OECD Development Policy Tools

Corruption in the Extractive Value Chain

TYPOLOGY OF RISKS, MITIGATION MEASURES AND INCENTIVES



OECD

dev
DEVELOPMENT CENTRE

OECD Development Policy Tools

Corruption in the Extractive Value Chain

TYPOLOGY OF RISKS, MITIGATION MEASURES AND INCENTIVES



This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the member countries of the OECD or its Development Centre.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

Please cite this publication as:
OECD (2016), *Corruption in the Extractive Value Chain: Typology of Risks, Mitigation Measures and Incentives*, OECD Development Policy Tools, OECD Publishing, Paris.
http://dx.doi.org/10.1787/9789264256569-en

ISBN 978-92-64-25655-2 (print)
ISBN 978-92-64-25656-9 (PDF)

Series: OECD Development Policy Tools
ISSN 2518-6248 (print)
ISSN 2518-3702 (online)

Photo credits: Cover design by the OECD Development Centre based on image © m.wolf/Shutterstock.com.

Corrigenda to OECD publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.
© OECD 2016

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of the source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to *rights@oecd.org*. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at *info@copyright.com* or the Centre français d'exploitation du droit de copie (CFC) at *contact@cfcopies.com*.

Foreword

The complex and specific corruption challenges related to the extraction and trade of natural resources and the management of its associated revenue flows are a source of growing concern across developing, emerging and developed countries. As a result, corruption in the extractive industries has been included in the Action Plans of the G20 Anti-Corruption Working Group. Recognising the need to step-up anti-corruption efforts, world leaders gathered at the Anti-Corruption Summit in May 2016 and explicitly identified the extractive industries as being among the sectors that are particularly vulnerable to corruption, undermining economic growth, threatening security and harming the poor.

For resource rich countries, corruption poses a major threat to development. The high rents generated by resource exploitation and the "gate-keeping" function performed by governments, combined with discretionary powers, limited competition among key economic players and an often blurred distinction between private and public interests, are among the factors that increase the exposure of the extractive sector to corruption. The adverse impacts on the public interest are huge. Corruption undermines trust in public institutions, disrupts sector effectiveness, reduces the level of revenue collected from resource production and distorts decisions on budgetary allocations.

The increasing global competition for access to natural resources coupled with the resource-seeking nature of foreign direct investment can also further exacerbate corruption risks and create perverse incentives for extractive companies. The proceeds from corruption often fuel transnational crime and illicit financial flows, and are facilitated by complex corporate structures, opaque financial transactions and off-shore centres.

Tackling the cross-border aspects of corruption in the extractive sector is vital. Focusing only on large multinationals, or only on host governments would fall short of achieving meaningful results. For example, the governing elite often rely upon resource rents to gain or maintain power, patronage and privilege. In these cases, supporting governmental reform and transparency and promoting the adoption of anti-corruption measures is important. However, relying exclusively on government action to effectively tackle corruption is illusory in situations where resource rents are the primary means for exercising and perpetuating political influence. Both the supply and the demand sides need to be addressed, at domestic and international levels, and between private and public actors.

Given these challenges associated with extractives governance, the OECD has developed, as part of its Initiative for Policy Dialogue on Natural Resource-based Development, Corruption in the Extractive Value Chain: Typology of Risks, Mitigation Measures and Incentives. *This study provides, for the first time, a systematic mapping of corruption risks at each stage of the value chain. Designed through a multi-stakeholder process, the Typology makes an important contribution towards building a common knowledge base on how corruption works and better informing evidence-based policy design and action.*

This work complements and supports existing international initiatives in the extractive sector that have already made important inroads in promoting transparency and integrity. Yet, the

Typology is distinctive in providing a toolkit for identifying, assessing and proactively managing corruption risks across the extractives value chain. Not only are risks identified and mapped, but concrete, appropriate and complementary responses are also set out, which can be tailored to fit home and host country governments and extractive companies, raising the incentives to effectively tackle those risks. The practical guidance offered on mitigation measures and incentives stems from the collaboration of different constituencies that are committed to finding ways to effectively prevent corruption and fulfil the shared commitments of the 2030 Agenda for Sustainable Development to "substantially reduce corruption and bribery in all their forms".

We encourage OECD and non-OECD countries, extractive industries and civil society to make use of this tool; both as a diagnostic framework to assess the corruption risks of resource-rich contexts, but also as a check-list for civil society organisations acting as corruption watchdogs and for the private sector to identify areas of risk and prioritise action. Going forward, this Typology can also serve as a common reference for developing a Compendium of Practices to track progress and identify good practices as part of the OECD Policy Dialogue on Natural Resource-based Development.



Angel Gurría
Secretary-General of the OECD

Acknowledgements

The OECD Initiative for Policy Dialogue on Natural Resource-based Development is led by Lahra Liberti, Head of Unit, under the direction of Mario Pezzini, Director of the OECD Development Centre. This report was prepared by Lahra Liberti, with the assistance of Laure Brillaud at the OECD Development Centre and with support from a multi-stakeholder working group comprising: France, Guinea, Indonesia, Papua New Guinea, Peru, Philippines, Eni, Berne Declaration, Engineers Without Borders, Natural Resource Governance Institute, Oxfam France, Sherpa France, Transparency International, U4 Anti-Corruption Resource Centre. The working group held seven teleconferences between January and November 2015. The authors are grateful for insightful comments and inputs by Christine Uriarte and Kathleen Kao (OECD Directorate for Financial and Enterprise Affairs), Julio Bacio Terracino and Frédéric Boehm (OECD Directorate for Public Governance and Territorial Development), Dan Devlin and Juergen Leske (OECD Centre for Tax and Policy Administration), and Alessandra Fontana and Manuel Papouschek (OECD Development Co-operation Directorate). The team is grateful to the Development Centre's Communications and Publications Unit, especially Delphine Grandrieux, Aida Buendía and Elizabeth Nash for assisting with the production of the report. The authors would like to express their deep appreciation to Mr Fuad Khoury Zarzar, Comptroller General, Republic of Peru and Mr Nicola Bonucci, OECD Director for Legal Affairs and Representative to the G20 Anticorruption Working Group, for leading the multi-stakeholder consultations held as part of the plenary meetings of the Policy Dialogue in 2015 and for providing guidance and continuous support for this work.

Table of contents

Executive summary 9

Overview 13

Chapter 1. **Corruption risks, mitigation measures and incentives of cross-cutting relevance across the extractive value chain** 17
Corruption risks of cross-cutting relevance across the extractive value chain 18
Risks and recommended mitigation measures of cross-cutting relevance across the extractive value chain 21
Risks and recommended incentives and disincentives across the extractive value chain. 25
Notes. 27
References 28

Chapter 2. **Corruption risks in the decision to extract** 31
Corruption schemes 32
Parties involved 32
Corruption risks 33
Notes. 35
References 36

Chapter 3. **Corruption risks in the award of mineral, oil and gas rights** 37
Contract negotiation. 39
Award of mineral, oil and gas rights through a bidding process 44
Notes. 51
References 52

Chapter 4. **Corruption risks in the regulation and management of operations** 55
Corruption in the procurement of goods and services 56
Regulatory capture and violation 61
Corruption in the conduct of daily operations 65
Corruption in the acquisition or selling of shares or concessions 71
Notes. 74
References 75

Chapter 5. **Corruption risks in revenue collection** 77
Corruption in the collection of taxes, royalties and fees 78
Corruption in commodity trading 83
Notes. 88
References 88

Chapter 6. **Corruption risks in revenue management** 91
Corruption related to revenue management through natural resource funds 92
Corruption in the redistribution of resource revenues through transfers 96
Notes. 99
References 99

Chapter 7. **Corruption risks in revenue spending and social investment projects** 101
Corruption in public spending 102
Corruption in social investment expenditure by private companies 107
Notes. 111
References 112

Figures

1.1. Corruption risks of cross-cutting relevance across the extractive value chain 18
2.1. Corruption risks related to the decision to extract 32
3.1. Corruption risks in the award of mineral, oil and gas rights. 38
4.1. Corruption risks in the regulation and management of operations 56
5.1. Corruption risks in revenue collection 78
6.1. Corruption risks in revenue management 92
7.1. Corruption risks in revenue spending and social investment projects 102

Follow OECD Publications on:

http://twitter.com/OECD_Pubs
http://www.facebook.com/OECDPublications
http://www.linkedin.com/groups/OECD-Publications-4645871
http://www.youtube.com/oecdilibrary
http://www.oecd.org/oecddirect/

Executive summary

Corruption in the value chain of extractives is a major impediment to development. The OECD Foreign Bribery Report shows the magnitude of the problem, finding that one in five cases of transnational bribery occur in the extractive sector. Corruption works as a tax on international investors, increasing the costs of doing business. It further deprives host countries of much needed revenues and significantly alters the efficient allocation and distribution of resources to achieve development objectives. Potential revenue losses are huge, considering that oil trading alone accounted for more than half of state public budgets in ten major sub-Saharan African countries in the period 2011-13. Participants in the OECD Initiative for Policy Dialogue on Natural Resource-based Development considered that a clearer understanding of the evolving patterns that perpetuate corruption is necessary for governments and companies to catalyse reforms and maximise the positive impact of extractive activities on development.

The typology of risks, mitigation measures and incentives across the extractive value chain is intended to help policy makers, law enforcement officials and stakeholders strengthen prevention efforts at both the public and private levels. It aims at improving the understanding and awareness of corruption risks and mechanisms, to better tailor responses to evolving corruption patterns and effectively counter corruption demand and supply.

The typology is based on the analysis of a sample of 131 concluded and ongoing corruption cases. The sample of cases reviewed has been compiled using publicly available databases, information in the press, a review of literature and input received from participants in the Working Group on Corruption Risks. All reported cases have been anonymised in order to collate information, identify corruption patterns and allow for frank and open exchanges among participants in the Working Group on Corruption Risks and in the OECD Initiative for Policy Dialogue on Natural Resource-based Development.

Key findings

- The reviewed cases show that corruption risks may arise at any point in the extractive value chain. The award of mineral, oil and gas rights, and the regulation and management of operations present 34 and 59 cases, respectively. The remaining 26 cases concern revenue collection. Identified offenses include: bribery of foreign officials, embezzlement, misappropriation and diversion of public funds, abuse of office, trading in influence, favouritism and extortion, bribery of domestic officials and facilitation payments.
- Large-scale corruption involving high-level public officials was observed in the award of mineral and oil and gas rights, procurement of goods and services, commodity trading, revenue management through natural resource funds, and public spending. Lower ranking officials (tax officials, customs or immigration agents, and inspectors) are

usually involved in corruption in connection with violation of customs clearance and immigration rules and tax collection. State-owned enterprises (SOEs) were involved in 20% of the reported cases. SOEs appear to be particularly exposed to corruption in the award of rights, the procurement of goods and services and commodity trading, as well as non-commercial activities such as social expenditures or management of fossil fuel subsidies.

- The analysis highlights that central or local government officials, local business partners, subcontractors, consultants, advisors and intermediaries as well as foreign companies may act indistinctly as instigators or beneficiaries of the corruptive behaviour.
- The analysis further shows that sophisticated vehicles for channelling illegal payments, disguised through a series of offshore transactions (12 cases) and complex layers of corporate structures, often involving shell companies (21 cases), are recurrent features rendering the detection and sanctioning of corruption more difficult. Shell companies may be used as a way for politicians or other public officials to disguise the award of contracts to companies in which they or their proxies hold interests. Shell companies can also be used as conduits to divert public funds and channel payments to the real beneficiaries of the transaction. In the private sector, extractive industries may resort to fronting practices to circumvent local content rules. Companies can also pay illegal fees to contract with front companies in order to pay lip service to host country laws. Third parties, including intermediaries, such as agents and consulting firms, or joint venture partners, subsidiaries, business partners, lawyers and accountants are often used to either influence the decision-making process or to conceal payments made and help distance oneself from the crime (49 cases).
- Discretion in the selection of joint venture or other business partners, in the hiring of local staff, in the application of pre-qualification criteria for the procurement of goods and services or in the enforcement of local content obligations increases corruption risks. In such cases, ill-designed local content provisions can end up favouring politically affiliated individuals and entities in which politicians and public officials or their proxies hold interests.
- Corruption in commodity trading constitutes another emerging area of heightened risk given the substantial revenues diverted through this channel and their crippling effects on government budgets. Trade mispricing practices and complex kickback schemes to secure deals illustrate the increasing sophistication of constantly evolving patterns of corruption in this field.
- At the local level, corruption may result from a culture of clientelism and patronage as well as informal networks of local public officials, civil servants, community leaders and local business elite. It may also result from a hasty decentralisation process carried out without proper assessment of the capacity of the local economy and of the human, technical and administrative capabilities of subnational authorities to absorb new responsibilities and large inflows of resource revenues.

Recommendations

- Taking a one-dimensional approach to combatting corruption in extractives is unlikely to achieve results. Both the supply and demand for corruption need to be tackled, domestically and internationally, with granularity and differentiation across the broad range of private and public actors.

- Understanding the nature of the problem is a necessary step to avoid investing in misguided efforts. However, in the face of evolving patterns and adaptive strategies that perpetuate corruption, a dynamic, innovative and proactive stance is needed in order to strengthen prevention alongside implementation and enforcement efforts. It is expected that recommended mitigation measures and incentives addressed to home and host governments and extractive companies will incentivise a voluntary change in behaviour, by making corruption more costly and helping to make it less attractive for public and private actors alike.
- Closing the gap between theory and practice calls for building an alliance of home and host governments using the typology as a standard diagnostic framework to assess risk and implementing recommended mitigation measures and incentives across the value chain, and through a peer review process.

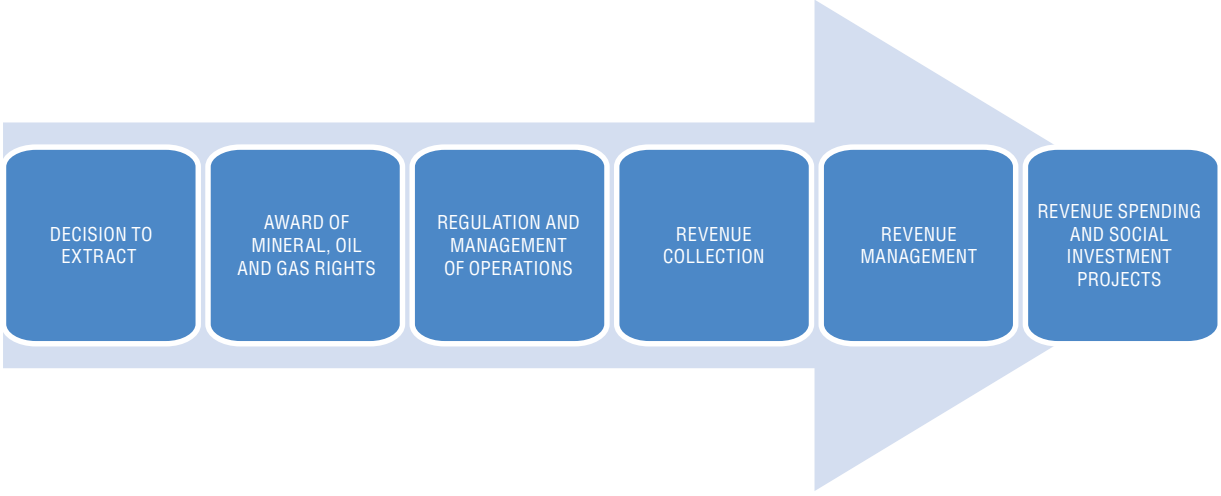
© OECD 2016

Overview

For the purpose of this report, corruption is understood as the "abuse of public or private office for personal gain".[1] This notion covers a broad range of activities and behaviours such as trading in influence, political capture and interference, conflicts of interest, bribery of domestic public officials and bribery of foreign public officials, including facilitation payments, extortion, fraud, embezzlement, misappropriation or other diversion of property, abuse of function, illicit enrichment, bribery in the private sector, embezzlement of property in the private sector, concealment of property resulting from corruption, and obstruction of justice.[2]

This typology is the first attempt to cover in a systematic manner the entire value chain from the decision to extract to the spending and allocation of extractive revenues. The World Bank Group's "extractive industries value chain" and the Decision Chain elaborated by the Resource Governance Institute[3] were used as reference frameworks. This analysis is articulated around the following phases, namely: i) decision to extract; ii) award of mineral, oil and gas rights; iii) regulation and management of operations; iv) revenue collection; v) revenue management, and vi) revenue spending and social investment projects.

Extractive industries value chain



It maps out corruption schemes, identifies the parties involved, clarifies their roles on the demand and supply side and how they interact. It also systematically reviews the mechanisms and vehicles commonly used to channel payments, and conceal corrupt activities and the proceeds of corruption. It further outlines specific factors at both public

and private levels that increase vulnerability and exposure to risk. Identified risks are matched against mitigation measures and options for incentives/disincentives are offered to reduce opportunities for corruption within both the public and private sectors.

This analysis is structured around the following building blocks, and seeks to systematise available information, knowledge and data on:

- typologies of conduct at risk and corruption schemes, i.e. examples of corrupt behaviour at each stage of the extractive value chain, following the above categorisation of offenses ("what");
- parties involved, their roles in the demand and supply sides and how they interact ("who");
- vehicles and mechanisms commonly used to conceal corrupt activities and/or channel the proceeds of corruption ("how");
- specific risk factors that increase vulnerability and exposure to corruption in both the public and private spheres;
- mitigation measures to reduce corruption risks;
- incentives and disincentives that can be put in place in the public and private sectors to make corruption less attractive.

An inductive and deductive approach was used. Schemes, parties involved, mechanisms and vehicles have been derived from the examination of 131 cases reported in publicly available databases and in the press, and based on input received from participants in the Multi-Stakeholder Working Group on Corruption Risks (hereafter referred to as the Working Group on Corruption Risks),[4] which was established under the OECD Initiative for Policy Dialogue on Natural Resource-based Development to support the preparation of the study. Additional material was drawn from literature reviews and studies carried out by the OECD, partner organisations in the Policy Dialogue (such as the UNDP and the World Bank Group), non-governmental organisations (Transparency International, Natural Resource Governance Institute, Berne Declaration, Global Witness, Friends of Europe, Centre for Public Integrity), research institutions (U4 Anti-Corruption Resource Centre) and law firms' publications. The majority of reported cases are based on the Trace Compendium database,[5] providing summaries of completed and ongoing international anti-bribery enforcement actions. Complementary sources of information on completed and pending cases include the OECD Watch's online database,[6] the Business Anti-Corruption Portal,[7] and the reports of the Extractive Industries Transparency Initiative (EITI).[8] Risk factors were inferred from the literature review, the reported cases and the direct experience of participants in the working group of the Policy Dialogue.

All the cases have been anonymised to protect the confidentiality of any ongoing legal proceedings, and the identities of persons and companies that have not been convicted to protect their right to be presumed innocent until proven guilty by a court of law. This has also been done in order to collate information, identify patterns of corruption and allow for frank and open exchanges among participants in the Working Group on Corruption Risks, and more broadly in the Policy Dialogue.

Notes

1. For a definition of the different terms, see OECD (2008), *Corruption: A Glossary of International Standards in Criminal Law*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264027411-en*.
2. See note 1.
3. The Resource Governance Institute's decision chain is articulated as follows: the decision to extract, getting a good deal; collecting revenues; managing volatile resources; investing for sustainable development.
4. The Working Group on Corruption Risks is composed as follows: France, Guinea, Indonesia, Papua New Guinea, Peru, Philippines, Eni, Berne Declaration, Engineers Without Borders, Natural Resource Governance Institute, Oxfam France, Sherpa France, Transparency International, U4 Anti-Corruption Resource Center. Seven teleconferences of the working group were held between January and November 2015.
5. The Trace compendium is a database of summaries of both completed and ongoing international anti-bribery enforcement actions. Most actions included in the TRACE Compendium are Foreign Corrupt Practices Act ("FCPA") enforcement actions brought by the U.S. Department of Justice ("DOJ") and/or the U.S. Securities and Exchange Commission ("SEC"). However, the TRACE Compendium also includes the growing number of international anti-bribery enforcement actions brought by enforcement authorities outside of the United States, particularly amongst signatories to the OECD Anti-Bribery Convention. Enforcement activity included in the TRACE Compendium shares one characteristic: the conduct at issue – the bribery – crosses an international border. Domestic anti-bribery prosecutions and investigations are outside the scope of the TRACE Compendium. *www.traceinternational.org/compendium* (last accessed in December 2014).
6. The OECD Watch's online case database contains information on OECD Guidelines cases raised by civil society organisations before National Contact Points. The database contains relevant information about the cases, including the complaint, supporting documents, letters and statements. It covers 34 OECD and 12 non-OECD countries. *http://oecdwatch.org/cases* (last accessed in January 2015).
7. The Business Anti-Corruption Portal is a government-sponsored one-stop shop for anti-corruption compliance resource aimed at the business community. The Portal is supported by the European Union; Sweden's Ministry for Foreign Affairs; Germany's Federal Ministry for Economic Cooperation and Development; the UK's Department for Business, Innovation & Skills (BIS); the Norwegian Agency for Development Cooperation (Norad); the Austrian Development Cooperation (ADC); and the Danish International Development Agency (Danida). *www.business-anti-corruption.com/*.
8. The reports published under the Extractive Industries Transparency Initiative (EITI) are available at: *https://eiti.org/countries*.

© OECD 2016

Chapter 1

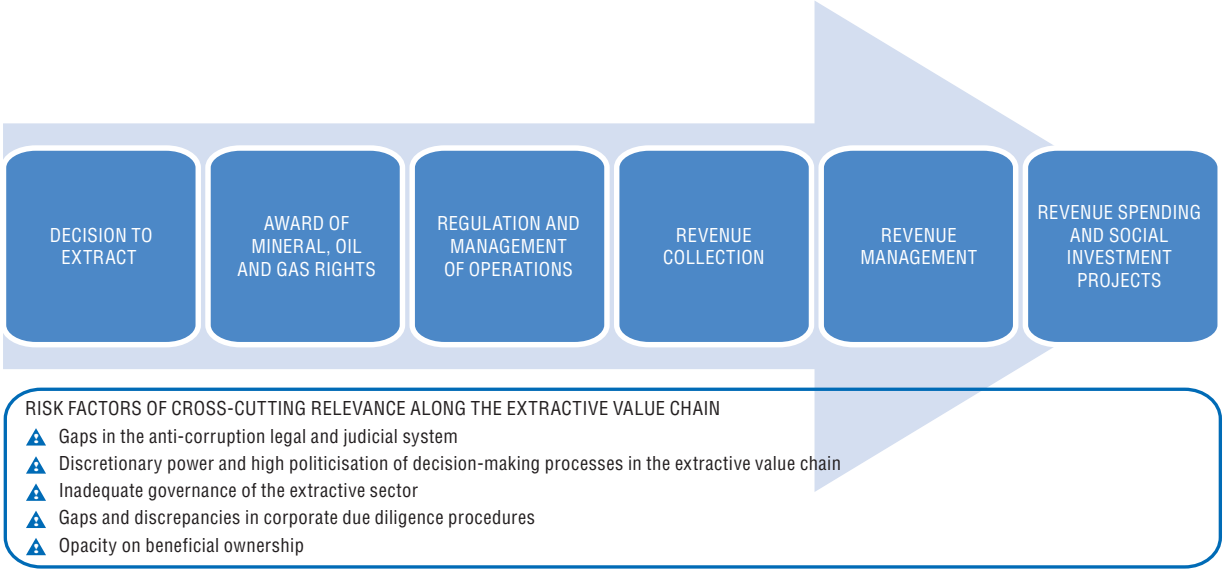
Corruption risks, mitigation measures and incentives of cross-cutting relevance across the extractive value chain

This chapter identifies risks of cross-cutting relevance commonly observed across the value chain of extractives and that contribute to increasing exposure and vulnerabilities to corruption. It also recommends mitigation measures for host government, companies' home governments and extractive industries to address those risks and offers options to make corruption less attractive by putting a price on it.

Corruption risks of cross-cutting relevance across the extractive value chain

A number of corruption risks account for increased vulnerability to corruption across the extractive value chain. First, weaknesses in the anti-corruption legal and judicial system may undermine host governments' capacity to effectively detect, prevent and sanction corruption. Regarding the extractive sector more specifically, high politicisation and discretionary power in decision-making processes, as well as inadequate governance arrangements leave room for favouritism, clientelism, political capture and interference, conflicts of interest, bribery and other corrupt practices. On the company's side, gaps and discrepancies in internal corporate anti-corruption compliance and due diligence procedures contribute to weakening detection and prevention efforts. Finally, shortcomings in corporate integrity measures, both in host and home governments and in particular with regards to the disclosure of beneficial ownership arrangements, provide opportunities for corruption to thrive.

Figure 1.1. **Corruption risks of cross-cutting relevance across the extractive value chain**



Gaps in the anti-corruption legal and judicial system

On the host government's side, a weak anti-corruption legal and institutional framework may constitute a major risk factor increasing vulnerability to corruption and undermining the state capacity to effectively prevent and prosecute cases of corruption. In particular, a host governments' anti-corruption legal, judicial and regulatory system may be inadequate due to lack of state institutional capacity, and lax, ambiguous, incomplete or outdated legislation, or lack of effective enforcement of existing laws and regulations, including prosecution and sanctioning.

More specifically, for host governments, legislative gaps may include failure to define corruption in all its forms as a criminal offence, including cross-border bribery, which is a major risk in the extractives sector, or lack of or insufficient coverage of specific anti-corruption measures such as guaranteeing the reporting by and protection of whistle-blowers or making a bribe payment expressly non-tax deductible.

Host governments are sometimes also home governments. They may host local companies with activities abroad. They may also host subsidiaries of multinational enterprises for the purpose of exporting the resources they have extracted. Where a host government is also a home government to companies with substantial activities abroad in the extractive sector, it is essential that it criminalise the bribery of foreign public officials in accordance with international standards, and ratify the OECD Anti-Bribery Convention, which focuses on stemming the supply of bribes to foreign public officials in international business transactions.[1]

Although usually equipped with more robust legal and judicial frameworks, home governments may also suffer from similar shortcomings that undermine the state's capacity to effectively prevent and sanction the bribery of foreign public officials by extractive companies. This may be the result of failure to include bribery of foreign public officials or facilitation payments in the legal definition of corruption or may be due to a weak enforcement record. Home governments with substantial extractive activities abroad should also ratify the OECD Anti-Bribery Convention.

Discretionary power and high politicisation of decision-making processes in the extractive value chain

Empirical analysis reveals a high level of politicisation of decision-making processes and of discretionary power held by both high and lower-ranking public officials as major risk factors undermining the effective prevention of corruption in the extractives sector. This may be observed for example in the process of approval of environmental impact assessments, in the granting of authorisations or waivers, in bidding or negotiation procedures, revenue collection, customs clearance, immigration visa application or administrative authorisations, and procurement of goods and services.

Moreover, discretionary power and politicisation of decision-making processes may result from insufficient compliance with public integrity standards regarding the management of conflicts of interest, the regulation of lobbying and political campaign financing and the transparency of public financial management systems. In particular, the legislation may not provide for safeguards against risks of collusion and political interference associated with the "revolving door phenomenon", whereby individuals frequently switch between high-level positions in both the public and private sectors.

Inadequate governance of the extractive sector

Risk factors related to the governance of the extractive sector include lack of or insufficient segregation of roles and responsibilities between administrative, regulatory and supervisory functions. In many instances, state-owned companies were found to be acting both as the administrator and regulator of the sector. More generally, the lack of transparency in the management and governance of state-owned companies may account for heightened risks of corruption in the extractive sector.

The lack of independence and accountability in monitoring and oversight activities as well as the lack of involvement and participation of local communities affected by extractive

activities in decision-making processes may increase risks of corruption across the extractive value chain.

Gaps and discrepancies in corporate due diligence procedures

General risk factors on the company's side include the lack of effective anti-corruption compliance and due diligence procedures applicable to employees, subsidiaries, business partners and intermediaries across the extractive value chain.

In particular, due diligence systems may not guarantee strict control over employees in compliance-sensitive positions, business partners, intermediaries and third parties, and they may fall short of providing adequate oversight of the parent company over the subsidiary's operations and robust internal financial controls related to anti-corruption compliance and internal audit processes.

Opacity on beneficial ownership

Moreover, transparency measures both in host and home governments may fail to adequately reflect the increasing complexity of patterns of corruption, which often rely on multi-layered structures across various jurisdictions and involve shell companies and corporate vehicles to channel or disguise corrupt payments and distance the corrupt agent from the crime. The lack of access to adequate information on these corporate structures, including on beneficial ownership, ranks among the greatest corruption risks in the sector.

Effectively detecting risks of corruption and money laundering through corporate vehicles requires capacity from the state to trace and identify the beneficial owners exercising effective control over a legal entity or on whose behalf a transaction is being conducted.[2] In this regard, national legislation on transparency may present important gaps with regard to the disclosure requirements of beneficial ownership. The nature of the information provided, the management of available data as well as harmonisation of national disclosure standards with international standards may be insufficient (OECD, 2014b; World Bank, 2011).[3] The risks associated with these grey zones and discrepancies are not the exclusive purview of home and host governments but also of third countries with attractive tax systems and opaque beneficial ownership disclosure requirements. Indeed, third countries may offer a safe place for disguising, channelling and laundering corrupt funds and payments.

These risk factors may arise in any transactions or payments involving corporate vehicles, shell companies, offshore bank accounts, front companies or local entities owned by politically affiliated persons; and they may impact, in particular, the award of contracts, commodity trading, enforcement of local content requirements, formation of joint ventures, privatisation or acquisition of shares in a public company.

Risks and recommended mitigation measures of cross-cutting relevance across the extractive value chain

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Gaps in the anti-corruption legal and judicial system	***What host governments can do*** ● Carry out a preliminary risk mapping of relevant institutions (leadership, independence and authority; culture and incentives; policies and processes; organisational structure, resources and capacities), including judicial and legislative bodies as well as institutions in charge of administering and regulating the extractive sector, to identify possible vulnerabilities and high-risk areas of corruption (Chêne, 2007). ● Explicitly criminalise corruption in all its forms at the public and private levels, including cross-border bribery, by introducing and strictly enforcing anti-corruption rules in accordance with international standards. Host governments that are also home governments with substantial exporting activities in the extractives sector should also be encouraged to ratify the OECD Anti-Bribery Convention, which focuses on stemming the supply of bribes to foreign public officials (OECD, 2011, UN, 2004). ● Include facilitation payments in the definition of corruption in national legislations. ● Provide effective, proportionate and dissuasive civil, administrative or criminal penalties for omissions and falsifications of the books, records, accounts and financial statements of companies (making of off-the-books, the recording of non-existent expenditures, the entry of liabilities with incorrect identification of their object, as well as the use of false documents for the purpose of bribing public officials or of hiding such bribery). ● Establish effective systems for reporting corruption, including through on-line platforms and protection of whistle-blowers (Davies and Fumega, 2014). ***What home governments can do*** ● Adopt anti-corruption criminal laws and ensure their application, providing for effective, proportionate and dissuasive sanctions and incentives, including for the bribery of foreign public officials, in accordance with international standards such as the OECD Anti-Bribery Convention. Home governments with substantial extractive activities abroad should also ratify the OECD Anti-Bribery Convention. ● Ensure that law enforcement authorities have necessary resources and institutional frameworks for detecting, investigating and prosecuting corruption cases involving bribery of foreign public officials. ● Eliminate any indirect support of foreign bribery, in accordance with the 2009 OECD Recommendation on Further Combating the Bribery of Foreign Public Officials in International Business Transactions, 2009 OECD Recommendation of the Council on Tax Measures for Further Combating Bribery of Foreign Public Officials in International Business Transactions, and 2006 OECD Recommendation on Bribery and Officially Supported Export Credits. ***What donors can do*** *In partner countries:* ● Provide support for the development or strengthening of anticorruption authorities; or strengthen citizen control via NGOs, media and parliament. ● Provide support for the development of a whistle-blowing system against corruption. *In home countries*: ● Encourage their respective governments to ensure anti-bribery legislation is updated and in line with international standards and provides for sanctions for companies that engage in bribery of foreign public officials.
Discretionary power and high politicisation of decision-making processes in the extractive value chain	***What host governments can do*** ● Set pre-determined and objective criteria to be explicitly and transparently considered in decision-making processes (e.g. contract renegotiation, selection of bidders and suppliers, pre-qualification of local suppliers, and granting of waivers). ● Limit political interference in state-owned companies' technical decisions by making merit-based appointments. Invest in staff integrity and capacity and adopt strong employee accountability provisions. ● Introduce standardised and automatic procedures (e.g. customs clearance, immigration visa application, revenue collection, bid submission, etc.)/develop standardised models or guidelines (e.g. licences and contract terms). ● Set clear ethical standards and codes of conduct and provide certification and regular training for public officials in compliance-sensitive positions.

