Submission to the International Accounting Standards Board discussion paper on Extractive Activities

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Joint submission by Christian Aid and the Ecumenical Council for Corporate Responsibility, July 2010

1. Christian Aid and the Ecumenical Council for Corporate Responsibility

Christian Aid is the official development and relief agency of 41 churches in the UK and Ireland. We exist to help those in need – regardless of religion, ethnicity or nationality – working in around 50 of the poorest countries in the world as well as some of the emerging economies. We work not only to help those in immediate need but also to challenge the structural constraints to development. Christian Aid is a preparer of financial statements and a capital market participant, through its investment in corporate bonds and through its contributions to pension funds. Many of the communities with which we work are touched by extractive industries either through the direct impact on them of extractive activities, or indirectly as citizens of countries in which such industries contribute a significant proportion of national income and public resources. In addition many of our 780 staff and 1.8 million supporters are investors through their pension funds and as individual shareholders.

The Ecumenical Council for Corporate Responsibility (ECCR) is a UK and Ireland church-based investor coalition and membership organisation working for economic justice, human rights and environmental sustainability. ECCR undertakes research, advocacy and dialogue to encourage companies to meet the highest standards of corporate responsibility and transparency, as well as assisting faith communities, their members and other investors in upholding these same high standards through responsible and positive-impact investment.

Christian Aid and ECCR take an interest in the proposed International Financial Reporting Standard (IFRS) on accounting for extractive activities for three main reasons:

a. We have identified corruption as a major constraint to development. This is a particular challenge in resource rich countries where the wealth which ultimately belongs to the citizens of the country is easily misappropriated for personal gain by those in positions of power.
b. We have identified a lack of sustainable finance as a major constraint to the ability of governments to provide essential state services such as health, education and welfare. Taxation of natural resources, if managed correctly, could finance poverty alleviation in the long term and contribute to achieving the Millennium Development Goals. Managed badly, natural resource wealth can contribute to the misery of millions of people by propping up corrupt and oppressive regimes.

c. If companies operating in developing countries are not accountable to all of their stakeholders (including governments, citizens, investors, and civil society), and payments to governments are not declared, then the potential for corruption and poor management of natural resource wealth increases.

Transparency in the operations of companies has the potential to address the three problems presented above by increasing accountability. With greater accountability, revenues from the extractive industries have the potential to deliver long term sustainable benefits for the citizens of developing countries living in poverty.

Christian Aid and ECCR therefore welcome the International Accounting Standards Board's consideration of country-by-country reporting for the extractives sector.

2. The value of country-by-country reporting in the IFRS

The International Accounting Standards Board (IASB) is in a unique position. By implementing an international country-by-country transparency standard, it can help change the face of how extractive industries operate for the benefit of millions of people. While some suggest that these standards would be better developed as part of a company's sustainability programme, we argue that voluntary standards are very likely to result in the more responsible companies being transparent, while others disregard better practice and do so unchallenged.

The importance of country-by-country reporting has been recognised by a number of national and international actors:

a. The European Parliament, in its recent report on the impact of the effects of the global financial and economic crisis on developing countries and on development cooperation (2009/2150(INI)), "ask[ed] the Commission to report on … how country-by-country reporting on profits and taxes paid can become a rule for transnational companies in the EU".[1]
b. The Stock Exchange of Hong Kong Limited recently amended its Rules Governing the Listing of Securities to include "if relevant and material to the Mineral Company's business operations, information on the following: ... compliance with host country laws, regulations and permits, and payments made to host country governments in respect of tax, royalties and other significant payments on a country by country basis".[2]
c. The European Commission in its recent Communication on "Cooperating with Developing Countries on Promoting Good Governance in Tax Matters" says that a country-by-country reporting standard for multinational companies "should ... be referred in the OECD Guidelines for Multinational Enterprises and in the OECD Principles of Corporate Governance".[3] More particularly, the Commission states its support for "ongoing research on a country-by-country reporting requirement of a reporting standard for multinational corporations, notably in the extractive industry".[4]
d. The OECD as part of its Taskforce on Tax and Development has formed a subgroup to look at the issue of country-by-country reporting.[5]
e. Section 1504 of the US Dodd-Frank Act amends Section 13 of the '34 Exchange Act and requires that the SEC issue final rules that "require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the [U.S.] Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including: (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals; and (ii) the type and total amount of such payments made to each government."

3. Objectives of reporting

Christian Aid and ECCR believe that companies should be required to report for each country in which they operate according to proposals from the Publish What You Pay (PWYP) civil society coalition.[6] This would:

a. Increase accountability of companies in the context in which they operate. It would provide tax authorities and civil society with information regarding the global operations of a company and, in doing so, would provide evidence of transfer pricing abuse.
b. Assist investors in evaluating the risk profile of companies they have an interest in.
c. Increase accountability of governments to their citizens by providing tax authorities with information to verify their own records and thus challenge corruption and provide civil society organisations, such Christian Aid's partner, the Budget Advocacy Network in Sierra Leone, with information to monitor how payments to governments are being used and to engage in the budgeting process.

To fulfil these objectives, disclosure requirements must have a minimum set of data to ensure coherence and credibility.

