

Campaign for country-by-country reporting by companies:
Action Pack – New International Financial Reporting Standards for extractives

BACKGROUND BRIEFING:

The potential benefits, global context, IASB, Discussion Paper, outstanding issues

This briefing addresses the International Accounting Standards Board’s (IASB) work on preparing a new International Financial Reporting Standard (IFRS) for the Extractive Industries and Publish What You Pay’s (PWYP’s) proposals on elements that should be included in the final IFRS.

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Background:

Publish What You Pay, the Revenue Watch Institute and other partners have been pushing for mandatory country-by-country disclosure standards through an improved set of international financial reporting standards for the past decade.

The recent publication of a discussion paper presenting the potential options for reform of IFRS 6 (*Exploration and Evaluation of Mineral Resources*) is a critical juncture which requires your mobilization. The adoption of country-by-country reporting would be a breakthrough in the way oil, gas and mining companies report on their activities which would enable countries and citizens to get a better deal from the extractive sector. However, multinational oil and gas companies' reluctance to this kind of change poses a major challenge to this progress. It is therefore crucial that civil society, socially responsible institutional investors, tax authorities and other actors that stand to benefit massively from this change join forces and convince the IASB that country-by-country reporting needs to become part of a new International Financial Reporting Standard (IFRS) for the Extractive Industries.

This paper serves as a briefing on recent developments in the process of creating a new IFRS for the extractive industries, the growing momentum for country-by-country reporting, the main actors, target groups as well as the most important issues at stake.

This paper provides you with what you need to take action..

The potential benefits of a new accounting standard on extractives with real country-by-country reporting requirements

Introducing country-by-country reporting through an International Financial Reporting Standard would be one of the most effective ways to increase transparency in the upstream extractive industries. Real country-by-country reporting requires company disclosure of benefit streams to governments (taxes, royalties and bonuses etc.), production revenues, costs, subsidiaries and properties, production volumes and reserves on a geographic basis. Using international accounting standards as the vehicle for this type of disclosure would be the best way to create a level playing field for companies operating in the extractive industries as they are applied automatically in more than 110 countries. Companies registered in these countries would be required to disclose information for all the countries they operate in.

Although it is not a silver bullet, there is no doubt that country-by-country reporting would benefit corporate and public governance, impede corruption and tax evasion as well as accelerate growth, resource mobilization and ultimately social development and poverty reduction in resource dependent countries. It would also help capital providers (such as large pension funds and other institutional investors) reduce financial and reputational risk from investments in companies that are engaged in extractive activities.

Global context – growing momentum and precedents for change

The need for a tool which makes country-by-country reporting mandatory is increasing and there is growing momentum for this around the world. Country-by-country is now being promoted by a strong alliance of organizations primarily promoting transparency as a way to enable citizens to hold governments and companies accountable and organizations that promote tax justice.

A number of different actions and actors are promoting country-by-country reporting outside a new accounting standard. These efforts are all complementary. A new International Financial Reporting Standard for the extractives would have a global reach. The main ones are summarized here:

New listing requirements:

On May 21st, 2010, the Hong Kong Stock Exchange issued its new listing requirements for Mineral Companies. It includes a requirement for a company to include in its listing document, “payments made to host country governments in respect of tax, royalties and other significant payments on a country by country basis.” (Section 18.05, point c).

This is the second instance of including country-specific reporting of payments to governments in listing requirements. The Alternative Investment Market (AIM), a market for small enterprises within the London Stock Exchange also requires disclosure by oil, gas and mining companies of payments to governments on a country-by-country basis. Their guidelines state that a company should disclose “any payments aggregating over £10,000 made to any government or regulatory authority or similar body made by the applicant or on behalf of it, with regards to the acquisition of, or maintenance of its assets.”

US Energy Security through Transparency Bill (ESTT)

In the US, **the Energy Security through Transparency Bill**, if passed, would require oil, gas and mining companies registered with the U.S. Securities and Exchange Commission (SEC) to report how much they pay each government for access to their oil, gas and minerals.

In late April, 2010, the United States Senate Foreign Relations Committee approved S. 2971, Foreign Relations Authorization Act, which included policy language on extractive industry transparency that parallels part of S. 1700, the Energy Security Through Transparency Bill. Amongst other things the Act states that the President to work towards the establishment of: “domestic requirements that companies under the jurisdiction of

each government publicly disclose any payments made to a government relating to the commercial development of oil, natural gas, and minerals”¹.

The US legislation has been supported by United Kingdom MP Chris Mullin (Labour Party) who introduced an early day motion in the UK Parliament urging the UK government to consider adopting legislation similar to that which has been introduced in the U.S. requiring oil, gas and mining companies to fully disclose revenue payments to governments².

The European Union

The EU is probably the most important consumer of IASB standards because of the sheer size of its market. Once adopted, IFRS’ are incorporated into European legislation through a streamlined process that does not allow for further modifications. Effectively this means that IFRS’ have the status of law throughout the 27 nation bloc. This makes it essential for the EU and its member states to ensure that the IFRS developed are in the European public interest.

This close dependence has already generated some concern with the IASB’s level of accountability and this was highlighted at a meeting in April 2010 where the European Commission proposed further reforms to the governance structure of the IASB after the recent revision of the body’s constitution. In particular there is an interest in seeing more prudential regulators involved in IASB governance³.

Different EU institutions have voiced support for the development of a new IFRS for the extractive industries. The **European Parliament** urged, already in 2007, the IASB to “move beyond voluntary guidelines and support the development of an appropriate accounting standard requiring country-by-country reporting by extractive companies”⁴. The question is how the European Parliament is following up on this request in light of the recent publication of the discussion paper that shies away from making any clear recommendations in this regard.

The **European Commission** has furthermore recently published a communication on Tax and Development that addresses the importance of genuinely considering the inclusion of country-by-country reporting in the new IFRS for extractive industries⁵. The

¹ Nilmini Rubin, email exchange on April 30, 2010

² <http://edmi.parliament.uk/EDMi/EDMDetails.aspx?EDMID=40521&SESSION=903>

³ Financial Times: *Push for accounting convergence threatened by EU reform drive*, April 5, 2010
<http://www.ft.com/cms/s/0/8fc6ab2e-404a-11df-8d23-00144feabdco.html>

⁴ Task Force on Financial Integrity and Economic Development (2009): *Country-by-Country Reporting*
http://www.financialtaskforce.org/wp-content/uploads/2009/06/Final_CbyC_Report_Published.pdf

⁵ European Commission (2010): *Tax and Development - Cooperating with Developing Countries on Promoting Good Governance in Tax Matters*, Brussels, 21.04.2010. This states, “In order to enhance transparency and facilitate access of relevant data by tax administrations in developing countries, there is an increasing

Commission's expression of support for the IASB's work in this regard comes at an important point in time in the process of developing a new standard.

The **EFRAG** (European Financial Reporting Advisory Group) - was set up in 2001 to assist the European Commission in the endorsement of International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). It is a key target for European NGOs because it provides advice to the Commission on the technical quality of IFRS. EFRAG is a private sector body set up by the European organisations prominent in European capital markets.

EFRAG has issued a draft of its comments on the Discussion Paper. At present, this is not supportive of our ask on disclosure of payments to governments on a country-specific basis. It is possible to submit comments to EFRAG on its position.

Comments should be submitted by 2 July 2010 to Commentletters@efrag.org.

The text of EFRAG's draft can be found at:

<http://www.efrag.org/files/EFRAG%20public%20letters/DP%20Extractive%20Activities/EFRAGs%20Draft%20Comment%20Letter%20on%20the%20IASBs%20DP%20Extractive%20Activities.pdf>

Finally, the EU is also reviewing the Raw Materials Initiative related to non-energy raw materials this year (2010). This initiative addresses the need for increased transparency in the production and trade of raw materials to ensure a level playing field for companies operating in the sector and a steady flow of raw materials to European markets. Moreover, it looks at the need to support developing countries to manage the extraction of raw materials in a sustainable manner such as will allow them to exploit their resources to the benefit of their citizens.