CORRUPTION IN THE EXTRACTIVE VALUE CHAIN © OECD 2016

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
	• Adequately regulate lobbying activities with a view to increasing transparency in the interaction between public officials and lobbyists, thus reducing the risk of policy capture, undue influence and unfair competition while recognising their importance for informed decision making. This may include a requirement for the establishment of publicly accessible lobbying registries that chronicle all lobbying efforts by corporations, civil society organisations and individuals, and codes of conduct (OECD, 2016; OECD, 2015c; OECD, 2010b).[4] • Properly regulate political campaign finance, including limits on contributions by corporations and individuals, and the requirement for publicly accessible registries of all contributions to all political parties and candidates. Further measures include banning anonymous/foreign donations, automating and using online technologies for collecting donations, and allocating sufficient human and financial resources to electoral monitoring bodies (OECD, 2016; OECD, 2015c; OECD, 2010b).[5] • Put in place mechanisms for preventing or detecting conflicts of interest of key public officials, including declarations of asset, specific disclosure requirements for Politically Exposed Persons (PEPs),[6] employment restrictions, regular redeployment of officials in positions susceptible to corruption (EITI, 2015; OECD, 2004; OECD, 1999). A conflict-of-interest policy should provide for a clear definition of conflicts of interest situations, specifying the information government officials are expected to disclose in order to identify and declare conflicts-of-interest situations and setting up clear procedures for managing and resolving those situations as they arise (OECD, 2004; OECD, 1999).[7] To the extent possible, favour the automation of procedures and the use of online technologies for the management of asset declaration by public officials to increase transparency and accountability to the public. ***What companies can do*** • Strictly control and monitor the relationship between corporate personnel and public officials. Due diligence rules and internal codes of conduct may, for example, require that discussions and interactions with public officials involve at least two employees from different functions, that employees periodically report on the activities carried out in relationship with public officials; that internal formal authorisation and delegation of powers are made at the appropriate level in order to bind the company; and that traceability and transparency of payments is ensured.[8] • Rotate personnel in compliance-sensitive positions on a regular basis.
Inadequate governance of the extractive sector	***What host governments can do*** • Clarify the role of state-owned enterprises separating the sector's administration and regulation functions. • Ensure independent oversight of state-owned enterprises. • Require state-owned enterprises to establish anti-corruption compliance programmes based on risk assessments and have their content and implementation reviewed by internal and external independent bodies. • Publish consistent reporting on state-owned enterprises in accordance with International Financial Reporting Standards (OECD, 2005). Disclosure requirements may include information related to the ownership, governance, operations, and financial situation of state-owned enterprises including for example, pricing policies, costs, revenue flows, tax payments, financial flows between the state-owned enterprise and the state, procurement plans, and shareholders including beneficial ownership (OECD, 2005). • Develop efficient internal audit procedures for state-owned enterprises and perform an annual independent external audit based on international standards (OECD, 2005). • Engage with affected local communities in order to provide meaningful opportunities for their views to be taken into account in relation to planning and decision making for extractive projects. In particular, clarify expectations, commitments or legal requirements for engaging with indigenous peoples about resource development, in accordance with applicable international standards and principles (ILO, 1989; IFC, 2012). • Promote the uptake and observance by extractives industries of the OECD Due Diligence Guidance on Meaningful Stakeholder Engagement in the Extractives Sector (OECD, 2015b). • Foster participatory monitoring and other independent oversight mechanisms separate from state regulatory authorities (e.g. civil society and/ or parliamentary committees and courts). • Build community capacity to monitor extractive projects (Beevers, 2015). ***What companies can do*** • Observe the OECD Due Diligence Guidance on Meaningful Stakeholder Engagement in the Extractives Sector. In particular, establish strong policies against the use of manipulation, illegal conduct (e.g. bribery, misrepresentation) in the course of stakeholder engagement activities and establish corrective procedures for such conduct (OECD, 2015b). ***What donors can do*** • Assist national EITI secretariats or other relevant initiatives to ensure adequate monitoring and oversight over all phases of the extractive value chain. • Engage with all stakeholders, in particular extractive companies or in public-private partnership initiatives. For example, organise multi-stakeholder dialogues, train company staff on relevant standards.

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Gaps and discrepancies in corporate due diligence procedures	***What companies can do*** ● Establish a robust and comprehensive anti-corruption management system (in accordance with OECD Good Practice Guidance on Internal Controls, Ethics and Compliance) supported by an adequate and dedicated budget; and based on a properly documented assessment of corruption risks, which is reviewed on a regular basis and designed to prevent and detect the risks of bribery for the company (including its management and employees), its subsidiaries and where appropriate its business partners[9] and intermediaries (OECD, 2010a). *In particular:* ● Secure strong, explicit and visible support and commitment and ensure senior management's overall responsibility for the anti-corruption management system. (OECD, 2010a). ● Put in place an independent and adequately resourced compliance oversight function with the authority to report matters directly to independent monitoring bodies such as internal audit committees or boards of directors and supervisory bodies (OECD, 2010a). ● Put in place ethics and compliance measures covering *inter alia* the following areas: gifts, hospitality, entertainment and social expenses, customer travel, political contributions, charitable donations and sponsorships, facilitation payments, and solicitation and extortion (OECD, 2010a). ● Put in place a system of financial and accounting procedures, including a system of internal controls designed to ensure the maintenance of fair and accurate books, records and accounts, to ensure that they cannot be used to bribe or hide bribery (OECD, 2010a). ● Undertake properly documented risk-based due diligence pertaining to the hiring, as well as to the appropriate and regular oversight of business partners (OECD, 2010a). ● Inform business partners of the company's commitment to abiding by laws against corruption and foreign bribery, and of the company's ethics and compliance programme or measures for preventing and detecting such bribery and seek a reciprocal commitment from business partners. ● Ensure effective communication and documented training on the anti-bribery management system for all levels of the company, in particular for employees in compliance-sensitive positions and, where appropriate, subsidiaries and business partners (OECD, 2010a). ● Adopt effective measures for confidential reporting by, and the protection of directors, officers, employees and, where appropriate, business partners, not willing to violate professional standards or ethics under instructions or pressure from hierarchical superiors, as well as for directors, officers, employees and, where appropriate, business partners, willing to report breaches of the law or professional standards or ethics occurring within the company, in good faith and on reasonable grounds; and undertake appropriate action in response to such reports. This may involve putting in place policies and procedures against retaliation, feedback on investigations and discipline and sanction mechanisms for those who have been found responsible of violations. ● Provide for regular documented reviews of the system to ensure its continued effectiveness (OECD, 2010a). ● Co-ordinate collective action by establishing country-specific industry-based groups in order to share experiences and practices on implementing effective measures to address corruption risks.[10] ● Design and implement appropriate internal rules on planning, authorisation, implementation and monitoring of investments. ***What home governments can do*** ● Encourage companies operating overseas to develop and adopt adequate internal controls, ethics and compliance programmes or measures for the purpose of preventing and detecting risk of corruption, including foreign bribery, taking into account the OECD Good Practice Guidance on Internal Controls, Ethics, and Compliance (OECD, 2010a). ● In particular, encourage companies to prohibit or discourage the use of facilitation payments in internal company controls, ethics and compliance programmes or measures, recognising that such payments are generally illegal in the countries where they are made, and must in all cases be accurately accounted for in company books and financial records. ● Provide information and training on anti-corruption laws, regulations and sanctions as appropriate for public officials posted abroad, including on home country laws implementing the OECD Anti-Bribery Convention, so that such personnel can provide basic information and appropriate assistance to home country companies operating abroad and appropriate assistance when such companies are confronted with bribe solicitations. ● Mandate regular independent and certified audits of corporate internal due diligence procedures and associated risk management strategies and require companies to remedy any gaps or discrepancies and integrate any recommendations for improvement in their policy or risk management strategy as identified by the auditors.

CORRUPTION IN THE EXTRACTIVE VALUE CHAIN © OECD 2016

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Opacity on beneficial ownership	***What host governments can do*** ● Establish an enabling legal framework for the disclosure of public beneficial ownership arrangements.[11] *In particular*: -Adopt a definition of "beneficial owner" that captures the natural person(s) who ultimately owns or controls extractive companies operating in the country with specific reference to PEPs. -Consider requiring public disclosure of beneficial ownership information for extractive companies and public beneficial ownership registries of extractive companies, reflecting changes in ownership and corporate structures over time. -Ensure effective supervision of beneficial ownership disclosure requirements, including the establishment and enforcement of effective, proportionate and dissuasive sanctions for non-compliance. -To the extent possible, seek harmonisation of national regulations related to beneficial ownership with international standards on transparency of ownership and consider making use of model beneficial ownership declaration forms, such as the one developed by the EITI.[12] -When the company ownership is structured across multiple jurisdictions, ensure that competent authorities participate in information exchange on beneficial ownership with international counterparts in a timely and effective manner. ***For home countries*** ● Promote increased understanding of complex corporate structures by establishing an easily and freely accessible public registry with charts of the MNE group(s) headquartered in the country illustrating the legal and ownership structure, and geographical location of operating entities, including all subsidiaries (domestic and foreign). ● Create public beneficial ownership registers of companies incorporated or having their seat in the home country, reflecting ownership changes over time. Require companies to disclose beneficial ownership and communicate any changes over time (OECD, 2014a). ***What companies can do*** ● Designate a senior company official to attest that the beneficial ownership information submitted or disclosed is correct.[13] ● Make information on the group corporate structure and beneficial ownership available to home and host governments to help them build charts/public registries. ● Limit as far as possible transactions and operations involving offshore companies.[14]

Risks and recommended incentives and disincentives across the extractive value chain

RISK FACTORS	WHERE IN THE VALUE CHAIN?	RECOMMENDED INCENTIVES/DISINCENTIVES
Gaps in the anti-corruption legal and judicial system	Cross-cutting relevance	***What host and home governments can do*** ● Consider adopting laws and regulations allowing authorities to suspend, to an appropriate degree, from competition for public contracts or deny other public advantages (including public subsidies, officially supported export credits, and contracts funded by official development assistance) to enterprises determined to have bribed foreign or domestic public officials in contravention of the country's national laws. ● Consider adopting laws and regulations allowing authorities to de-list companies guilty of corruption from stock exchanges. ● Consider adopting laws and regulations recognising advantages (for instance participating in public tenders, requesting public subsidies) for companies with continuous certified compliance with ethical standards and anti-corruption programmes. ● Consider implementing measures to encourage co-operative behaviours and corporate self-reporting regarding instances of corruption (e.g. leniency mechanisms, alternative means of settlements such as deferred prosecution agreements, reduced financial penalties, compliance defence or limitation of liability, exemption from interim measures), while avoiding condoning deviant behaviours. ● Make bribes or expenditures incurred in furtherance of corrupt conduct in contravention of criminal or any other laws non tax-deductible, and ensure that tax authorities rigorously detect bribe payments concealed as allowable expenses (OECD, 2009). ● Provide adequate guidance to taxpayers and tax authorities as to the types of expenses that are deemed to constitute bribes for foreign public officials. ***What home governments can do*** ● Consider adopting laws and regulations allowing authorities to de-list companies guilty of corruption from stock exchanges. ● Organise awareness-raising initiatives in the public and private sectors for the purpose of preventing and detecting corruption (including foreign bribery) and provide specific written guidance to companies on anti-corruption laws, including, if applicable, those implementing the OECD Anti-Bribery Convention.
Discretionary power and high politicisation of decision-making processes in the extractive value chain	Cross-cutting relevance	***What host governments can do*** ● Take merit-based human resource decisions, developing positive career development paths, offering competitive base pay and reward packages for high ethical performance in order to encourage public officials to comply and exceed anti-corruption compliance standards.
Gaps and discrepancies in corporate due diligence procedures	Cross-cutting relevance	***What companies can do*** ● Adopt a "zero tolerance" policy towards corruption and put in place appropriate incentives to encourage observance of anti-bribery management systems by directors, officers, employees and, where appropriate, business partners, and appropriate disciplinary measures for violations (OECD, 2010a). ***What home governments can do*** ● Reward (directly or through NGOs) good corporate conduct and behaviour, including continuous certified compliance with ethical standards and anti-corruption programmes, through for example case-specific publication, public comparison of companies' positive anti-corruption performance (Humboldt-Viadrina School of Governance, 2013).
Non-transparent and asymmetric negotiation and contracts	Award of mineral, oil and gas rights through contract negotiation	***What host and home governments and companies can do*** ● Participate in international fora such as the Negotiation Support Forum, a joint effort between the OECD Initiative for Policy Dialogue on Natural Resource-based Development and the G7 CONNEX Initiative to share knowledge, experience and good practices in contract negotiations.

RISK FACTORS	WHERE IN THE VALUE CHAIN?	RECOMMENDED INCENTIVES/DISINCENTIVES
Opacity and discretion in bidding processes	Award of mineral, oil and gas rights through bidding processes	***What host and home governments can do*** ● Debar companies found guilty of violating tender regulations from participating in future bids for a set period of time determined on the basis of the seriousness of the violation.[15] ● Consider adopting laws and regulations recognising advantages (for instance participating in public tenders, requesting public subsidies) for companies complying with ethical standards and adopting and implementing effective anticorruption programmes. ***What host governments can do*** ● Prohibit campaign contributors from receiving contracts and concessions during their candidate's term in office when the latter is in a position to influence the assignment of such contracts and concessions.[16] ● Consider evidence of unreliable or fraudulent statements or information, including on beneficial ownership, provided by the company obtaining a licence as legal grounds for terminating the licence, taking into account the seriousness of the violation.
Lack of, or inadequate due diligence procedures governing relationships with suppliers	Regulation and management of operations – Procurement of goods and services	***What extractive companies or main contractors[17] (public or private) can do*** ● Provide preferential treatment to suppliers that adhere to anti-corruption standards such as granting preferred supplier status to the extent it does not distort fair competition (e.g. inclusion in a list of pre-qualified suppliers), guarantee higher visibility for compliant companies (Humboldt-Viadrina School of Governance, 2013). ● Grant public recognition to compliant companies (e.g. "business partners of the year" award, mention on websites, promotional activities, etc.) (Humboldt-Viadrina School of Governance, 2013). ● Consider the establishment of a list of qualified suppliers (where possible cross-industry) where a host government's pre-qualification standards are lower than industry standards.
Lack of co-ordination and asymmetries of information between national and sub-national governments	Revenue management – Redistribution of resource revenue through transfers	***What central governments can do*** ● Allocate extra grants supplementing funding of local development projects based on performance in budgetary information disclosure and results of audit reporting.[18]
Insufficient capacity for budget planning and execution	Revenue spending and social investment projects – Public spending	***What central governments can do*** ● Introduce penalties applicable to local authorities when they deviate from planned revenue and expenditure targets.
Lack of transparency of public procurement processes	Revenue spending and social investment projects – Public spending	***What central and local governments can do*** ● Provide attractive, competitive and merit-based career options for procurement officials, and ensure protection from political interference in the procurement process. ● Include prevention and detection of bid rigging or corrupt practices in procurement officers' professional duties and make it a requirement for career development/progression. ● Provide that money saved from uncovering a cartel formed as part of a public procurement process remains in part with the administration that helped discover it. ● Debar companies found guilty of violating tender regulations from participating in future bids, and for a set period of time as determined on the basis of the seriousness of the violation.[19] ● Prohibit campaign contributors from receiving contracts during their candidate's term in office when the latter is in a position to influence the assignment of such contracts.[20] ● Insert anti-collusion tender clauses specifying sanctions for breaches of competition rules in public procurement contracts (OECD, 2015a).

Notes

1. The full name of the OECD Anti-Bribery Convention is the Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions. It currently has 41 Parties, the 34 OECD countries plus seven non-members (Argentina, Brazil, Bulgaria, Colombia, Latvia, Russia and South Africa).
2. According to the Financial Action Task Force (FATF), the beneficial owner is defined as "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." See FATF (2012), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendation, Financial Action Task Force FATF-OECD, Paris, February 2012. *www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf*. Similarly, the OECD defines beneficial ownership as "the ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder." See OECD (2001), Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes, OECD Publishing, *http://dx.doi.org/10.1787/9789264195608-en*.
3. Written comments received from participants in the Working Group on Corruption Risks during the consultations between January and November 2015.
4. Comments received from participants in the Working Group on Corruption Risks during the consultations between September and November 2015.
5. See note 4.
6. PEPs are considered to be persons who occupy important public positions: heads of state or government, high-level regional or national politicians, senior officials of the administration, judiciary, military and parties at national or regional level, the highest organs of state enterprises of national importance, companies and people who are close to the above-mentioned persons for family, personal or business reasons.
7. See note 4.
8. Comments received from participants in the Working Group on Corruption Risks during the consultations between January and May 2015.
9. Business partners include third parties such as agents and other intermediaries, consultants, representatives, distributors, contractors and suppliers, consortia, and joint venture partners. Factors to be taken into account in conducting due diligence on a business partner include whether it is a legitimate entity, is qualified and has the necessary resources to fulfil its part of the contract, whether it has an effective anti-bribery management system, whether it has been investigated, prosecuted or convicted of fraud or bribery, and whether it has direct or indirect links to an authority involved in the decision to award the contract. See OECD (2010), "Good Practice Guidance on Internal Controls, Ethics and Compliance", adopted by the OECD Council as an integral part of the Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions of 26 November 2009, 18 February, *www.oecd.org/daf/anti-bribery/44884389.pdf*.
10. Global Economic Symposium, Selected Solutions 2014/2015.
11. See Requirement 2.5 of the EITI Standard (2016), *https://eiti.org/files/english-eiti-standard_0.pdf*.
12. See note 4. See also G20 (2014), G20 High-Level Principles on Beneficial Ownership Transparency, *www.g20australia.org/sites/default/files/g20_resources/library/g20_high-level_principles_beneficial_ownership_transparency.pdf*.
13. EITI Beneficial Ownership Pilot, *https://eiti.org/pilot-project-beneficial-ownership#Progress*.
14. See note 4.
15. See the country profiles available on the Business Anti-Corruption Portal at: *www.business-anti-corruption.com/country-profiles*.
16. See *www.business-anti-corruption.com/country-profiles/the-americas/colombia/initiatives/public-anti-corruption-initiatives.aspx*.

17. "Contractors" is an all-inclusive notion encompassing all entities with whom extractive companies enter into a contractual relationship.

18. Open Government Partnership, "Promoting Good Local Governance through Performance-Based Grants in Philippines", *www.opengovpartnership.org/sites/default/files/Inspiring%20Story%20-%20Philippines.pdf*.

19. See note 15.

20. See note 15.

References

Beevers, D.M. (2015), "Large-scale mining in protected areas made possible through corruption: Options for donors", *U4 Brief*, U4 Anti-Corruption Resource Centre, June.

Chêne, M. (2007), "Corruption and the renegotiation of mining contracts", *U4 Expert Answer*, U4 Anti-Corruption Resource Centre, 30 November.

Davies, T. and S. Fumega (2014), "Mixed incentives: Adopting ICT innovations for transparency, accountability, and anti-corruption", *U4 Issue* 2014:4, *www.u4.no/publications/mixed-incentives-adopting-ict-innovations-for-transparency-accountability-and-anti-corruption/#sthash.6jYd9HQm.dpuf*.

EITI (2016), The EITI Standard, *https://eiti.org/files/english-eiti-standard_0.pdf* .

EITI (2015), *EITI Progress Report 2015 – Making Transparency Matter*, Section "Breaking ground on beneficial ownership transparency", *http://progrep.eiti.org/#!/2015/looking-ahead/beneficial-ownership*.

FATF (2012), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, updated October 2015, FATF, Paris, France, *www.fatf-gafi.org/recommendations.html*.

G20 (2014), G20 High-Level Principles on Beneficial Ownership Transparency, *www.g20australia.org/sites/default/files/g20_resources/library/g20_high-level_principles_beneficial_ownership_transparency.pdf*.

Humboldt-Viadrina School of Governance (2013), *Motivating Business to Counter Corruption, A practitioner Handbook on Anti-Corruption Incentives and Sanctions*, October.

IFC (2012), "International Finance Corporation Performance Standard 7 on Indigenous Peoples", *www.ifc.org/wps/wcm/connect/1ee7038049a79139b845faa8c6a8312a/PS7_English_2012.pdf?MOD=AJPERES*.

ILO (1989), "International Labour Organisation Convention 169 on Indigenous and Tribal Peoples", *www.ilo.org/indigenous/Conventions/no169/lang--en/index.htm*.

OECD (2016), *Financing Democracy: Funding of Political Parties and Election Campaigns and the Risk of Policy Capture*, OECD Public Governance Reviews, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264249455-en*.

OECD (2015a), "Draft report to the Council on Implementation of the 2012 Recommendation on Fighting Bid Rigging in Public Procurement", Note by the Secretariat prepared for the Working Party No.2 on Co-operation and Enforcement, 15 June.

OECD (2015b), "Due Diligence Guidance on Meaningful Stakeholder Engagement in the Extractive Sector", April, *www.oecd.org/daf/inv/mne/OECD-Guidance-Extractives-Sector-Stakeholder-Engagement.pdf*.

OECD (2015c), "Transparency and integrity in lobbying", in *Government at a Glance 2015*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/gov_glance-2015-35-en*.

OECD (2014a), *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264219236-en*.

OECD (2014b), *Illicit Financial Flows from Developing Countries: Measuring OECD Responses*, OECD Publishing, *http://dx.doi.org/10.1787/9789264203501-en*.

OECD (2011), "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions", OECD Publishing, *www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf*.

OECD (2010a), "Good Practice Guidance on Internal Controls, Ethics and Compliance", adopted by the OECD Council as an integral part of the Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions of 26 November 2009, 18 February, *www.oecd.org/daf/anti-bribery/44884389.pdf*.

OECD (2010b), *Post-Public Employment: Good Practices for Preventing Conflicts of Interest*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264056701-en*.

OECD (2009), "Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions", C(2009)64, 25 May, *www.oecd.org/tax/crime/2009-recommendation.pdf*.

OECD (2005), "OECD Guidelines on Corporate Governance of State-owned Enterprises", in OECD, *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264009431-10-en*.

OECD (2004), *Managing Conflicts of Interest in the Public Service: OECD Guidelines and Country Experiences*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264104938-en*.

OECD (2001), *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, OECD Publishing, *http://dx.doi.org/10.1787/9789264195608-en*.

OECD (1999), *Public Sector Corruption: An International Survey of Prevention Measures*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264173965-en*.

UN (2004), *United Nations Convention Against Corruption*, *www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf*.

World Bank (2011), *The Puppet Masters – How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*, Stolen Asset Recovery Initiative, The World Bank and United Nations Office on Drugs and Crime, Washington, DC.

For further reading

FATF (2014), *Guidance on Transparency and Beneficial Ownership*, October 2015, FATF, Paris, *www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf*.

OECD (2015), *Consequences of Corruption at the Sector Level and Implications for Economic Growth and Development*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264230781-en*.

OECD (2014), *OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Bribery Officials*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264226616-en*.

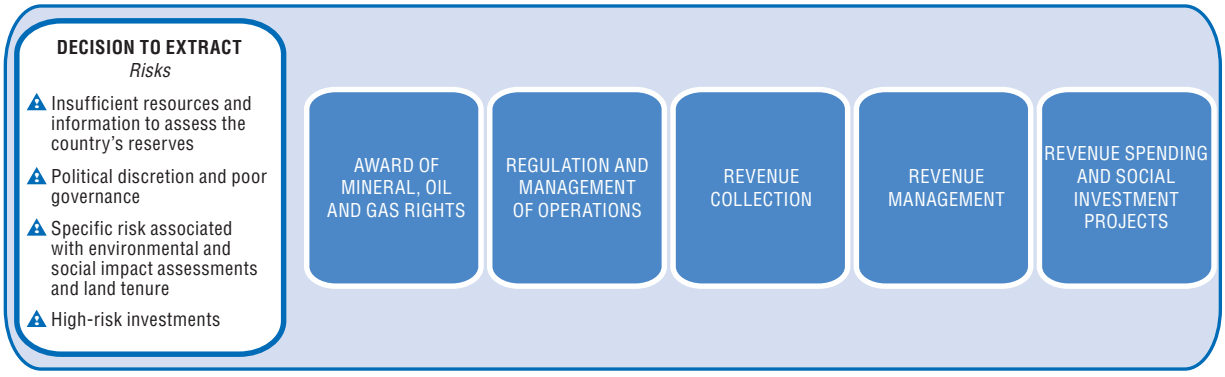
© OECD 2016

Chapter 2

Corruption risks in the decision to extract

This chapter identifies corruption risks arising in the decision to extract, the patterns of corruption and parties involved. It further provides recommended mitigation measures for home, host governments, and donors. In this phase governments enjoy the opportunity to undertake a cost-benefit analysis weighing the costs, benefits and risks over the expected timeframe of extraction and beyond.[1] *It is in this phase that governments strike a balance between possible alternative use of lands and associated restrictions, preservation of the environment, protection of cultural sites and the rights of indigenous peoples and local communities.*

Figure 2.1. **Corruption risks related to the decision to extract**



Corruption schemes

Bribery of domestic or foreign public officials, collusion, trading in influence, political capture or interference, or extortion may be used to influence the decision-making process, and to circumvent or overlook rules regarding environmental preservation, protection of land rights and land access restrictions to protect important sources of livelihoods for local communities, including indigenous peoples.

Corruption schemes may also include policy or regulatory capture for the benefit of private investors or the political elite. Distortions in policy making typically aim at shaping policies, rules, licensing regimes and processes in ways to facilitate corruption in subsequent phases (UNDP, 2015).

Finally, governments or extractive companies may use bribery and other corrupt behaviours, including trading in influence and extortion, to obtain the consent from traditional chiefs on behalf of local communities to undertake extractive operations on their land, especially in countries under customary land tenure regimes.

Parties involved

The decision-making process may be influenced by political elites and private companies in order to maximise their benefits in the further development of the project. The presence of so-called "junior companies" in the exploration phase has intensified in recent years partly due to rising costs and risks associated with the initial phases of extractive projects. Risks of corruption may be higher where extractive activities are being carried out by small "junior" companies since they are less exposed to reputational risk than big multinationals (Beevers, 2015).

The beneficiaries of the bribe may be high-level public officials who receive bribes in exchange for granting the necessary authorisations, and circumventing or modifying existing laws and regulations. In one case, two companies were awarded concessions to

undertake exploration in a protected area. A member of a national parliament allegedly admitted to taking monthly payments to lobby for the award of the concession to the company. A company is also alleged to have paid for an official government delegation to a UN meeting where talks were being held on whether explorations in the national park should be allowed. In another case, a former minister was found guilty of interfering in the granting of prospecting licences for personal benefit.

The receivers of the bribe may also be lower-ranking officials such as technical experts in charge of carrying out environmental impact assessments.

Finally, traditional leaders or members of local communities may receive bribes or extort money from companies in exchange for buying communities' consent, avoiding social tensions or acting in their capacity as land owners or custodians and giving their consent for companies to start operations.

Corruption risks

On the government side

Insufficient resources and information to assess the country's reserves

First, corruption risks affecting host governments in the decision to extract may include the lack of or inadequate information and technical capacity to evaluate the country's resource base (geological potential, quantum of the resource, geographic distribution, etc.) and to address land tenure and distribution issues. For example, a participant in the Working Group on Corruption Risks reported that in his country hydrocarbon reserve calculations are made manually in an excel sheet by the competent department, without any specialised software for hydrocarbon reserves simulation.[2]

More specifically, the lack of pre-investment in geological and geophysical surveys often leads host governments to rely primarily, if not exclusively, on the information provided by extractive companies. When extractive companies do not or incompletely report on the evaluation process and methodology used for the determination of countries' reserves and when there is no verification by governments of the information provided by extractive companies, governments may be prevented from making informed decisions. In such case, the asymmetry of information potentially opens the door to corruption.[3]

Political discretion and poor governance

Political discretion and poor governance may provide opportunities for corruption in the decision-making process leading to the authorisation to extract and the allocation of extraction rights in protected areas, at the expense of the livelihoods of local communities and indigenous peoples living in the vicinity.

The lack of co-ordination among relevant government authorities may account for the increased risks of corruption. For example, as reported by a participant in the working group, the lack of co-ordination between the authority responsible for granting prior authorisations and that responsible for awarding the licence may create opportunities for corrupt conduct. In this particular case, the Ministry of Energy and Mines ratified decrees awarding licences to explore and exploit hydrocarbons in protected areas, in violation of the legal obligation to obtain the prior favourable opinion of the responsible authority.[4] Lack of co-ordination and asymmetry of information between the national and subnational levels may also undermine decision making and increase exposure to corruption risks.

Specific risk factors associated with environmental and social impact assessments and land tenure

The process for undertaking environmental and social impact assessments and the granting of subsequent authorisations presents specific vulnerabilities. Risks include bureaucratic procedural delays in the approval of environmental and social impact assessments,[5] a highly politicised process of approval as well as the lack of communities' participation in the environmental impact assessment process (Beevers, 2015).

Ambiguous, outdated or unenforced legislation on the protection of socio-environmental rights may contribute to increase a country's vulnerability to corruption in the decision to extract. For example, unclear and opaque land tenure systems, in particular where customary land tenure regimes are prevalent, may encourage the use of corrupt practices to obtain the authorisation to extract on lands traditionally owned by local communities.

On the company side

High-risk investments

Vulnerabilities to corruption in the pre-investment phase could be explained by the type of contracts, the nature of the investment and the risk assumed by the investor in this initial phase. Risks vary depending on the company size and profile. In the case of multinational companies, vulnerabilities to corruption may result from the capital intensity required to make the initial investment. The low reputational risk of junior companies involved in the exploration phase and their high dependence on capital financing rather than production-derived cash flows may make them prone to take higher risks for higher returns.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Insufficient resources and information to assess the country's reserves	***What host governments can do*** ● Develop a medium- to long-term plan for conducting geological and geophysical surveys to build knowledge on available resources, thus reducing asymmetries of information.[6] ● Carefully design and review requirements for extractive companies to report on the evaluation of the geological potential and put in place mechanisms to verify the information that companies provide.[7] ● Make geological and geographic information publicly and freely available to provide investors and other interested parties with information about the location of exploration and extraction rights. ***What donors can do*** ● Provide technical and financial support to conduct studies/resource mapping. ● Support government agencies in charge of land registries through staff capacity building or the provision of equipment. ● Provide technical and financial support to develop national resource strategies and legislation (e.g. mining code) and facilitate partner countries' access to lessons learned by peers. ● Support consultation processes with affected stakeholders, such as communities around extractive areas.

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Political discretion and poor governance	***What host governments can do*** ● Ensure clear alignment and consistency of the allocation strategy for extraction rights with broader national and local development objectives so as to limit political discretion and ensure government's accountability to citizens (ICAC, 2013). ● Develop a set of pre-determined criteria to provide guidance in the allocation of extraction rights and require them to be explicitly and transparently considered in the decision-making process. ● Put in place governance mechanisms to improve co-ordination among different central and local authorities involved in the decision to extract and the awarding of licences while ensuring segregation of roles (evaluation/planning/impact assessment/authorisation). For example, governments could consider establishing inter-ministerial bodies to work as focal point for all the above activities (ICAC, 2013).[8] ● Clearly define the roles of the national and local authorities in the approval process and in the granting of the relevant authorisations and permits.[9] ● Set up effective controls to ensure independence in the granting of authorisations and the application of appropriate sanctions.
Specific risks associated with environmental and social impact assessments	***What host governments can do*** ● Simplify bureaucratic and administrative procedures for environmental and social impact assessments in order to reduce the risk that public officials receive corrupt payments in exchange for accelerating the granting of extraction rights.[10] ● Develop indicators to measure the environmental and social impact of extractive activities, set baselines against which to evaluate performance and provide for regular data collection, storage and analysis. ● Put in place a system to monitor environmental performance and sanction non-compliant companies (Beevers, 2015).
Specific risks associated with land tenure issues	***What host governments can do*** ● Set and enforce laws, policies, rules and regulations for protected areas in order to limit discretion in the allocation of extractive rights that may threaten the integrity of protected areas (Beevers, 2015) or the livelihoods of local communities and indigenous peoples living in the vicinity of the extractive areas.[11] ● Systematically map existing concessions, protected areas and community land rights including customary rights so as to avoid overlaps and risk of conflict uses (PWYP, 2014). In doing so, governments should encourage an open, transparent, inclusive and participatory spatial planning process involving local communities (OECD, 2015). ● Engage with affected local communities in order to provide meaningful opportunities for their views to be taken into account in relation to planned extraction operations. In particular, clarify expectations, commitments or legal requirements for engaging with indigenous peoples about resource development, in accordance with applicable international standards and principles (ILO, 1989).
High-risk investments	***What home governments can do*** ● Encourage the design and implementation of ethical standards and codes of conduct specific to junior exploration companies operating abroad. ***What donors can do*** ● Raise awareness and sensitise small and junior companies about responsible mining. This may take the form of training on relevant national and international standards, including through extractive industries associations.

