closely held; state-owned enterprises; professional firms (e.g. law and accountancy firms).

**Conflict of Interest** involves a conflict between the public duty and private interests of a public official, in which the public official’s private capacity interests could improperly influence the performance of their official duties and responsibilities. Source: *OECD Guidelines for Managing Conflict of Interest in the Public Service*.

**Corruption** is the act of a public official or person with a fiduciary duty or other position of trust, who wrongly or unlawfully uses his position to procure some benefit for himself or for another person.<sup>1</sup>

**Heightened managerial care (or heightened care).** Heightened managerial care is a variant of the risk management term – “due care”. The use of the word “heightened” stresses the fact that companies need to use extra vigilance and care in managing the heightened risks encountered in weak governance zones. Due care can be defined as the effort that an ordinarily reasonable and prudent person would use under the same or

similar conditions to avoid harm to the company or to another party. In view of the heightened risks encountered in weak governance zones, companies will want to reinforce the risk management techniques that they use in other investment contexts. Heightened care consists of extra efforts in: board level involvement, gathering information about the investment environment, verification and follow-up, record keeping and documentation, assessments, decision making, building in safeguards, management practices for relevant staff, associates and business partners (e.g. selecting appropriate staff, associates and business partners for at-risk positions and providing them with appropriate incentives and special training), monitoring and, where necessary, taking corrective measures.

**High-level governmental and political figures** are individuals who are or have been entrusted with prominent public functions in a foreign country. These include, for example, Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important political party officials. Business relationships with family members or close associates of high-level political figures involve business risks similar to those with the political figures themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories. [This definition is adapted from the definition of “politically exposed persons” in the *Financial Action Task Force’s Glossary of Terms*.]

**High quality accounting practices.** The OECD Revised Recommendation (Article V) and the OECD Convention on Combating Bribery (Article 8) define “adequate accounting practices” as:

- Maintaining adequate records of the sums of money received and expended by the company; identifying the matters in respect of which receipts and expenditures take place. Companies should not make off-the-book or inadequately identified transactions or keep off-the-book accounts.
- Companies should disclose in their financial statements the full range of material contingent liabilities and should adequately sanction accounting omissions, falsifications and fraud. They should prohibit the recording of non-existent expenditures or liabilities with incorrect identification of the object. They should not use false documents.

**Improper involvement in local political activities.** Clarification of the meaning of improper political activity is a subject of ongoing relevance with respect to OECD anti-corruption instruments. At a minimum, political involvement is deemed improper in a foreign country if it is illegal in a company’s home or host country. For instance, under the legal systems of some countries, an advantage promised or given to any person, in anticipation of his or her becoming a foreign public official, is illegal; under the legal

systems of many countries it is considered technically distinct from the offence of bribery.<sup>2</sup> More generally, in thinking about this issue, companies might want to ask themselves whether their political activities are transparent; whether they would feel comfortable if these activities were described in detail in the media; and whether their activities are in the best interests of the host country (see also **legitimate political activity**).

**Internal audit** is an independent objective assurance and consulting activity designed to create value and to improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.

**International humanitarian law** is the body of law which seeks, for humanitarian reasons, to limit the effects of armed conflict. It protects persons who are not or no longer participating in hostilities and restricts the means and methods of warfare. International humanitarian law is also known as the law of war or the law of armed conflict. Although directed at the activities of States and organized armed groups, awareness of this body of law is also relevant for companies to the extent that government forced may be involved in the provision of security of their activities. More information on international humanitarian law may be found at [www.icrc.org](http://www.icrc.org).

**International standards for combating money laundering.** These standards include the *Financial Action Task Force's 40 Recommendations* and the *Basel Committee on Banking Supervision's Customer Due Diligence for Banks*. The *Wolfsberg Standards* have been developed by a group of international banks – they provide guidance on various aspects of bank responsibilities and roles in the fight against money laundering.

**Legitimate political activity.** The following characteristics of legitimate political activity were proposed by participants in OECD consultations conducted as part of the development of this *Risk Awareness Tool*:

- the purpose of the activity is to promote better participatory processes and a competitive market environment;
- the company is acting in good faith – its intention is candid, *bona fide* and in the best interest of the host country;
- the company is well informed about the local political situation and understands the national, regional, local and ethnic dimensions of host country politics;
- the company works in partnership with legitimate civil society actors and with international organisations. Such partnerships allow organisations to pool their competencies and to enhance co-ordination and transparency.