The OECD and the G20

The OECD is similarly working on country-by-country reporting through a review of its Guidelines for Multinational Enterprises. This work was initiated after the British-French summit in July 2009 where French President Sarkozy and British Prime Minister Brown called on the OECD to examine country-by-country reporting as a means to reduce tax avoidance and create tax transparency.

interest in a country-by-country reporting (CBCR) standard for multinational corporations operating in developing countries. The Commission supports the timely conclusion of ongoing work being done by the OECD with respect to a CBCR guideline, which should then be referred in the OECD Guidelines for Multinational Enterprises and in the OECD Principles of Corporate Governance. Moreover, the Commission supports research work currently undertaken by the International Accounting Standards Board towards the possible inclusion of CBCR in an International Financial Reporting Standard for extractive industries and encourages further investigation into other methods which could be used to help developing countries authorities to correctly assess, at low cost, the tax liabilities of their taxpayers.”

At the 3rd Plenary of the OECD Global Forum on Development in January 2010 this issue was discussed and it was decided to set up a Task Force on Tax and Development to look closer into the issue of transparency. The meeting brought together the OECD's Development Assistance and Fiscal Affairs Committees and also included participants from business and civil society organizations. At the meeting, participants noted, among other things, "the urgency of making progress on country-by-country reporting"⁶. In May 2010, the Task Force agreed set up a Working Group focusing on country-by-country reporting.

Both the OECD and the EU have hence made clear commitments to helping developing countries improve their tax collection including from extractive industries. Country-by-country reporting is being investigated as one of the most important tools to reach this goal.

The Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative (EITI) has so far been the most prominent mechanism aimed at increasing revenue transparency in the extractive industries. This is done through a reconciliation of company payments and government revenues from oil, gas and mining – all overseen by a multi stakeholder group comprising government, companies and civil society. Nearly half the EITI implementing countries publish company by company payment data.

32 countries are officially implementing the EITI, and two have been declared compliant under the voluntary initiative. More than 80 companies report under the terms of EITI and this number is growing. The EITI is demonstrating growing momentum for greater transparency in the extractive industries.

If a new IFRS for extractive activities were to include country by country reporting of payments to governments, the IASB's position as the world's leading accounting standard setter would provide a far-reaching mandatory standard to complement the EITI and other initiatives aimed at country by country reporting.

PricewaterhouseCoopers: Total Tax Contribution

In the private sector, PricewaterhouseCoopers has introduced a tool for measuring companies' total tax contribution to a country. This tool includes not only the direct taxes that a company pays on its own profits and production, but also the taxes it collects on behalf of government (e.g. VAT and employment tax). The downside is that it is a voluntary initiative and much of the information generated is treated as confidential and

⁶ Summary Record – Global Forum on Development, <http://www.oecd.org/dataoecd/20/3/44612061.pdf>

presented in an aggregated manner. This demonstrates, however, that it is possible to collect the information that would be required for country-by-country reporting.

Investors

A number of institutional investors already provide substantial support to the development of mechanisms to strengthen transparency and lower the risks posed by operating in the extractive industries. As capital providers, they are also exposed to the risks and need to be sure that the companies they invest in do not engage in illicit or unethical activities at the same time as they have fiduciary responsibilities to their clients.

In 2008, Railpen Investments, the corporate trustee of the various UK railway industry pension funds with an approximate total market value of £14 billion wrote to the IASB noting that: “The proposal for a new international accounting standard, requiring companies to report their payments to government, their reserves, production data and costs, and key assets on a country-by-country basis, are important in order to increase transparency in a high risk industry. We believe that such disclosure is very much part of mainstream financial reporting and will provide investors with better information to judge company exposure in different country contexts”⁷.

In 2009, 80 institutional investors representing US\$ 16 trillion actively supported the development of international mechanisms to address payments transparency as part of EITI⁸.

In May 2010, Calvert Investments published a really useful paper strongly endorsing country-by-country reporting of payments to each country of operation⁹. In this they state that country-specific reporting, “could be used by investors to account for material, country-specific, tax/regulatory, reputational risks and would substantially improve investment decision making regarding the extractive industries sector.” This paper also argued against leaving decisions on materiality to companies.

⁷ Railpen Investments (2008): Support for a new accounting standard for the extractive industries, 28.10.2008

⁸ Investors Statement on Transparency in the Extractives Sector:
<http://eitransparency.org/supporters/investors>

⁹ <http://www.calvert.com/NRC/literature/documents/10003.pdf>

Extractive companies – examples of country-specific reporting showing its possible

Even if companies form the group of actors most reluctant to embrace mandatory disclosure on a country-by-country basis, some of them have begun country-by-country reporting on a voluntary basis. So far a handful of oil, gas and mining companies have taken the lead on voluntary disclosure showing that far from being bad for business, greater openness is likely to improve a company's reputation, credibility and ultimately its profit margin. The problem with voluntary initiatives is that they do not create a level playing field within the sector which is detrimental to progress. Research by Transparency International demonstrates that there is a lot of variability and lack of consistency in reporting¹⁰. In the following we present a short list of companies that have taken steps to disclose on a country-by-country basis (links to each of the companies' tables in box 1).

Box 1: List of links to company tables disclosing tax payments etc:

Newmont:

<http://www.beyondthemine.com/2009/?l=2&pid=4&parent=17&id=148>

AngloGold Ashanti (page 53 in the report):

http://www.anglogold.co.za/subwebs/informationforinvestors/reports09/SustainabilityReview09/f/AGA_SR09.pdf

Rio Tinto:

http://www.riotinto.com/ourapproach/17213_socioeconomic_development_17363.asp

Anglo American (page 21 in the report):

<http://www.investis.com/aa/docs/RTS-08-final.pdf>

Talisman Energy:

<http://cr.talisman-energy.com/2009/key-performance-indicators/economic-performance.html>

Statoil:

<http://www.statoil.com/annualreport2009/en/financialperformance/positiveimpacts/pages/overviewofactivitiesbycountry.aspx>

Newmont:

As one of the largest producers of gold in the World, US based Newmont publishes its royalties and tax payments to the governments in each country of operation. Furthermore, Newmont has expressed strong support of the ESTT legislation in the US (see above) stating that: "By introducing greater transparency into the process, we believe this legislation can help promote increased accountability which is in everyone's best interests"¹¹.

BHP Billiton:

At its Forum for Corporate Responsibility meeting on 20 May 2010, BHP Billiton also committed to publishing its payments to government in each country of operation.

¹⁰ Transparency International (2008): Promoting Revenue Transparency, 2008 Report on Revenue Transparency of Oil and Gas Companies, http://www.transparency.org/publications/publications/other/prt_2008

¹¹ <http://www.revenuewatch.org/news/092309.php>

AngloGold Ashanti:

South Africa-based AngloGold Ashanti is a global gold mining company. It discloses all payments to government on a country-by-country basis.

Rio Tinto and Anglo American:

The British-Australian mining company Rio Tinto published its total tax and royalty payments to each of 13 countries where these payments totaled USD \$10 million or more in its 2008 annual CSR report¹². In 2009 the number of specific country disclosures had increased to 18 out of 29 countries where the company had operations. According to Rio Tinto the company does not make significant (material) profits in any country that is not specified in the list.

The disclosure practice of London based Anglo-American is similar to that of Rio Tinto. In its 2008 CSR report it published its total tax contribution to 10 countries.