Notes

1. *www.resourcegovernance.org/training/resource_center/backgrounders/value-chain*.
2. Comments received from participants in the Working Group on Corruption Risks during the consultations between January and May 2015.
3. See note 2.
4. See note 2.
5. See note 2.
6. Comments received from participants in the Working Group on Corruption Risks during the consultations between September and November 2015.
7. See note 6.
8. See note 6.
9. See note 6.
10. See note 6.
11. See note 6.

References

Beevers, D.M. (2015), "Large-scale mining in protected areas made possible through corruption: Options for donors", *U4 Brief*, Anti-Corruption Resource Centre, June.

ICAC (2013), "Reducing the Opportunities and Incentives for Corruption in the State's Management of Coal Resources", Independent Commission against Corruption, New South Wales, October.

ILO (1989), *International Labour Organisation Convention 169 on Indigenous and Tribal Peoples*, *www.ilo.org/indigenous/Conventions/no169/lang--en/index.htm*.

OECD (2015), "Due Diligence Guidance on Meaningful Stakeholder Engagement in the Extractive Sector", April, *www.oecd.org/daf/inv/mne/OECD-Guidance-Extractives-Sector-Stakeholder-Engagement.pdf*.

PWYP (2014), "PWYP Indonesia on using project-level data, 11 September 2014", *www.publishwhatyoupay.org/pwyp-resources/pwyp-indonesia-on-using-project-level-data/*.

UNDP (2015), "A Practitioner's Guide for Corruption Risk Mitigation in Extractive Industries", March.

© OECD 2016

Chapter 3

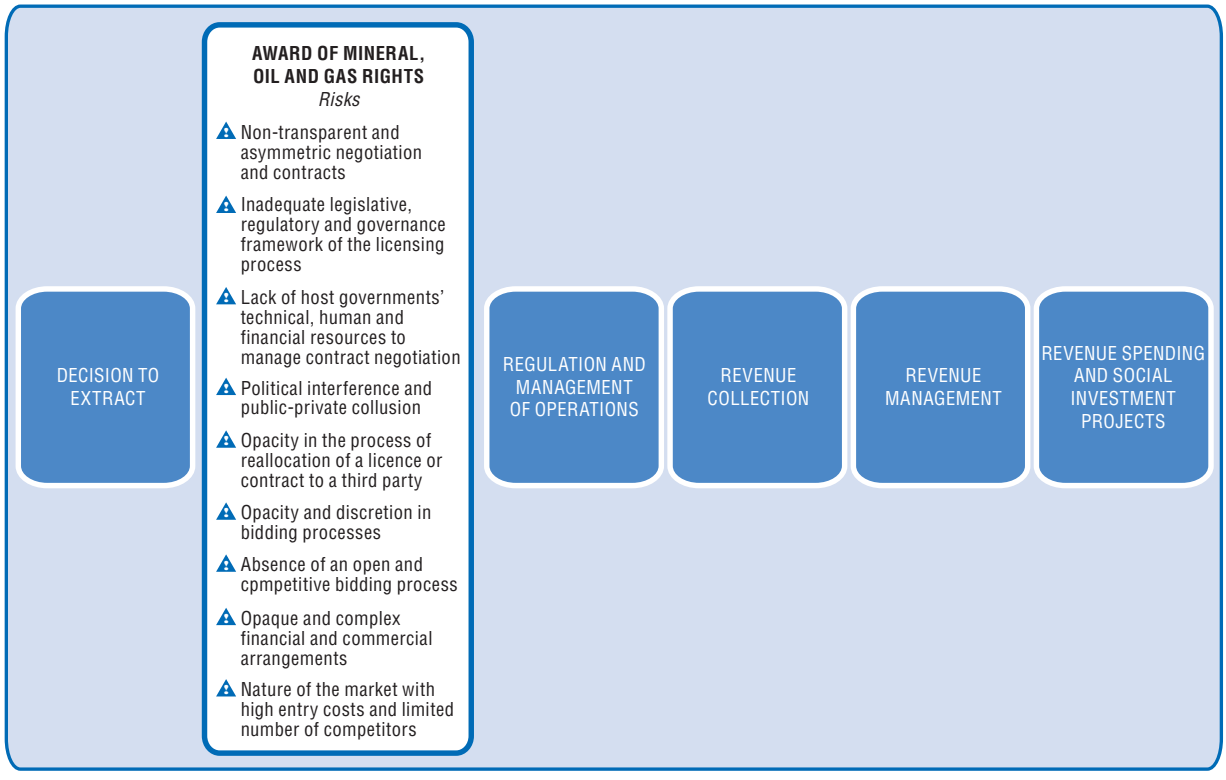
Corruption risks in the award of mineral, oil and gas rights

This chapter identifies corruption risks arising in the award of mineral, oil and gas rights through direct contract negotiations or a competitive bidding process. It further describes in detail the schemes, parties involved and mechanisms used to channel corrupt payments. Recommended mitigation measures are addressed to home and host governments, donors and extractive companies.

With the exception of the United States and some Canadian provinces, governments generally retain ownership over sub-soil natural resources. The acquisition of a licence or contract does not imply that the ownership of the sub-soil resources is also transferred. Governments retain the rights to their resource endowments and they decide who should undertake exploration and production of oil, gas and minerals and under what terms. Exploration and exploitation rights may be allocated through different mechanisms, depending on the type of resource and the size of the deposit.[1] The contractual form of the agreement can range from a concession, licence (permit for exploration and lease for exploitation) to a production sharing agreement in the oil and gas sector or a mineral development agreement in the mining sector. Rights can be granted by governments through open door mechanisms (first come, first served basis or direct negotiations with one or more interested investors) or through a competitive bidding process.

Regardless of the system used, the allocation of rights to explore and produce minerals, oil and gas is a heightened risk of corruption.

Figure 3.1. **Corruption risks in the award of mineral, oil and gas rights**



Contract negotiation

This section covers corruption risks in contract negotiation, regardless of the type of award and including instances where countries adopt an open door policy for the allocation of rights (either through a first come, first served basis or by entering into direct negotiations with one or more interested investors). These negotiations may take place at different stages of the extractive production cycle.

Corruption schemes

Trading in influence, political capture and interference

Corruption risks associated with contract negotiations may take the form of trading in influence, political capture and interference. Trading in influence is the process or act by which a person who has real or apparent influence on the decision making of a public official exchanges this influence for an undue advantage (OECD, 2008a). Political capture or interference refers to private interests significantly influencing decision-making processes of public officials to their own advantage.

In contract negotiation the typology of corruption risks includes the exercise of undue influence to gain favourable contractual terms (including the application of favourable royalty rates in violation of national laws), or to get permit approvals, even in breach of national laws, or to gain access to commercially sensitive information. In doing so, companies may offer or be solicited to provide improper advantages in the form of anything of value, such as illegal commissions, gifts and entertainment (i.e. first class flights, expensive hotels, dining, school fees), job or business opportunities to public officials and politicians or their family members, with a view to unduly influencing the negotiation process.

In an iron ore producing country, the government granted mining rights over one of the largest untapped deposits in the world, with a potential for revenue generation estimated at about USD 140 billion over 20 years. The company paid nothing up front to obtain the rights and allegedly invested USD 165 million in exploration works before selling a 51% interest in the project to another company for USD 2.5 billion. The mining rights were later terminated following an administrative review of allegations that the company obtained its rights only after gifts and cash given to members of the then-president's family.

Local content requirements can be part of the corruption scheme during the negotiation phase. Local content requirements generally refer to obligations enshrined in law or included as part of licensing, procurement agreements or other contracts. This may include employment or inputs, goods and services procured from local sources, locally hired workforces, operations carried out in partnership with local entities, development of enabling infrastructure, the improvement of domestic capacity, or the improvement of local technological capabilities. Where the negotiation process is not transparent and highly discretional, public officials responsible for the award of contracts or licences may force companies wishing to operate in the country to enter partnerships or sign service contracts with particular companies (Martini, 2014). The associated risk in this case arises from favouring a particular company on the basis of family ties, party affiliation or ethnicity rather than on the basis of qualifications such as technical expertise, financial capability and reputation.[2] In the corrupt scheme, the local partner may make no significant contribution to the venture itself, with value accrued to the corrupt official, without any cash changing hands. Otherwise, the cost of the service, which may not be performed in practice, functions as a bribe.

Risks of trading in influence or political capture may also arise in the context of contract renegotiation as a result of a regime change. Companies may be prone to accommodate some of the demands of the new government while protecting the economic terms of the agreement by dumping old partnerships and accepting new local partners with strong links with the new government (Chêne, 2007). Companies may also make gifts or facilitation payments to influence political decisions and deter the government in place from renegotiating or changing the rules of the game (e.g. increasing the price of resources sold by the state).

Favouring companies in which public officials have an ownership stake

Several cases of conflicts of interest were reported by participants in the Working Group on Corruption Risks. These include for example the involvement in the decision-making process of high-level politicians who had previously provided consultancy services to the same companies. In another case, a public officer was holding a position both in the operating state-owned enterprise and in the overseeing body in charge of approving extractive projects. Similarly, a public official holding both the position of president of the board of a state-owned enterprise and the position of administration and financial manager of a private company was left with the task to arbitrate on contractual interpretation differences between the two companies. The dispute was ultimately solved in favour of the private company. Participants further reported the case of a president of a state-owned enterprise advising private companies with business activities with the state-owned enterprise and billing them for the services provided through third parties.[3]

Embezzlement and misappropriation of public funds

Contract negotiation may offer the opportunity to divert public funds for the benefit of private interests. The press and literature reports a case currently under investigation where public funds were allegedly misappropriated in the context of the acquisition of a licence by foreign companies from a government. It is alleged that the public funds generated by the deal were transferred to a company in which a former high-level politician held substantial beneficial interest. It is alleged that the licence had been previously awarded to that company by the high-level politician therefore implying that the company, not the government owned the licence. It is alleged that the money paid was then transferred abroad to multiple shell companies with hidden beneficial owners so as to conceal the proceeds of the transaction. The proceeds of the transaction were frozen in two foreign jurisdictions.

Lack of transparency in contract negotiation is conducive to corrupt conduct aimed at circumventing or violating existing legal provisions for the payment of royalties and taxes. Provisions negotiated in secret contracts may set ridiculously low corporate tax rates compared to the national rate. In a post-conflict country, the High Level Panel on Illicit Financial Flows reports the case of a company that had negotiated a corporate tax rate at only 1.43%. In another instance, a hidden contract set the royalty rate for the extraction of a mineral at 20% of the rate established by law. The disparity in the values illustrates the potential loss of revenues from secret and unbalanced contracts in the extractive sector (AUC/ECA, 2015). The review of contracts awarded in another country's principal gas producing area revealed that royalties were set below the percentage prescribed by law, following a different methodology. Similarly, a contractual clause setting a fixed percentage of royalties had been negotiated in violation of national legislation providing for variable royalty rates depending on technical and economic factors.[4] The revenue generation potential of the contract may be further undermined by asymmetries of

information between governments and companies, where companies often have more information about the quantity and quality of the mineral deposits covered by the contract. The UN High Level Panel on Illicit Financial Flows reports several cases where secret and unbalanced contracts severely eroded the revenue generation capacity of the host country.

Parties involved

Politicians and central or local government officials with conflicts of interest, local partners, consultants, advisors and intermediaries as well as foreign companies may act indistinctly as instigators or beneficiaries of corrupt acts. Officials of state-owned enterprises may also be involved in corrupt schemes that are tainted by conflicts of interest.

Some cases demonstrated that corruption schemes can be linked to broader foreign policy interests involving for example high-level officials and politicians from the company's home country (OECD, 2012).[5] The involvement of home country governments or politicians can either be driven by security concerns or out of economic and commercial interests in promoting their companies abroad. In such cases, the corruption scheme may not only involve money but also promises of economic assistance and/or political or military support (World Bank, 2007).[6]

Vehicles and mechanisms

Shell companies and fronting to comply with local content requirements

When companies are obliged to enter into joint ventures with local companies to operate in a country, local content requirements may be used as a mechanism to perpetuate elite capture and rent-seeking, and to generate revenues for government-affiliated individuals or government-favoured partners, based on their ethnicity, loyalty or close ties with public officials. In this case, shell companies may be used as a way for politicians to disguise the award of contracts to companies in which they or their proxies hold interests (Martini, 2014). The literature reports the case of a country where companies owned by government officials would commonly bid for licences in consortia with foreign groups and would receive a percentage of the total contract the company gets if successful (World Bank, 2007).

Shell companies can also be used as a conduit to divert public funds and channel payments to the real beneficiaries of the transaction. On the other hand, foreign companies may use shell companies to circumvent local content requirements or simply give the appearance of compliance through the use of "fronts" with a PO box registered locally in order to secure the contract. Companies can also pay illegal fees to contract front companies in order to pay lip service to host country laws (World Bank, 2007).

Signature bonuses and intellectual services

Signature bonuses can constitute a pool for bribery payments and embezzlement of public funds. The signature bonus is commonly used in contracts and licences in the oil and gas sector. It consists of a one-off payment made by the company up front to the host country for the right to develop a block. This system is a widely recognised and legally accepted way for an oil company to secure the right to explore a certain field or block (Global Witness, 2009).

However, signature bonuses might be prone to corruption due to the non-uniform criteria used to define their size. The amount of the bonus varies according to the block's

size and prospective wealth. In addition, the signature bonus' level is set relative to the royalty rate, which renders it difficult to predict and calculate (McMillan, 2005). In recent years, the size of signature bonuses has skyrocketed particularly in major oil and gas producing countries (Niekerk and Peterson, 2002). Considering the amounts potentially at stake, signature bonuses may be used as a mechanism to conceal big corruption schemes.

In fact, a problem with signature bonuses, apart from their size, may regard their destination. In several major corruption scandals, a share of the signature bonus was assigned to an offshore account and did not appear in the public financial accounts (Global Witness, 2009). Furthermore, signature bonuses may not clearly appear in corporate financial reports, as expenditures may be disaggregated into broad categories in annual reports.

Other contractual terms may serve as possible vehicles to disguise improper payments. These include provisions on cost recovery or on profit sharing. Typically used in profit sharing agreements in the oil sector, cost recovery and profit sharing clauses define respectively the share of profit used to recover capital and operational expenditure, also known as "cost oil" and the split of the remaining profit, also known as "profit oil" between the government and the company. Given the difficulty of estimating the volume of recoverable oil in a particular field, and the substantial risks associated with exploitation, most operators serve under a cost recovery basis rather than seeking complete compensation for these risks. The ceiling amount and nature of items that can be included in the cost recovery scheme vary significantly, and are therefore central to the negotiations of contracts and will vary depending on a variety of factors, including characteristics of the block, local conditions to extract, international market prices, etc. Since the percentage share of profit to the oil company is fixed in the contract, risk of corruption may arise when determining how the cost should be calculated as this will impact upon operators' real profits (Al-Kasim, Søreide and Williams, 2008).

The provision of intellectual services by local consultants to the company can also be used as a vehicle to channel illegal payments. The selection of local consultants may be tainted with conflicts of interest where they present close ties with public officials and decision makers in the negotiation.[7]

Corruption risks

Non-transparent and asymmetric negotiations and contracts

Asymmetries of information between the negotiating parties as well as the lack of transparency in contract negotiations (Transparency International, 2012) constitute major risk factors for corruption in the negotiation phase. Indeed, opportunities for corruption may arise when no document is produced to support each party's proposals, report on parties' positions throughout the negotiation process, and compare the outcomes of the negotiation against the initial objectives.[8]

Non-transparent negotiations provide the ideal setting for the exchange of abnormal and non-traceable cash payments (e.g. for fees and commissions) by exempting parties from justifying their size and destination. Moreover, the disclosure of the list of awarded licences and contracts (e.g. cadastral survey map of the rights and applications, etc.) is still not common practice in many producing countries. Where transparency rules and disclosure standards exist, they may not be enforced or fall short of international disclosure standards. Finally, host governments may not provide incentives, and in some cases clearly

disincentivise the disclosure of contracts. It is alleged that the government of an oil producing country threatened to cancel the production sharing agreement of a company that had started disclosing its annual production and payments data (McMillan, 2005).

Inadequate legislative, regulatory and governance framework of the licensing process

Corruption risks may arise from inadequate, ill-designed legislation and regulations that govern the different aspects of the contract under negotiation. Legislation granting discretion to select the mechanisms for the award of rights may be a source of risk. Similarly, the lack of expertise and capacity of local businesses that deviate a long way from industry or international standards presents some risks when national legislation requires companies to partner with local entities.

Governance arrangements overlooking the need for independent oversight and monitoring of the licensing process and parliamentary scrutiny may also introduce governance vulnerabilities that allow corruption to thrive.

Lack of host governments' technical, human and financial resources to manage contract negotiation

The insufficient technical, human and financial capacity of host governments managing negotiations is among the factors that render government's susceptible to corruption risks. For example, the lack of supporting technical and economic baseline documents may undermine the government's position. Weak administrative capacity may also result in unreasonable delays in licensing approvals that corruption may exacerbate or avoid.

Political interference and public-private collusion

Political interference and public-private collusion in the negotiation phase are also enabling factors for corruption, and typically rely on informal clientelistic networks between public officials, civil servants, traditional leaders and business elite (McMillan, 2005) at both local and central levels (McMillan, 2005). The so-called "revolving door" phenomenon may also foster collusion and political interference with individuals frequently switching between high-level positions in the public and private sectors.[9]

Opacity in the process of reallocating a licence or contract to a third party

Risks associated with acquiring a licence or contract by a third party include the lack of effective corporate anti-corruption compliance and due diligence to verify the conditions and circumstances under which the licence or contract was initially acquired. For government, risks may include the lack of clear guidance and procedures to address allegations of corruption on a licence initially acquired under opaque conditions before reallocating it to a third party.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Non-transparent and asymmetric negotiation and contracts	***What host governments can do*** ● Involve technical and legal experts from all relevant ministries and other relevant public bodies in the negotiation team (ECDPM, 2013). Publish the list of the negotiation team members, with full description of members' curriculum and profile.[10] ● Enable access to critical data including, for example, on geological potential, for all parties involved in the negotiation. ● Draw up and publicly disclose a list of criteria under which contract renegotiation is possible.[11] ● Develop standardised models or guidelines for licence and contract terms in order to minimise discretion in contract negotiation (Chêne, 2007; OECD, 2015). ● Require that contracts, annexes and licences detail the specific rights associated with the licence and ensure that the specific location of the assets covered by the licence are fully disclosed and open to scrutiny in publicly available registries, with any exceptions or limitations defined by law. Make this information available online in open electronic formats where capacity exists (EITI, 2015b). Where the contracts, annexes and licences affect a local community, make sure that they are translated into the local community's language, if it differs from the national language.
Inadequate legislative, regulatory and governance framework of the licensing process	***What host governments can do*** ● Clearly stipulate in law the rules and procedures governing the choice of the mechanisms for the award of extraction rights (direct negotiation or bidding process) as well as roles and responsibilities. ● Strengthen existing institutions and regulatory frameworks or consider establishing a separate, autonomous and effective body or regulatory institution that oversees the allocation, renegotiation and implementation of contracts (Chêne, 2007). ● Ensure appropriate mechanisms for parliamentary oversight are in place. These may include review of key contracts by parliament for final approval (ECDPM, 2013). ● Mandate independent audit and monitoring of contract implementation, which may involve assisting local communities in developing specific community-based monitoring tools.[12]
Lack of host governments' technical, human and financial resources to manage contract negotiation	***What host governments can do*** ● To the extent possible, favour automation of administrative services in order to reduce permitting and approval delays.
Political interference and public-private collusion	***What host governments can do*** ● Enact strict rules to prevent or limit the "revolving door" phenomenon between government and the private sector, for example by introducing a cooling-off period preventing former high-level officials taking employment with any company with which they have been negotiating deals during a certain period after they left office (OECD, 2004; OECD 2010).[13] ● Ensure that extractive projects carried out through joint ventures are subject to rigorous anti-corruption safeguards, including due diligence on business partners for the purpose of preventing conflicts of interest.[14]
Opacity in the process of reallocation of a license or contract to a third party	***What host governments can do*** ● When the awarding of a licence is allegedly tainted with corruption, define a process for re-awarding the licence in a transparent manner so as to ensure that the new licensee will not bear responsibility for wrongful acts committed by the former licensee. ***What companies can do*** ● Undertake comprehensive due diligence to understand the past history of extraction rights and assets at stake, including how these were first acquired and under what conditions they were transferred to other owners afterwards.[15]

Award of mineral, oil and gas rights through a bidding process

Corruption in the award of mineral, oil and gas rights through a bidding process may serve diverse objectives. First, it can be intended to secure favourable treatment in the bidding process by bypassing or rigging control and evaluation procedures or by disqualifying legitimate bidders. Second, it can be used to simply avoid a public bidding process or circumvent specific bidding requirements such as local content obligations. Third, companies' executives may bribe government officials in order to access confidential information on competitive bids and revise their own bids accordingly.

Corruption schemes

Different types of schemes can be observed to achieve these objectives. These include favouring in the bidding process companies in which public officials or their affiliates have

a stake through tender evaluation criteria or pre-qualification of bidders. There is also the potential to bribe for bid exclusion, with companies paying to have a competitor somehow disadvantaged in the competitive process. The performance of bidders in the bidding process can further be assessed against a range of local content criteria, including the score attributed for the implementation of government programmes aimed at benefitting disadvantaged groups.

Favouritism and political capture through tender evaluation criteria and pre-qualification of bidders

Bidding processes may be rigged by political capture, patronage and conflicts of interest. There are instances in which tender evaluation or the rules for contract award provide for eligibility thresholds or criteria rewarding the offer of local content. For example, the award of an oil licence through a bidding process may require the formation of consortia or joint ventures between the foreign company and a local firm (or a businessman) or a state-owned enterprise. The obligation to form a joint venture with a local partner may be diverted from its initial objective of local capacity development to favour companies owned by or connected to public officials and serving in politicians' interests. For example, Transparency International reports the case of an oil and gas producing country where a foreign company entered into a consortium with two local companies to bid for certain oil blocks. It turned out that the real owners of one of these local companies were the former chairman and CEO of the state-owned enterprise and a minister of state (Martini, 2014).

In some countries, indigenous companies are also pre-qualified to bid for shares in such licences, even though the beneficial owners remain undisclosed. In some instances, senior public officials turn out to be the ultimate beneficiaries of valuable shares in the project.

In another pending case involving a bidding process for the award of exploration rights in oil blocks managed by a state-owned enterprise, the formula used for the qualification of oil enterprises and the selection of the best offer was modified to favour one company in the bidding contest. The change in the weight of scores downplayed the importance of royalties, despite a scenario of rising oil prices. Moreover, the qualifications and capacity of the company with regard to high-risk investment in exploration had not been verified by the government and their evaluation was solely based on a sworn unilateral declaration by the company.[16]

Abuse of office in the bidding process

The bidding process may be rigged by corrupt practices resulting in the biased selection of one bidder over others. This can result from crafting the bidding terms so as to favour one particular company over its competitors. Another typical corruption scheme involves the disclosure of confidential information on competitive bids to allow the company to revise its own bid accordingly. Abuse of office by politicians or high-level officials or bribery payments may also serve to circumvent the bidding process. The literature reports the case of a country where companies owned by government ministries commonly bid for licences in consortia with foreign groups receiving a percentage of the total contract secured (World Bank, 2007). After the awarding and the signing of the contract, some of the contractual obligations (provision of services, hiring of local people) incumbent on the winning bidder may also be modified to his benefit. These changes may be due to dealings between public officials and the winning bidder prior to the bidding process, or even after the award. In either case, this violates the principle of equal treatment of the bidders.[17]

Corruption associated with bid rigging (collusive bidding or bid exclusion)

Collusive bidding occurs when conspiring bidders manipulate a competitive public bid in such a way that a preselected bidder wins the bid. Colluding companies submit defective bids in order to allow a preselected bidder to win the bid while giving the appearance of competition. Collusive bidders may also submit complementary bids from shell companies or affiliates to further give a semblance of competition (OCDE, 2009a; World Bank, 2007).

Unlawful bid exclusion prevents potential bidders from bidding through pressure and threats. Bribe payments may also be made to companies in exchange for withdrawal, or to government officials in exchange for disqualifying legitimate bidders or providing confidential information about competitive bids (FATF, 2012b).

Parties involved

The instigator of a corruption scheme during the bidding process can either be the private agent, the public or state-owned official exerting pressure and trading its influence over the decision-making process or an intermediary/third-party, agent/subsidiary facilitating the deal. In the case of collusive bidding, bid rigging takes place among conspiring bidders without the knowledge of the public officials who are in charge of overseeing the bidding process itself. Yet, in some instances, collusive bidding may involve corrupt public officials, in particular when the size of the project requires government backing to conceal the reduced cost of access to resource and to preserve a semblance of competition. The cartel or chosen company may also bribe public officials to overlook any instances of collusion.

In several cases, particularly in the oil and gas sector, the officials involved are executives of state-owned enterprises. Yet, they may also come from ministries and/or central or local government authorities that oversee the bidding process or have a say in the final approval of the bid. In some cases, the corruption scheme involves politicians at the highest level (president, minister, etc.) abusing their authority and accepting gifts or bribes. However, illegal payments may also be made to lower-ranking officials such as engineers responsible for the technical evaluations of bids. In the different bid-rigging schemes described above, the government officials involved may receive compensation in the form of cash payments, in-kind contributions or a share of the contract value over a certain period of time, and in return for awarding the contract.

On the private side, top executives from the private entity (CEOs, country managers, etc.) are typically involved in complex deals. More specifically, the company's entity involved or initiating the bribery is often the subsidiary operating in the country or a foreign subsidiary. Furthermore, there might be the risk for third companies that have previously acquired a licence or concession through an opaque processes of being held liable or subject to threats and pressure by corrupt officials to perpetuate the corruption scheme.

Vehicles and mechanisms

The use of third parties including intermediaries

The use of third parties to facilitate an improper deal is a common feature in the different cases documented above. An intermediary "can act as a conduit for legitimate economic activities, illegitimate bribery payments, or a combination of both" (OECD, 2009b). Third parties can refer to a diverse range of actors, including agents, consultants or consulting firms, providers of intellectual services, joint venture partners, subsidiaries, business partners such as lawyers and accountants (OECD, 2009b). The role played by the

intermediary in the corruption scheme, whether it is active or passive, may depend on the circumstances. It could either be as facilitator or the mastermind behind the corruptive behaviour. The decision to hire or operate through an intermediary may be made by public officials or the company itself. It can also be imposed by the jurisdiction requiring the employment of a local agent for any business transaction in the local market. In some cases, the intermediaries may even be designated by government officials. In this type of situation, it is possible that the intermediary is the mastermind of the criminal enterprise, operating without the company's knowledge (OECD, 2009b).

The improper use of intermediaries by the parties (the company or foreign officials) may have distinct objectives. They can be used to make payments, convey the offer or promise to bribe or influence the decision-making process. In this case, intermediaries will generally be local agents or business consultants more familiar with the local business environment and with close political ties, sometimes belonging to the circle of friends or family members of the corrupted public officials purportedly hired to provide consultancy and advisory services to the company. Instead, they use their personal relationship with government officials to influence the decision-making process, and to obtain favourable treatment or confidential information about the bidding process. They may not provide any identifiable or economically justifiable services or, alternatively, perform a combination of legitimate and illegitimate services (OECD, 2009b). In the former case, the consultant charges the company using false invoices for sham services; forwards the funds to the official and receives a fee or retains a certain percentage of the funds transferred. When intermediaries trade their influence in return for an undue advantage from the company, the public official may not receive any advantage personally and be unaware of the corrupt deal (OECD, 2008b). In all these instances, false invoicing and fake documentation are often used to provide a seemingly legitimate cover for the payments such as the provision of legal, administrative or consulting services. This allows the company to disguise such payments on their books or records as loans, consultancy fees, and payments for legal services. Such payments are referred to as broad categories of expenditures using general, vague and non-descriptive language such as "supporting the company's business in country X", "conducting (market) research", or "establishing necessary contacts" (OECD, 2009b).

Third parties, including intermediaries, can also be used to conceal such payments and distance oneself from the crime. In some cases, the bribe is conveyed to a third party beneficiary, such as a spouse or other family member, business party, political party, charity or company in which the public official has an interest.

A number of alternative or complementary techniques may be used to further increase opacity of corrupt relationships. Though intermediaries are commonly locally based in the country, the parties involved may sometimes rely on a third-country agent to make improper payments more difficult to track. The corruption scheme may also involve multiple layers of transactions between related companies in order to add complexity and increase the difficulty of gathering evidence.

Joint ventures

Joint ventures may add another layer of complexity and opacity in the chain of payments: i) by making each partner dependent on the level of integrity of the other joint venture partner(s), in particular of the leading partner dealing with the host government and/or operating the joint venture, ii) by using themselves as intermediaries. This may render transactions more vulnerable to corruption risks if proper due diligence is not

carried out across the chain. In the latter case, improper payments are typically made by the joint venture through the intermediary and generally disguised as commissions.

Joint ventures constitute particularly effective instruments for concealing bribery payments, particularly in the case of a joint venture with a state-owned enterprise or a local partner, which provides a safe space for potentially less transparent interactions between the company and government officials.

Misuse of corporate vehicles

This type of structure provides an efficient and flexible instrument to conceal the proceeds of corruption by introducing greater opacity and making the identification of the beneficial owner difficult.[18] They can be easily created and dissolved in most jurisdictions, and may form part of a multi-layered chain of inter-jurisdictional structures whereby an entity in one jurisdiction will be controlled and owned by a trust or corporate vehicle in another jurisdiction. This has the effect of blurring the lines of ownership, and makes it challenging to go up the chain and identify the ultimate beneficial owner. This type of multi-layered scheme can help ensure that beneficial owners are located in a jurisdiction that does not require public disclosure of information about beneficial ownership (OECD, 2009b). Corporate vehicles may be used in combination with additional mechanisms in order to further obscure beneficial ownership. Examples of such mechanisms include exercising control through contract instead of standard ownership and control positions (World Bank, 2011). And finally, the beneficial owner may also be disassociated with formal control through the use of surrogates (the name in which the corporate vehicle will be registered) such as specialised intermediaries, professionals, or nominees hired to hold *in name only* a position or assets on behalf of the beneficial owner; or "front men" with rather informal connections to the beneficial owner and usually selected in the close circle of friends, relatives and family members (OECD, 2014b).

Bearer shares can constitute another mechanism by which transparency on the ultimate beneficiary is further obstructed.[19] Bearer shares are company shares that exist in certificate form, and whoever is in physical possession of the bearer shares is deemed to be their owner. Transfer requires only the delivery of the instrument from person to person (in some cases, combined with endorsement on the back of the instrument). Unlike "registered" shares (for which ownership is determined by entry in a register), bearer shares typically give the person in possession of the certificate (the bearer) voting rights or rights to dividend. For these reasons, this type of instrument facilitates anonymous transfers of control and can be used for money laundering purposes (World Bank, 2011).

Corporate vehicles to conceal bribe payments. Corporate vehicles can be used to conceal bribery payments in contract negotiation. The Trace Compendium database features a particularly complex bribery case involving the acquisition of shares in a company located abroad with no apparent connection with the case. The entity appeared to be owned by an official from a country in which the investor had interests and operations. Investments in the official's company abroad served to induce the latter to use his influence with the government to assist the investor in getting favourable terms in a contract negotiation. This particularly complex scheme aimed at fostering transactional decoupling between the giver and the receiver and making illegal payments more difficult to track.

Fronting to comply with local content requirements in the bidding process. There have been some instances in the oil industry where foreign companies allegedly paid illegal fees to contract with front companies with opaque ownership and shareholding structures in order to comply with host-country laws. For example, joint ventures may be created for fronting purposes to respond to bidding requirements (Martini, 2014).

Corporate vehicles to conceal the proceeds of corruption. On the receiving side, government officials may resort to complex and opaque money laundering schemes in order to conceal the proceeds of corruption, especially when these are high. The mechanisms usually consist of creating or using a whole web of corporate vehicles (i.e. shell companies,[20] trusts, foundations, etc.) in order to conceal the official's involvement in corruption, create a disconnect between the official and his illegally acquired assets and provide the appearance of legitimacy for illicit activities (OECD, 2014b).

Rubber stamping approval of compliance with local content requirements in the bidding process

The Trace Compendium database reports a case where illegal fees were paid in exchange for a rubber-stamp approval by government authorities in respect of the company's compliance with local content requirements so as to be granted the mining licence.

Barter contracts

Barter contracts, where investments in infrastructure are made in exchange for granting rights, present risks of corruption. Corruptive behaviours are more difficult to demonstrate in these cases due to the difficulty of balancing the value of rights awarded with the value of the investment. The level of risk is also associated with the modalities through which the investment is carried out, whether through financing or through the development of infrastructure, which in the latter case involves proper selection, qualification and monitoring of suppliers.