**Public officials.** These include people who hold a legislative, administrative or judicial office (either appointed or elected); any person exercising a public function, including for a public agency or a public enterprises (e.g. a state-owned enterprise); any official or agent of a public international organisation. (This definition is based on the definition of “public sector representative” provided in Article 1 of the OECD Convention on Combating Bribery).

**Related companies.** Related companies are companies that do not have an arm’s-length relationship (e.g., a relationship involving independent, competing interests). This could be due to both companies being part of the same business group or could stem from family or personal ties between officials of two companies. Accounting for transactions between related companies is particularly difficult (see **Arm’s length principle**). For this reason managerial, regulatory and tax arrangements often provide for greater scrutiny of transactions between related companies.

**Relevant international instruments.** Many international instruments provide useful guidance for evaluating risks and identifying appropriate business conduct. This is especially true in weak governance zones, where host country sources of information and guidance may be lacking. In some cases, the instruments create binding obligations on States, which can, in turn, create legal obligations for companies. For instance the OECD Convention on Combating Bribery requires that State parties criminalise bribery of foreign public officials, making bribery a criminal offence for companies and individuals. Companies will need to evaluate their particular business situations in order to decide which instruments are relevant for their operations and how they should be reflected in company policies. The international instruments cited in the *OECD Guidelines for Multinational Enterprises* are (by issuing organisation):

- *United Nations*: Universal Declaration of Human Right; Copenhagen Declaration for Social Development; ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (1977 Tripartite Declaration); ILO Declaration of Fundamental Principles and Rights at Work (1998 Declaration); ILO Convention 29 of 1930 and C.105 of 1957 (Elimination of all forms of compulsory labour); ILO convention 111 of 1958 (Principle of non-discrimination with respect to employment and occupation); ILO Convention 138 of 1973 (Minimum age for admission to employment); ILO Convention 182 of 1999 (Elimination of the worst forms of child labour); ILO Recommendation 94 of 1952 (Consultation and Co-operation between Employers and workers on the Level of Undertaking); ILO Recommendation 146 of 1973 (Minimum age for admission to employment). Rio Declaration on Environment and Development, Agenda 21; Convention on Access to Information, Public Participation in Decision-making, and Access to Justice in Environmental

Matters (Aarhus); UN Guidelines on Consumer Policy. [Other United Nations instruments mentioned by consultation participants include: the United Nations Convention against Corruption, the International Covenant on Civil and Political Rights; the International Covenant on Economic, Social and Cultural Rights; the Millennium Development Goals; the World Summit on Sustainable Development Plan of Implementation.]

- OECD. Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; Revised Recommendation of the Council on Combating Bribery in International Business Transactions; Principles of Corporate Governance; Recommendation of the Council on the Tax Deductibility of Bribes to Foreign Public Officials; Guidelines for Consumer Protection in the Context of Electronic Commerce; Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.
- *Private*. ISO 14000 Series of Standards on Environmental Management Systems; the International Chamber of Commerce Report on Extortion and Bribery in Business Transactions.

**Risks.** Risks stem from changes in the company's external environment (*e.g.* a change in regulation) or from the actions of employees (*e.g.* a rogue employee deciding to violate company policy by paying a bribe) that give rise to changes in the value of the company. (Changes may involve increases in company value, in which case, the risk is an opportunity). Companies run risks of many types (financial, operating, political, etc.) in the course of routine business activities – in weak governance zones additional risks stem primarily from failures of government (failure to protect rights, enforce law, provide public services, impose financial and management controls on public sector actors, etc.). The main sources of risks that are relevant to consideration of investments in weak governance zones are:

- Unfavourable developments in law, policy or practice – The legal, regulatory and political context may evolve in a manner that is unfavourable (or favourable) for the company (*e.g.* actual or threatened expropriation, solicitation, threats related to the absence of the rule of law). Since there are relatively few formal constraints on public sector actors in weak governance zones, this risk is a particularly important one.
- Legal non-compliance – The company may be unable to control its operations or employees so as to comply with home or host country laws.
- Non observance of international standards – The company may be unable to control its operations or employees so as to observe international standards.
- Close association with external events or people – The company may be closely associated with external events or people that do not reflect well on it (*e.g.* human rights abuses in the immediate vicinity of its operations;



alliances with high level political officials that are widely viewed as corrupt).

These can lead to the following sources of value loss for the company:

- Direct and indirect legal costs.
- Loss of reputation – A company may sustain losses in the value of an intangible asset – business reputation. This may make it more difficult to conduct business in the future or to compete in capital or labour markets.
- Reductions in brand value – A company that operates in brand-sensitive segments of retail and business-to-business markets may sustain losses in the value of its brands.
- Reductions in employee morale and integrity (damage to internal business culture) – A company may suffer from loss in the effectiveness of internal value creation and control processes due to lack of employee motivation and growth of cynicism and of the belief that ethics do not matter.