The problem with this type of disclosure, which is done in line with the PricewaterhouseCoopers' **Total Tax Contribution** described above, is that in addition to being voluntary and limited to a selection of the countries where the companies have operations it actually boosts the amount of taxes paid by including all tax payments (including taxes born by employees). Although this is a step in the right direction the companies need to disclose the corporate tax charge shown in the company's income statement on a country-by-country basis to provide more useful information.

Talisman Energy:

The Canada based upstream oil and gas company Talisman Energy has been disclosing country-specific information for all its countries of operation, including data on fiscal contributions to host governments, royalties, production, gross sales revenues, exploration and development expenditures. It discloses all payments of \$1 million or greater paid to governments.

Statoil :

Similarly to Talisman, the Norwegian oil and gas company discloses data on revenues, investments, direct and indirect taxes, profit oil in kind, signature bonuses, social investments purchase of goods and services, pay and social benefit and number of employees on a country-by-country basis in 36 of the 40 countries where the company is represented.

Conclusion to current global context

These examples clearly illustrate that there is a global trend moving towards increased transparency and disclosure of financial data by companies operating in the extractive

¹² <http://www.publishwhatyoupay.org/en/resources/rio-tinto-takes-step-towards-transparency-publishing-payments-governments>

industries. However, there is a strong need for a mandatory international mechanism that would ensure a level playing field for companies and access to universal, comprehensive and comparable data for all companies operating in the extractive industries. The increasing worldwide reach and influence of the IASB means that it is ideally placed to turn the new IFRS for extractive industries into such a mechanism.

The International Accounting Standards Board

The IASB is the world's most influential accounting rule setter. As its name suggests, it develops and approves international accounting standards. The goal of the IASB is to develop, in the public interest, a single set of high-quality global accounting standards.

Currently IFRSs (International Financial Reporting standards, the accounting standards developed by the IASB) are used in more than 110 countries around the globe and serious efforts are being invested in bringing major economies such as Canada¹³, India, Japan Korea, Mexico and Brazil on board. In addition, a convergence program with the national US standard-setter (the Financial Accounting Standards Board) is underway and expected to be completed by 2011.

Box 2: For a full list of use of IFRS by jurisdiction see: <http://www.iasplus.com/country/useias.htm>

China has also expressed commitment to convergence with IFRSs and the principles of the current Chinese Accounting Standards for Business Enterprises are substantially in line with IFRSs, with a few exceptions. The convergence program likewise targets 2011 as the year for completion of the convergence¹⁴. The G20 has pledged support for global convergence in accounting standards.

Accounting standards are of vital importance because they state how companies should structure and undertake financial reporting. A company's financial report is crucial information for a number of users. Shareholders and capital providers need these to make investment decisions and other users of the information such as employees, lenders, suppliers, customers, governments and their agencies and the general public also use the information to get reliable information about how a given company is doing. The greater the coherence between different national accounting standards the better the chances of comparing financial records across companies.

It is extremely important that accounting standards are high-quality and in the public interest.

Structures around the IASB

- The IASB is the body actually charged with developing and deciding on new accounting standards. It has 14 members plus the Chair and they come from all over the world.

¹³ Canada has defined a timeline for moving to IASB by 2011 <http://www.iasplus.com/country/canada.htm>

¹⁴ Accounting Standards Update by Jurisdiction, China, November 2009 update: <http://www.iasplus.com/country/china.htm#1003>

- The IASB is one part of a broader overall structure called the **IFRS Foundation**. (It was formerly known as, and is still sometimes referred to as the IASC Foundation.) It has a constitution laying out its purpose and sections¹⁵.
- To develop a new standard, the IASB often puts together a **Working Group** to do the research, write drafts and solicit opinions. The In the case of the new IFRS on Extractive Industries the discussion paper has been developed by staff from the national accounting standard-setters in Australia, Canada, Norway and South Africa.
- The Foundation is governed by a body of 22 **Trustees** who are responsible for the appointment of the IASB and the promotion of the IFRSs.
- The **IFRS Advisory Council (formerly known as the SAC)** is the formal advisory body to the IASB and the Trustees of the IASC Foundation. It is comprised of a wide range of representatives from user groups, preparers, financial analysts, academics, auditors, regulators, professional accounting bodies and investor groups that are affected by and interested in the IASB's work. Members of the Advisory Council are appointed by the Trustees.
- Under pressure from the G20 to improve the IASC Foundation's public accountability, the Trustees agreed to a mechanism "establishing a link to a **Monitoring Board** of public authorities....Through the Monitoring Board, securities regulators that allow or require the use of IFRS in their jurisdictions will be able to more effectively carry out their mandates regarding investor protection, market integrity, and capital formation.... The Monitoring Board's main responsibilities are to ensure that the Trustees continue to discharge their duties as defined by the IASC Foundation Constitution, as well as approving the appointment or reappointment of Trustees. It is envisaged that the Monitoring Board will meet the Trustees at least once a year, or more often if appropriate¹⁶.

The Monitoring Board is external to the bodies of the Foundation. However, the public authorities involved so far are all related to the private financial sector. Its members are the Emerging Markets and Technical Committees of the International Organization of Securities Commissions (IOSCO), Financial Services Agency of Japan (JFSA), and US Securities and Exchange Commission (SEC). The Basel Committee on Banking Supervision participates in the Monitoring Board as an observer

The IFRS Foundation is organized as an independent, not-for-profit, private-sector body and hence not directly accountable to any elected bodies beyond this new mechanism of

¹⁵ The IASC Foundation changed its name to the IFRS Foundation as a result of changes to the most recent revision of the constitution. The new constitution is effective of 1 March, 2010 <http://www.iasb.org/NR/rdonlyres/B6uDD9A-F4FB-4AoD-AEC9-0036F6895BEF/o/Constitution2010.pdf>

¹⁶ http://www.iosco.org/monitoring_board/

the Monitoring Board of public authorities. It is funded partly through government-sponsored funding systems and partly through contributions from companies and accounting firms¹⁷. The funding relationship with the big 4 accounting firms (KPMG, PWC, Deloitte and Ernest and Young) which in 2004 paid approximately one-third of the IASB's operating budget has been viewed as creating a relationship of dependency on these firms¹⁸.

The creation of the Monitoring Board has not prevented a recent disagreement between the IASB and the European Union about the future governance of the IASB. According to the Financial Times: "...many European policymakers believe prudential regulators should be more involved in IASB governance..."¹⁹ The current process of developing a new IFRS for the extractive industries will be a vital litmus test of the strengthened accountability and transparency of the decision-making process as well as the IASB's responsiveness to its users and commitment to develop international financial reporting standards in the public interest.²⁰

The process and timeline for the creation of the new reporting standard for the extractives

Due process for a new accounting standard stipulates a mandatory public consultation and follows a number of steps from drafting a discussion paper to the final vote on the new International Financial Reporting Standard (IFRS).

One of the most important components is the solicitation of comments on the 'Discussion Paper'. For the extractives, the IASB published this on 6th April, 2010²¹. Comments can be submitted from any party and will be publicly listed on the IASB's website. **The final deadline for written submissions is 30th July 2010.**

The next stage will be for the IASB to make a decision as to whether 'extractives' should be formally added to its agenda for developing new standards. In making this 'Agenda Decision', the IASB considers the needs of all users but prioritises the needs of investors as particularly important when deciding to add a new item to the agenda. This is scheduled to take place by mid 2011. Current information suggests this is highly likely to pass for the extractives, but it will need close monitoring.

¹⁷ <http://blog.ifrs.com/2010/02/iasb-funding.html>

¹⁸ Cortese, Corinne and Irvine, Helen J. and Kaidonis, Mary (2007): Standard setting for the extractive industries: a critical examination. *The Australasian Accounting Business & Finance Journal* 1(3):pp1-10.