Corruption risk factors

Opacity and discretion in bidding processes

Opacity and discretion in bidding processes with regard to evaluation criteria, roles and responsibilities of key actors may account for increased corruption risks in this phase of the value chain. In many cases, information related to the bidding process is not made publicly available (e.g. number of bids received, requirements, winning bids, etc.) (OECD, 2012). Moreover, blurred divisions of responsibility and conflicts of interest sometimes lead a single government agency to play the dual role of administrator and regulator of the sector (Global Witness, 2012), which tends to increase the vulnerability of the bidding process to corruption. Additional vulnerabilities may stem from the administrative, human resource and financial aspects of the process including excessively complex and bureaucratic tender procedures, insufficient turnover of personnel in charge of managing tender procedures, or inadequate level of transparency and accounting for payments in public financial records.

In some instances, it may even be that the legislation is vague on the choice of the process for the allocation of extraction rights. For instance, as reported by a participant in the Working Group on Corruption Risks, the country law establishes that hydrocarbon blocks can be awarded either through a bidding process or by direct negotiation. Yet,

subsequent regulations do not provide any specific criteria to make a choice leaving a wide margin of discretion to decide which option to apply for each block.[21]

Absence of an open and competitive bidding process

In other cases, opacity and discretion may come from the mere absence of an open and competitive bidding process in the allocation of the contract. This may be observed in the context of a contract renewal or extension. Barter contracts are particularly subject to such risks. Opacities surrounding the terms of this type of contract (e.g. mechanisms of financing and reimbursements down to the project level, pledged resources and the value of payments, investments and infrastructure projects, etc.) increase exposure to corrupt behaviours (EITI, 2015a).

Opaque and complex financial and commercial arrangements

Opaque and complex financial and commercial arrangements involving multi-layered schemes of offshore companies, joint ventures, public-private partnerships or partnerships with local companies enable corruption to thrive. Such complexity and opacity may help conceal, for example, the abuse or circumvention of bidding requirements in favour of politically affiliated local entities or select front companies with no technical and financial capacity. This is facilitated in particular by the lack of comprehensive and harmonised legislation in host, home and third party countries on the disclosure of beneficial ownership information, which would enable governments to identify the beneficial owners of bidding entities, corporate vehicles, local partners, joint venture partners, etc. When information on beneficial ownership is disclosed, the lack of proactive data management by government authorities hosting companies' registry systems contributes to further eroding governments' capacity to detect and prevent risks of corruption and money laundering (World Bank, 2011).

Nature of the market

The intrinsic nature of the market characterised by high entry costs and limited competition may also increase the chances of collusive bidding and other forms of corruption.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Opacity and discretion in bidding processes	***What host governments can do*** ● Make information related to all stages of bidding processes publicly available to all stakeholders. Such information may include timelines for submitting bids, selection and evaluation criteria, contract award decisions as well as other critical information such as geological potential, cost recovery, length of operations (OECD, 2014a). ● Appoint independent bodies responsible for the technical design of the bid and the oversight of the bidding process (ICAC, 2013). ● Ensure effective management of possible conflicts of interest and clear segregation of roles (design, evaluation and selection of the bid). ● Where possible, put in place an online submission process to increase transparency and limit interaction between public officials in charge of the bidding process and bidders. ● Debrief bidders on how the award decision was made. ● Establish dispute mechanisms to enable losing bidders to challenge the results in case of discontent. ● Mandate that awarded contracts and licences are fully disclosed in publicly available registries and open to scrutiny.
Absence of an open and competitive bidding process	***What host governments can do*** ● Provide for an open and competitive bidding for the allocation of extraction rights, particularly for barter contracts and contract renewals or extension.

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Opaque and complex financial and commercial arrangements	***What host governments can do*** ● Conduct technical and financial analyses of companies enjoying preferential treatment to determine if they have the technical expertise and financial capacity to undertake the required activities (ICAC, 2013). ● Ensure that extractive projects carried out through joint ventures with private firms, are subject to rigorous anti-corruption safeguards, including due diligence on business partners for the purpose of preventing conflicts of interest.[22] ● Require bidders to disclose information and documentation on the natural persons who are the beneficial owners of the company applying for the licence as part of the tendering process; and declare any real or potential conflicts of interest.[23] ***What companies can do*** ● Conduct due diligence on public or local private partners in joint ventures, public-private partnerships, or partnerships with local businesses for the purpose of determining if they have the technical and financial capacity and to prevent conflicts of interest.[24]

Notes

1. Global Witness (2012), "Rigged? The Scramble for Africa's Oil, Gas and Minerals", London, January, *www.cabinda.net/RIGGED%20The%20Scramble%20for%20Africa's%20oil,%20gas%20and%20minerals%20.pdf*: "For example, licenses to explore for oil and gas (which can then be converted into production rights) are often awarded on the basis of auctions. In mining countries, by contrast, a "first-come-first-served" system is more usual. Mining exploration often takes place across vast areas where the chance of finding commercially exploitable mineral deposits may be quite small. For this reason, it may be difficult to attract enough bidders at one time to offer exploration rights by auction. But where a commercial-sized mineral deposit is already known to exist, bidding is appropriate."
2. Comments received from participants in the Working Group on Corruption Risks during the consultations between January and May 2015.
3. See note 2.
4. See note 2.
5. OECD (2012), *International Drivers of Corruption: A Tool for Analysis*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264167513-en*: pp. 46 "There is evidence of large-scale corruption in the oil sector in the 1980s and 1990s, mainly centred on manipulation of the process of awarding concessions. [The case in point] revealed a well-established system of corrupt payments to [host countries'] leaders in exchange for securing oil concessions that was linked to […] broader foreign policy interests [of the company's home country]".
6. World Bank (2007), *The Many Faces of Corruption - Tracking Vulnerabilities at the Sector Level*, edited by J.E. Campos and S. Pradhan, The International Bank for Reconstruction and Development/The World Bank, Washington DC. : pp. 199 "Consuming-country governments are rarely blameless either. As suggested earlier, driven by supply security concerns, or simply out of an interest in promoting the commercial success of their companies abroad, they may use simple bribes or their leverage – economic, political, or military – in the form of either carrots or sticks to influence outcomes in producing countries in their favour. […] Bribes [can be] more broadly interpreted to include not just money but promises of economic assistance and political or military support […]."
7. See note 2.
8. See note 2.
9. Comments received from participants in the Working Group on Corruption Risks during the consultations between September and November 2015.
10. See note 2.
11. See note 10.
12. *www.ucmc.ug/*.
13. See note 10.
14. Factors to be taken into account include whether the partner is a legitimate entity, is qualified and has the necessary resources to fulfil its part of the contract, whether it has an effective anti-bribery

management system, whether it has been investigated, prosecuted or convicted of fraud or bribery, and whether it has direct or indirect links to an authority involved in the decision to award the contract.

15. See note 10.

16. See note 2.

17. See the Business Anti-Corruption Portal country profiles available at *www.business-anti-corruption.com/country-profiles*.

18. According to the Financial Action Task Force (FATF), the beneficial owner is defined as "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." See FATF (2012), "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendation", Financial Action Task Force FATF-OECD, Paris, February 2012. *www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf*. Similarly, the OECD defines beneficial ownership as "the ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder." See OECD (2001), Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes, OECD Publishing, *http://dx.doi.org/10.1787/9789264195608-en*.

19. See note 2.

20. A "shell company" is a non-operational company, i.e. a legal entity that has no independent operations, significant assets, ongoing business activities or employees.

21. See note 2.

22. See note 2. Factors to be taken into account include whether the partner is a legitimate entity, is qualified and has the necessary resources to fulfil its part of the contract, whether it has an effective anti-bribery management system, whether it has been investigated, prosecuted or convicted of fraud or bribery, and whether it has direct or indirect links to an authority involved in the decision to award the contract.

23. See note 10. See also *https://eiti.org/pilot-project-beneficial-ownership*.

24. See note 2. Factors to be taken into account include whether the partner is a legitimate entity, is qualified and has the necessary resources to fulfil its part of the contract, whether it has an effective anti-bribery management system, whether it has been investigated, prosecuted or convicted of fraud or bribery, and whether it has direct or indirect links to an authority involved in the decision to award the contract.

References

Al-Kasim, F., T. Søreide and A. Williams (2008), "Grand corruption in the regulation of oil", *U4 Issue* 2:2008, U4Anti-Corruption Resource Centre, *www.cmi.no/publications/file/3034-grand-corruption-in-the-regulation-of-oil.pdf*.

AUC/ECA (2015), "Illicit Financial Flows - Report of the High Level Panel on Illicit Financial Flows from Africa", commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development, *www.uneca.org/sites/default/files/publications/iff_main_report_english.pdf*.

Chêne, M. (2007), "Corruption and the renegotiation of mining contracts", *U4 Expert Answer*, U4 Anti-Corruption Resource Centre, 30 November.

ECDPM (2013), "Negotiation of Fair Contracts: For a Sustainable Development of Extractive Industries in Africa", *GREAT Insights*, Volume 2, Issue 2, February-March.

EITI (2015a), "Chinese companies reporting in EITI countries – Review of the engagement of Chinese firms in countries implementing the EITI", *Brief*, March, *https://eiti.org/files/Chinese-companies-reporting-in-EITI-implementing-countries.pdf*.

EITI (2015b), *EITI Progress Report 2015 – Making Transparency Matter*, Section "Opening up extractive industry data", *http://progrep.eiti.org/#!/2015/looking-ahead/open-data*.

FATF (2012a), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, updated October 2015, FATF, Paris, France, *www.fatf-gafi.org/recommendations.html*.

FATF (2012b), "Specific Risk Factors in Laundering the Proceeds of Corruption - Assistance to Reporting Institutions", Financial Action Task Force FATF-OECD, Paris, June.

Global Witness (2012), "Rigged? The Scramble for Africa's Oil, Gas and Minerals", London, January, *www.cabinda.net/RIGGED%20The%20Scramble%20for%20Africa's%20oil,%20gas%20and%20minerals%20.pdf*.

Global Witness (2009), "A country for sale – How Cambodia's elite has captured the country's extractive industries", February, *www.globalwitness.org/sites/default/files/library/country_for_sale_low_res_english.pdf*.

ICAC (2013), "Reducing the Opportunities and Incentives for Corruption in the State's Management of Coal Resources", Independent Commission against Corruption, New South Wales, October.

Martini, M. (2014), "Local content policies and corruption in the oil and gas industry," *U4 Expert Answer* 2014:15, September.

McMillan, J. (2005), "The Main Institution in the Country Is Corruption: Creating Transparency in Angola", *CDDRL Working Papers* Number 36, Center on Democracy, Development, and The Rule of Law Stanford Institute on International Studies, 7 February, *www.cabinda.net/Corruption_transparency_Angola1_No36.pdf*.

Niekerk, P. and L. Peterson (2002), "Greasing the skids of corruption", Center for Public Integrity, November, *www.publicintegrity.org/2002/11/04/5684/greasing-skids-corruption*.

OECD (2015), "Summary Report of the Fourth Meeting of the Policy Dialogue on Natural Resource-based Development", 29-30 June 2015, OECD, Paris, *www.oecd.org/dev/EN_SummaryReport_FourthMeetingofthePolicyDialogueonNaturalResource.pdf*.

OECD (2014a), "Compendium of Good Practices for Integrity in Public Procurement", document prepared by the Public Governance and Territorial Development Directorate for the Meeting of the Leading Practitioners in Procurement, 17-18 June 2014, at OECD Headquarters, Paris.

OECD (2014b), *Illicit Financial Flows from Developing Countries: Measuring OECD Responses*, OECD Publishing, *http://dx.doi.org/10.1787/9789264203501-en*.

OECD (2012), *International Drivers of Corruption: A Tool for Analysis*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264167513-en*.

OECD (2010), Post-Public Employment: Good Practices for Preventing Conflicts of Interest, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264056701-en*.

OECD (2009a), "Guidelines for Fighting Bid Rigging in Public Procurement - Helping governments to obtain best value for money", *www.oecd.org/daf/competition/cartels/42851044.pdf*.

OECD (2009b), "Typologies on the Role of Intermediaries in International Business Transactions", OECD Publishing, 9 October, *www.oecd.org/daf/anti-bribery/43879503.pdf*.

OECD (2008a), *Corruption: A Glossary of International Standards in Criminal Law*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264027411-en*.

OECD (2008b), *The Istanbul Anti-Corruption Action Plan: Progress and Challenges, Fighting Corruption in Eastern Europe and Central Asia*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264055094-en*.

OECD (2004), *Managing Conflicts of Interest in the Public Service: OECD Guidelines and Country Experiences*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264104938-en*.

OECD (2001), *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, OECD Publishing, *http://dx.doi.org/10.1787/9789264195608-en*.

Transparency International (2012), *Annual State of Corruption Report 2012 – A look at the mining sector in Zimbabwe – Gold, Diamonds and Platinum*, Transparency International Zimbabwe, Harare.

World Bank (2011), "The Puppet Masters – How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It", Stolen Asset Recovery Initiative, The World Bank and United Nations Office on Drugs and Crime, Washington, DC.

World Bank (2007), *The Many Faces of Corruption – Tracking Vulnerabilities at the Sector Level*, edited by J.E. Campos and S. Pradhan, The International Bank for Reconstruction and Development /The World Bank, Washington, DC, *https://openknowledge.worldbank.org/handle/10986/6848*.

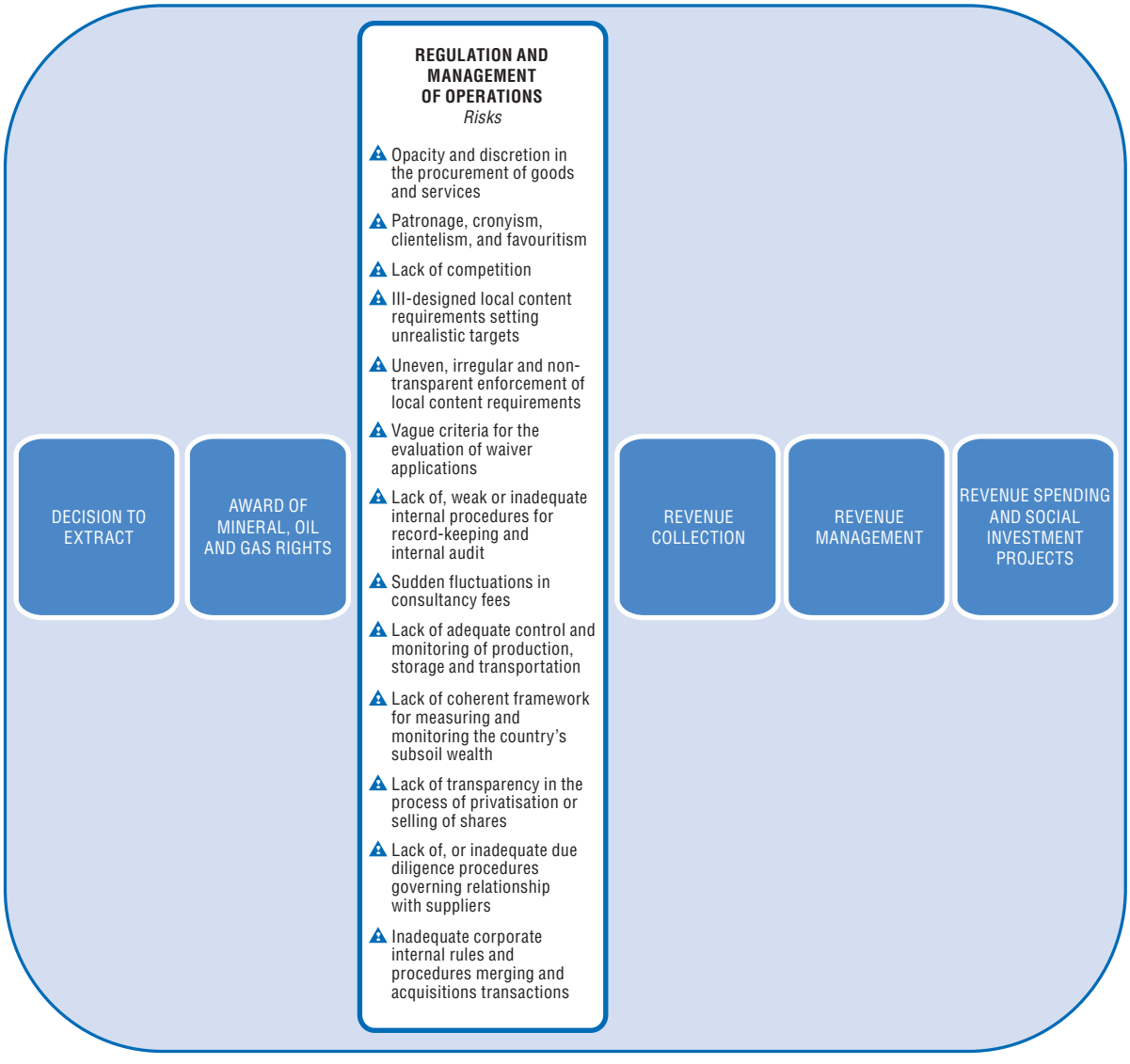
© OECD 2016

Chapter 4

Corruption risks in the regulation and management of operations

This chapter identifies corruption risks in the regulation and management of operations. It is divided into four main categories: i) corruption in the procurement of goods and services; ii) regulatory capture or violation; iii) corruption in the conduct of daily operations, and iv) corruption in the acquisition or selling of shares or concessions. It further elaborates on mitigation measures that home and host governments and companies can take to address those risks.

Figure 4.1. **Corruption risks in the regulation and management of operations**



Corruption in the procurement of goods and services

The procurement of goods and services in the extractive sector refers to the acquisition of goods, equipment and services from local or foreign suppliers by the main contractor. The main contractor is understood as any entity (either private or a state-owned) with whom extractive companies enter into a contractual relationship (e.g. for engineering, procurement and construction, and maintenance service contracts). Goods and services may be acquired through a bidding process or direct negotiation with suppliers.

Procurement processes are regarded as one of the highest areas of risk in the operational management of extractive projects, and in the development phase in particular.

Corruption schemes

Corruption schemes may include bid rigging practices, undue favouritism in the choice of suppliers, cronyism and bribery associated with the misuse of local content requirements, bribery associated with mispricing practices in the procurement of infrastructure services, and bribery associated with the provision of intellectual services.

Bid rigging

Bid rigging (OECD, 2009) (or collusive bidding) occurs when "businesses, that would otherwise be expected to compete, secretly conspire to raise prices or lower the quality of goods or services acquired through a bidding process". Bid rigging schemes in procurement processes include cases in which co-operating companies agree not to compete or to submit deliberately inflated or defective bids to ensure the selection of the designated winner. In exchange, the winner might pay to the losing bidders a share of the premium of the contract obtained as a result of the collusion, hire them as subcontractors, or allow them to win in following bids or other high priced contracts. The last case is referred to as bid rotation schemes.

Inflated bids resulting from these collusive behaviours generate a windfall with which to bribe cooperating companies or public officials. Bribery payments are often disguised as commissions or mark-up on sales.

Other bid rigging schemes include "lowballing" practices that consist of a collusive arrangement between a bidder and the public official responsible for awarding the contract. In a lowballing scheme, the bidder agrees with the public official to submit the lowest bid with the understanding that once the contract is awarded, the price will increase (World Bank, 2007). The modifications and amendments can also be agreed following the award of the contract. Such was the case in the example of a contract for the distribution of natural gas, which stipulated the specific number of domestic users to benefit from the service, a provision that was modified two years after the signing of the contract, without any explanation.[1]

Undue favouritism of suppliers

Direct negotiation with suppliers for the procurement of equipment, goods and services may be prone to corruption (for example, bribery, conflicts of interest and favouritism) when the company favours one supplier against competitors on non-market grounds; or for reasons other than longstanding connections due to trust; or as a result of political capture when the company is being urged to select local suppliers with close political ties and affiliations.[2] Companies may also be exposed to those risks in contract renegotiation or extension.

Favouritism, cronyism, kickbacks and bribery associated with the misuse of local content requirements

Local content requirements may be misused when contracts to supply extractive industries are awarded to shell or front companies, resulting in cost inflation and delays in project execution. In such cases, there is only a semblance of compliance with local content requirements since typically the front company does not have the capacity to actually implement the contract and will most likely further subcontract to a competent

foreign operational entity. Alternatively, local content requirements may be used to favour local companies with political ties and connections and/or to channel and disguise kickback schemes involving the prime contractor and public officials. Companies may be "advised" that awards to certain local firms, connected with public officials, could have a favourable impact on their business (World Bank, 2007). There can also be a risk that local companies bribe or offer kickbacks to public officials to be included in the list of pre-qualified suppliers (Martini, 2014).

Bribery associated with mispricing practices in the procurement of infrastructure services

Foreign companies may be exposed to specific corruption risks in the context of the procurement of infrastructure services. Transportation infrastructure for extractives, including pipelines, storage or transfer terminals, and port jetties is often characterised by natural, absolute or quasi-monopolies. Empirical evidence based on concrete experience, shared by participants in the Working Group on Corruption Risks, show that corruption may occur when granting or controlling access to infrastructure services. At the initial stage, a company may be prompted to make payments to public officials when negotiating and entering into an agreement with government. The lack of competition also favours opacity and discretion in defining the terms and conditions of access, including the appropriate level of fees and charges to be applied which may be inflated for bribery purposes. At a later stage, the company may be further solicited for bribery payments by public administrators in charge of controlling access to infrastructure (World Bank, 2007).

Patronage and clientelism in the procurement of intellectual services

Extractive companies may be exposed to risks of patronage and clientelism in the procurement of intellectual services when they are urged to hire local consultants based on political affiliations rather than on commercial grounds (price, skills and competencies).[3]

Parties involved

With regard to bid rigging schemes and the misuse of local content requirements, the principal parties to corruption in procurement processes are usually the main contractor and the subcontractors. In many reported corruption cases, the main contractor is a state-owned enterprise, particularly in the oil and gas sector. When the main contractor is a foreign private company, the company's entity involved in the corruption scheme will most often be the subsidiary operating in the country. Even in cases where no public institution is involved in the tendering process (e.g. between the main private operator and suppliers), the ultimate award of the contract might rely upon favourable recommendations by public officials such as executives of state-owned enterprises, resulting in awards to firms with limited demonstrated capacity.

Subcontractors may be either local suppliers with strong connections and an affiliation with public officials from government or a state-owned enterprise. When the main contractor is a foreign private company, it may also be that the goods or service providers are affiliated with the company or from the company's home country.

High-level public officials and politicians may also be involved. In a large-scale corruption scandal in the procurement of services in the oil and gas sector, the press reports the involvement of politicians and officials at the highest level (ministers, state governors, members of parliament, top executives from the state-owned enterprise) through kickback schemes. It is alleged that in exchange for granting the contracts, top executives of the state-

owned enterprise would take bribes from local contractors and service providers and funnel the funds to politicians and members of the ruling coalition in order to finance political campaigns and secure congressional votes. Apart from the allegation of bribery payments to the state-owned enterprises, the contractors are accused of forming a cartel to drive up contract prices.

In the case of infrastructure procurement, parties to corruption may be the public officials in charge of negotiating the terms and conditions of the infrastructure service agreement or those in charge of administering and controlling access to the infrastructure. Moreover, high-level influential officials not directly linked to the procurement process may also be involved in this type of corruption scheme.

Vehicles and mechanisms

Shell and front companies

Special-purpose vehicles, such as shell or front companies, may be used to circumvent local content requirements, particularly in countries where local content rules do not clearly define what "local" or "indigenous" actually means. These companies may be hired or purposefully created by foreign companies to participate in the bidding process though these local partners might not have the capacity to deliver on the awarded contract.

Shell and front companies may be further used to disguise kickback schemes between the primary contractor and public or state-owned enterprise officials. As already described in the previous chapter, these types of vehicles may prove particularly efficient to conceal and launder the proceeds of corruption due to the opacity typically surrounding beneficial ownership (World Bank, 2007).

List of local suppliers

National laws and regulations may require principal contractors to select suppliers from a list pre-established by the government. This may expose the contractor to risks of corruption if the criteria required to qualify for the government-sponsored suppliers' register are lower than the company's standards on anti-corruption and due diligence.[4]

Corruption risks

Opacity and discretion in the procurement of goods and services

Insufficient clarity and transparency of procurement rules may leave room for the abuse of power in decision making. For example, inadequate, vague or deliberately exclusive pre-qualification criteria may grant excessive discretion to evaluators in bid evaluation systems, particularly for non-price evaluation criteria (e.g. evaluation systems based on the conversion of evaluation criteria into notional points).[5]

Similarly, corruption may be facilitated when the legislation does not clearly specify the roles and responsibilities of the different actors, or when it does not spell out information disclosure requirements on private stakes and conflicts of interest for public or state-owned enterprise officials involved in the sector.[6] Potential conflicts of interest for state-owned companies may arise in state owned companies where the distinction between the roles of administrator and regulator of the sector are not clearly established. It is reported for example that in an oil-producing country, subsidiaries of the national oil company participate in bidding processes that the state company is responsible for overseeing (Global Witness, 2012).

Another corruption risk arises in the lack of independent monitoring and oversight of bidding processes, particularly where there are decentralised responsibilities. Limited reporting by state companies and government agencies to the legislature may also contribute to further weakening the integrity of procurement processes.

In some cases, the lack of open, publicly advertised and competitive bidding, the limited participation of international bidders or the excessively bureaucratic nature of the bidding process may limit competition, deter potential bidders from competing, and lead to the suboptimal allocation of contracts to firms with limited demonstrated capacity.

More specifically, risk factors associated with the procurement of infrastructure include the lack of transparency of rules governing access to infrastructure (e.g. non-official and non-public tariffs) as well as of administration of access.

Lack of or inadequate due diligence procedures governing the relationship with suppliers

For the private sector, opportunities for corruption may arise from inadequate segregation of roles and duties within the qualification process, including in the assignment of the contract, monitoring of its performance inadequate rules for the selection of the contractors (e.g. no separate treatment in bids of the technical offer and the economic offer); and insufficient auditing and monitoring of the suppliers' contract performance may exacerbate the risks.[7]

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Opacity and discretion in the procurement of goods and services	***What host governments can do*** ● When local content targets are in place, assess whether they reflect the sector's needs and available local capabilities. ● Adopt, clear, specific, objective criteria for the identification or pre-qualification of local suppliers and the granting of any waivers in order to limit public officials' discretion. ● Make all information related to existing local content requirements and pre-qualification criteria publicly available and easily accessible. ● Carefully define commercial and non-commercial roles of state-owned enterprises and establish appropriate governance mechanisms in order to ensure clear segregation of roles, avoid conflicts of interest and guarantee fair competition in procurement processes (Heller, Mahdavi and Schreuder, 2014). ● Establish transparent public rules and tariffs for infrastructure access (World Bank, 2007). ● Publicly disclose infrastructure deals. ***What extractive companies/main contractors can do*** ● In cases of monopolistic or quasi-monopolistic markets such as for the infrastructure services, require transparency from the government with respect to the calculation of fees and charges, and through international benchmarking or the use of international parameters and quotations.[8]
Lack of or inadequate due diligence procedures governing the relationship with suppliers	***What extractive companies/main contractors can do*** ● Conduct due diligence on local suppliers by establishing detailed supplier registration systems and questionnaires in order to gather information (for example, on the business structure, ownership, political connections to government officials and organisations closely linked with the government and other basic information) that can reveal corruption risks.[9] ● Where companies are obliged to procure goods and services from pre-qualified suppliers, undertake due diligence in line with the company's internal management systems and in accordance with available best practice guidance before the opening the offer.[10] When pre-qualified suppliers present anomalies, devise a mechanism to alert competent authorities in order for them to take corrective measures or remove the supplier from the list. If no action is taken, consider suspending or discontinuing the relationship with suppliers. ● Assess, in collaboration with relevant government authorities, chambers of commerce, other business organisations, development agencies and other relevant institutions, the capabilities of domestic businesses to supply particular goods and services.[11] ● Implement procurement, commercial and other non-financial controls (e.g. competitive tendering, two signatures on work approvals and strict rules on variations).[12]

Regulatory capture and violation

This section covers corruption risks related to the regulation of extraction operations. It looks in particular at cases where the purpose of the corrupt conduct is to facilitate regulatory capture and violation. Regulatory capture occurs when a regulatory agency, created to act in the public interest, furthers the interests of groups that dominate the industry or sector it is charged with regulating. Corrupt conduct may be intended to influence regulatory design or enforcement. Corruption associated with regulatory violation is a form of corruption intended to break or disregard existing legislation and regulations.

Corruption schemes

Corruption associated with enforcement of local content requirements

Selection of local joint venture partner. Some countries require that international companies set up a joint venture with local partners for the performance of a licence or permit. In such case the absence of clear rules for the identification of the local company or the discretion left to the government to identify such local partners presents some risk. For instance, when the ultimate beneficiary is a public official or, even worse, when such public official is at the same time the representative of the government involved in the transaction.

Hiring of local staff. Local employment regulations may be subject to nepotism and cronyism, in particular in the context of tight labour markets where good and well-paid employment opportunities are low. The literature highlights instances where local content policies have been abused and positions filled on the basis of family ties, party affiliation or ethnicity rather than qualifications (Oxford Policy Management, 2012).

Regulatory capture and discretion in the enforcement of local content obligations. The discretion often enjoyed by public officials responsible for implementing local content policies, combined with lack of transparency, opens the door for uneven implementation and enforcement of local content rules.

In some instances, international oil companies have complained that local content implementation is "uneven, irregular and non-transparent, particularly at local levels of government" (Martini, 2014). Participants in the working group indicated that impractical or unrealistic requirements provide perverse incentives for companies to obtain waivers under applicable legal regimes or to negotiate tax breaks or subsidies as compensation for compliance with local content regulations.

Finally, public officials' discretion in the evaluation of waiver applications may provide incentives for corruption. For example, the legislation in one country grants power to the minister to decide to waive local content obligations for a given company or project. Such practice can be highly vulnerable to corruption if the criteria for evaluating waiver applications are not made public, or are not applied in an objective or transparent manner (Martini, 2014).

Corruption related to the violation of customs clearance rules

Corruption related to the violation of customs clearance rules may serve the following purposes: accelerating the customs clearance process, skipping inspection or influencing the inspection's findings, ignoring errors in documentation and non-compliance with customs regulations, reducing customs duties or resolving a customs dispute. Kickbacks for customs

officials may also be designed to circumvent export or import bans or restrictions, or absolve non-compliance with specific product transformation requirements before export.

Thirteen cases in the Trace database refer to corruption related to violation of customs procedures. In three of the cases, improper payments were made to customs authorities to allow shipments to pass through customs in spite of small paperwork errors, to avoid causing significant delays in the importation of necessary supplies by the companies. In one case a company bribed a customs official to block the employees of a competitor company from entering the country. Payments were then made to facilitate the company's own employees to enter the country and obtain work visas. In the other cases, bribery payments were made in exchange for favourable resolution of a customs dispute, avoidance or reduction of customs duties and penalties, circumvention of customs regulations with regard to special import permits or permit extensions (e.g. for temporary import permits).

Corruption related to the violation of labour and immigration rules

Similarly, corruption related to the violation of labour and immigration rules may be intended to accelerate immigration visa and work permit processing and approval or to settle disputes. The Trace database reports three cases in which improper payments were made to immigration officials to facilitate immigration visa and work permit issuance. In two cases at least, the bribery resulted in abuse of discretionary power, attempted extortion and embezzlement by immigration officials.

In one particular case, a settlement agreement was signed between a company and the country's tax authorities. The company paid fees and penalties for violation of labour and immigration rules, subsequently embezzled by public officials.

Another case involved insider trading practices as the immigration official started investigating the company's competitors, purportedly on his own initiative, providing the company with confidential information and making it difficult for the competitors to gain entry.

Corruption related to the violation of environmental regulations

Corruption related to the violation of environmental regulations may be intended to bypass existing legislation, to accelerate administrative procedures to get the necessary operational permits (e.g. environmental assessment, etc.) or to avoid penalties or secure the favourable resolution of disputes. It may take the form of bribery, trading in influence by the company or extortion by public officials.[13]

The literature cites an ongoing case of opposing indigenous communities and a foreign oil company accused of polluting local waterways severely affecting the indigenous peoples living in the region. Trading in influence by the company and the suspected bribery of a judge from the host country in exchange for false testimony were reported.