**Weak fiscal system.** The following questions are based on the OECD *Best Practices for Budget Transparency*. Although primarily addressed to governments, these questions may help companies and other interested parties to identify weak governance fiscal systems (negative answers to many of the following questions would be an indication of weakness):

- 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?

Companies can find information on most governments’ fiscal policies and institutions on the Web site of the International Monetary Fund ([www.imf.org](http://www.imf.org)). Companies whose activities have major fiscal impacts in weak governance host countries might also wish to join the Extractive Industries

Transparency Initiative, which seeks to increase the transparency of extractive industry revenues, thereby making it easier to hold host governments accountable for their use.

**Weak governance zones** are defined as investment environments in which public sector actors are unable or unwilling to assume their roles and responsibilities in protecting rights (including property rights), providing basic public services (e.g. social programmes, infrastructure development, law enforcement and prudential surveillance) and ensuring that public sector management is efficient and effective. These “government failures” lead to broader failures in political, economic and civic institutions that are referred to as weak governance. Weak governance zones can be identified by:

- extremely low “human development” indicators (published by the United Nations Development Programme, these indicators measure welfare performance outcomes such as infant mortality, literacy, life expectancy and various measures of material standard of living; and inputs such as health and education spending);
- widespread and serious corruption and lawlessness;<sup>3</sup>
- serious violations of human right and international humanitarian law and endemic violent conflict driven by cross-cutting motivations (e.g. economic, political, ethnic, tribal) and involving potentially diverse combatants (e.g. domestic or international and formal or informal);
- extremely weak evaluations of the country’s public sector management and performance in economic and policy reviews conducted by international financial institutions or other international organisations.

## Notes

1. Corruption includes, for instance, the bribery of a foreign public official, which pursuant to the OECD Convention means the intentional offer, promise or gift of any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.
2. Description of legal systems’ treatments of transactions made in anticipation of a person becoming a public official is from Commentaries on the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Paragraph 10.
3. The Transparency International website ([www.transparency.org](http://www.transparency.org)) contains information relevant for understanding the host country’s corruption status (see, for example, the Corruption Perception Index and corruption mapping tools). The World Bank Governance Indicators also provide relevant information.

## APPENDIX II

### *Resources for Companies*

#### **Human rights, humanitarian law and security forces**

The OECD Guidelines for Multinational Enterprises. Chapter II. [www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines).

International Labour Organisation [www.ilo.org](http://www.ilo.org).

International Committee of the Red Cross ([www.icrc.org](http://www.icrc.org)) Geneva Conventions of 1949 and their two Additional Protocols of 1977.

Voluntary Principles for Security and Human Rights [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org).

OECD Development Assistance Committee Guidelines on Helping Prevent Violent Conflict [www.oecd.org/dac/conflict/preventionguidelines](http://www.oecd.org/dac/conflict/preventionguidelines).

Human Rights and Business Project <http://hrca.humanrightsbusiness.org> of the Danish Institute for Human Rights [www.humanrights.dk](http://www.humanrights.dk).

International Alert ([www.international-alert.org](http://www.international-alert.org)) Extractive Industries: Conflict – Sensitive Business Practice [www.international-alert.org/our\\_work/themes/extractive\\_industries.php](http://www.international-alert.org/our_work/themes/extractive_industries.php).

UN Global Compact ([www.unglobalcompact.org](http://www.unglobalcompact.org)) Business Guide for Conflict Impact Assessment and Risk Management [www.unglobalcompact.org/docs/issues\\_doc/7.2.3/BusinessGuide.pdf](http://www.unglobalcompact.org/docs/issues_doc/7.2.3/BusinessGuide.pdf).

World Bank Conflict Prevention and Reconstruction Unit [www.worldbank.org/conflict](http://www.worldbank.org/conflict).

#### **Anti-corruption**

OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions [www.oecd.org/daf/nocorruption](http://www.oecd.org/daf/nocorruption).

United Nations Convention against Corruption ([www.unodc.org](http://www.unodc.org)).

OECD Guidelines for Managing Conflict of Interest in the Public Service [www.oecd.org/gov/ethics](http://www.oecd.org/gov/ethics).

OECD Guidelines for Multinational Enterprises. Chapter VI. [www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines).

The UN Global Compact. Tenth Principle [www.unglobalcompact.org](http://www.unglobalcompact.org).

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