¹⁹ Rachel Sanderson (05.10.2010): **Push for accounting convergence threatened by EU reform drive**, The Financial Times Limited 2010

²⁰ The IASB's project page for the work on extractives can be found here:

<http://www.iasb.org/Current+Projects/IASB+Projects/Extractive+Activities/Summary.htm>

²¹ The full text of the Discussion Paper can be found at <http://www.iasb.org/NR/rdonlyres/735FoCFC-2F50-43D3-B5A1-oD62EB5DDB99/o/DPEExtractiveActivitiesApr10.pdf>

Box 3: Summary of key moments in the due process with dates for the IFRS on extractive industries

Normal due process	New IFRS for EI
Publication of Discussion Paper	April 6, 2010
Hearing (usually 120 days) – the crucial time to lobby and generate support for the content that we are seeking. (It is harder to generate change later in the process.) If this hearing shows a lot of support, the next stage is:	Ends July 30, 2010
Agenda decision. If this is successfully passed, the next stage is:	Expected first or second quarter 2011
Publication of exposure draft	?
Hearing (usually 120 days)	?
Drafting of IFRS	?
Pre-ballot draft reviewed by IFRIC	?
Near-final draft exposed to a limited group (paying subscribers)	?
Ballot	?
Publication of final IFRS	Expected 2013

After the project has been added to the active agenda, due process requires the development and publication of an **‘Exposure Draft’**. This is considered the IASB’s second formal vehicle for consulting the public. However, historically, issues have a much stronger chance of making it into the final standard if they are included as a result of consultation on the Discussion Paper – it can be too late to lobby on the content of the Exposure Draft.

THIS IS WHY WE NEED TO LOBBY EFFECTIVELY NOW!!

The exposure draft takes the form of a proposed standard. It has to pass a simple majority vote before the IASB publishes it for comments. The IASB normally allows 120 days for comments on exposure drafts but can allow for longer periods for major projects. We don’t yet know when the consultation period will be.

Box 4: Further reading

IASB Constitution:

<http://www.iasb.org/NR/rdonlyres/B611DD9A-F4FB-4A0D-AEC9-0036F6895BEF/0/Constitution2010.pdf>

IASB Due Process Manual:

<http://www.iasb.org/NR/rdonlyres/1E8D75B7-927F-495B-BE4A-04C9BE967097/0/DueProcess09.pdf>

Cortese, Corinne and Irvine, Helen J. and Kaidonis, Mary (2007): Standard setting for the extractive industries: a critical examination. The Australasian Accounting Business & Finance Journal 1(3):pp1-10.

<http://eprints.qut.edu.au/13046/1/13046.pdf>

Key issues in the Discussion Paper

There are some positive elements in the discussion paper but five main issues need to be addressed if the IFRS is to contribute positively by introducing mandatory country-by-country disclosure. These relate to:

1. Whether country-specific reporting will only be used for the countries that a company deems **material** to them and information for the other smaller countries would still be 'lumped together'
2. Whether the **benefits outweigh the costs** for the disclosure sought by PWYP.
3. Whether the recommendations from PWYP are included as a **coherent package of information**, vital to comparing accuracy and fairness of the whole, or whether the IASB decides to drop certain components from reporting requirements
4. Whether any **exemptions** from company reporting should be allowed
5. Who the IASB treats as legitimate **users** of IFRSs, and thus whose needs the standards will be designed to meet – they currently focus only on the needs of investors.

1. Materiality – why reporting should not be left to the companies to choose?

Materiality is a key issue that could potentially undermine the positive results of a new IFRS on extractive industries. In accounting the term 'materiality' is synonymous with 'significance/importance' and it is a concept which is deeply ingrained in accounting practice. The IASB defines materiality in technical terms as: "Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement."

In practical terms, the IASB notes that this allows for establishing a cut-off point or threshold for what level of information should be included in the financial report (for a practical illustration of what this means see the box on the next page). This means that small figures in the books that are judged not to have a significant impact on a business can be omitted, aggregated or grouped as 'others' in company reports.

Materiality is therefore a highly contentious issue because if it is interpreted as the ability to set high quantitative benchmarks for disclosure, especially as determined from the viewpoint of large multi-national companies, it means that information will not be available for all countries.

Box 5: Example of company disclosure with low and high materiality benchmark for disclosures

In this hypothetical and simplified example Company X has investments and profits before tax in the 16 countries presented in Case I. In case II the company auditors applied a US\$ 10 million benchmark to its level of disclosure of countries of operations. In case III the benchmark has been raised to US\$ 100 million.

Case I: No materiality threshold		Case II: Materiality threshold US\$ 10 million		Case III: Materiality threshold US\$ 100 million	
Country	Profits before tax (US\$)	Country	Profits before tax (US\$)	Country	Profits before tax (US\$)
USA	2,076	USA	2,076	USA	2,076
United Kingdom	2,009	United Kingdom	2,009	United Kingdom	2,009
Norway	1,998	Norway	1,998	Norway	1,998
Russia	1,627	Russia	1,627	Russia	1,627
Azerbaijan	1,179	Azerbaijan	1,179	Azerbaijan	1,179
The Netherlands	874	The Netherlands	874	The Netherlands	874
Algeria	543	Algeria	543	Algeria	543
Venezuela	112	Venezuela	112	Venezuela	112
Angola	99	Angola	99	Others	235
Nigeria	54	Nigeria	54		
Brazil	53	Brazil	53		
Kazakhstan	13	Kazakhstan	13		
Turkmenistan	8	Others	16		
Burma	5				
Republic of Congo	2				
Chad	1				

The difference in the level of information the company discloses in case I, II and III is clear. In the worst case information for 8 countries (or 50% of the countries where the company is present) is unavailable. In the middle case 4 countries (25% of the countries where the company is present) are omitted. If a situation emerged in one of these countries that would cause shareholders to request an investigation of activities or disengagement from this country it would not be possible to find out about payments made to that country. An example of this could be the government crackdown in Burma in 2007, which led to substantial pressure on investors to disengage with companies such as Chevron and Total that have investments in Burma or the pressure arising from Shell's shared responsibility for the precarious environmental and social situation in the Niger delta.

The Discussion Paper currently proposes that the threshold of materiality in deciding which countries will be presented individually, and which will remain aggregated together' as 'other' will be set:

- in relation to what is material to the company, not the countries
- in relation to the size of a company's reserves in each country
- at the discretion of each individual company.

Specifically, it recommends that country-specific reporting of reserves, production and costs shall only be for countries in which a company's reserves are material to its international operations²².

In its discussion of materiality thresholds in relation to reputational risk, it makes the recommendation, "It will not always be clear whether a country is material to the entity in this way, but ultimately this decision rests with the entity" (paragraph 6.24).

These proposals are problematic for three reasons.

Firstly, small figures might actually be a sign of risk. For example, apparently low payments, costs etc may themselves be the root of potential future problems, if they represent non-payment of fair value to national governments and communities. However this risk would remain invisible to investors and others until crises were reached if quantitative thresholds were used to determine materiality.

Secondly, size of transactions is not related to the potential reputational risk to companies and investors. If a company is revealed to have engaged in illegal activities such as bribery or tax evasion it is highly problematic for the investors as they will be obliged to disinvest in these companies. This is why a large number of investors today engage agencies to screen companies for their compliance with legislation and social responsibilities. By setting a clear standard for country-by-country reporting the IASB would provide investors' with much more transparent, consistent and comparable information particularly in relation to taxation and transfer mispricing issues, which is a growing concern.