Another case points to extortion practices exerted on a company by public officials from the ministry of energy in relation to authorising the implementation of a power plant. The refusal of the company to pay bribes has led to attempts by public officials to sabotage the project, as reported in the complaint filed by the company.[14] In another country, public officials allegedly imposed arbitrary fines on companies in order to generate additional revenue regardless of whether environmental regulations were breached or not.[15]

Finally, corruption may occur during the assessment of environmental liabilities arising in operations at a given site. The high level of discretion exercised by public officials

in charge of identifying these environmental liabilities will determine the costs of the investment or operation. In particular, collusion with representatives from the operating companies may prompt those public officials to underestimate environmental liabilities and costs associated with the operations.[16]

Corruption related to the granting of administrative authorisations to operate

Given the complexity of extractive projects, there are several instances in which companies must obtain authorisations to perform their operations. In addition to work permits and customs clearance, health and environmental permits, security, quality control and assurance of operations (plants, storage, drilling), and local community development are also needed, and corruption (bribery, trading in influence and extortion) may be intended to speed up or circumvent procedures for the issuance of the necessary authorisations.[17]

Further gate-keeping and corruption may arise in the exercise of periodic controls to confirm the validity of the authorisation granted. These controls can be performed directly by a public official or through authorised third parties (specialised companies/consultants). Corruption may serve to keep inspectors from reporting violations and to avoid penalties or receive favourable treatment in dispute resolution. In some jurisdictions, mining companies may face difficulties in ensuring inspections of their sites and facilities by public officials, and as mandated by law, without providing significant benefits in the form of transport, accommodation and hospitality due to government resource and capacity constraints, especially in remote areas. Although this type of logistical assistance does not by itself substantiate corruption, it might offer opportunities for corruption in exchange for a favourable inspection report.

Parties involved

For corruption cases associated with the enforcement of local content rules, the parties involved in the corruption may be public officials from state-owned enterprises or ministries, representatives of local authorities and communities and private parties including executives from the foreign company's subsidiary or local suppliers.

In some countries, state-owned enterprises, in particular national oil companies, may be central to administrative corruption stemming from regulatory capture or the violation of local content rules. This may be due to the dual role they sometimes play, *de jure* or *de facto*, as producer and regulator of the sector. Where this occurs, national oil companies are typically filling the gap or compensating for the weak capacity of the formal regulatory agency (World Bank, 2007).

Corruption in customs clearance or visa and work permit issuance typically involve customs and immigration officials, yet public officials in ministries may also be bribed to expedite approvals.

For customs clearance and visa or work permit issuance, companies may resort to intermediaries, e.g. independent brokers or consultancy companies, commonly hired to facilitate administrative processing of routine activities (e.g. customs clearance of routine shipment of equipment and materials, issuance, extensions and renewals of temporary importation permits, visas and work permits, etc.).

Depending on the scale of the scheme, corruption related to the violation of environmental regulations, may involve high-level officials in the executive and judiciary,

or government inspectors and administrative officers in charge of verifying legislative compliance or delivering authorisations for companies to operate.

In the private sector, junior companies may be prone to engaging in corrupt behaviour in cases of regulatory violation due to their short operational timelines, low reputational risks, highly mobile and flexible nature, limited internal control capabilities and reliance on fickle venture capital. Often subjected to less scrutiny than larger companies, they may operate below accepted standards of corporate ethics. Moreover, due to their higher dependence on finance capital compared with revenue, junior companies tend to face short-term horizons, invest in high-risk areas where the prospects of return are the highest, and operate in weak institutional and regulatory environments where larger firms do not tend to go (Dougherty, 2015).

Vehicles and mechanisms

Intermediaries may be parties to the corrupt schemes described above or used as a vehicle to disguise bribery payments. For instance, in one case in the Trace Compendium database, the intermediary immigration consultancy company had been set up by the immigration official in charge of visa processing and approval in order to conceal bribery payments. In another case, the company hired consultants with no licence to provide visa services but with a close relationship to high-level officials responsible for issuing visas. In those cases, improper payments are disguised in invoices using vague sounding terms such as "consultancy fees" and are falsely recorded in the company's accounting records.

Corruption risks

Risks associated with the design and enforcement of local content rules

Ill-designed local content rules setting unrealistic targets or vaguely defined roles and responsibilities or evaluation criteria for waiver applications may urge companies to use corrupt practices to circumvent those rules or get favourable treatment. Such rules may also foster political discretion and lack of transparency in their interpretation and enforcement with risks of favouritism and conflicts of interest.

Corruption may also be encouraged by lax or lower standards of government-sponsored supplier registers, compared with operators' international standards.

For the private sector, corruption risks may include the lack of, or inadequate harmonisation between control standards required by the company and local content requirements provided by the government,[18] together with unclear or inappropriate internal procedures for effective implementation and compliance with local content requirements.[19]

Risks associated with administrative authorisation and clearance procedures

Corruption in authorisation and clearance procedures may be encouraged by ill-designed, lax or unclear procedures that leave too much scope for interpretation by public officials in charge of enforcement. In one case cited in the Trace Compendium database, the company alleged that procedures associated with obtaining labour and immigration authorisations for short-term workers were not clearly established in the country's legislation, leaving companies vulnerable to the abuse of power on the part of public officials.

With respect to the regulatory process itself, an insufficient separation between the functions of inspection and assessment, authorisation, and monitoring and control may increase chances of corruption.

Inspections carried out prior to authorisation (e.g. environmental, health and safety inspections, customs inspections) may suffer from inconsistencies, arbitrariness and lack of transparency which increase opportunities for corruption.[20] Corruption risks may also arise from excessive bureaucracy, which causes unreasonable processing and approval delays for import permits, visas, work permits, etc. Finally, the lack of safeguards (anti-corruption compliance training, regular rotation, etc.) for officials exposed to corruption (e.g. inspectors, customs or immigration officials) is of particular concern.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Risks associated with the design and enforcement of local content rules	***What host governments can do*** ● Collaborate with the extractive industry to collectively assess the sector's needs against available capabilities in the local economy in order to devise a realistic strategy for promoting the participation of local workforces in the value chain of extractive projects (OECD, 2016). ● Where local content regulations exist, ensure their transparent enforcement and reduce public officials' discretion by outlining objective criteria for the hiring of local staff and the evaluation and approval of waiver applications, if any. ● Establish government-sponsored suppliers' registers based on certification schemes or objective and publicly available evaluation criteria, and ensure mechanisms for banning local enterprises from the register for a defined period of time in cases of non-compliance with anti-corruption laws and policies, and depending on the seriousness of the violation concerned.
Risks associated with administrative authorisation and clearance procedures	***What host governments can do*** ● Demonstrate leadership and commitment at the highest level of customs and immigration authorities (Revised Arusha Declaration, 2003). ● Make customs and immigration laws, regulations, procedures and administrative guidelines public, easily accessible and ensure that they are applied in a uniform and consistent manner (Revised Arusha Declaration, 2003). ● Simplify and streamline the overall operational framework for customs (Revised Arusha Declaration, 2003) and immigration processes in order to reduce discretion of power. For instance with regard to customs clearance processes, this may include harmonising tariff rates, minimising exemptions to standard rules, eliminating unnecessary administrative requirements, reducing the number of customs officials involved in the clearance process, providing clear rules for the classification of goods and transparent clearance requirements, and reducing the number and type of supporting documents to be provided for customs clearance (World Bank, 2007). ● Ensure regular rotation of customs officers or immigration officials, changing both location and functions assigned, and provide for adequate anti-corruption training (World Bank, 2007). ● To the extent possible, automate and computerise specific processes so as to reduce the exercise of discretion and the need for direct contact between customs officials and importers or their agents, or between immigration officials and visa applicants.[21] ● Implement a range of appropriate monitoring and control mechanisms for customs and immigration processes such as internal check programmes, internal and external auditing and investigation and prosecution regimes (Revised Arusha Declaration, 2003). ● Solicit private sector feedback – through periodic perception surveys or routine consultations between customs or immigration officials and private sector representatives – in order to assess the performance of the anti-corruption strategy, highlight trends, and identify problem areas (World Bank, 2007). ***What companies can do*** ● Perform due diligence on the selection of local workforces and suppliers, in particular for service providers (such as those providing assistance for obtaining visas or other permits, custom brokers, freight forwarders). ● Require control and oversight of the activities of the subsidiaries by the parent company. This may include formal approval of the parent company for performing the most important transactions (World Bank, 2007).

Corruption in the conduct of daily operations

This section covers corruption risks associated with the conduct of daily operations in the different phases of extraction projects (e.g. production, transformation, distribution, transport, marketing, etc.). Corruption schemes described further include corruption

related to fraud and document falsification in audit reporting, illegal resource extraction activities, corruption in connection with resource theft, extortion by means of threats on security or continuity of operations, and corruption in connection with espionage activities.

Corruption schemes

Fraud and document falsification in record-keeping or audit reporting

Corruption and bribery may be facilitated by fraud and document falsification in the context of audit reporting. The Trace Compendium database reports a case of corruption in the context of an agreement between a foreign company and a state-owned enterprise under which the company assumed all operational and financial control over the project and was to pay a tariff to the state-owned enterprise in order to use its pipeline to deliver the recovered oil. The state-owned enterprise would then reimburse the company for certain costs incurred in the oil and gas recovery process. Reimbursement was made on the basis of the submission of monthly invoices by the company documenting the volume of oil delivered through the pipeline, the pipeline fee and a calculation of the company's reimbursable monthly operating costs. Independent auditors were annually mandated by the state-owned enterprise to determine whether costs were properly claimed. The auditors' report would then be reviewed, discussed and conclusions agreed among the auditors, the company and the state-owned enterprise. It is alleged that during these review sessions, the company made improper payments in order to receive favourable audit reports, increase the costs recoverable under the contract, and reduce the company's tax obligations.

Suspicious fluctuations in consultancy fees suggest the payment of bribes. In one case, the parent company's management had an opportunity to discover the improper payments when a senior finance officer took note of an increase in contract labour costs, including consultancy fees in the country branch office. However, because the finance officer accepted the local controller's explanation and did not make further inquiries, the issue was not investigated fully. As a result, the improper payments were not discovered until the following year; when, as part of the annual budgeting process, the company's senior management made inquiries upon noticing narrower profit margins in the country branch office. Upon learning of the kickback scheme, the company's senior management reported the issue to the parent company's audit committee.

Corruption associated with illegal resource extraction

Informal small-scale and artisanal mining (ELLA, 2012)[22] is particularly exposed to corruption risks, and these are often associated with and fuelled by conflicts, political instability and criminal activities such as drug smuggling. Corruption can take the form of exploitation or extortion, as well as fraud, bribery and theft. Some evidence has emerged about the mechanisms of money laundering associated with informal small-scale and artisanal mining involving international transactions as well as gold smuggling and tax fraud. For example, in one gold producing country, illegally extracted gold is laundered through the legal domestic gold sector of the neighbouring country (Global Witness, 2013). Another case shows how drug smugglers launder illegal money through fictitious transactions with local government officials in regions with informal mining activities. Drug smugglers import gold acquired abroad with the proceeds of drug smuggling and distribute it to local government officials. Government officials then send it to the Central Bank and report it as local production in order to receive the corresponding royalties, which are then divided between the local government officials and the drug smugglers (ELLA, 2012).

Bribery and diversion of public resources and assets, including through resource theft

Oil theft is a major concern in certain oil producing countries where it is practised on a large scale and severely erodes and drains revenues from oil. Even more challenging is that it is very often linked to other criminal activities. The diversion of public assets as a result of resource theft can range from small-scale pilfering and illegal local refining to large-scale illegal bunkering in the field or theft at export terminals (Katsouris and Sayne, 2013). Resource theft commonly arises through the bribery of public officials responsible for overseeing and monitoring production volumes. But it may also be orchestrated by elites benefitting from illicit oil exports.

Large-scale oil theft was often reported in the particular context of oil trading restrictions imposed by the UN Oil-for-Food Programme in Iraq. The Programme was initially established to enable Iraq to sell its oil for humanitarian purposes despite an extensive international sanctions regime. Oil thefts can also be used as a system for diverting resources for the benefit of local officials.

Extortion by means of threats on security or continuity of operations

Three cases in the Trace Compendium database relate to the payment of bribes connected to conflicts with local communities. Bribes were paid by a company in exchange for assistance in protecting and defending its operations, managing social unrest and maintaining a stable business environment.

Bribery can also happen in response to the threat of delays or halts in extractive operations or extortion demands in exchange for retaining business in the country. In one case involving extortion on the part of government officials, the company was forced to submit false paperwork and cash in order to retain business with the government and benefit from favourable tax treatment.

In a second case, threats and attempts of extortion were exerted on a subsidiary company following non-compliance with the country's legislation. The company was required to obtain immigration documentation prior to an expatriate worker's entry into the country. Immigration officers conducted audits after which they claimed that the company's expatriates were working without proper immigration documentation. Following the threat of fines, jail and deportation of the expatriate workers unless the company paid cash fines, employees of the subsidiary sought and received authorisation from the parent company's senior management to pay these officials in cash using their personal funds. The parent company then reimbursed these employees and reflected these payments as visa fines and as payroll advances on the employees' upcoming bonus. Charges subsequently brought against the parent company did not concern the payment of bribes made in response to extortion demands but rather the inaccurate recording of payments in company's records.

The database reports a third case in which threats were exerted by public officials from a state-owned enterprise (SOE) on a consultant hired by a foreign company to provide assistance with daily operations, including with the submission of invoices to the SOE. It is alleged that SOE employees threatened to stop or delay the company's work if the consultant refused to take part in a kickback scheme, which consisted of the consultant overbilling his own services to the company and providing kickbacks to SOE employees. In return, the company would submit inflated invoices to the SOE justified as "lost rig time" in order to cover these additional consultancy costs.

Bribe payments in connection with espionage in industrial operations

One case in the Trace Compendium database relates to the prosecution of a foreign mining company and four employees accused of paying bribes to executives from major local industries in exchange for confidential information on industrial activities and commercial trade secrets. Press reports suggest that political and commercial interests were at the centre of the case and that the arrest of the foreign company's employees might be related to the decision by the foreign company to cancel an investment deal with one of the country's state-owned enterprises. Before the case was investigated, the foreign company had been repeatedly accused of forming cartels with other foreign companies to manipulate prices and harm the country's mining industry.

Parties involved

Corruption associated with illegal resource extraction in the context of artisanal and small-scale artisanal mining (ASM) can involve a variety of stakeholders: i) ASM miners who may not respect the laws regulating their activities; ii) the customers and purchasers of the illegally extracted resources including large-scale mining (LSM) companies, state-owned enterprises, security forces, militia groups or local communities; and iii) the authorities in charge of overseeing the sector, which may include public officials operating at both central and local levels. Local government officials and police forces may agree to turn a blind eye to illegal extraction activities or deprive legitimate right holders in exchange for bribe payments or, conversely, they may actively extort a share of the proceeds (Resosudarmo, 2005). At the national level, high-level officials and senior army officers may also be involved in the ASM activity, which partly explains why there might be little incentive or inclination to regulate artisanal mining or assist in the formalisation of what is often an economically important sector. The literature reports a few large-scale bribery schemes in the informal mining sector involving high-level government officials engaged in illegal mining activities. In one country, the practice was even institutionalised through the formation of syndicates between politicians, police officers and illegal gold partners engaged in an organised and complex network of hidden corruption (Transparency International, 2012). Another case regards the outbreak of a corruption scandal when it was discovered that a high-level government official was heavily involved in the trading of gold, and was operating a gold-exporting company in areas where gold mining was banned.

The literature points to the major role played by illegal extraction activities in financing illegal armed groups operating in conflict zones. Illegal armed groups may profit from resource extraction and trading by controlling mine sites and demanding crippling taxes from artisanal miners and local mining communities. In some cases, they may confiscate a proportion of the production from artisanal miners and sell it on themselves (Global Witness, 2013).

For oil theft, the parties involved depend on the type of schemes: small-scale pilfering and local refining or illicit trading. In the first case, oil theft activities will mainly involve actors at the local level (public officials, security forces, local communities). The second type of oil theft activities, i.e. illicit oil trading usually require high-level involvement including senior officials from the government and the military, high-level politicians, or regulatory agencies in charge of measuring production and export volumes. Private parties to the scheme include well-connected "big men" operating through local and international networks or commodity traders as well as international oil corporations actively lifting

excess crude oil at the export terminals or simply turning a blind eye to the laundering of illicit fuel (Global Initiative Against Transnational Organised Crime, 2015).

In certain countries, large-scale oil thefts have led to the build up of a sophisticated and organised criminal industry involving domestic and international networks. These networks may function as forms of protection "unions", comprised mainly of corrupt officials from the navy and government, and operating across the illicit supply chain, illegally taxing all actors engaged (Katsouris and Sayne, 2013).

In the particular case of the UN Oil-for-Food Programme, parties to the theft included politicians and senior officials, as well as lower-ranking officials who were in charge of authorising, controlling and verifying the volumes of oil being loaded. For example, in one reported case, the independent quantity-control expert that had been specifically appointed to prevent such thefts agreed to disregard unauthorised oil loadings in exchange for a 2% kickback of the proceeds of the operations from government officials (World Bank, 2007).

Corrupt schemes related to the security of operations and facilities commonly involve local public officials or civil servants. For instance, the mayor of the town located in the vicinity of resource extraction operations, the leader of the local community or local security forces may receive bribes in exchange for serving private security interests, i.e. ensuring security of the company's facilities without government official permission or prescription.

In the case of extortion by way of threats and pressure exerted on the company's operations, the instigators of corruption are typically lower-ranking public officials from national or local authorities. The other parties to the scheme will usually be company employees though in one of the above-mentioned cases, the corrupt activity only involved SOE employees and a consultant, without the company's knowledge.

Vehicles and mechanisms

Vehicles and mechanisms that enable oil theft include underreporting and diversion of production volumes, as well as more direct means, such as tapping into producing wells or pipelines and carrying off the oil. The stolen oil is often added to cargoes transporting legal oil as in the case of the UN Oil-for-Food Programme.

Corruption risks

Risks associated with fraud and document falsification

For both the public and private sectors, risks associated with fraud and document falsification may result from the lack of, weak or inadequate internal control procedures and poor record-keeping and monitoring.

With specific regard to companies, the lack of robust internal financial controls exercised by the parent company may extend to its subsidiaries and offer room for corruption to thrive.

Risks associated with illegal resource extraction

First, corruption associated with illegal resource extraction may arise where regulation of the artisanal and small-scale informal mining sector is either missing, incomplete, too complex or weakly enforced. Opacity of the sector may also be reinforced due to the outdated

registration of minerals, limited access to mining titles or the lack of a coherent framework for determining and monitoring the extent of the country's subsoil wealth.

Moreover, in many cases mineral extraction does not require as much equipment and investment as required for oil and gas which facilitates its illegal extraction and export (OECD, 2012).

Finally, illegal resource extraction and corruption tend to thrive in contexts of conflict, political instability and criminal activity such as drug smuggling, which further challenges the state's capacity for detection and prevention.

Risks associated with resource theft

Risks associated with resource theft include the lack of adequate control and metering capacity on oil production, storage and transportation on the part of both the government and the private sector[23] as well as weaknesses and shortcomings in the inspection of oil volumes produced.

Risks associated with extortion practices

Abuse of power, particularly at the local level (local political elite or security forces), and insufficient control of the central government over local authorities may exacerbate corruption and extortion.

For the private sector, risks favourable to extortion include the lack of internal procedures to tackle extortion demands and prohibit facilitation payments, the failure to conduct due diligence into intermediaries' and consultants' backgrounds and to provide anti-corruption compliance training to intermediaries or consultants to avoid exposure and vulnerability to extortion themselves.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Risks associated with fraud and document falsification	***What host governments and companies can do*** ● Design and implement clear internal procedures for record-keeping and financial control. ***What companies can do*** ● Ensure that the parent company exerts financial control over all subsidiaries.
Risks associated with illegal resource extraction	***What host governments can do*** ● Regulate the artisanal and small-scale mining sector. ● Facilitate access to finance by informal miners to legally acquire land for mining. ● Develop standards and a certification system for artisanal mining. ● Provide a comprehensive and systematic mapping of mineral resources and mining titles, and make it available in a public registry. ● Provide incentives for miners to operate legally. ***What home governments of companies involved in commodity trading can do*** ● Support transparency efforts and regulatory reforms regarding, for example, payments and beneficial ownership.[24] ***What companies can do*** ● When sourcing minerals from conflict-affected and high-risk areas, perform due diligence in accordance with OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (OECD, 2016). ● Adopt clear rules and procedures to govern the relationship with artisanal and small-scale miners.

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Risks associated with resource theft	***What host governments can do*** ● Refer to mitigation measures recommended in the sub-section on corruption in commodity trading under Section V (Corruption in Revenue Collection) ● More specifically, put in place robust mechanisms for metering, monitoring and reconciliation of production volumes at pipelines, transit stations and export terminals. ***What home governments of companies involved in commodity trading can do*** ● Require commodity trading companies to conduct risk-based supply-chain due diligence (Katsouris and Sayne, 2013). ● Support transparency efforts and regulatory reforms regarding, for example, payments and beneficial ownership information disclosure. ***What companies can do*** ● Collaborate with host governments to implement adequate control and metering systems on oil production, storage and transportation.
Risks associated with extortion practices	***What companies can do*** ● Include extortion practices and facilitation payments in internal compliance procedures and provide adequate training to help employees and intermediaries deal with this kind of situation.

Corruption in the acquisition or selling of shares or concessions

Corruption schemes

The privatisation or the acquisition of shares in a state-owned enterprise, the acquisition of shares in a private company by public or private investors, and the acquisition or selling of concessions may be tainted with risks of bribery, conflicts of interest, political capture, favouritism and clientelism. In the case where shares are sold through a bidding process, the process may be hampered by collusive conduct (Collier and Venables, 2011).

Corruption related to the acquisition or selling of concessions ("grabbing and flipping")

In one case, assets in a concession were initially transferred at knockdown prices to a series of offshore companies owned by a personal friend of a high-level politician, and registered in jurisdictions where regulations allow beneficial owners to remain secret. The offshore companies in turn sold the same assets at market value to major multinational companies, striking immensely profitable deals. In another case, national authorities revoked a concession awarded to a private company where production was imminent and passed it on to a new joint venture. Through a series of complex transactions, a person with close ties to high-level politicians acquired the rights to the concession. Government officials received kickbacks in return for their sale of assets to the joint venture. The concession was then sold to another multinational company.

Corruption related to privatisation or acquisition of shares in a state-owned enterprise and the acquisition of shares in a private company

Corruption related to the privatisation or acquisition of shares in a state-owned enterprise. The Trace Compendium database reports two cases of corruption in connection with the direct acquisition of state-owned assets by private actors in the absence of a formal bidding procedure. One case has to do with allegations of bribes paid for the privatisation of a state-owned enterprise; the other is related to the acquisition of shares in a state-owned enterprise. The purpose of the bribe was to secure shares, win control over the state-owned enterprise, or purchase shares at below-market value.

When the process involves a bidding contest, various corruption risks may arise in the different phases of privatisation. First, trading in influence, favouritism, political capture and conflicts of interest may interfere in the decision to privatise and lead to the setting of bidding

terms favouring one competitor over the others. Corrupt agents may be offered an interest in the venture. Then, corrupt conduct may plague the pre-privatisation phase during which internal reforms are undertaken to ensure appropriate governance, management and administrative structures to operate as a private company. Conflicts of interest or political interference may contribute to influencing the reforms and changes. During this phase, assessors, consultants and asset evaluators may be hired to evaluate the state-owned enterprise assets and derive the fair value at which the company's share or the company itself should be sold. These consultants may not be selected on the basis of their competencies but rather on their political affiliations and ties. They may influence decisions in favour of one particular bidder or share confidential information about the company with external actors and potential bidders. During the award itself, the bidding process may be undermined by risks of corruption described in previous sections (i.e. collusive bidding, favouritism, patronage, clientelism, etc.).[25] The Trace Compendium database cites a case of collusion between a businessman and public officials to win an auction to seize control of a state-owned enterprise. Bribes were offered in stock shares, cash and other gifts and several front companies owned by the businessman's family and friends were created to purchase vouchers and options in order to bid for shares in the country's state-owned extractive enterprise.

Regarding privatisation more specifically, the literature cites, in particular, allegations of political capture and collusion between the government and business elite in a number of producing countries, during the waves of privatisation in the 1990s (Chêne, 2012).

Corruption related to the acquisition or selling of shares of a private entity. Instances of corruption may also arise during the acquisition of shares in a private entity by a private company. Collusive behaviour between the companies involved in the transaction may lead to an over or underestimated value of the shares, which may conceal improper advantages. Where shares are sold at inflated prices and where the beneficial owner of the acquired shares is a public official, the difference between the real value of the shares and the price paid may integrate a bribe. In case of underestimated value, if the beneficial owner of the acquiring party is a public official, the difference between the price paid and the real value (discount) may constitute a bribe.

The press further reports suspicions of corrupt practices in the context of a lawsuit filed by a private company against one of its partners in the exploitation of a mine. The company had sued its partner following its announcement to sell its stake in the mine to a third party, on the grounds that the partnership agreement gave the remaining partners the first right of refusal on any sale. The vendor was suspected of threatening and blackmailing its former partners to abandon judicial charges and corruptly interfered in the national court decision.

When strategic resources are at stake, the state may be entitled by law to become shareholder in ongoing business ventures in order to bear part of the risks and get its share of the profit. Risks of corruption may arise when the decision-making process allows for a high level of discretion of public officials; and public officials, in turn, may collude with or impose their authority on incumbent private entities for personal interests.[26]

Parties involved

This type of corruption scheme usually involves politicians at the highest level and officials from the state-owned enterprise. It may also involve judicial officers receiving bribes in exchange for favourable treatment in resolving disputes.

For the private sector, corrupt agents may be senior executives in the interested companies, investors, consultants, advisors and intermediaries. In the case of acquiring shares in a private company, the acquirer may be a public (e.g. state-owned) or a private entity. The private entity may be a local private company owned or affiliated with public officials or politicians.

Vehicles and mechanisms

In the case of the privatisation or acquisition of shares in a state-owned company, the bribery scheme may involve setting up a series of front companies to purchase vouchers and options in order to bid on the shares of the state-owned enterprise. Those companies are typically owned by relatives and friends of the public officials or private investors behind the conspiracy. Government officials may be offered vouchers and options as well as a share of the profits realised from the operation by the acquiring companies.

In case of the sale and acquisition of private companies, the corrupt transaction may involve the use of companies whose beneficial owners are concealed or shielded through figureheads or foundations.[27]

Corruption risks

Lack of transparency in the process of privatisation or selling of shares

Opacities in the process of privatisation or selling of shares may result from the lack of the following elements: an open and transparent bidding process; transparent and appropriate evaluation methods to assess state-owned enterprise's assets and determine the base price for the sale of shares or privatisation of the state-owned company;[28] transparent rules and procedures for the hiring of external consultants, assessors and asset evaluators; harmonisation and enforcement of disclosure standards regarding contractual arrangements (McMillan, 2005); full disclosure of the form of payment, governance and ownership arrangements in the case of state equity participation in private companies (composition of board, audit practices, etc.) (IMF, 2007); and clear regulations allowing for the identification of the ultimate beneficial owners of the operations subject to privatisation or share acquisition.

Inadequate internal rules and procedures governing corporate mergers and acquisitions

For the private sector, risks associated with corruption in the acquisition of shares in a public or private company may include the lack of clear rules and constraints on payment (e.g. cross-border transfers, particularly when tax heavens are involved) (IMF, 2007); insufficient oversight of the parent company over the subsidiary's merger and acquisition[29] as well as inadequate segregation of roles and duties within the sale process (proposal, evaluation, negotiation, final authorisation).

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Lack of transparency of the process of privatisation or selling of shares	***What host governments can do*** ● Provide for appropriate and robust regulatory frameworks to be put in place before privatisation begins. ● Draw up a plan of action to encourage accountability and transparency of privatisation programmes. ● Allocate shares and interests only through public, transparent and clear tender rules.[30] ● Require government officials to disclose assets, including any ownership interests in extractive companies and require public disclosure of beneficial ownership information from corporate entities. ● Identify and apply in a transparent manner international standards and best practices to determine the base price for the shares of the state-owned company to be fully or partly privatised.[31] ● Define a set of transparent rules and a clear and objective process to hire external consultants, assessors and asset evaluators.[32] ● Mandate the disclosure of all significant aspects of share acquisition/disposal, ownership and governance in the case of state equity participation in private companies.[33] ● Support regulatory reforms regarding, for example, the disclosure of beneficial ownership.
Inadequacy of corporate internal rules and procedures governing mergers and acquisitions	***What companies can do*** ● Strengthen financial controls, particularly on mergers and acquisitions involving cross-border transfers. ● Ensure proper segregation of roles and duties within the sale process. ● Ensure close co-ordination and oversight of the activities of subsidiaries by the parent company, including in mergers and acquisitions. This may involve requiring the approval by the parent company for the most important transactions.

Notes

1. Comments received from participants in the Working Group on Corruption Risks during the consultations between January and May 2015.
2. See note 1.
3. See note 1.
4. See note 1.
5. World Bank (2007), *The Many Faces of Corruption - Tracking Vulnerabilities at the Sector Level*, edited by J.E. Campos and S. Pradhan, The International Bank for Reconstruction and Development/The World Bank, Washington, DC. pp 314-315: "The most vulnerable evaluation systems are those that convert evaluation criteria, and sometimes, inexplicably, even price itself, into notional points, which are then awarded to each bid by one or more evaluators based on his or her own subjective assessment of the worth of the bid against each criterion. Under such evaluation systems, there is often no right or wrong answer in the decision-making process, as the winning bid is simply the one that receives the most points; in such a situation, the decision is wide open to corrupt influence, and it becomes all but impossible to hold the evaluators accountable for the correctness of their decision."
6. See note 1.
7. See note 1.
8. See note 1.
9. Comments received from participants in the Working Group on Corruption Risks during the consultations between September and November 2015.
10. See note 1.
11. See note 9.
12. See note 9.
13. See the Business Anti-Corruption Portal country profiles available at *www.business-anti-corruption.com/country-profiles*: "[...], environmental controls are not effective. It is generally known that company owners violate rules on noise, emission and waste management, and bribes are employed in order to obtain business licenses without complying with all the requirements."
14. See the Business Anti-Corruption Portal country profiles available at *www.business-anti-corruption.com/country-profiles*.
15. See note 14.

16. Comments received from participants during the consultation of the Fourth Meeting of the Policy Dialogue on Natural Resource-based Development on 29 June 2015 at the OECD in Paris.
17. See note 1.
18. See note 1.
19. See note 1.
20. See note 14.
21. Revised Arusha Declaration (2003), "Declaration of the Customs Co-operation Council Concerning Good Governance and Integrity in Customs", done at Arusha, Tanzania, on the 7th day of July 1993 (81st/82nd Council Sessions) and revised in June 2003 (101st/102nd Council Sessions).
22. See note 1.
23. See note 1.
24. See Chapter 1 for more information.
25. See note 1.
26. See note 16.
27. See note 16.
28. See note 1.
29. See note 9.
30. See note 9.
31. See note 9.
32. See note 9.
33. See note 9.

References

Chene, M. (2012), "Corruption in natural resource management in Mongolia", *U4 Expert Answer*, 16 November.

Collier, P. and A.J. Venables (2011), *Plundered Nations? Successes and Failures in Natural Resource Extraction*, Palgrave Macmillan, October.

Dougherty, M.L. (2015), "By the gun or by the bribe: Firm size, environmental governance and corruption among mining companies in Guatemala", U4 Issue No. 17, Anti-Corruption Resource Centre, September 2015.

ELLA (2012), "Small-scale and Informal Mining: A Big Problem for Latin American States", *Policy Brief*, Evidence and Lessons from Latin America, London, December. *http://r4d.dfid.gov.uk/PDF/Outputs/ELLA/121129_ECO_ExtIndConMan_BRIEF4.pdf*.

Global Initiative Against Transnational Organised Crime (2015), "Illicit Financial Flows resulting from Illicit Trade in West Africa", *Inception Report*, commissioned by the OECD Development Cooperation Directorate, February 2015.

Global Witness (2013), "Putting principles into practice – Risks and opportunities for conflict-free sourcing in eastern Congo", May.

Global Witness (2012), "Rigged? The Scramble for Africa's Oil, Gas and Minerals", January, London. *www.cabinda.net/RIGGED%20The%20Scramble%20for%20Africa's%20oil,%20gas%20and%20minerals%20.pdf*.

Heller, P., P. Mahdavi and J. Schreuder (2014), *Reforming National Oil Companies: Nine recommendations*, Natural Resource Governance Institute, July, *www.resourcegovernance.org/sites/default/files/NRGI_9Recs_Web.pdf*.

IMF (2007), *Guide on Resource Revenue Transparency*, Fiscal Affairs Department, International Monetary Fund, Washington, DC.

Katsouris, C. and A. Sayne (2013), *Nigeria's Criminal Crude: International Options to Combat the Export of Stolen Oil*, Chatham House, September.

Martini, M. (2014), "Local content policies and corruption in the oil and gas industry," *U4 Expert Answer* 2014:15, September.