The IASB recognizes this issue in the discussion paper in section 6.24 when it assesses reputational risk in relation to materiality: "...an entity's exposure to reputational risks and the associated potential economic loss **is not correlated to the scale of the entity's investment in a particular country**. This is an important point, particularly for large diversified mineral, oil and gas entities that may have operations in countries that are immaterial in size to the entity. Although immaterial to the entity in quantitative terms, the entity's operations in some of those countries could be material to the entity in

²² Specifically, the recommendations are:

Reserve quantities "the project team considers that a regional aggregation of reserve quantities is acceptable if the reserves attributable to a country are not material to the entity".(paragraph 6.39)

It is suggested that reserves values are likely to be presented by region not country (paragraph 6.40)

"Production quantities, would be shown by country (or property) where that is material to the entity. Consequently, the project team's proposals would not include separate disclosure of production quantities by country where those reserves were not material to the entity. (paragraph 6.42)

"This cost information would be disclosed at the same level as the reserve quantities information and therefore would not include separate disclosure of costs by country where the reserves were not material to the entity. (paragraph 6.45)

qualitative terms (e.g. material to the entity's reputation) if, for example, the country was economically dependent on the investments made by the entity or if the political, social or environmental conditions in that country could be reasonably viewed as exposing the entity to reputational risks"²³.

Calvert Investments have produced an impressive paper outlining these two points. They recommend country-by-country reporting of payments to the governments of all countries in which a company operates, regardless of whether any particular country operation is considered material by quantitative measures²⁴.

Thirdly, as the American Institute of Certified Public Accountants suggests, profit before tax for continuing operations "...may be a suitable benchmark for profit-oriented entities but may not be an appropriate benchmark for the determination of materiality when, for example, the entity's earnings are volatile..." and this is clearly the case in the extractives sector.

It is positive that the IASB recognizes that the extractive industries have unique exposure to material country-specific, tax/regulatory and reputational risk. This is why consistent and comparable disclosure of the payments required by the IASB should include all of the countries in which a company operates, regardless of whether any particular country operation is considered material by quantitative measures.

It is therefore surprising and disappointing that the IASB shies away from making a clear recommendation on country-by-country reporting and instead suggests that company management should determine on a case-by-case basis whether a country is qualitatively material to its operations.

Box 6: Extensible Business Relationship Language (XBRL)

XBRL has been called a "new age of financial reporting". It is a digital technology standard for accounting data that can be used to create financial statement data and in other reporting situations. It can make the process of creating, distributing, reporting and analyzing information more efficient and effective. Users can receive, find, compare and analyze data much more rapidly than by receiving information as a block of text. It allows companies to send out shorter form statements to the shareholders and other users of financial information who can then refer to the website for more detailed information.

This new technology has many uses that are beyond the focus of this briefing but it seems to be useful to make more information available at request such as detailed disclosure of financial data on a country-by-country basis and it eliminates the argument for not doing this because of information overload.

The US Energy Security through Transparency Act (see above) mandates the use of XBRL which makes it even more relevant to consider for the IASB.

²³ IASB (2010): Discussion Paper - Extractive Activities DP/2010/1, section 6.24
<http://www.iasb.org/NR/rdonlyres/735FoCFC-2F50-43D3-B5A1-oD62EB5DDb99/o/DPEExtractiveActivitiesApr10.pdf>

²⁴ Calvert Investments (2010): Materiality of disclosure required by the Energy Security through Transparency Act <http://www.calvert.com/NRC/literature/documents/10003.pdf>

Some companies and auditors would argue that without high materiality benchmarks the amount of information would be overwhelming and impossible to present in an intelligible form in a financial report. However, the IASB is currently working on developing electronic means of presenting data that would overcome this (see the box 6 on the previous page on ‘extensible business relationship language’ or XBRL).

Summary – our ask on materiality

- The IASB should not allow companies in the extractive industries to establish a quantitative cut-off point for country-specific reporting according to what is material for the company.
- The IASB should respond accordingly to the fact that that reputational risk is an issue independent of the size of the company’s profits from the country. Thus payment disclosure becomes material from a qualitative perspective.
- Companies should report for each and every country in which they operate.

Box 7: Highly recommended additional literature on materiality: Calvert Investments (2010): Materiality of disclosure required by the Energy Security through Transparency Act

<http://www.calvert.com/NRC/literature/documents/10003.pdf>

This report outlines why disclosures required by the Energy Security Through Transparency Act (S. 1700) or ESTTA currently pending in the U.S. Senate would give investors information necessary to assess material country-specific, regulatory, and tax risk in the oil, gas and mining industries. It is, however, also highly relevant for the development of the new IFRS for extractives. The report argues that no materiality threshold should be set for payments to governments and gives two main reasons for this:

- Transactions size is an inadequate predictor of risk to companies and investors, especially in relation to reputational risks.
- Small payments to governments may themselves be the source of risk, if these are inappropriate to the scale of production/revenues and companies may be perceived as “not paying their fair share”. Therefore, size of payments cannot be used as a materiality threshold, and payments to all governments should be the reporting requirement.

2. Payments to governments – why this information is needed and the benefits outweigh the costs of disclosure

The IASB aims to test the proposed standards against the costs and benefits of providing this information within a financial report. The only area where they argue remaining uncertainty is the issue of reporting payments to governments where they say they are seeking further evidence before they can make a recommendation to include this as a requirement.

The costs must necessarily be attributed to the preparers of the reports who are the oil, gas and mining companies and the benefits must be attributed to the users. In line with our argument above, we will argue that the users must include the broader group of users that have been identified by the IASB, as well as investors.

The IASB does not make the disclosure proposals on reserves dependent on a cost/benefit test to nearly the same extent as it does in relation to disclosing benefit streams to governments. The IASB argues that the level of detail of the PWYP proposals is so extensive that it is necessary to consider the costs of disclosure in detail. This argument does not stand up to scrutiny, however, because companies already have revenue and cost information recorded in their books and it should be relatively simple to access and present this information. This compares to the extra cost and time that probably will be required to disclose reserve quantities as proposed in the discussion paper. It is puzzling that the IASB finds it necessary to subject the proposals for disclosing benefit streams to governments to a cost/benefit test when this is not deemed necessary for the more complex disclosure requirements for reserves.

Low costs:

The IASB states that there will be increased preparation costs associated with “significant changes to accounting systems and reporting processes” necessary to disclose financial data on a country-by-country basis. Auditing costs are also perceived to increase as a result of the more precise and detailed examination of payments²⁵. It is argued that some payments such as taxes or royalties paid in kind, indirect taxes and exercise duties and net payments that include both a tax or royalty component and a purchase or sale transaction are very difficult to identify. It seems dubious that these difficulties should be impossible to overcome at a reasonable cost for some of the highest earning corporations in the world. To illustrate this point see the selection of oil, gas and mining companies as they appear on Fortunes list of the world’s most profitable companies in table next page.

²⁵ IASB (2010): Discussion Paper - Extractive Activities DP/2010/1, section 6.31 – 6.32
<http://www.iasb.org/NR/rdonlyres/735FoCFC-2F50-43D3-B5A1-oD62EB5DDb99/o/DPExtractiveActivitiesApr10.pdf>

There are several voluntary initiatives that demonstrate that this is not only possible but also warranted by many companies. The Total Tax Contribution developed by Price Waterhouse Coopers clearly demonstrates this point (see above).

As argued by Richard Murphy from the Tax Justice Network, it is moreover highly dubious that the companies should not have difficulties accessing this information: "...if true the reporting entity would be failing to keep the books and records required to prepare financial statements by the law of almost all countries in which their group consolidated financial results will be published..."²⁶. The reputational risks arising from the apparent lack of proper auditing of these high risk transactions is currently being passed on to capital providers and it would be in their clear interest to require significant improvements through an inclusion of country-by-country reporting in the new IFRS for extractive industries.

No.	Company	Profit 2008 billion US\$
1	Exxon Mobil	45,220.0
2	Gazprom	29,864.1
3	Royal Dutch Shell	26,277.0
4	Chevron	23,931.0
5	BP	21,157.0
6	Petrobras	18,879.0
11	Total	15,500.4
12	BHP Billiton	15,390.0
13	Petronas	15,308.9

Table 1:

<http://money.cnn.com/magazines/fortune/global500/2009/performers/companies/profits>

These reflections indicate that even without taking the concerns of a more broadly defined user group into consideration the benefits seem to outweigh the costs which under all circumstances would be minuscule in comparison to the massive profits generated by oil, gas and mining companies.

Massive benefits:

If the costs are considered to be comparatively low the benefits of including country-by-country reporting in the new IFRS are massive. It is not possible to quantify the benefits as they are very far reaching. They will affect all users of financial reports positively and the following highlights some of the most prominent benefits.

Benefits for Companies:

1. A level playing field for all companies operating in the extractive industries
2. Recognition of the contribution to public finances through taxes and other payments made to host governments
3. More stable operating environment in the medium-term (avoiding instability, attacks on installations, corruption and conflicts)

Benefits for investors:

- Increased transparency in a high risk sector.
- More effective evaluation of risk/reward profile of individual extractive projects.
- Better comparison of different projects within and among companies.
- Better information on country and reputational risk (how likely is it that the income stream from a country will continue given the political risks peculiar to that country).
- More accurate pricing of corporate securities in the extractive industries.
- Level playing field for companies in the extractive industries.
- Support good corporate governance and sustainable value creation.
- Diminish corruption, tax evasion and other illegal activities that diminish the value of the global portfolio.
- Stable business environments with limited risk of interruptions of production, nationalization etc.

Benefits for governments:

- Better chances of ensuring a fair share of the value of the resources being extracted
- **Tax authorities** in particular will benefit from improved ability to collect reliable economic data to verify that the tax payments made are correct
- Better possibilities for preventing transfer mispricing and other illicit forms of tax evasion and avoidance and thereby increase the tax to finance development

Citizens in resource dependent countries

- Access to independent and reliable sources of information about the amounts of resources and revenues generated from their extraction
- Better chances of holding governments and companies to account
- Decrease in the high levels of mismanagement, fraud and corruption
- Improved chances for good governance and socio-economic development

Summary of our asks – cost-benefit analysis of reporting payments to governments

- The IASB recognizes the relatively low costs of the PWYP asks
- The IASB recognizes the massive benefits from further disclosure in line with the PWYP asks and that these benefits be accessed for all relevant users, not just capital providers

3. A coherent package of reporting by companies – the types of information that should be reported on a country-specific basis

A crucial part of the discussion paper applies a cost/benefit analysis to the different disclosure types proposed by PWYP (see box 8) and outlines the Working Group's recommendations on whether they could be included in a new IFRS for the extractive industries.

Box 8: PWYP proposal

- **Benefit streams to government:**

The significant components of the total benefit streams to government and its agencies should be disclosed. At a minimum, this would include separate disclosure of:

1. Royalties and taxes paid in cash
2. Royalties and taxes paid in kind (measured in cash equivalents)
3. Dividends
4. Bonuses
5. License and concession fees

- **Reserves:**

Reserve volumes and valuation measures should be disclosed on a country-by-country basis.

- **Production volumes:**

Production volumes for the current reporting period should be disclosed on a country-by-country basis. Optional disclosure of production volumes by key products and key properties is encouraged.

- **Production revenues:**

Revenues from production should be disclosed on a country-by-country basis, with separate disclosure of production revenue attributable to:

- Sales to external customers
- Transfers to downstream operations

- **Costs**

The following costs should be disclosed on a country-by-country basis:

- Development costs
- Production costs

- **Key subsidiaries and properties**

The names and locations of each key subsidiary and property in each country should be disclosed.

The IASB analyses each of the disclosure types individually, which is a problematic approach. Developing a new IFRS for the extractive industries that would require one type of disclosure and not another seems to be inconsistent. It does not seem to make sense for example to require disclosure of production costs and production volumes but not production revenues as these figures are obviously closely related.

As Richard Murphy's paper argues, "The IASB has elected to consider each information request that the IASB has made as if they were entirely independent variables. This is completely illogical. They are not. ...The information requested is, as this report shows, the minimum accounting data that can be supplied to provide a coherent perspective of the activity of an EI reporting entity in each of the countries in which it operates. So, for example, the request for information on production revenues is made to ensure that payments of royalties can be validated by comparison of one with the other; a consistent ratio between revenues and royalties being expected over time on the basis of most mineral extraction agreements.The data that the IASB is recommending be supplied is not coherent, is not comparable and will not be of high standard as a result. Indeed, despite the fact that the IASB suggest that the criteria for assessment of the PWYP request is to assess whether or not they can be considered a part of a complete set of financial statements they appear to have deliberately compromised objective assessment using this criteria by recommending the supply of incomplete information. This makes no accounting sense."²⁷

a. Benefit streams (Payments) to governments:

This is the group of disclosure types for which the IASB is most firmly sitting on the fence. At the same time it is arguably the most vital disclosure type for PWYP and other civil society organizations and networks that promote transparency in the extractive industries because this would be a major step towards better governance and accountability for citizens living in resource rich countries. Requiring disclosure of benefit streams is certainly an area where financial reporting could make improvements as the IASB notes in the discussion paper. It would enable investors to better judge profile and risk of exposure in every country of operation as well as knowing how dependent corporate performance is on the stability and returns from each country.

The highest unit of geographical aggregation possible should be the nation state. Cases where lower level units are used (e.g. a region within a country or a specific property as for example a mine or a field) are welcome but the financial reports should in addition aggregate the data for the entire country using a country-based unit of account to facilitate comparison (e.g. company disclosure of information for 5 mines in Indonesia and 3 mines in New Guinea individually is welcome but a figure totaling the information for each country should also be made available). This would allow exposure of both potential geological risks associated with the individual property and political risks related to the national jurisdiction.

In cases where a higher level of aggregation makes sense from a geological perspective (such as a geological province or a basin) the figures should be made available for each

²⁷ Country-by-Country Reporting and The Extractive Industries: A review of the International Accounting Standards Board discussion paper on Extractive Activities published in April 2010. (May 2010) Richard Murphy FCA

country within this area. In joint development zones (such as the Nigeria-São Tomé and Príncipe JDZ) it should also be clear which country receives which payments. The breakdown of benefit streams is also important because different payment streams raise different considerations for investors who need to understand the risk profile of extractive companies. For instance, signature bonuses, which can be sizeable and are paid before commencement of production, have very different investment impacts than royalties, which are paid continually during production. Investors need to know how important each payment stream is to the total to be able to better assess the risk profile of the investment. Aggregate payment disclosure furthermore makes it easier for illegitimate payments to be hidden among legitimate ones. A higher level of disaggregation reduces risk and gives investors greater confidence that a company's reputation will not be questioned and that the company's tenure of contract will be more stable. Regular and detailed reporting of taxes paid provides a stable operating environment without sudden claims of non-payment or demands of back-taxes as has been seen in Russia and elsewhere.

Some companies have already initiated country-by-country reporting on their own initiative and there is evidence of a growing momentum within the industry to be more transparent. The pioneering initiatives by certain companies demonstrate that it is possible to disclose this type of information on a country by country basis. The level of comparability between the different companies disclosing payments points to the need for a standardization of disclosure requirements opting for the highest common denominator.

Finally, it should be easier to provide information on payments to governments than information on reserve quantities as this information exists and be recorded and audited in the books of the companies. This not being the case would be equivalent to failing basic audit requirements.