McMillan, J. (2005), "The Main Institution in the Country Is Corruption: Creating Transparency in Angola", *CDDRL Working Papers* Number 36, Center on Democracy, Development, and The Rule of Law, Stanford Institute on International Studies, 7 February, *www.cabinda.net/Corruption_transparency_Angola1_No36.pdf*.

OECD (2016), *Framework on Public-Private Collaboration for In-Country Shared Value Creation from Extractive Projects*, available at *www.oecd.org/dev/frameworkonpublic-privatecollaboration.htm*.

OECD (2016), *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Third Edition*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264252479-en*.

OECD (2012), *International Drivers of Corruption: A Tool for Analysis*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264167513-en*.

OECD (2009), *Guidelines for Fighting Bid Rigging in Public Procurement – Helping governments to obtain best value for money*, *www.oecd.org/daf/competition/cartels/42851044.pdf*.

Oxford Policy Management (2012), *Enhancing the integrity of the Oil for Development Programme: Assessing vulnerabilities to corruption and identifying prevention measures – case studies of Bolivia, Mozambique Uganda*, NORAD, *www.norad.no/globalassets/import-2162015-80434-am/www.norad.no-ny/filarkiv/vedlegg-til-publikasjoner/enhancing-the-integrity-of-the-oil-for-development-programme.pdf*.

Resosudarmo, B.P. (2005), *The Politics and Economics of Indonesia's Natural Resources*, Institute of Southeast Asian Studies, Indonesia Update Series.

Revised Arusha Declaration (2003), Declaration of the Customs Co-operation Council Concerning Good Governance and Integrity in Customs, done at Arusha, Tanzania, on the 7th day of July 1993 (81st/82nd Council Sessions) and revised in June 2003 (101st/102nd Council Sessions).

Transparency International (2012), *Annual State of Corruption Report 2012 – A look at the mining sector in Zimbabwe – Gold, Diamonds and Platinum*, Transparency International Zimbabwe, Harare.

World Bank (2007), *The Many Faces of Corruption – Tracking Vulnerabilities at the Sector Level*, edited by J.E. Campos and S. Pradhan, The International Bank for Reconstruction and Development/The World Bank, Washington, DC, *https://openknowledge.worldbank.org/handle/10986/6848*.

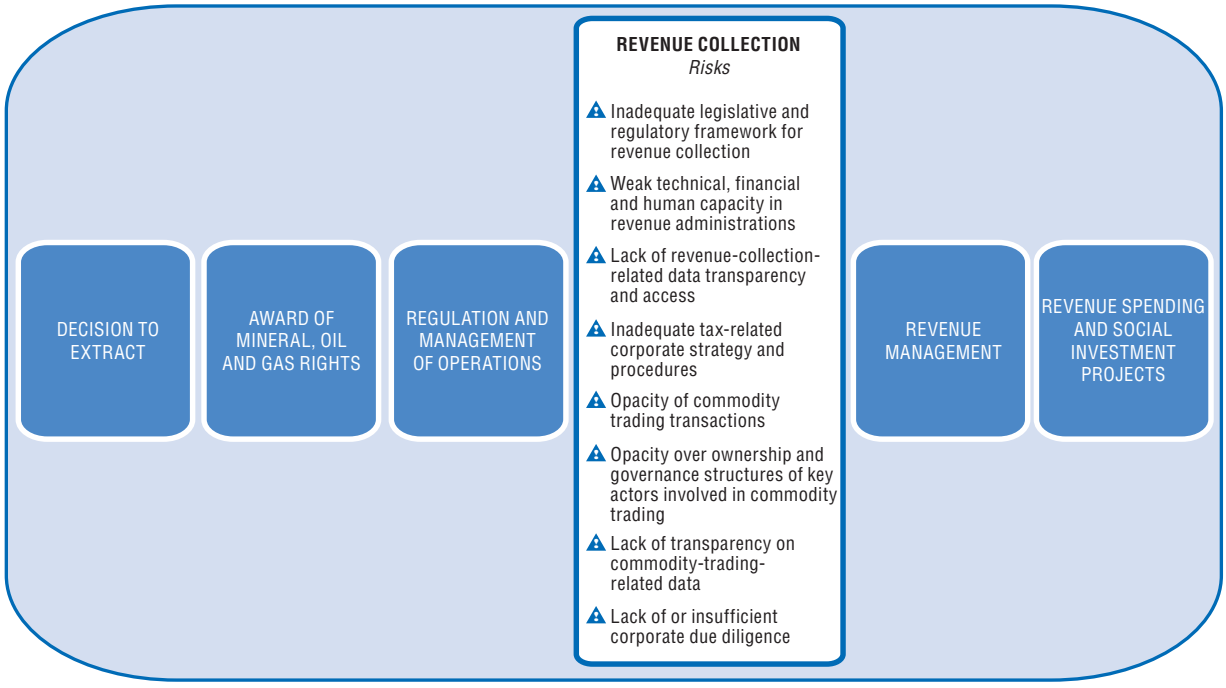
© OECD 2016

Chapter 5

Corruption risks in revenue collection

This chapter identifies corruption risks associated with the collection of taxes, royalties and fees or the trading of commodities, which can result in a loss of public revenues. It further elaborates on recommended mitigation measures designed for home and host governments, donors, and extractive companies to minimise risks in the public and private sectors.

Figure 5.1. **Corruption risks in revenue collection**



Corruption in the collection of taxes, royalties and fees

Corruption schemes

Extortion, embezzlement and misappropriation of collected revenues

The collection of taxes, royalties and fees may be undermined by extortion, misappropriation and diversion of funds by public officials for private gain. Diverted revenues are usually transferred to bank accounts located in offshore jurisdictions with low tax liabilities and lax legislation on information disclosure on beneficial ownership.

Bribery to receive favourable tax treatment

Corruption in revenue collection can take the form of collusion and bribery between tax payers and tax officers for receive favourable tax treatment such as tax or royalty reduction, or favourable treatment in pending litigations related to tax matters. In six cases reported in the Trace Compendium database, bribes were paid to local tax officials in exchange for reducing the company's tax assessment and minimising its tax obligations. For example, in one specific case, the bribe was intended to reduce the amount of expatriate employment taxes payable by the company. Payroll expenses were regularly underreported and improper payments mischaracterised in the company's books and

records. These types of schemes may involve the use of local agents by the company in charge of dealing with tax authorities.

Parties involved

Parties involved in corruption related to revenue collection are typically the tax payer, i.e. the extractive company (i.e. international oil companies or state-owned enterprises) and tax officials at the local and/or central levels, depending on the country's institutional arrangements for levying taxes and collecting royalties and fees.

In certain cases, politicians or officials at higher level may be involved, particularly in cases of extortion, embezzlement, special exemptions, etc. For example, the literature points to the case of a state-owned enterprise engaged in large-scale corruption and tax evasion that was made possible with the complicity of top political circles (World Bank, 2007). Some corruption schemes involve collusion between the tax payer and the tax authorities such as bribery in exchange for favourable treatment in tax dispute resolutions, tax exemptions, VAT fraud, etc. In embezzlement, fraud and falsification of tax receipts, tax officers or high-level officials can be the only party involved. In addition to public officials, the auditors within the tax administration as well as the banks where the diverted revenues are transferred might play a role in the scheme.

Vehicles and mechanisms

Use of offshore bank accounts and companies

Parties to the corrupt scheme may use offshore companies with obscure beneficial ownership arrangements or alternatively offshore bank accounts to channel and launder illegal payments, or to conceal the proceeds of corruption or the funds misappropriated during the tax collection process.

Fraud and distortions in accounting and reporting

Misreporting practices mainly consist of distortions in accounting and reporting of various items used to calculate the company's tax obligations. These include, for example, the underreporting of production volumes or diversion of production volumes to reduce royalties; or the under-reporting of turnover, and the over-reporting of costs (e.g. capital allowances and operating expenditures (Curtis, 2012) or treatment of customs duties and levies as "development costs") to reduce taxable income and resulting tax liabilities. Unaccounted sales of crude oil or fuel to trading companies registered in foreign jurisdictions, which is often immediately resold in the international market, may also result in the loss of financial windfalls for producing countries as the profits of these transactions are (lightly) taxed in the jurisdiction where those trading companies are registered.

The underestimation of taxes may also concern other tax liabilities including value added tax, payroll tax, foreign withholding tax and various tax incentives or penalties. An example of taxes for this last category is the expatriate employment tax that is sometimes applied by resource-producing countries above a certain threshold to encourage local employment.

The Trace Compendium further reports a case in which false invoices from local vendors were created to offset VAT obligations.

Trade mispricing

Corruption through trade mispricing is the falsification of the price, quality and quantity values of traded goods for a variety of purposes including tax evasion and corruption. The most common occurrence is in under-invoicing for exports and over-invoicing for input imports, which leads to an artificial reduction in profit margins and revenues; or increase in the charges of the company's subsidiary operating in the host country. In these types of transactions, affiliated entities registered in tax havens play the role of intermediaries and receive most of the profits in order to minimise taxes owed in the host country. This mispricing can facilitate tax base erosion, tax evasion, and money laundering, and can be used to conceal the international transfer of illicit financial flows.

Corruption risks

Inadequate legislative and regulatory framework for revenue collection

The lack of a clearly defined legal and regulatory framework for revenue collection may constitute a major driver of corruption. Indeed, legislative gaps and shortcomings may include:

- Unnecessarily convoluted and complex accounting rules, tax and trade regimes including multiple discretionary exemptions, confusing and non-transparent procedures for tax compliance (World Bank, 2007; Kar and Spanjers, 2014);
- Systemic under-taxation and tax concessions by-passing existing tax rules (Africa Progress Panel, 2013); loopholes in tax regimes or ill-designed and counterproductive tax incentives resulting in disincentives for companies to provide correct cost estimates;
- Weak internal and external controls of revenue administrations (for example, allowing corrupt officers access to taxpayer files without authority or tracking; no review of tax assessments by parties connected to the initial assessment; weak controls over access to physical records and computer networks);
- Excessive political or administrative discretion over fiscal settings without external review;
- Excessive discretionary power and lack of independence of tax inspectors and auditors;
- Inadequate reward and penalty structures sanctioning corrupt practices by tax or custom officers (Africa Progress Panel, 2013);
- Ineffective mechanisms for officials to report corrupt behaviour (either within or outside the agency);
- Insufficient centralisation and state control over local authorities in charge of revenue collection (OECD, 2012).

Weak technical, financial and human capacity in revenue administration

Weak technical, financial and human capacity may prevent local and central revenue administrations from assessing company tax and royalty obligations, effectively enforcing fiscal rules and securing tax compliance, monitoring quantities produced, sold or exported and detecting potential acts of fraud or corruption, and in particular mispricing practices (AUC/ECA, 2015; African Progress Panel, 2013). The lack of co-ordination between central and local revenue administrations may introduce further vulnerabilities to corruption and fraud (PH-EITI, 2015).

Lack of revenue-collection-related data transparency and access

The lack of updated, comprehensive, disaggregated, comparable and harmonised data on revenue collection may challenge tax administrations' capacity to perform their tasks including conducting accurate and informed transfer pricing risk assessments, ensuring enforcement of tax rules, monitoring compliance, and detecting possible discrepancies, corruption and fraud. Data and information deemed relevant for tax purposes include data on transactional transfer pricing, geological potential, production, taxpayers (permit registry, cadastral system, taxpayer database, etc.), tax rules, liabilities and effective revenue payments. The lack of data transparency and public scrutiny over the revenue collection process may further increase exposure to corruption risks.

Inadequate tax-related corporate strategy and procedures

For the private sector, risks include aggressive tax planning facilitated by the extensive use of offshore companies and high levels of intra-company trade (Africa Progress Panel, 2013), inadequate procedures for the identification and appointment of tax consultants,[1] weaknesses in internal financial reporting systems, lack of transparent and proper accounting of the payments made by the company to the host government in the company's books and records.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Inadequate legislative and regulatory framework for revenue collection	***What host governments can do*** ● Promote transparency and standardisation in tax codes and rules in order to facilitate enforcement and avoid discretionary behaviour, including for example, requiring a public ministerial declaration where changes are made to standard fiscal settings outlining the concessions provided, their cost and justification.[2] ● In particular, promote standardisation of tax incentives, tax holidays and concessions in legislation rather than provisions in specific contracts and licences to reduce discretion, enable independent scrutiny by the legislature or other stakeholders and ensure that a typology of available tax concessions is publicly recorded.[3] ● Favour clarity, simplicity and centralisation of the revenue collection process in agencies with appropriate revenue collection expertise and mandate to raise revenue. Revenues from extractive resources should be recorded as part of the normal budgetary system to facilitate oversight and accountability.[4] ● Provide credible avenues for whistleblowing against corrupt practices for tax officials, either within or outside the tax administration. ● Put in place mechanisms for tax auditors and tax examiners to detect possible acts of bribery, corruption and money laundering and report to the appropriate law enforcement authority or public prosecutor. Such mechanisms may include selecting cases for tax audits based on appropriate technical risk-based criteria rather than at individual discretion, putting in place examination plans and compliance checks such as an examination of internal audit reports, a review of the taxpayer's copies of reports filed with other governmental regulatory agencies, consideration of the use of foreign entities and operations, the terms of contractual or pricing arrangements, details of fund transfers, and the use of tax havens. Training may be available through the OECD's International Academy for Tax Crime Investigation, which is a key component of the Oslo Dialogue.[5] ● Ensure confidentiality and protection of tax auditors, examiners and investigators, reporting suspicions of possible bribery or corruption (OECD, 2013a). ● Adopt the FATF Guidance for Politically Exposed Persons (Recommendations 12 and 22) (FATF, 2013), put in place internal ethical codes and asset declarations and implement robust internal controls and independent external audit. ● Adopt the OECD Council's 2010 recommendation to facilitate co-operation between tax and other law enforcement authorities to combat serious crimes, including that countries "establish, in accordance with their legal systems, an effective legal and administrative framework and provide guidance to facilitate reporting by tax authorities of suspicions of serious crimes, including money laundering and terrorism financing, arising out of the performance of their duties, to the appropriate domestic law enforcement authorities" (OECD, 2010).

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Weak technical, financial and human capacity in revenue administrations	***What host governments can do*** ● Strengthen the human and technical capacity of revenue administrations to assess production volumes, costs, quality of production, and apply commonly accepted transfer pricing principles that are based on the arm's length principle.[6] ● To the extent possible, foster automation of services in order to remove intermediaries and reduce direct interactions between companies' representatives and tax officials (Davis and Fumega, 2014). ● Use physical audits of production volumes and benchmark-based valuations by trusted parties to mitigate risks of under-declaration and discretion. ● Put in place an internal control system for revenue administration based on robust risk management and adequate human, financial and technical resources. ● Provide capacity building for criminal tax investigators to detect and investigate tax and other financial crimes such as bribery and corruption, tax evasion and money laundering, and recover the proceeds of those crimes, by developing the skills of criminal investigators. Training is available through the OECD's International Academy for Tax Crime Investigation. ● Develop the expertise of tax authorities to detect mispricing and false invoicing through the sharing of effective audit procedures or of methods for verifying mineral products pricing in transactions between related parties when no comparable data for benchmarking exists (OECD, forthcoming 2016). ***What donors can do*** ● Support the development of well-trained human resources in partner countries' revenue administrations for example by developing university modules on revenue/financial administration studies specifically applied to the extractive sector.
Lack of revenue-collection-related data transparency and access	***What host governments can do*** ● Publicly disclose information about tax rules, government revenue streams, contracts, licences, production in order to assist tax authorities with enforcement and enable more efficient public scrutiny. ● In particular, require the public disclosure and reconciliation of disaggregated information on payments made by extractive companies to the government and on revenues collected by the government from extractive companies, taking advantage of existing national or international mechanisms, such as the EITI.[7] ● Promote the adoption of a standardised payment reporting process for all companies operating in the country. ● Synchronise data on payments received and revenues collected at the national vs. sub-national levels to ensure that the figures reported by central government and local government match (PWYP, 2014). ● Participate in international tax information exchange by adopting the legal frameworks required and then build administrative systems and capability to enable information exchange.[8] ● Require companies to provide transactional transfer pricing documentation in the tax jurisdiction in which they do business, identifying relevant related party transactions, the amounts involved in those transactions, and a clear explanation of the company's methodology for the transfer pricing determinations they have made with regard to those transactions. ● Require companies to engage in co-operative discussions and provide access to all relevant information to tax administrations, consistent with applicable national laws, to enable an accurate and informed transfer pricing risk assessment (such as transfer pricing forms, transfer pricing mandatory questionnaires focusing on particular areas of risk, general transfer pricing documentation requirements identifying the supporting evidence necessary to demonstrate the taxpayer's compliance with the arm's length principle). ● Empower tax administrations to have ready access to relevant information at an early stage to conduct a transfer pricing risk assessment and make an informed decision about whether to perform an audit. In addition, it is important that tax administrations be able to access or demand, on a timely basis, all additional information necessary to conduct a comprehensive audit once the decision to conduct such an audit is made. ● Require companies to provide access to relevant information on the operations, functions and financial results of associated enterprises with which the company has entered into controlled transactions (including related party interest payments, royalty payments and especially related party service fees), information regarding potential comparables, including internal comparables, and documents regarding the operations and financial results of potentially comparable uncontrolled transactions and unrelated parties. ***What home governments can do*** ● Require companies to articulate consistent transfer pricing positions in accordance with the arm's length principle and provide tax administrations with useful information to assess transfer pricing risks. ● In particular, participate in international information exchange on tax matters. This includes requiring companies to provide tax administrations with high-level information regarding the company's global business operations and transfer pricing policies in a "master file", made available to all relevant country tax administrations.[9] ***What companies can do*** ● Identify each entity within the group doing business in a particular tax jurisdiction and provide home and concerned host countries' tax administrations with an indication in reasonable detail of the business activities each entity engages in. ● Report annually to each tax jurisdiction in which they do business: the amount of revenue, profit before income tax and income tax paid and accrued; their total employment, capital, retained earnings and tangible assets in each tax jurisdiction, in accordance with existing international standards such as EITI.

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
	• Provide, consistent with national laws, transactional transfer pricing documentation to the tax jurisdiction in which they do business, identifying relevant related party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions. • Engage in co-operative discussions and provide access to all relevant information to tax administrations in accordance with applicable national laws, to enable an accurate and informed transfer pricing risk assessment (such as transfer pricing forms, transfer pricing mandatory questionnaires focusing on particular areas of risk, general transfer pricing documentation requirements identifying the supporting evidence necessary to demonstrate the taxpayer's compliance with the arm's length principle). • Where national laws require that a transfer pricing audit is carried out, provide tax administrations with access to all relevant documents and information in accordance with applicable laws. ***What donors can do*** • Support better co-ordination for automatic data exchange among all relevant government agencies for revenue collection at both the local and central levels (for example, those involved in production, customs clearance, tax collection, etc.) • Support the harmonisation of fiscal frameworks at the regional level in order to mitigate the potential for resource smuggling. • Support efforts in their respective home countries to participate in international information exchange on tax matters
Inadequate tax-related corporate strategy and procedures	***What companies can do*** • Define adequate procedures for the identification and appointment of tax consultants, which should include performing thorough due diligence on potential candidates with particular focus on technical skills, ethical profile and conflicts of interest.[10] • Perform periodical analysis of the internal financial reporting system in order to identify and overcome any potential reporting gaps.[11] • Define a clear set of principles and rules to be followed when making payments to the host government, including proper accounting rules for and adequate maintenance of books and records.

Corruption in commodity trading

In principle, producer countries, in particular oil producers, can derive a large portion of their revenue from selling the share of oil produced by their joint venture partners or the share of production of their state-owned enterprises. Revenue streams can be significantly reduced due to corrupt conduct such as bribery or extortion and kickbacks offered to secure deals, commodity export trading and laundering, diversion of resources and embezzlement or commodity trade mispricing.

Corruption schemes

Bribery or extortion and kickback schemes to secure deals

The UN Oil-for-Food Programme is a particularly striking illustration of this kind of corruption. The United Nations allocated certain volumes of crude oil for sale on international markets and determined a "fair market price" at which Iraqi crude oil could be sold. This price happened to be below international market prices, creating an immediate premium for access to Iraqi crude and incentives for corruption. Indeed, Iraqi government officials started extorting kickbacks and illicit payments from oil purchasers (trading companies, processing companies, etc.). The programme mandated that the proceeds of oil sales be deposited in a UN bank account in order to purchase humanitarian goods and services. The illicit 'surcharges' never reached the UN bank account but were instead transferred to Iraqi-controlled banks in Jordan and Lebanon or selected Iraqi embassies (World Bank, 2007).

Misappropriation of funds and embezzlement

Another common corruption scheme in commodity trading consists of diverting licit resources and/or misappropriating revenues generated from commodity sales. For example,

the press reports a case of substantial oil revenues, intended to be remitted to the national budget, allegedly being misappropriated in the context of the sale of the state's share of oil by the national oil company, which claimed a subsidy deduction. Other suspicious transactions suggest the diversion of rents by intermediary trading companies turning a blind eye to the misappropriation of rents through legitimate means (cashing dividends on behalf of politically exposed persons) or contributing to the creation of complex and opaque structures of corporate vehicles rendering the identification of beneficial owners more difficult.

Bribery related to commodity trade mispricing[12]

Mispricing in commodity trading usually consists of under-reporting volumes or under-invoicing the value of the resource sold, allowing its purchaser to resell it at an inflated margin. A share of the windfall usually serves to pay bribes. One case in the Trace Compendium database features a typical situation where bribery payments were made by the foreign trading company to secure below-market discounts on the purchase of raw materials from the state-owned enterprise. The UN High Level Panel on Illicit Financial Flows from Africa reports at least five African countries having been affected by such practices on a large scale either in the oil, mineral or timber sector (AUC/ECA, 2015).

For the company, in addition to securing good deals, trade mispricing practices allow a reduction in the amount of customs duties owed to the exporting country.

Parties involved

On the seller's side, the parties involved in corrupt transactions in commodity trading are typically politicians or high-level officials from ministries or state-owned companies.

In oil producing countries in particular, the national oil companies are usually at the centre of oil transactions, either selling their share of production resulting from their own activities or selling the state's share on behalf of the government. As a result, national oil companies may also be central to corruption in oil trading (Gillies, 2012). It is quite common in the business of oil trading to see national oil companies create separate subsidiaries for their trading activities. The complex and often opaque ownership structure of these entities and the lack of information on shareholding and beneficial ownership may facilitate corrupt practices (Global Witness, 2013).

On the purchaser side, parties involved can be end user companies such as companies converting resources into usable products or commodity traders, i.e. major trading companies, investment banks active in commodity trading, small trading companies with little logistical and financial capacity often acting as first purchaser from the government and immediate onward seller to larger trading companies. The latter tends to render the transaction more opaque, money flows tend to be more difficult to track (Guéniat, 2015).

It is also common that corruption in commodity trading, in particular commodity trade mispricing and stolen resource trading, involve intermediaries or "big men", which are defined by the World Bank (World Bank, 2007) as powerful individual influence peddlers operating through local and international trading networks (active in particular in the trade of oil [World Bank, 2007] and diamond [OECD, 2012]), involving players from both consuming and producing countries.

Vehicles and mechanisms

Use of offshore companies

As described above, offshore companies may serve as a vehicle for corrupt practices in commodity trading by enabling concealment of beneficial owners. Offshore companies may also take part for example in the ownership structure of the trading subsidiary of a state-owned company.

Offshore companies may also be used by private trading companies to hide their involvement in opaque or corrupt trading activities such as over-invoicing imports to get the cash off-shore as in the case of the Oil-for-Food Programme (Berne Declaration, 2011).

Back-to-back sales, immediate re-sales, crude-for-refined-products swap contracts

In principle, the sale proceeds of domestic crude, net of processing costs, represent an important source of remittance for the national budget. However, in practice these revenue streams can be considerably reduced when sold to small trading companies with no logistical or financial capacity. Often these companies act as mere intermediaries or brokers that purchase crude oil or oil products from a state-owned oil producer or refinery on favourable terms and then resell them with a significant profit margin to third parties on the international market. The opacity of such transactions, the absence of tangible and obvious value added for the vendor, the observed discrepancies between benchmark estimates and actual revenues generated for the government suggest that these types of transactions may serve as mechanisms to create and conceal pockets of funds that may be used for corruption purposes (i.e. bribery, misappropriation of oil rents, etc.).

Crude-for-refined-products swap contracts

Crude oil trading may take the form of non-monetary transactions known as crude oil swaps, which involves oil producing countries swapping oil with commodity traders in exchange for refined fuel imports such as gasoline and gas oil of the equivalent value. In other cases, the deal may provide for the exchange of commodities in return for the provision of infrastructure (e.g. roads, hydroelectric power stations, health centre, etc.). Though not illegal *per se*, this type of swap may offer opportunities for corruption and misappropriation of oil rents as suggested by large discrepancies observed between benchmark estimates and actual figures for government revenues in certain oil producing countries. The absence of money transfer and the secrecy surrounding contractual clauses make corrupt behaviours difficult to detect.

Stolen commodity export trading and laundering

Illegally extracted or stolen resources are usually laundered in the trading process by being loaded onto freighters transporting other resources or by being sold to trading or producing companies, which turn a blind eye to the illicit origins of the traded resources.

Corruption risks

Opacity of commodity trading transactions

The lack of transparency and oversight in the trade of government's share of production, provide opportunities for corruption. The lack of open and competitive public tender for the sale of commodities and the use of inappropriate commodity pricing benchmarks may lead to suboptimal allocation and overly favourable contractual terms for the purchaser at the

expense of the seller. This may occur in particular when the trading company offers little value added and acts as a mere intermediary between the public entity or its marketing agent and a second-tier purchaser. The literature reports the case of suspicious transactions where a small trading company with no credentials in the trading business was offered very generous contractual terms to trade refined products, despite the fact that it would provide no logistical or other reasonable service. Contractual provisions included unusual long-term repayment periods, and payments in open credit with no financial guarantee led to unbalanced terms where the seller assumed substantial risks of default.

Opacity over the ownership and governance structures of key actors involved in commodity trading

The complex and opaque ownership and governance structures of agents in the commodity trading sector may constitute a factor conducive to corruption. This may be observed for example in the case of national oil companies that create subsidiaries for oil trading activities in purchaser and consumer countries; or in the case of commodity trading firms using multiple entities with holdings and subsidiaries registered in different jurisdictions, front companies or front men to conceal beneficial owners (Global Witness, 2013).

Lack of transparency on commodity-trading-related data

Corruption may thrive where there is no full disclosure by host governments of disaggregated data on: oil volumes received by national oil companies; oil sales by national oil companies (i.e. buyer, volume, crude grade, price and date for every cargo); revenue streams and financial transfers to and from the national oil companies and to and from the government (Gillies, 2012).

With regard to the home countries of trading companies, risks may include: the lack of requirements for payments disclosure by commodity traders and their business partners where these companies are registered or listed (i.e. annual reporting on the price, volume, grade and date for each transaction) (Gillies, 2012); the lack of harmonisation across national jurisdictions with regard to disclosure requirements, including information on commodity trading related payments and beneficial ownership (Global Witness, 2013); and insufficient international co-ordination to allow cross-checks and matching of information on export and import reporting (Berne Declaration, 2011).

Lack of or insufficient corporate due diligence

The lack of due diligence and compliance procedures by financial institutions, banks, trading companies and their business partners involved in commodity trading renders the effective prevention and detection of corruption risks more difficult (Guéniat, 2015).

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Opacity of commodity trading transactions	***What host governments can do*** ● Create a transparent and competitive tendering process for the selection of commodity trading companies, based on performance against select anti-corruption compliance criteria with regard to ethical standards, conflicts of interest, involvement of PEPs, beneficial ownerships, etc.[13] ● Provide a transparent price system for commodity trading companies engaged in commodity import/export using internationally recognised benchmark pricing supplemented by in-house technical expertise and ensuring independent authorities to monitor such activity. ***What home governments of companies involved in commodity trading can do*** ● Establish suitable oversight mechanisms on material transactions in commodity trading (Déclaration de Berne, 2014).
Opacity over ownership and governance structures of key actors involved in commodity trading	***What host governments can do*** ● Clearly define and disclose the institutional arrangements and practices governing the state's role in the extractive industries, ranging from the legal framework and fiscal regime to the financial relationship between the government and the state-owned enterprises (e.g. on transfers of funds, retained earnings, reinvestment and third-party financing) (EITI, 2015b). ● Require private and public producing companies to publicly report on their corporate structure, including the location of any of their subsidiaries in other countries serving as the trading arm of the company.[14] ***What home governments of companies involved in commodity trading can do*** ● Require companies active in commodity trading to publicly disclose beneficial ownership information related to businesses involved in transactions, including the direct or indirect involvement of any politically exposed persons.
Lack of transparency in commodity-trading-related data	***What host governments can do*** ● Where the state share of production or other revenues collected is material, require state-owned enterprises or other government entities to publicly report on volumes produced/received, volumes sold and revenues received disaggregated by individual company, government entity, revenue stream and project. ● Require state-owned enterprises or other government entity to further disaggregate the data shipment by shipment, by type and grade of product, price, market and sale volume, date of sale (EITI, 2015a; EITI, 2015b; NRGI, PWYP, BD, Swissaid, 2015). ● Publish the name of commodity buyers and require them to disclose payments related to the commodity transaction made to governments or state-owned enterprises (at the same level of disaggregation) to allow for reconciliation of state and company data (EITI, 2016; EITI, 2015a; EITI, 2015b). ● Reconcile data received from buyers and disclosures from the government and state-owned enterprises (EITI, 2015a). ● Ensure independent audit and oversight over financial flows between the state-owned company and the state general budget. ● Increase engagement with downstream actors, i.e. transit countries, where refineries are located, as well as final destination countries. ***What home governments of companies involved in commodity trading can do*** ● Require companies active in commodity trading to disclose all payments to governments (NRGI, PWYP, BD, Swissaid, 2015; Africa Progress Panel, 2013; ECDPM, 2014). ***What companies involved in commodity trading can do*** ● Disclose payments to governments, also where not required by an EITI implementing country (RCS Global, 2015).
Lack of or insufficient corporate due diligence	***What host governments can do*** ● Strengthen control, monitoring and oversight over state-owned companies' activities in commodity trading. ***What home governments of companies involved in commodity trading can do*** ● Require companies active in commodity trading to carry out rigorous due diligence on their business partners, to prevent illicit transactions with politically exposed persons or other intermediaries (UK Financial Conduct Authority, 2014). ● Require companies active in commodity trading to carry out rigorous due diligence on their supply chain to verify the origin of the commodities, and the conditions under which they are acquired, in particular when sourcing from high-risk areas (OECD, 2013b). ***What companies involved in commodity trading (private and public) can do*** ● Adopt, commit to and clearly communicate to suppliers a supply chain policy for identifying and managing risks, including corruption risks. Companies should ensure that an anti-corruption policy extends across the supply chain of commodities, incorporating the standards against which due diligence is to be conducted (OECD, 2013b). ● Structure internal management systems to support supply chain due diligence (OECD, 2013b). ● Establish a system of controls and transparency over the supply chain. This includes a chain of custody or a traceability system or the identification of upstream actors in the supply chain (OECD, 2013b). ● Strengthen company engagement with suppliers and incorporate due diligence standards and requirements into contracts and/or agreements with suppliers and other business partners (OECD, 2013b). ● Identify and assess corruption risks in the supply chain.

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
	• Strengthen company engagement with suppliers and incorporate due diligence standards and requirements into contracts and/or agreements with suppliers and other business partners (OECD, 2013b). • Identify and assess corruption risks in the supply chain. • Devise a strategy to respond to identified risks, by either: i) continuing trade throughout the course of measurable risk mitigation efforts; ii) temporarily, if appropriate with reference to the kind of risk, suspending trade while pursuing ongoing measurable risk mitigation; or iii) disengaging with a supplier after failed attempts to eliminate a risk or where the company deems risk mitigation not feasible or not acceptable (OECD, 2013b). • Carry out independent third-party audit of supply chain due diligence (OECD, 2013b). • Publicly report on supply chain due diligence policies and practices, for example by expanding the scope of sustainability, corporate social responsibility or annual reports to cover additional information on commodity trading supply chain due diligence (OECD, 2013b).

Notes

1. Comments received from participants in the Working Group on Corruption Risks during the consultations between January and May 2015.
2. See "Principles to Enhance the Transparency and Governance of Tax Incentives for Developing Countries developed by Task Force on Tax and Development", *www.oecd.org/ctp/tax-global/transparency-and-governance-principles.pdf*.
3. See note 2.
4. See note 2.
5. Further information on the Academy and the Oslo Dialogue is available at: *www.oecd.org/ctp/crime/tax-crime-academy.htm* and at OECD (2013), *Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264205376-en*.
6. The OECD is currently developing toolkits to assist developing countries to apply these commonly accepted transfer pricing approaches. Further information is available at: *www.oecd.org/tax/tax-global/work-on-transfer-pricing-and-beps-in-developing-countries.htm*.
7. Comments received from participants in the Working Group on Corruption Risks during the consultations between September and November 2015.
8. Further information on the new global standard on automatic information exchange is available at: *www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax-matters.htm*. Further information on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (as amended by the 2010 Protocol) is available at: *www.oecd.org/ctp/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm*.
9. This is Action 13 of the OECD/G20 Base Erosion and Profit Shifting Project. Further information is available at: *www.oecd.org/ctp/beps-actions.htm*.
10. See note 7.
11. See note 7.
12. Trade mispricing practices have already been detailed in the previous sub-section on corruption in revenue collection. The present section provides specific examples in commodity trading. Refer to the section above for general information on the vehicles and mechanisms used in trade mispricing (fraud, underreporting, etc.).
13. See note 7.
14. See note 7.

References

Africa Progress Panel (2013), *Equity in Extractives – Stewarding Africa's natural resources for all*, Africa Progress Report 2013, Geneva, *www.africaprogresspanel.org/wp-content/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf*.

AUC/ECA (2015), "Illicit Financial Flows – Report of the High Level Panel on Illicit Financial Flows from Africa", commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development, *www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf*.

Berne Declaration (2011), *Swiss Trading SA. – La Suisse, le négoce et la malédiction des matières premières*, Éditions d'en bas.

Curtis, M. (2012), *The One Billion Dollar Question: How Can Tanzania Stop Losing So Much Tax Revenue*, First edition, The Interfaith Standing Committee on Economic Justice and the Integrity of Creation, June.

Davies, T. and S. Fumega (2014), "Mixed incentives: Adopting ICT innovations for transparency, accountability, and anti-corruption", *U4 Issue* 2014:4, *www.u4.no/publications/mixed-incentives-adopting-ict-innovations-for-transparency-accountability-and-anti-corruption/#sthash.6jYd9HQm.dpuf*.

Déclaration de Berne (2014), « Plaidoyer pour une autorité de surveillance du secteur des matières premières – le rôle de la Suisse dans la malédiction des matières premières et ses responsabilités politiques », *www.ladb.ch/fileadmin/files/documents/Rohstoffe/14_295_EVB_ROHMA_Paper_A4_FR_FINAL_LowRes.pdf*.

ECDPM (2014), "Commodities and the Extractive Sector - Can transparency foster prosperity, progress and development in the EU and Switzerland?", *Briefing Note* No. 68, September.

EITI (2016), The EITI Standard, *https://eiti.org/files/english-eiti-standard_0.pdf*.

EITI (2015a), *EITI Progress Report 2015 – Making Transparency Matter*, Section "Momentum building for oil trade transparency", *http://progrep.eiti.org/#!/2015/looking-ahead/oil-trade-transparency*.

EITI (2015b), "The EITI, NOCs & the First Trade – The Extractive Industries Transparency Initiative as a Tool for Improving the Trading Climate with National Oil Companies (NOCs)", *Brief*, EITI International Secretariat, March, *https://eiti.org/files/EITI_Brief_NOC_FirstTrade_March2015.pdf*.

FATF (2013), "FATF Guidance for Politically Exposed Persons (Recommendations 12 and 22)", June 2013, Financial Action Task Force FATF-OECD, Paris, *www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-PEP-Rec12-22.pdf*.

Gillies, A. (2012), *Selling the Citizens' Oil – The Case for Transparency in National Oil Company Crudes Sales*, Revenue Watch Institute, April.

Global Witness (2013), "Azerbaijan Anonymous, Azerbaijan's State Oil Company and Why the Extractive Industries Transparency Initiative Needs to Go Further", December.

Guéniat, M. (2015), *Philia's refined ventures in Brazzaville – How Swiss traders misappropriate Congolese oil rents*, Berne Declaration, Lausanne, February, *www.bernedeclaration.ch/fileadmin/files/documents/Rohstoffe/BD-2015-Investigation-Philias_s_refined_ventures.pdf*.

Kar, D. and J. Spanjers (2014), *Illicit Financial Flows from Developing Countries: 2003-2012*, Global Financial Integrity, Washington, DC.

NRGI, PWYP, BD, Swissaid (2015), "In Pursuit of Transparent Trading", *Briefing*, October, *www.resourcegovernance.org/sites/default/files/nrgi_TradingPaper.pdf*.

OECD (forthcoming, 2016), "OECD Report on Assisting Revenue Authorities to Verify Mineral Product Prices in Transactions between Related Parties", OECD Paris.

OECD (2013a), *Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264205376-en*.

OECD (2013b), *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Second Edition*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264185050-en*.

OECD (2012), *International Drivers of Corruption: A Tool for Analysis*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264167513-en*.

OECD (2010), "Recommendation of the Council to Facilitate Co-operation between Tax and Other Law Enforcement Authorities to Combat Serious Crimes Further information", C(2010)119, 14 October 2010 available at: *www.oecd.org/tax/crime/2010-recommendation.pdf*.

PH-EITI (2015), *Philippines Extractive Industries Transparency Initiative Report 2014, Reconciliation Report, Volume II*, *http://ph-eiti.org/document/EITI-Report/First-Country-Report/PH-EITI_Report_Volume_II_Reconciliation_Report_final.pdf*.

PWYP (2014), "PWYP Indonesia on using project-level data, 11 September 2014", *www.publishwhatyoupay.org/pwyp-resources/pwyp-indonesia-on-using-project-level-data/*.

RCS Global (2015), "Transparency and Commodity Trading: A Business Case for Disclosing Payments to Governments by Commodity Trading Companies", 3 February, *www.rcsglobal.com/wp-content/uploads/2015/03/Traf_2660_RCS_v19_pages.pdf*.

UK Financial Conduct Authority (2014), "Commodity Markets Update", p. 9, February, *www.fca.org.uk/static/documents/commodity-market-update-1402.pdf*.

World Bank (2007), *The Many Faces of Corruption - Tracking Vulnerabilities at the Sector Level*, edited by J.E. Campos and S. Pradhan, The International Bank for Reconstruction and Development/The World Bank, Washington, DC, *https://openknowledge.worldbank.org/handle/10986/6848*.

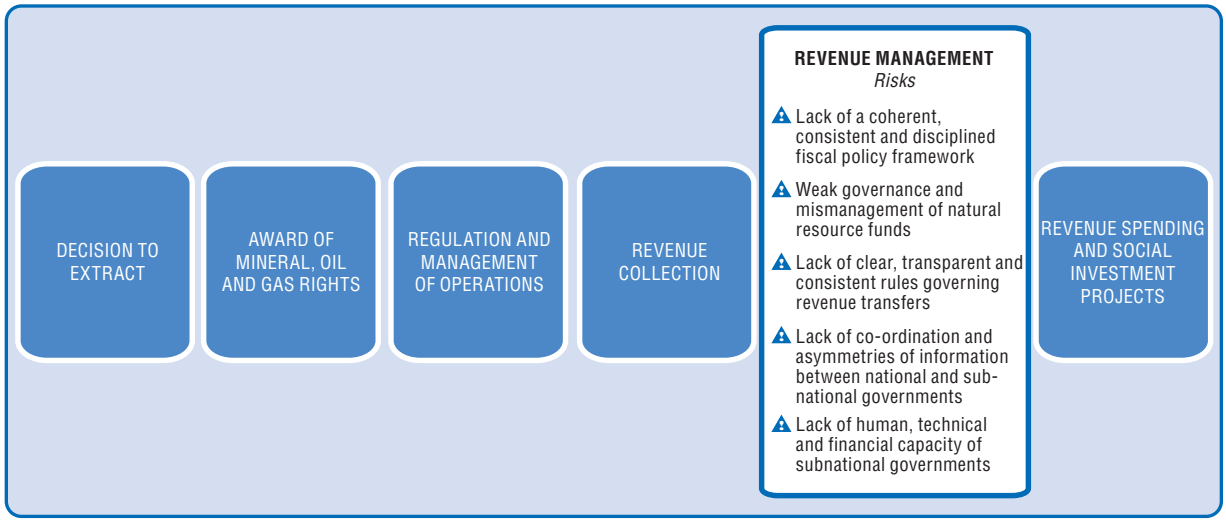
© OECD 2016

Chapter 6

Corruption risks in revenue management

This chapter looks into corruption risks associated with different types of revenue management and distribution. In particular it covers risks related to the management of revenues through natural resource revenue funds and government transfer schemes for the redistribution of revenues. It further offers practical guidance on recommended mitigation measures to host governments, at central and local levels, and donors.

Figure 6.1. **Corruption risks in revenue management**



Corruption related to revenue management through natural resource funds

Many resource-rich countries have established funds for managing resource revenues. These funds have a variety of different purposes, ranging from stabilisation of revenue flows, sterilisation of exchange rate fluctuations,[1] to saving for inter-generational equity and investment to promote local development (IMF, 2014). The purpose of a fund and the investment mandate that it sets forth for this purpose, imparts different degrees of corruption risk.

Stabilisation funds, for instance, are inherently short-term, low-risk and passive investment funds. They typically hold a portfolio of government bonds in major international currencies (largely US Treasuries and other sovereign debt from developed economies), and occasionally highly rated corporate bonds. There are numerous commercial providers that offer portfolio management services at a reasonable cost. Another approach, as some countries with stabilisation funds have taken involves the central bank providing asset management services. Given that the investment mandate is limited to short-term and low-risk securities and cash, there is limited to no opportunity for funnelling capital to investments that could be of a corrupt nature. But this does not mean that stabilisation funds due to their low-risk nature are free of corruption risk. If third-party asset managers are used, the payment of higher than market-rate management fees could suggest incompetence or potential corruption.

For savings funds, including those with stabilisation objectives, investment options are not, in principle, as restricted. If the objective of a fund is to maintain and increase wealth for future generations, then there is reason to diversify the portfolio across a greater range of asset classes with different risk-return characteristics. With this larger investment

mandate there is a greater risk of corruption either through direct investments or in the use of asset management contracts.

Moreover, some countries have established special-purpose investment vehicles that are charged with fostering local economic development by targeting certain sectors and/or investing in infrastructure. Establishing a natural resource fund with a domestic mandate is not without significant risk, of which corruption is one. For example, there is a risk that these funds invest in industries where the commercial viability is weak or in infrastructure projects that have limited purpose – so-called "white elephants" or "bridges to nowhere". In effect, they may lack the rigor and savvy to execute investments that produce a better developmental outcome. If such investments derive from corruption, rather than insufficient due diligence, then the fund would reinforce underdevelopment.

Corruption schemes

Fraud, diversion of resource revenues for private interest and embezzlement

In the management of natural resource funds, the transfer of funds from the general budget as well as the disbursement of financial resources are vulnerable to risk of embezzlement and diversion of public funds for private interests.

Political capture, bribery, favouritism and clientelism in investment decisions

Financial flows to and from resource revenue funds may bypass the regular budget process and become vehicles for patronage and discretionary allocations (OECD, forthcoming 2016; NRGI, 2014). The press has reported several cases where conflicts of interest and political capture have led to mismanagement, misuse and misappropriation of funds which has severely undermined the performance of natural resource funds. It is common to find government officials or well-connected elite on the supervisory board of these funds. In one particular case, the board was almost exclusively composed of members belonging to the President's inner circle. This resulted in a series of opaque and high-risk investments in hedge funds and complex derivative transactions.

The management of natural resource funds, in particular investment decisions may be marred by patronage and clientelist practices. Corruption can occur either through direct investments or in the use of asset management contracts. Indeed, suspicions of corruption underlie several cases where non-commercially credible or imprudent investments were made in companies affiliated to (owned, managed and/or advised by) well-connected elites. In all cases identified, the amounts of revenues missing from the funds' accounts or lost as a result of mismanagement, misconduct and lack of oversight amounted to billions of dollars.

Similarly, the management of portions of the fund's assets may be entrusted to external managers (e.g. foreign banks) with political ties and affiliations in the country. For example, in one oil producing country, a manager in the national natural resource fund was accused by members of parliament of contracting his former employer, a foreign bank, as an external manager of the fund's assets without following due process (NRGI, 2014). In another case, a lawsuit was filed by the natural resource fund against a foreign bank for allegedly bribing key officials and top executives of the fund to influence decisions over the fund's investments.

In some resource-rich countries, in particular oil producing countries, patronage can be a broader feature of the economic and political system under which natural resources are governed and managed (Ramos, 2012).

Parties involved

On the public side, parties involved in corrupt schemes related to mismanagement of natural resource funds may be the fund's board members, managers or staff. Politicians and high-level government officials from ministries or central banks involved in the management of the fund may also play a role in the corrupt scheme through trading in influence, conflicts of interest or embezzlement.

On the private side, foreign or local investment banks and other fiduciary entities acting as external managers of portions of the fund's assets may also be the instigator of the corrupt scheme and may bribe public officials with a view to influencing investment decisions.

Vehicles and mechanisms

Use of shell companies

In cases of bribery or diversion of public funds, parties to the corrupt scheme may use offshore companies with obscure beneficial ownership to channel and launder the illegal payments or to conceal the proceeds of corruption. For example, one lawsuit case reports the payment by a foreign bank of advisory fees to a friend of the President's son through an offshore company.

Use of offshore bank accounts

The proceeds of corruption or diverted funds are usually transferred to offshore bank accounts pertaining to friends or relatives of the corrupt officials in jurisdictions with lax regulations regarding beneficial ownership.

Fraud and misinvoicing

As illustrated in the example above, illegal payments and bribes may be falsely recorded as advisory or consultancy fees. When external asset managers or investment consultants are used, higher than market-rate management fees or commissions may suggest potential corruption.

Corruption risks

Lack of a coherent, consistent and disciplined fiscal policy framework

The lack of a coherent fiscal policy framework stating clear medium-term to long-term fiscal objectives and integrating natural resource funds into the general budget may provide ground for corruption in the revenue management phase (IMF, 2007). Overly rigid or inconsistent deposit and withdrawal rules, unclear accounting of revenue flows between the government and the fund, insufficient reporting of off-budget accounts in the general budget and circumvention of the regular parliamentary budget process increase the risk of dual budgeting and encourage corrupt practices to bypass existing rules or take advantage of legislative and regulatory gaps. The lack of transparency and accountability in the use of extra-budgetary allocations and secret bank accounts or deposits outside the national banking system contribute to opacities in the origin and destination of the fund's revenue flows.

Mismanagement of the fund

Shortcomings in the management of natural resource funds may provide opportunities for corruption. Such gaps may include a mismatch between the fund's policy objectives and

its investment function, as well as between the investment function and the organisational and human resource capabilities and expertise of the fund. In relation to the latter, the lack of staff professionalisation and technical capacity may leave room for unchecked and excessive executive discretion in the budget process, increasing the risk that resource revenue funds become a parallel budget managed under the discretion of the executives (Sharma and Strauss, 2013; Collier and Venables, 2011; Gauthier and Zeufack, 2009).

The lack of transparency in the management of the fund may also encourage corrupt practices. Opacity may result from unclear or vague procedural and operational rules governing the management of the fund, internal controls and monitoring systems. It may also result from the lack of public disclosure on natural resource funds activities and governance structures including: its institutional structure; functions; relations with the executive; investment mandates; investment policy; risk management policy; asset allocation; targets, benchmarks and results for asset classes and direct investment assets; external management fees and fees paid to investment consultants (Gelb, Tordo and Halland, 2014). In some countries, information disclosure about natural resource funds is even prohibited by law (NRGI, 2014; Collier and Venables, 2011; Gauthier and Zeufack, 2009).

Weak governance of the fund

Inadequate governance arrangements may foster discretion in decision-making processes and hamper integrity and compliance in the management of natural resource funds. First, the lack of clear rules defining the roles and responsibilities; between ownership and regulatory/supervisory functions of natural resource funds (Gelb, Tordo and Halland, 2014); and/or between board membership and executive management may result in weakening the board's oversight function. It may also allow for the exercise of political discretion in changing the fund's rules and making investment decisions (NRGI, 2014; Collier and Venables, 2011; Gauthier and Zeufack, 2009). Additional risk factors include: the lack of an independent and accountable supervisory board (Collier and Venables, 2011; Gauthier and Zeufack, 2009); the lack of expertise and professionalisation of the fund's board members; as well as the lack of clear behavioural guidelines and codes of conduct requiring board members, executives and staff to disclose potential conflicts of interest (NRGI, 2014).

Finally, the lack of independent audits and the lack of parliamentary and public scrutiny on the management of natural resource funds may further increase risks of political discretion and associated corrupt practices.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Lack of a coherent, consistent and disciplined fiscal policy framework	***What host governments can do*** ● Define a coherent and disciplined fiscal policy framework in which natural resource funds are integrated with the budget through clear deposit and withdrawal rules and procedures. ***What donors can do*** ● Assist with the development of clear medium- to long-term fiscal policy/fiscal objectives. ● Support the implementation of transparency and accountability guidelines for the management of revenue generated from extractive industries, including whenever relevant considerations for the creation of a sovereign wealth fund or similar arrangements to manage revenues. Help with access to information on the experience of other countries which have used such arrangements.
Mismanagement of funds	***What host governments can do*** ● Put in place a robust and stable legal framework establishing roles and responsibilities as well as rules for the accumulation and investment of assets. ● Ensure coherence between the fund's policy objectives, such as stabilisation or saving for the future, and its investment function. ● Establish ethical guidelines to screen companies in which funds are invested. ● Ensure that the degree of allowable investment risk and the scope of allowable investments match the organisational and human resource capabilities available to the fund as an institutional investor (OECD, forthcoming 2016). ● Require disclosure of fees paid by natural resource funds to investment consultants or external asset managers. ● Require natural resource funds to provide comprehensive and timely reports on their transactions and assets (OECD, forthcoming 2016).
Weak governance of the fund	***What host governments can do*** ● Establish sound institutional and governance arrangements that limit discretionary behaviours and ensure insulation of the fund from short political cycles. ● Promote merit-based selection of governance board members and operational managers with a remuneration scheme that attracts and maintains qualified professionals, clear procedures for appointment terms and removal (OECD, forthcoming 2016). ● Establish internal integrity measures including requiring governing bodies, managers and staff to disclose any direct or indirect business interests with any activity involving the fund (OECD, forthcoming 2016). ● Where domestic state institutions are weak, consider contracting out management to an independent and professional domestic, regional or international institution (OECD, forthcoming 2016). ● Subject the natural resource fund to parliamentary oversight and independent external audits (OECD, forthcoming 2016). ● Publish reports and audit results. ● Invest in public education and transparent communication on the fund's strategy, objectives and results in order to build and maintain trust among citizens and investors over time (OECD, 2015). ***What donors can do*** ● Provide capacity-building support to train parliamentarians on issues related to fiscal policy and revenue management in order to ensure effective parliamentary scrutiny over the management of funds.

Corruption in the redistribution of resource revenue through transfers

The redistribution of revenues with transfer of funds from central to subnational entities presents major risks of corruption, in particular risks of revenue diversion and embezzlement and risks of patronage and clientelism.

Natural resource revenues can be transferred from central to subnational authorities through various mechanisms. Revenue-sharing arrangements can be grouped into three main categories: i) devolution or derivation-based transfers; ii) direct allocations from the central government and iii) formula-based revenue sharing arrangements. The purpose of devolution or derivation-based formula is to transfer revenue, or a share of it, to jurisdictions associated with the extractive activity, either producing regions or regions hosting infrastructure for refining, transportation and distribution. This mechanism aims to compensate the producing regions for the extraction of resources or the negative externalities linked to the extractive activity. The second scenario consists of centrally managed allocations whereby the central government consolidates the management of revenues,

allocated through development or regional investment funds on an annual basis from a central budgetary account, or through competitive investment grants aimed at supporting specific types of projects, to promote a more strategic investment of resources and to minimise the fiscal liability of uncontrolled subnational expenditure. Finally, governments can rely on pre-determined formula to distribute resource revenues across all subnational jurisdictions, including non-producing ones, taking into account the different needs and characteristics of each jurisdiction, the size of the population and territory, pre-existing social and economic inequalities, and in some cases fiscal effort. In practice, these criteria can be combined when deciding on reallocation and distribution schemes (Acosta, 2015).

Corruption schemes

Embezzlement and diversion of revenues

Risks of leakages and revenue diversion may affect the phase of calculation of the share of revenues available for transfer. Embezzlement and misappropriation of funds may also occur throughout the revenue transfer process, from intra-governmental transfers through various designated national accounts all the way through to subnational authorities' accounts where the revenues are actually disbursed.

Patronage, favouritism and clientelism

The rationale behind central government revenue assignments to subnational governments may be driven by patronage and electoral clientelism with a view to securing loyalties at the subnational level. This can be facilitated in the case of non-statutory assignments that provide for a certain level of discretion in determining the criteria for allocation as in the case of revenue distribution through specific purpose funds or competitive investment grants aimed at supporting specific types of projects (ODI, 2006).

Parties involved

In cases of revenue diversion and embezzlement, parties involved can be national or local government officials depending on where in the transfer process revenue misappropriation and leakages occur.

In cases of patronage and clientelism, the instigator of the corrupt scheme may be national government officials, or alternatively local government officials bargaining their affiliation and loyalty in exchange for bribe payments.

Vehicles and mechanisms

Miscalculation of the share of revenues available for transfer

The complexity of calculations of the share of total revenue available for transfer and the share allocated to each subnational government may provide an opportunity for fraud, misappropriation and embezzlement. This is true in particular in the case of formula-based revenue-sharing types of arrangements for which criteria for allocation and redistribution might be unclear as well as in the case of derivation-based transfers for which determining the proportion of total resource revenues derived from a particular producing state, province, district or affected community may prove challenging (ODI, 2006).

Use of offshore bank accounts

Diverted funds can be transferred to offshore bank accounts pertaining to friends or relatives of the corrupt officials in jurisdictions with lax regulations regarding beneficial ownership.

Corruption risks

Lack of clear, transparent and consistent rules governing revenue transfers

Corruption risks in revenue redistribution may result from the lack of clear, coherent and consistent rules governing revenue transfers from national to subnational authorities. Revenue distribution schemes may suffer from inconsistency with national fiscal policy and macroeconomic objectives. Moreover, legislation may fail to set clear and transparent transfer rules and assignments of expenditure responsibilities or when a legal framework exists, it may lack stability or not be enforced (Acosta, 2015; World Bank, 2011). Finally, unclear or vague rules and regulations may provide room for unchecked and excessive executive discretion in the budget process allowing for discretionary or *ad hoc* transfers (Bauer, 2013).

Lack of co-ordination and asymmetries of information between national and sub-national governments

Corruption risks may arise from the lack of co-ordination and the asymmetry of information between national and sub-national governments (World Bank, 2011). This may take the form of insufficient tracking and transparency over transfer payments from various "disbursement" accounts at national level (ODI, 2006). Moreover, the lack of disaggregated data disclosure by the central government leaves local authorities with insufficient information (e.g. data on volumes produced, consumed and exported, and on the prices actually realised, and the amount the government receives for its share of production) to verify their entitlements (World Bank, 2011).[2] This lack of transparency may be due in particular to the confidentiality of contractual clauses on company payments to the national government (Bauer, 2013; Morgandi, 2008). Conversely, asymmetries of information may work in favour of local governments due to the lack of or unclear legal provisions for the reporting of financial accounts by lower levels of government to the central government (NRGI, 2013), as well as weak central government's control systems (IADB, 2014; Martini, 2012).

Lack of human, technical and financial capacity of subnational governments

Finally, corruption in revenue transfers may thrive where subnational governments lack the human, technical and financial capacity to manage and spend large revenue inflows. In particular, local governments often lack the statistical capacity to measure fiscal performance, model complex revenue streams and verify entitlements (Bauer, 2013). Moreover, local governments may not have appropriate safeguards and transparency mechanisms in place to protect budget levels from potential fiscal volatility (Ushie, 2012; Acosta, 2015).

Reforms towards greater decentralisation have often translated into increased transfers of responsibilities and revenues without transferring the necessary financial and human capacity or investing in building local institutional and administrative capacity to manage these new large inflows of resource revenues. This has led to poor budget execution, difficulties in planning and inefficient resource allocation (ODI, 2006; IADB, 2014; Martini, 2012;

World Bank, 2011). Moreover, the high concentration of revenues contributes to encouraging rent-seeking behaviours and dependency on transfer payments at the expense of tax collection (World Bank, 2011).

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Lack of clear, transparent and consistent rules governing revenue transfers	***What central governments can do*** ● Structure a revenue distribution scheme which is consistent with national fiscal policy and macroeconomic objectives. ● Define and enforce legislation clearly setting transfer rules, assigning expenditure responsibilities and segregating roles in the authorisation process (proposal, examination, approval) to limit executive discretion in the budget process. ● Introduce a transparent and clear regulation and accounting system for revenue transfers.
Lack of co-ordination and asymmetries of information between national and sub-national governments	***What central governments can do*** ● Define clear legal provisions for the reporting of financial accounts by lower levels of government to the central government. ● Introduce periodical reconciliation of transfers between the national and subnational levels. ● Publicly disclose the revenue sharing arrangements between central and subnational governments as well as the actual disaggregated transfer payments so as to enable local authorities to verify their entitlements and facilitate the identification of any discrepancies. Publicly disclose any further *ad hoc* or discretionary transfers (World Bank, 2011). ● Increase collaboration with local administrations to develop standard systems to model revenue streams, standard reporting systems, etc.
Lack of human, technical and financial capacity of subnational governments	***What local governments can do*** ● Plan appropriate organisation and staffing and strengthen financial management, oversight and audit functions in local administrations to increase capacity to manage transfers and local revenues (World Bank, 2011). ● Develop systems and build capacity to model revenue streams to verify entitlements and facilitate budget planning activities. ● Develop appropriate fiscal rules, safeguards and transparency mechanisms to protect budget levels from potential fiscal volatility.

Notes

1. Comments from participants in the Working Group on Corruption Risks further point to risk associated with the manipulation of the exchange rate, when decisions are influenced by third parties' interests such as export industries, in particular in the extractive sector, benefitting from the depreciation of the national currency.
2. See also recommendations contained in the following EITI reports: Democratic Republic of Congo (2012 report), *www.itierdc.com/formulaire/Rapport%20de%20Conciliation%20ITIE%20RDC%202012%20-%20Final%20.pdf*. Ghana (2012-2013 report), *https://eiti.org/files/2012-2013_Final_Oil_and_Gas_Sector_Report_0.pdf*. Guinea (2012 report), *https://eiti.org/files/Guinea-2012-EITI-Report-FR.pdf*. Kazakhstan (9th 2013 report), *https://eiti.org/files/EITI-2013-Report-Kazakhstan_Annex.pdf*. Liberia (5th 2011-2012 report), *https://eiti.org/files/EITI_Report_Liberia_2011-12.pdf*. Peru (2011-2012 report), *https://eiti.org/files/Peru-2011-2012-EITI-Report_0.pdf*. Zambia (2013 report), *https://eiti.org/files/zeiti_2013_reconciliation_final_report_18_12_14%20%281%29%20%282%29.pdf*. Philippines (2nd 2015 report) *http://ph-eiti.org/document/EITI-Report/First-Country-Report/PH-EITI_Report_Volume_II_Reconciliation_Report_final.pdf*.

References

Acosta, A.M. (2015), "The Governance of Natural Resource Wealth: Some Political Economy Considerations on Enhancing Social Investment", Chapter 11 in *Growth is Dead, Long Live Growth – The Quality of Economic Growth and Why it Matters*, JICA Research Institute, Tokyo, January.

Bauer, A. (2013), "Subnational Oil, Gas and Mineral Revenue Management", *Briefing*, Revenue Watch Institute, *www.resourcegovernance.org/sites/default/files/Sub_Oil_Gas_Mgmt_20151125.pdf*.

Collier, P. and A.J. Venables (2011), *Plundered Nations? Successes and Failures in Natural Resource Extraction*, pp. 50-57, Palgrave Macmillan, October.

Gauthier, B. and A. Zeufack (2009), "Governance and Oil Revenues in Cameroon", *OxCarre Research Paper* 38, Oxford Centre for the Analysis of Resource Rich Economies, Oxford University, 7 October.

Gelb, A., S. Tordo and H. Halland (2014), "Sovereign Wealth Funds and Long-Term Development Finance Risks and Opportunities, *Policy Research Working Paper* 6776, World Bank, February, *www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/02/11/000158349_20140211115309/Rendered/PDF/WPS6776.pdf*.

IADB (2014), "Transparency in the Management of Revenues from the Extractive Industries: The case of Colombia", Chapter 9 in *Transparent Governance in an Age of Abundance, Experiences from the Extractive Industries in Latin America and the Caribbean*, Inter-American Development Bank, Washington, DC.

IMF (2014), *Sovereign Asset-Liability Management – Guidance for Resource-Rich Economies*, International Monetary Fund, 10 June, *www.imf.org/external/np/pp/eng/2014/061014.pdf*.

IMF (2007), *Guide on Resource Revenue Transparency*, Fiscal Affairs Department, International Monetary Fund, Washington, DC.

Martini, M. (2012), "Causes of Corruption in Indonesia", *U4 Expert Answer* No. 338, 7 August.

Morgandi, M. (2008), *Extractive Industries Revenues Distribution at the Sub-National Level: The Experience in Seven Resource-Rich Countries*, Revenue Watch Institute, New York, June, *www.resourcegovernance.org/sites/default/files/Extractive%20Industries%20Revenues%20Distribution%20at%20the%20Sub-National%20Level.pdf*.

NRGI (2014), *Managing the Public Trust: How to Make Natural Resource Funds Work for Citizens*, Natural Resource Governance Institute and Columbia Center on Sustainable Investment, *www.resourcegovernance.org/sites/default/files/NRF_Complete_Report_EN.pdf*.

NRGI (2013), *The 2013 Resource Governance Index*.

ODI (2006), "Sub-National Implementation of the Extractive Industries Transparency Initiative (EITI)", *Issue Paper*, Overseas Development Institute, May, *www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/6160.pdf*.

OECD (forthcoming, 2016), Comparative analysis on the performance of stabilisation funds and investment options, OECD, Paris.

OECD (2015), "Summary Report of the Fourth Meeting of the Policy Dialogue on Natural Resource-based Development", 29-30 June 2015, OECD, Paris, *www.oecd.org/dev/EN_SummaryReport_Fourth MeetingofthePolicyDialogueonNaturalResource.pdf*.

Ramos, M. (2012), *Angola's Oil Industry Operations*, Open Society Initiative for Southern Africa (OSISA), 30 October, *www.osisa.org/sites/default/files/angola_oil_english_final_less_photos.pdf*.

Sharma, N. and T. Strauss (2013), "Special Fiscal Institutions for Resource-rich Developing Economies – The State of the Debate and Implication for Policy And Practice", *ODI Research Report*, London, May.

Ushie, V. (2012), "Subnational Management of Resource Revenues in Nigeria", The North South Institute *Policy Brief*, March, *www.nsi-ins.ca/wp-content/uploads/2013/03/2013-Subnational-Management-of-Resource-Revenues-in-Nigeria1.pdf*.

World Bank (2011), "Implementing EITI at the Subnational Level, Emerging Experience and Operational Framework", *Extractive Industries for Development Series* No. 23, October.

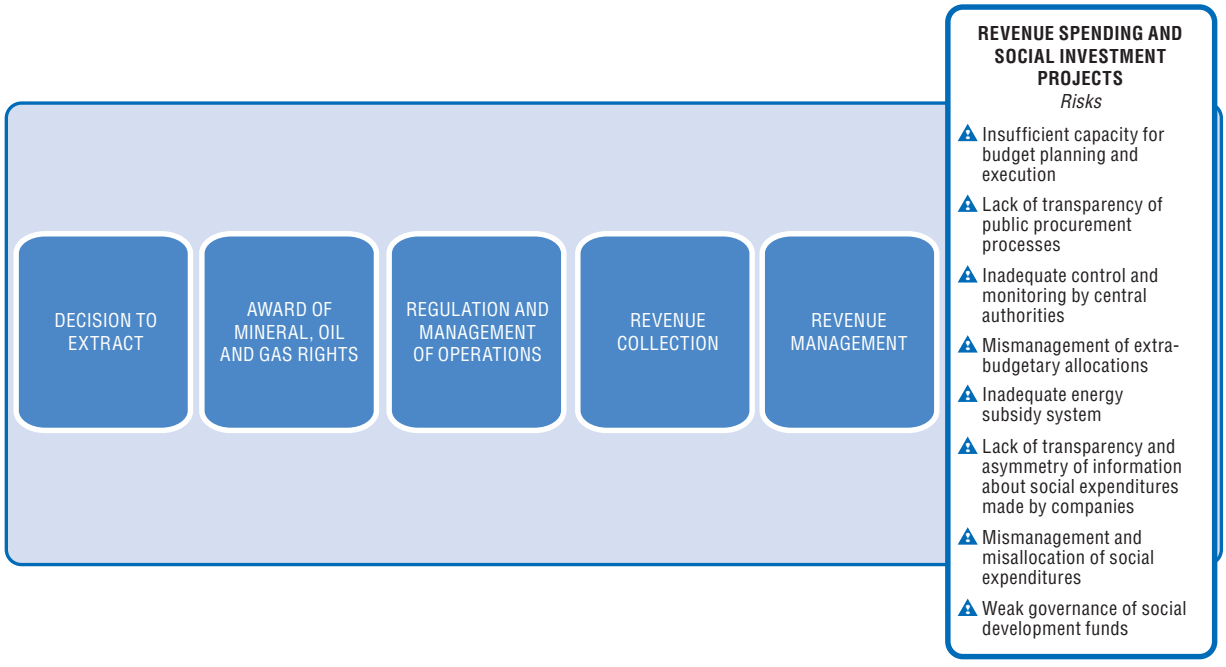
© OECD 2016

Chapter 7

Corruption risks in revenue spending and social investment projects

This chapter describes corruption risks associated with malpractices in public spending or social expenditure by private companies. It covers various areas including public procurement and investment, provision of fossil fuel subsidies, direct cash transfers, and social investment expenditures. It further offers recommended mitigation measures addressed to host governments, both at central and local level, donors and companies to minimise identified risks.