Summary of our asks – Benefits streams (Payments) to governments

- Country-by-country disclosure of benefit streams to governments without any exemptions
- Benefit streams should be broken down by payment types
- Aggregation of information related to lower level units to the national level to facilitate comparison

b. Reserve quantities, production quantities and costs

Some degree of country-specific reporting is recommended for these areas in the Discussion Paper. This is positive but there are still a couple of pitfalls that need to be avoided.

The IASB is fairly keen on disclosure of reserves which it dedicates most of chapter 5 to justify in the discussion paper. The main reason is that reserves (deposits of oil, gas and minerals) are the most important asset of a company operating in the extractive industries. The amount of reserves controlled by a company hence informs the investor about the position of the company in the market. In 2004, Shell was involved in a big scandal about its reserves as it was revealed that the company had overstated its proven oil and gas reserves by 20%. This immediately led to a 7% fall in the value of the company's shares as investors sold off the shares they had in the company²⁸.

The calculation of the value of reserves is very technical and requires specialist and expert knowledge in that field. Given that they lie in deeply buried geological formations, oil and gas reserves are difficult to measure and, until a company extracts them, it can only estimate their volume. Contrary to earlier drafts, the IASB is no longer proposing audits of the disclosed reserves in the discussion draft.

The most important issue is that the IASB is somewhat positive towards requiring country-by-country disclosure of reserves. In the opinion of the IASB this makes sense because of "the significance and prevalence of risks that are country-specific (e.g. taxation regime, legal and regulatory framework, governmental / sovereign risk)"²⁹. It states, however, that in cases where boundaries are geological rather than political a higher level of aggregation than the country level might be relevant. The IASB goes as far as saying that aggregation on a continental basis could be appropriate "...if the reserve quantities attributable to individual countries are of limited significance relative to the entity's total reserve position"³⁰. Finally, the IASB leaves the judgment to determine the level of aggregation to the management of companies.

The same caveats apply to production quantities and exploration, development and production costs as these would also be disclosed on a country-by-country level only where it would be material to the company. This therefore needs to be seen in connection with the discussion on materiality above where we argue that any company engagement in a country is material.

The delimitations introduced related to geological issues and materiality are highly unfortunate as they would undermine the benefits of a clearer requirement for country-by-country disclosure. In particular it would result in a continued lack of transparency, comparability of information and unlevel playing field characterizing the sector today.

²⁸ <http://news.bbc.co.uk/2/hi/business/3382045.stm>

²⁹ IASB (2010): Discussion Paper - Extractive Activities DP/2010/1, paragraph 5.45, p. 120
<http://www.iasb.org/NR/rdonlyres/735FoCFC-2F50-43D3-B5A1-oD62EB5DDb99/o/DPEExtractiveActivitiesApr10.pdf>

³⁰ Ibid.

Summary – our ask relating to reserve quantities, production quantities and costs

- A clear standard for country-by-country disclosure of reserve and production quantities as well as development and production costs
- No possibility for higher levels of aggregation than the country level
- Not to be determined on a case-by-case basis by company management

c. Production revenues

The IASB rejects country-by-country disclosure of revenues on the basis of this being “more relevant to capital providers if it is separately presented by commodity rather than by country”. Instead it recommends that revenues are separately presented by commodity rather than by country. An accounting system needs to be consistent and offer a coherent picture of a company’s finances. It is therefore inconsistent to require country by country disclosure of production figures, costs and payments to governments but not revenues.

Country-by-country disclosure of audited information on production revenue is also important to ensure that companies are paying the correct amounts of tax. Tax authorities in particular need access to this information in order to prevent transfer mispricing and other kinds of tax evasion and avoidance which is often related to manipulation of profit rates. Research has shown that illicit capital flows totaled between US\$641 and US\$979 billion in 2006 which would otherwise have been a valuable source of mobilizing local resources for development. Increased transparency of company revenues is therefore essential as it would be more difficult to manipulate profits if information on production revenues were publically disclosed in the ways outlined above. The IASB should not be allowed to ignore this issue as the new IFRS for extractive industries provides a unique chance to address this problem.

Summary of our asks – Production revenues

- Production revenues should be disclosed on a country-by-country basis to ensure the consistency of the new IFRS for extractive industries and prevent tax avoidance and evasion
- That evidence is provided for key subsidiaries and properties typically being available for companies operating in the extractive industries

d. Key subsidiaries and properties:

The IASB claims that this information is already required by IAS 24 *Related Party Disclosures* and IAS 27 *Consolidated and Separate Financial Statements*. The problem is that this is not typically available as the IASB claims in the project report.

Summary of our asks – Key subsidiaries and properties

- The names and locations of each key subsidiary and property in each country should be reported

4. Exemptions – why the recommended exemption would undermine the whole purpose of the standard

The Discussion Paper outlines a concern expressed by companies that “the disclosure of tax payments on a country-by-country basis may breach confidentiality agreements that the entity has with a government. The concern is that by disclosing this information, the entity may contravene the undertakings it has made with a government and face the risk of losing its assets (through expropriation) in that country.”

However, the Paper goes on to note that, “Most [contracts confidentiality] clauses indicated that no party to the contract could disclose any information flowing from the contract without the written consent of the other parties, but typically the clauses include some standard exceptions that would permit the disclosure of information for compliance with the law and regulations. This would include compliance with IFRSs in those jurisdictions that incorporate IFRSs into their law or regulations. In other words, it is very unlikely that a reporting entity could not disclose if IFRS required that it did.

Thus, the Paper states, “The project team does not consider that the existence of confidentiality clauses that may prevent this level of disclosure in particular cases, or the perceived threat of the loss of existing assets or future opportunities that may discourage such disclosure, justifies not requiring this information to be provided.”

Despite this, the Paper goes on to suggest an exemption, a ‘get-out’ clause that they leave to the discretion of the company, suggesting “one approach could be to require the disclosure subject to an exemption similar to that in IAS 37 Provisions, Contingent Liabilities and Contingent Assets, which as explained in Chapter 5 provides an exemption in cases when disclosing the required information could be expected to prejudice seriously the position of the entity. In genuine cases where the disclosure of payments to governments is considered either to breach confidentiality requirements that a host government is expected to enforce or is expected to prejudice seriously the position of the entity for other reasons, the project team recommends that the entity should disclose why it is unable to disclose the information.

Such an approach would undermine the very usefulness of an IFRS, i.e. its ability to supercede confidentiality clauses and create a level playing field for companies operating in the extractive industries.

In most cases it would be very difficult for a company to disclose payments and other financial information based on an assessment of the particular country posing a reputational risk to the operations. The governments of countries that do pose this kind of risk are usually highly sensitive to disclosure of financial information and could directly or indirectly discourage companies from disclosing. It could also easily be perceived as an insult of the host government which might threaten ongoing operations or lead to the loss of future investment opportunities in that country to other entities that choose not to make that disclosure. This is why the IASB as a leading global standard setter, in tandem with other initiatives such as the US Energy Security through Transparency Act, needs to promote a level playing field for all companies operating in the extractive industries.

Summary of our asks – No exemptions

- The IASB should guarantee audited, consistent and comparable information and create a level playing field by setting a clear standard for disclosure with payments to all governments as the reporting requirement without exemptions.

5. Legitimate users of company financial reports – why the needs of civil society, governments and citizens must be used as valid criteria in assessing proposals, not just investors.

The IASB terminology includes preparers and users of financial reports. The ‘preparers’ are the companies and their auditors which ‘prepare’ company financial reports. ‘Users’ are those who are expected to draw on or benefit from the reports. Defining who the users are is a highly significant aspect of the process because it determines whose needs the standard should aim to satisfy. If this group is very narrowly defined it will require less of the IFRS but if it is broader and more inclusive it would suggest stronger requirements for example for disclosure.