Figure 7.1. **Corruption risks in revenue spending and social investment projects**



Corruption in public spending

Corruption schemes

Corruption in public procurement and investment

Corruption in public procurement and investment can take the form of tender rigging, budget capture, embezzlement, extortion, bribery and kickback from suppliers or customers in exchange for securing contracts and deals, patronage, cronyism and clientelism (e.g. officials granting projects to members of their inner circle), abuse of office, diversion of public funds allocated to social projects to benefit private interests, misuse of public assets and violation of regulations (e.g. ordering goods and services not authorised in the budget, investing public funds in other projects than those initially foreseen in budgets or development plans,[1] theft of government supplies, etc.).

Tender rigging includes practices such as collusive pricing, lowballing (i.e. underpricing of bids using change orders to raise costs), contract steering and favouritism in contract awards as detailed in previous chapters. These corrupt practices tend to particularly affect the procurement of large, capital-intensive and complex public works projects such as infrastructure building (World Bank, 2007). However, even smaller projects involving the provision or financing of power generators to communities may be tainted by conflicts of interest.[2]

Corruption and misuse of public funds in connection with public spending and investment in local communities development

In producing countries, national legislation may require local governments to spend a share of revenues from resource extraction on social services such as health, education and capacity development for local communities living in the vicinity of the production area. Earmarked resources may however be diverted or misused and spent for other purposes.[3]

In some countries, a share of the resource revenues may be directly transferred to traditional authorities who are responsible for funding local community development projects. In this case, the allocation and spending process may be undermined by risks of elite capture, cronyism and clientelism, and appropriation of resource revenues by traditional authorities and leaders for personal enrichment.

Bribery and misuse of public assets

Fossil fuel subsidies[4] commonly funded out of resource revenues can represent a driver of corruption in the refining and marketing segment of the oil value chain. The most common associated corruption schemes include the misuse of public assets and bribery (World Bank, 2007). Fossil fuel subsidies in the form of the imposition of price controls for fossil fuels often results in product shortages creating opportunities for lucrative corrupt activities and smuggling practices. For instance, the literature reports the case of subsidies for petroleum products used to fuel corruption and illicit activities. Refined products purchased on international markets were sold domestically at a control price of less than a quarter of the import price. Yet, a very high percentage of this cheap gasoline went right back out of the country through smuggling and illicit trade (World Bank, 2007). This type of scheme may involve the payment of bribes and kickbacks to public officials in the negotiation phase of product import contracts and may also be part of more complex schemes involving crude-for-refined-products swap contracts described in the previous chapters.

Parties involved

On the public side, parties involved may be government officials at the central or local level as well as representatives of traditional leaders depending on the level of power devolution in public expenditure. Corrupt conduct such as embezzlement and misappropriation of funds may also be found in regional development or targeted funds (e.g. innovation, education, etc.)[5] or in natural resource funds as shown in the previous section. Finally, state-owned enterprises in the extractive sector may sometimes be mandated to undertake social or environmental expenditure or to provide subsidies (IMF, 2007; World Bank, 2007). They might therefore also be parties or instigators of corrupt schemes associated with procurement of goods or the provision of energy subsidies (World Bank, 2007).

More specifically, corruption in public spending may involve high-ranking officials as well as administrative officers such as officers in charge of commitment, verification, and payment authorisation in the procurement process, or inspectors. For example, the press reports the case of a state governor who practised large-scale diversion of public funds by inflating state contracts and awarding them to relatives, taking kickbacks and stealing money directly from state accounts.

On the private side, main parties to corrupt schemes in public procurement and investment are usually suppliers and contractors. Moreover, representatives of local non-governmental organisations and local communities might also be involved in corrupt schemes affecting investment in local community development projects.

Vehicles and mechanisms

Fraudulent overbilling and cost overruns

Fraudulent overbilling and project cost inflation may be used to conceal corrupt conduct in public spending and investment. Illegal payments or misappropriated funds may be recorded as payments for goods and services not received or for unearned salaries following for example a failure to ensure the timely deletion of names of former staff from the payroll (World Bank, 2007).

Moreover, corrupt agents may encourage the use of substandard materials or practices in construction projects in order to divert part of the funds dedicated to the project.

Use of offshore bank accounts and shell companies

Corrupt agents may resort to offshore bank accounts or shell companies to conceal the proceeds of corruption or diverted funds.

Fossil fuel price controls and subsidies

Price control policies and subsidies may serve as a vehicle for corrupt conduct and smuggling practices.

Corruption risks

Insufficient capacity for budget planning and execution

Corruption in public spending may be attributable to poor budget planning and execution capacity, at the local level in particular. Local authorities may be faced with the challenge of estimating budgetary inflows and outflows. The lack of access to comprehensive and transparent budgetary information and revenue estimation and collection may result in poor cash planning and predictability of funds and systemic overestimation of revenues (World Bank, 2007). On the expenditure side, budget formulation may be undermined by the misalignment of spending choices with development objectives (e.g. education, health care, drinking water, infrastructure, etc.) (UNDP, 2015); the lack of consultation with beneficiaries, and the ineffective design of development projects (e.g. specifications, scope of work, deliverables, project completion milestones and assumptions about project risks) (UNDP, 2015). Moreover, the lack of absorptive capacity of the local administration and the local economy (e.g. local domestic supply of qualified labour, training capacity, ease of access to inputs, ease of access to credit for businesses, and presence of management systems and institutions) challenges the ability of local governments to transform financial resources into concrete infrastructure and social services (Acosta, 2015).

Budget planning and execution may suffer from additional weaknesses including the lack of clear definition and segregation of roles and responsibilities among officers in charge of budget formulation and execution resulting in excessive power discretion and the lack of regular independent audits of public expenditures to ensure timely project completion, quality deliverables and value-for-money (UNDP, 2015). Weak local government capacity tends to *de facto* legitimise traditional authorities' power, increasing

risks of political discretion and corruption (e.g. trading in influence, collusion, nepotism) (Standing and Hilson, 2013).

Lack of transparency in public procurement processes

With regard more specifically to public procurement processes, corruption may arise from the lack of open, publicly advertised and competitive bidding for the selection of contractors and subcontractors. When public procurement is made through bidding, corruption risks may be attributable to vague and unclear pre-qualification and evaluation criteria or excessive discretion of evaluators in bid evaluation systems. Moreover, possible collusion between traditional leaders and extractive companies or between traditional leaders and members of local or central governments may result in inefficient allocation of resources including duplication of funds for identical projects;[6] the awarding of "exclusive contracts"; or unpredictable renegotiation of awarded contracts.

Inadequate control and monitoring by central authorities

Ineffective and insufficient state control and monitoring over local governments' revenue administration may contribute to increasing corruption risks in public spending. More specifically, vulnerabilities may result from non-adapted state certification systems, weak accounting practices and reconciliation procedures, irregular, inaccurate or incomplete fiscal reporting or the lack of penalties for deviations from planned revenue and expenditure targets.

Overly rigid allocation rules may provide little leeway for local authorities to respond to unexpected or urgent needs and incentivise them to commit irregularities (e.g. making informal agreements with contractors to obtain extra goods or services without including them in the receipts).

Finally, in some countries, central authorities may face difficulty in ensuring resource revenue traceability and control due to the lack of transparency and accountability over funds directly transferred and allocated to traditional authorities (Standing and Hilson, 2013); or the lack of clear and explicit legislation regarding the role and responsibilities of traditional authorities in local political processes (Standing and Hilson, 2013).

Mismanagement of extra-budgetary allocations

Another risk factor for corruption in public spending consists of mismanagement practices in extra-budgetary allocations such as those made to resource-related funds, special investment vehicles (e.g. regional development or targeted funds) or state-owned extractive companies. The lack of transparency and accountability over the use of these extra-budgetary allocations combined with the lack of commercial viability of domestic investments made through these special investment vehicles contribute to increasing exposure to corruption risks.

In the case of state-owned enterprises, risk factors include: the lack of clear definition of their ownership structures and fiscal role, the lack of separation between their commercial and non-commercial activities such as policy, regulatory and social obligations (NEITI, 2011), the lack of compliance with international accounting standards and inclusion of their financial information in the national budget (NEITI, 2011), the lack of regular and independent audits, and the lack of public disclosure of financial audits and information on their activities, in particular on quasi-fiscal activities (World Bank, 2007).

Inadequate energy subsidy system

Risk factors contributing to corruption related to energy subsidies include inadequate levels of price controls and subsidies, the lack of transparent competitive tendering for import contracts and insufficient metering capacities to detect fraud in oil volume reporting or theft.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Insufficient capacity for budget planning and execution	***What central and local governments can do*** ● Put in place transparency and accountability mechanisms to ensure that spending choices align with national and local development objectives. ● Put in place a transparent and robust authorisation process for spending, segregating roles in the authorisation process (proposal, examination, approval) and defining criteria for exceptional treatment such as the awarding of exclusive contracts or contract renegotiation. ● Perform feasibility study of planned development projects, involving third-party experts. ***What donors can do*** ● Support capacity building of budget planning units at the central and local levels or of budget parliamentary committees involved in the drafting of budgeting laws. ● Support the preparation of national and local development plans, including the development of indicators and milestones to measure progress in the implementation.
Lack of transparency of public procurement processes	***What central and local governments can do*** ● As much as possible, favour public procurement and investment through open, competitive and transparent tendering procedures. ● Digitalise public procurement processes (e.g. one-time online registration, online document exchange, automatic collection of bidders' qualification data, delivery report, e-invoicing and e-payment) as a way to increase transparency, limit direct interactions between officials and potential suppliers, facilitate the detection of bid rigging cases and gather useful background information on suppliers' past performance with regard to integrity and business ethics (OECD, 2014a). ● Use databases of bidding information generated by e-procurement to systematically screen data and detect suspicious bid strategies and symptoms of collusive arrangements (e.g. submission of identical bids, high correlation between bids, lack of correlation between the supplier's costs and the bid submitted, significant differences between the winning and the losing bid) (OECD, 2015); and whenever possible, cross-check procurement expenditure data with other government databases as a means of identifying atypical situations (e.g. possible conflicts of interest, suspicious patterns of bid-rotation and market division among competitors by sector, geographic area or time (OECD, 2014a). ● Regularly map out risk factors and vulnerabilities of the integrity of the public procurement process in order to prevent and detect irregularities and failures in procurement processes (OCDE, 2014a). ● Debrief bidders on how the award decision was made. ● Set clear ethical standards and codes of conduct and provide certification and regular training for procurement officials. ● Perform regular audit and assessment of public expenditures through an independent control authority. ● Make information related to all stages of bidding processes publicly available through, for example, e-procurement portals. Such information may include annual procurement plans, procurement opportunities, timelines for submitting bids, selection and evaluation criteria, contracts award decisions as well as procurement statistics and testimony from civil society actors scrutinising the procurement process (OCDE, 2014a). ● More generally, build a publicly available and centrally managed, searchable database with data on budget execution, revenue and expenditure (e.g. contracts, grants, loans, and co-operative agreements, etc.) to increase accountability and strengthen citizens' capacity for political dialogue, monitoring and oversight (OECD, 2014a; IADB, 2014). ● Encourage co-operation between competition authorities, public procurement authorities and anti-corruption bodies (e.g. training, exchange of information, data or staff) in order to detect and uncover possible bribery or corruption in bid rigging or price fixing cases (OECD, 2015; OECD, 2014b).
Inadequate control and monitoring by central authorities	***What central governments can do*** ● Ensure control and monitoring of decentralised resource revenue expenditures by central authorities. This can be achieved by putting in place collective decision-making bodies involving national, provincial and/or municipal delegates (IADB, 2014). ● Prepare guidelines for the use of resource revenues at the local and community level. ● Promote citizen oversight over public spending and service delivery. For example, create citizens' committees bringing together representatives of chambers of commerce, unions, and citizen oversight bodies to examine and disseminate information from central and local authorities on the use and allocation of resource revenues; organise public accountability hearings where government authorities are asked to communicate their actions (IADB, 2014).

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Mismanagement of extra-budgetary allocations	***What central governments can do*** ● Establish and publish clear rules with regard to state-owned enterprises performing quasi-fiscal activities such as social or infrastructure expenditure (including fuel subsidies) and require state-owned enterprises to report actual expenditure. ● Ensure reporting and oversight of financial flows between state-owned enterprises and the state. This may involve establishing clear reporting requirements, commissioning audits of the state-owned enterprise by skilled independent professionals, and making results available to citizens (Heller, Mahdavi and Schreuder, 2014). ● Develop an appropriate and sustainable revenue retention model for state-owned companies that guarantees sufficient revenue flows to cover costs while preventing excessive control over state finances and risks of generating a parallel state (Heller, Mahdavi and Schreuder, 2014).
Inadequate energy subsidy system	***What central governments can do*** ● As much as possible, favour open, competitive and transparent tendering process for import contracts ● Strengthen metering capacities to detect fraud in oil volume reporting or theft.

Corruption in connection with social investment expenditure by private companies

Private extractive companies may make social or environmental expenditure according to contractual arrangements entered into with the government or local authorities. Social expenditure may also be made outside contractual arrangements as part of the licensing decision process. Cases of corruption have been found in the context of the design and management of local development programmes or funds as well as in the context of sponsorship or charitable donations.

Corruption schemes

Corruption in connection with mandatory local development funds or programmes

It is quite common for extractive companies to be required to grant additional funds above licence fees to the central or local government with the understanding that those funds should be spent to finance local development projects such as the building of irrigation infrastructure, schools and hospitals for the benefit of the communities directly affected by those extractive activities. These funds are usually administered through local development funds which may be state-managed, firm-managed or state-established and community-managed. Hybrid governance structures involving all three types of stakeholders may also occur (Dupuy, forthcoming 2016).

In this case, corruption schemes in connection with the creation and management of local development funds may include elite capture, embezzlement, misappropriation and misuse of funds for purposes other than those governing the fund.

During the approval process for the allocation of funds, decisions, including those over the choice of contractors, may be tainted with risks of conflicts of interest, elite capture, political interference, favouritism, and clientelism. The construction phase itself may suffer from unjustified over-expenditures suggesting diversion or misuse of the funds.[7] Local infrastructure construction projects carried out as part of resettlement projects may also be exposed to such corruption risks. For example, a member of the Working Group on Corruption Risks reported the case of the misappropriation of funds as part of a resettlement project financed by a large multinational company. The owner of the subcontracting company in charge of building the housing and other community infrastructure for the resettled communities allegedly benefitted from good political connections for the award of the contract and was suspected of embezzlement resulting in poor infrastructure delivery to resettled communities.[8]

Corruption related to contractual and non-contractual contributions in the form of charitable donations or sponsorship

Extractive companies may also make contributions as part of or outside contractual arrangements to support local community development taking the form of charitable donations or sponsorship.

In both cases, most commonly found corruption schemes include bribery as well as diversion and misuse of public assets. The OECD Watch online database reports a case of alleged diversion and misuse of public assets in connection with charitable donations whereby an agreement between the government and a foreign company provided for the donation of trucks to the government purportedly intended to support agricultural activities in rural areas. The company indicated that there was an understanding with the government that the relevant ministry would ensure the proper distribution, use and monitoring of the vehicles. However, it is alleged that the vehicles ended up mostly in the hands of the members of parliament and decision makers that had a say on issues regarding the company's future investments in the country.

Voluntary contributions may also serve to influence the licensing decision process and be used as a bargaining chip in exchange for undue advantages (e.g. awarding of the licence, exemption of certain obligations, etc.).

Parties involved

Corruption schemes in connection with social expenditure by private companies may involve local traditional authorities who commonly play a key role in receiving and spending redistributed resource revenues due to their important role as custodians of land on behalf of the community, or raising taxes, and providing local justice and performing other functions under customary law (Dupuy, forthcoming 2016).

Parties to corrupt schemes may also be local or central government officials, members of parliament and politicians. On the private side, the main operator/contractor and subcontractors may also be involved.

Vehicles and mechanisms

Fraudulent overbilling and cost overruns

Fraudulent overbilling and cost overruns may be used to conceal corrupt conduct in the social expenditures by private companies.

Fraud and distortions in accounting and reporting

Social expenditures by private companies channelled through the government or directly transferred to local communities may not be appropriately reported and accounted for in the government's books and records. Voluntary contributions may be particularly vulnerable to this type of fraud as they do not always appear in contractual provisions.

Corruption risks on the government side

Lack of transparency and asymmetry of information about social expenditures made by companies

On the government's side, opacity, vagueness and inconsistency may characterise the rules and procedures governing social expenditures by companies. The confusion may come from: the lack of distinction between social expenditures mandated by law and voluntary

commitments by companies; the inadequate level of transparency and selective information disclosure on contractual provisions between the companies and public authorities regarding social expenditure; and the time lag existing between a licensing decision or contract negotiation process and the actual disbursement of social expenditure.

The information asymmetry regarding social expenditures does not exclusively occur when funds are centrally managed and exclusively entrusted to central authorities. Such funds may also be conferred by extractive companies to traditional leaders or local governments, without central government's proper oversight and monitoring (PH-EITI, 2015b).

These factors, combined with the lack of transparent and proper recording in public accounting of the private companies' contributions to community development projects (in particular with regard to non-contractual contributions),[9] make tracking and monitoring difficult (NRGI and RELUFA, 2014). On the company's side, the lack of harmonised practices in reporting on social expenditures may further challenge the government's ability to track and reconcile payments (PH-EITI, 2015b).

Mismanagement and misallocation of social expenditures

Corruption may thrive as a result of mismanagement and misallocation of social expenditures by government authorities. Diverse factors may account for corrupt practices starting with the inconsistent allocation of social expenditures with local development plans and actual needs (NRGI and RELUFA, 2014; PH-EITI, 2015b). Moreover, the decision-making process over social expenditure management and allocation may be inappropriate – either too centralised, excluding local communities and authorities, or alternatively, delegated to influential local elites and unaccountable local institutions. When funds are centrally managed, the lack of collaboration and consultation with local community leaders and members may result in ill-designed solutions for the selection, design and implementation of projects (NRGI and RELUFA, 2014; Transparency International, 2012). When funds are directly transferred by the extractive company to traditional leaders, the legislation may not offer a proper framework for the negotiation between the company and traditional leaders and the use of funds by traditional leaders (Standing and Hilson, 2013). Finally, mismanagement practices may perpetuate owing to the lack of proper assessment and monitoring by public independent control bodies of how funds provided by private companies are managed and spent (NRGI and RELUFA, 2014; PH-EITI, 2015a) or to inadequate delays in publication of audit and assessment reports on implementation.

In some cases, the company is directly involved in spending choices and project implementation which however, does not prevent the process from being marred with corruption. Factors on the company's side which increase corruption risks include:

- Lack of, or inadequate internal rules and corresponding contractual clauses in the agreement with the public authority regarding planning, project financing, implementation and supervision, including verifying the economic viability of the infrastructure plan, defining compliance requirements for contractors' selection; agreeing on instalment payments on the basis of measurable work in progress;[10]
- Failure to define clear and transparent criteria for the selection of projects, selection of the contractors that will perform the activities foreseen for local development projects financed by private companies through grant/sponsorship/donation, identification of the beneficiaries of the activities in the agreement with the government.[11]

- Insufficient collaboration and consultation with local community leaders and members for the selection, design and implementation of projects (NRGI and RELUFA, 2014);
- Lack of adequate due diligence carried out on the beneficiaries (including local communities' leaders) (NRGI and RELUFA, 2014).

Weak governance of social development funds

When social expenditures are administered through social development funds, corruption may arise from the lack of a transparent, independent, inclusive and accountable governance structure and of professionalisation in the management of the social development funds. Indeed, this may leave room for high discretionary power of the private executives or public officials managing local development funds and social expenditures;[12] or, when the fund is administered by local communities, political interference and discretion of influential local elite. In one of the cases reported in the OECD Watch online database, the social development fund was to be administered by a hybrid committee formed by the foreign company and the government which could be complemented by local management committees in the recipient regions. Yet, the company seemed to have little control over the way the money was spent. It is reported that the majority of those involved with the management of the fund were presidential appointees and that local community members were largely marginalised and excluded from the process.

Recommended mitigation measures

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
Lack of transparency and asymmetries of information about social expenditures made by companies	***What host governments can do*** ● Ensure a clear delineation between government entities involved in seeking and using social expenditure funds provided by private companies and those involved in licensing processes. ● Require competent government authorities to publicly disclose agreements and/or contractual clauses on voluntary or mandatory social expenditure by extractive industries as well as any other supporting documentation (e.g. minutes of meetings, resolutions etc.). ● Require extractive industries to publicly disclose actual mandatory and voluntary social expenditures, including loans, grants and infrastructure works, as well as details on beneficiaries. Where benefits are provided in-kind, require disclosure of the nature and deemed value of the in-kind contribution. Where the beneficiary of the mandated social expenditure is a third party, i.e. not a government entity, require that the name and function of the beneficiary be disclosed (EITI, 2016). ● Promote standardisation and centralisation of information on social expenditure. ● Require social expenditures received from companies by government to be included in the government's reporting on revenues received from companies. ● Publicly report on social expenditure. ***What donors can do*** ● Support civil society organisations to conduct social audits of social expenditures by the private sector when such audits are mandated by law or based on voluntary commitments by companies.
Mismanagement and misallocation of social expenditures	***What host governments can do*** ● Properly assess the needs of the communities impacted by the operations undertaken by the company.[13] ● Promote policy coherence across relevant ministries (education, health, water, energy, etc.) on the definition, implementation and monitoring of social expenditure by extractive companies (NRGI and RELUFA, 2014). ● Carry out proper impact assessment of the development projects financed by companies' social expenditure. ● Award the contracts for the realisation of social expenditures through public tenders based on clear and transparent rules and ensure monitoring through an independent authority.[14] ● Perform due diligence on the beneficiaries of the funds (including local community leaders).[15] ***What companies can do*** ● Where they play a role in the implementation of the project, either directly or through participation in the governance of local development funds: ❖ Assess the viability of the project, so as to mitigate the risk of inflated costs. ❖ Perform due diligence on the beneficiaries of the funds (including local community leaders).

RISK FACTORS	RECOMMENDED MITIGATION MEASURES
	❖ Enter into an agreement with relevant authorities (central and/or local) whereby the project is identified in detail in accordance with existing local development plans.[16] ❖ Consult, negotiate and sign a Community Development Agreement with local communities benefitting from the funds to define the company's relationships and obligations with impacted communities. ❖ Provide in the agreement clauses for the transfer of funds in tranches/instalments, against presentation of adequate and verifiable documentation that the activities for which the funds are requested have been actually performed in line with the relevant contractual terms; fund transfers through bank transfers on an account held by the authority under its name in a bank located in the host country.[17]
Weak governance of social development funds	***What host governments can do*** ● To the extent possible, favour hybrid types of governance structures involving local communities, the government and the extractive company for the management of local development funds. ● Map out local power dynamics in which resource management is embedded, particularly land, labour, and social relations, in order to design adapted local development fund policies and laws (Dupuy, forthcoming 2016). ● Design and effectively enforce local development fund policies and laws defining clear rules for fund allocation and use, public reporting on revenue flows and uses, open contracting and procurement, and monitoring and evaluation procedures as well as clarifying the role of traditional authorities (Dupuy, forthcoming 2016). ● Promote the adoption of integrity measures such as codes of conduct and good practices by local development funds; ● Ensure independent oversight and auditing of local development funds' management and create opportunities for beneficiaries to hold decision makers to account through grievance and complaint mechanisms as well as through robust, proportionate and dissuasive sanction measures (Dupuy, forthcoming 2016). ***What companies can do*** ● Undertake third-party evaluation of governance mechanisms associated with potential social expenditure contributions.

Notes

1. Comments received from participants in the Working Group on Corruption Risks during the consultations between January and May 2015.
2. See note 1.
3. See note 1.
4. The International Energy Agency defines an energy subsidy as "any government action that concerns primarily the energy sector that lowers the cost of energy production, raises the price received by energy producers or lowers the price paid by energy consumers." Fossil fuel subsidies in particular aim at providing support to fossil fuel production and/or consumption. They may take the form of direct cash transfers to producers, consumers, or related bodies, as well as indirect support mechanisms, such as tax exemptions and rebates, price controls, trade restrictions, and limits on market access. The present section focuses on fossil fuel subsidies in the form of price controls.
5. *https://eiti.org/blog/deepening-knowledge-about-how-oil-money-spent#*.
6. See note 5.
7. See note 1.
8. Comments received from participants in the Working Group on Corruption Risks during the consultations between September and November 2015.
9. See note 1.
10. See note 1.
11. See note 1.
12. See note 1.
13. See note 8.
14. See note 8.
15. See note 8.
16. See note 8.
17. See note 8.

References

Acosta, A.M. (2015), "The Governance of Natural Resource Wealth: Some Political Economy Considerations on Enhancing Social Investment", Chapter 11 in *Growth is Dead, Long Live Growth – The Quality of Economic Growth and Why it Matters*, JICA Research Institute, Tokyo, January.

Dupuy, K. (forthcoming, 2016), "Corruption and Elite Capture of Mining Community Development Funds in Ghana and Sierra Leone", in Philippe Le Billon and Aled Williams (eds.), *Corruption, Natural Resources, and Development: From Resource Curse to Political Ecology*, Edward Elgar Publishing.

EITI (2016), The EITI Standard, Requirement 6.1., *https://eiti.org/files/english-eiti-standard_0.pdf*.

Heller, P., P. Mahdavi and J. Schreuder (2014), *Reforming National Oil Companies: Nine recommendations*, Natural Resource Governance Institute, July, *www.resourcegovernance.org/sites/default/files/NRGI_9Recs_Web.pdf*.

IADB (2014), "Transparency in the Management of Revenues from the Extractive Industries: The case of Colombia", Chapter 9 in *Transparent Governance in an Age of Abundance, Experiences from the Extractive Industries in Latin America and the Caribbean*, Inter-American Development Bank, Washington, DC.

IMF (2007), *Guide on Resource Revenue Transparency,* Fiscal Affairs Department, International Monetary Fund, Washington, DC, *www.imf.org/external/np/fad/trans/guide.htm*.

NEITI (2011), *2006-2008 EITI Reconciliation*, Final Report, Nigerian Extractive Industry Transparency Initiative, 3 February, *https://eiti.org/files/Nigeria%202006-2007-2008%20EITI%20Report.pdf*.

NRGI and RELUFA (2014), *EITI and Mining Governance in Cameroon: Between Rhetoric and Reality, Subnational payments and transfers from quarry exploitation in the locality of Figui*l, October.

OECD (2015), "Draft report to the Council on Implementation of the 2012 Recommendation on Fighting Bid Rigging in Public Procurement", Note by the Secretariat prepared for the Working Party No. 2 on Co-operation and Enforcement, 15 June 2015.

OECD (2014a), "Compendium of Good Practices for Integrity in Public Procurement", document prepared by the Public Governance and Territorial Development Directorate for the Meeting of the Leading Practitioners in Procurement, 17-18 June 2014, at OECD Headquarters, Paris.

OECD (2014b), "Fighting Corruption and Promoting Competition", Conclusions of the discussions held during Session I of the 13th meeting of the Global Forum on Competition on 27-28 February 2014.

PH-EITI (2015a), *Philippines Extractive Industries Transparency Initiative Report 2014, Reconciliation Report, Volume I, http://ph-eiti.org/document/EITI-Report/First-Country-Report/PH-EITI_Report_Volume_II_Reconciliation_Report_final.pdf*.

PH-EITI (2015b), *Philippines Extractive Industries Transparency Initiative Report 2014, Reconciliation Report, Volume II, http://ph-eiti.org/document/EITI-Report/First-Country-Report/PH-EITI_Report_Volume_II_Reconciliation_Report_final.pdf*.

Standing, A. and G. Hilson (2013), "Distributing mining wealth to communities in Ghana: Addressing problems of elite capture and political corruption", *U4 Issue* No 5, U4 Anti-Corruption Resource Centre, May.

Transparency International (2012), *Annual State of Corruption Report 2012 – A look at the mining sector in Zimbabwe – Gold, Diamonds and Platinum*, Transparency International Zimbabwe, Harare.

UNDP (2015), *A Practitioner's Guide for Corruption Risk Mitigation in Extractive Industries*, March.

World Bank (2007), *The Many Faces of Corruption – Tracking Vulnerabilities at the Sector Level*, edited by J.E. Campos and S. Pradhan, The International Bank for Reconstruction and Development/The World Bank, Washington, DC, *https://openknowledge.worldbank.org/handle/10986/6848*.

For further reading

OECD (2009), *OECD Principles for Integrity in Public Procurement*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264056527-en*.

OECD (2005), *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264009431-10-en*.

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

OECD DEVELOPMENT CENTRE

The Development Centre of the Organisation for Economic Co-operation and Development was established in 1962 and comprises 27 member countries of the OECD: Belgium, Chile, the Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey and the United Kingdom. In addition, 24 non-OECD countries are full members of the Development Centre: Brazil (since March 1994); India (February 2001); Romania (October 2004); Thailand (March 2005); South Africa (May 2006); Egypt and Viet Nam (March 2008); Colombia (July 2008); Indonesia (February 2009); Costa Rica, Mauritius, Morocco and Peru (March 2009); the Dominican Republic (November 2009); Senegal (February 2011); Argentina and Cabo Verde (March 2011); Panama (July 2013); Côte d'Ivoire, Kazakhstan and Tunisia (January 2015); the People's Republic of China (July 2015) and Ghana and Uruguay (October 2015). The European Union also takes part in the work of the Centre.

The Development Centre occupies a unique place within the OECD and in the international community. It provides a platform where developing and emerging economies interact on an equal footing with OECD members to promote knowledge sharing and peer learning on sustainable and inclusive development. The Centre combines multidisciplinary analysis with policy dialogue activities to help governments formulate innovative policy solutions to the global challenges of development. Hence, the Centre plays a key role in the OECD's engagement efforts with non-member countries. To increase the impact and legitimacy of its work, the Centre adopts an inclusive approach and engages with a variety of governmental and non-governmental stakeholders. It works closely with experts and institutions from its member countries, has established partnerships with key international and regional organisations and hosts networks of private-sector enterprises, think tanks and foundations working for development. The results of its work are discussed in experts' meetings as well as in policy dialogues and high-level meetings, and are published in a range of high-quality publications and papers for the research and policy communities.

For more information on the Centre, please see *www.oecd.org/dev*.

OECD PUBLISHING, 2, rue André-Pascal, 75775 PARIS CEDEX 16
(41 2016 09 1 P) ISBN 978-92-64-25655-2 – 2016

OECD Development Policy Tools

Corruption in the Extractive Value Chain

TYPOLOGY OF RISKS, MITIGATION MEASURES AND INCENTIVES

The series *OECD Development Policy Tools* aims to provide decision makers with innovative policy frameworks and guidelines to design, implement and monitor development policies. It covers a wide spectrum of domains and supports country-level implementation for greater impact. It builds on cross-country comparative analysis and benefits from discussions with OECD and non-OECD countries as well as non-government stakeholders.

Contents

Chapter 1. Corruption risk, mitigation measures and incentives of cross-cutting relevance across the extractive value chain

Chapter 2. Corruption risks in the decision to extract

Chapter 3. Corruption risks in the award of mineral, oil and gas rights

Chapter 4. Corruption risks in the regulation and management of operations

Chapter 5. Corruption risks in revenue collection

Chapter 6. Corruption risks in revenue management

Chapter 7. Corruption risks in revenue spending and social investment projects

Consult this publication on line at ***http://dx.doi.org/10.1787/9789264256569-en***

This work is published on the OECD iLibrary, which gathers all OECD books, periodicals and statistical databases. Visit ***www.oecd-ilibrary.org*** for more information.

OECD*publishing*
www.oecd.org/publishing

ISBN 978-92-64-25655-2
41 2016 09 1 P1