In its constitution the IASB defines the **users** of its work as: “...investors, other participants in the world’s capital markets and **other users of financial information...**” During a recent revision of the constitution, investors were added as a specific user group but the IASB clarified that the addition: “...does not minimise the importance of other users of financial information...”. Regardless of these assurances the discussion paper states that: “...the PWYP proposals have been assessed only from the perspective of whether capital providers [investors] would find the information to be decision useful.”

To justify this decision the IASB refers to the Framework for the Preparation and Presentation of Financial Statements which describes the basic concepts by which financial statements are prepared. In this framework users are broadly defined as: “present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the general public” but it is also stated that financial statements that meet the needs of investors will also meet **most** (i.e. not all) of the general financial information needs of other users.

Investors undoubtedly constitute an important user group but the IASB should not ignore the users that are identified in the framework or forget about its objective of developing IFRSs in the **public interest**.

What about...Citizens?

It could be argued that **citizens in resource rich countries** have particular needs for more transparency in the extractive industries. Sixty percent of the world’s poor live in resource-rich countries, and most constitutions grant citizens “ultimate ownership” of natural resources. Resource rich countries are often characterized by a democratic deficit and very restricted access to information. As the companies are depleting non-renewable resources that essentially belong to them it is only reasonable that they have access to information about the amount of reserves, the revenues of the companies and benefit streams to governments etc.

What about...Tax authorities and regulators?

This would also be highly relevant for some government agencies such as tax authorities as they often have limited access to information and little capacity to seek verification of the information they do have access to. Transfer-mispricing and other illicit financial flows are growing concerns internationally and this is one of the strongest arguments for country-by-country reporting. Governments and tax agencies need to mobilize resources for sustainable development in their country.

It should be noted that the constitution of the IASC Foundation, the governing body of the International Accounting Standards Board, requires that in setting standards the IASB should “take account of, as appropriate, the special needs of ...emerging economies”.

As noted in an analysis appended to this Action Pack by Richard Murphy, the Discussion Paper gives, “No consideration whatsoever of the needs of these economies has been shown in the recommendations made in the IASB report although the PWYP proposals are specifically intended to enhance the revenues of those countries, reduce the risk of

Box 6: Narrow user survey

As part of the preparation of the discussion paper the IASB project team interviewed 34 professional users. This group included buy-side analysts, sell-side analysts, venture capitalists, lenders and debt-rating agencies. The survey focused on information about minerals or oil and gas reserves and resources, and not on other information in the financial statements such as cash flow, debt and exploration expenditures. PWYP finds that this survey is too narrow both in terms of the group interviewed and the issues covered. The preparation of the exposure draft should include a survey targeting a broader group of users.

corruption within them and promote good governance in developing countries.....The emerging economies and developing countries, those who live in them and those who lobby on their behalf, have particular information needs and that the IASB has a particular duty to respond to those needs”³¹.

Excluding a broad definition of users, their needs, contributions and the beneficial effects country-by-country disclosure would have for them would undermine the credibility and legitimacy of the IASB. If the IASB goes down this route it will emphasize the questions raised about its lack of accountability to elected institutions.

Please note!!!!

It is crucial in all lobbying activities, to recognize that the information that we are calling for will also be useful to investors/capital providers. **Therefore, even if other users are not accepted as legitimate in setting criteria for information inclusion, our ‘asks’ still meet the IASB’s minimum criteria. So this debate on users should not be allowed to deflect attention from our core demands.**

Summary: Our ask on who should be defined as key users of financial reports

- The users of accounts that PWYP seeks to represent, including employees, consumers, the public, civil society organizations and governments and their institutions are each in their own right valid user groups of accounting data. As a result their interest in financial statements must be recognized by the IASB. Therefore, their information needs must be valid criteria in judging the value and benefits of proposed reporting requirements.

³¹ Country-by-Country Reporting and The Extractive Industries: A review of the International Accounting Standards Board discussion paper on Extractive Activities published in April 2010. (May 2010) Richard Murphy FCA

What to ask for: the problems with the proposals, and what needs to change

1. Companies should be required to report for each and every country in which they operate.

We do not accept the current proposal to allow companies in the extractive industries to establish a cut-off point for country-specific reporting. We are particularly concerned by the proposal to allow the threshold to be set in terms of what is material for the company based on the size of national reserves relative to their international operations. This ignores the fact that reputational and legal risks are unrelated to the scale of operations. We also believe that the proposal to leave the decision on where to set the cut-off to the discretion of the company to decide, will reduce comparability of data, a key principle of international standards. Combined, we are convinced that this will leave the data on many countries still aggregated together and inaccessible.

- **The requirement must be that companies should report for each and every country in which they operate. Suggested thresholds for reporting that are set in terms of what is quantitatively material to the company, and set at its own discretion, should be removed.**

2. Information on specific payments to individual governments is essential

The current proposal recognizes that capital providers have stated that they would find country-specific information on payments to governments useful to their decision-making. Other users of financial reports – like civil society and tax authorities - also anticipate significant benefits in assessing the appropriateness of payments and holding governments to account for their use. Companies should already have this country-specific information to comply with host government taxation reporting. Many will also need it to address anti-bribery and corruption legislation in their home countries. Therefore, additional costs should not be significant, making the proposal for further cost-benefit analysis unnecessary.

- **The IASB should recommend country-specific reporting of payments to governments without the need for further analysis, in the same way that it has done for other reporting requirements.**

3. A minimum set of information is needed to ensure the coherent and credibility of what is reported by a company for operations per country. These are the six type of data specified in the PWYP proposals.

The list of reporting types proposed by PWYP is the smallest integrated set of data that can be disclosed to ensure accounting credibility. The current proposal treats it as a set of options by rejecting country-specific reporting requirements related to production revenues, subsidiaries and properties, and by failing to give a clear recommendation relating to payments to governments. But all elements must be required to allow meaningful judgments and comparisons.

Therefore the minimum package must include:

- **Benefits streams (payments) to governments** should be disclosed for each country and broken down by payment types – the proposals do not yet make a clear recommendation
- **Reserves, production quantities and costs** - the proposals make some recommendations here but also leaves scope for only regional and sub-national data in some cases. Data should also be disclosed on a standard country-specific basis.
- **Production revenues** should be disclosed on a country-by-country basis to ensure the consistency of the new IFRS for extractive industries and prevent tax avoidance and evasion – this type of reporting is currently rejected by the proposals
- **The names and locations of each key subsidiary and property in each country** should be reported – the proposal paper claims these are already available but does not offer proof.

4. There should be no reporting exemptions, especially where these are unnecessary, would undermine comparability and would increase pressure on ethical companies seeking to be transparent

The current proposal to give companies the option to exempt themselves for reporting payments to particular governments undermines the whole added value of an IFRS. It would remove the protection of a standard reporting requirement, leaving companies to explain to untransparent host governments why they were not using the exemption. Resulting non-reporting will reduce the comparability of company reports. Such exemptions are not needed since regulations like IFRSs would override restrictions of confidentiality clauses if applied in a uniform manner.

- **The IASB should remove the currently proposed exemption. To protect companies, the standard should require disclosure of payments to all governments without exemptions.**

5. There are many legitimate users of company financial reports other than investors and other capital providers and their needs must be considered by the IASB in the design of standards

The constitution governing the IASB states that it must act in the public interest and address the needs of the various users of company financial reports. In spite of this, the Discussion Paper explicitly rejects specific consideration of the needs of any users except capital providers/investors.

- **Other users of accounts - including employees, consumers, the public, civil society organizations and governments and their institutions - are each in their own right valid user groups of accounting data. Therefore, their specific information needs must be included in the criteria used to judge the benefits of proposed reporting requirements.**