We will therefore proceed by evaluating the IASB discussion paper on *Extractive Activities* (hereafter referred to as "the discussion paper") based on coherence with a selected range of principles, objectives and trends. These are limited to four points, with a view to enabling the IASB to respond to each in turn.

While we believe a country-by-country reporting standard for all sectors is necessary, we will restrict comments to the extractives sector in this instance.

4. Response to the discussion paper

4.1. Coherence with International Accounting Standards Committee (IASC/IFRS) Foundation principles and IFRS objectives

The discussion paper states that "proposals have been assessed only from the perspective of whether capital providers would find the information useful" (para 6.10). We question the extent to which the consideration of this limited stakeholder group is consistent with the constitution of the IASC/IFRS Foundation, which states that one of its purposes is "to develop, *in the public interest* [emphasis added], a single set of high quality, understandable, enforceable and globally accepted financial reporting standards … to help investors, other participants in the world's capital markets and *other users of financial information* [emphasis added] make economic decisions".[7]

The IASC/IFRS constitution refers to taking account of the needs of entities "in diverse economic settings". By excluding reference to non-capital-providers who are nevertheless key stakeholders, such as civil society actors in low income and emerging economies, we question the consistency of the discussion paper with the IASC/IFRS constitution.

The discussion paper suggests that materiality thresholds are set in relation to a company's international operations and left to the company's discretion. In addition, it suggests a potential exemption "in cases when disclosing the required information could be expected to prejudice seriously the position of the entity" (para 6.37). These proposals will reduce the comparability of information across companies and countries – undermining one of the objectives of IFRSs.

4.2. Coherence with international principles

UNCTAD's 2008 *Guidance on Corporate Responsibility Indicators in Annual Reports* states that financial statements might be used by investors and financial institutions, business partners, consumers, employees, surrounding community, civil society organizations, and governments and their institutions.[8] The fact that in the discussion paper "proposals have been assessed only from the perspective of whether capital providers would find the information useful" (para 6.10) is inconsistent with the view of UNCTAD.

4.3. Coherence within the discussion paper

The discussion paper states (para 6.15) that "The effect that country-specific investment risks may have on an entity depends on the materiality (in quantitative terms) of its investments in that country relative to its overall financial position and performance. This is because the potential economic loss (or gain) to the entity arising from country-specific investment risks would be expected to be correlated to the relative value of the entity's investments in that country."

However, this is contradicted later where the paper states (para 6.24) that "an entity's exposure to reputational risks and the associated *potential economic loss* [emphasis added] is not correlated to the scale of the entity's investment in a particular country. This is an important point ..."

It is increasingly recognized that reputational risk may not be related to size of operations. For example, a company making corrupt payments in a country with a bad human rights record, even though investment in that country might be small in relation to the company's overall position, would be exposed to serious reputational - and potentially legal and financial - consequences.

4.4. Coherence with Christian Aid's and ECCR's objectives

Section 3 of this response outlines Christian Aid's and ECCR's objectives for a country-by-country reporting standard for the extractives industry. The discussion paper contains a number of contentions and omissions which are inconsistent with our objectives for the standard:

a. *A lack of specific recommendations on reporting of country specific information on payments to governments*
   Payments to governments present specific risks in relation to corruption (bribery) and in relation to transfer pricing abuse. To build accountability of governments and companies, the IASB should be specific on the disclosure of payments to governments.

b. *Proposal that materiality thresholds should be set by the company*
   The discussion paper proposes that the threshold of materiality is set a) in relation to what is material to the company rather than the country, b) in relation to the size of a company's reserves in a country, and c) at the discretion of each company. What may be immaterial for a company may not be immaterial for a country. This would undermine the objective of building accountability at the country level.

c. *Proposal for reporting exemptions*
   The discussion paper proposes exemptions "in cases when disclosing the required information could be expected to prejudice seriously the position of the entity" (para 6.37). This would create a situation where confidentiality clauses at the national level (on the part of the government or the company) could easily be invoked to withhold data. This would undermine the objective of a consistent standard of transparency for the purposes of building accountability.

d. *A selective approach to data disclosure*
   The discussion paper recommends country level reporting for reserves, production volumes and costs, but excludes production revenues, benefit streams to governments, and subsidiaries and properties. This selective approach would undermine the utility of the information and we therefore recommend that the IASB accept the value of disclosure of production revenues, benefit streams to governments, and subsidiaries and properties.

5. Conclusion and recommendations

Christian Aid and ECCR recognise the potential of the IASB to deliver significant benefits to the world's poor through an effective country-by-country reporting standard for the extractives sector and commit to issuing a joint public statement of support if each of our considerations is addressed fully.

We look forward to a written response from the IASB which considers each of our comments in turn. In addition, we would be more than happy to meet to discuss our submission.

Recommendation 1: To remain consistent with the IASC/IFRS constitution, IFRS objectives and the views of UNCTAD, the IASB should expand its analysis of the usefulness of country-by-country reporting to a broader range of stakeholders.

Recommendation 2: To build accountability at the country level, materiality must be set at the country level.

Recommendation 3: To build accountability at the country level in a consistent manner, reporting exemptions should be removed.

Recommendation 4: To provide maximum utility for disclosed information, the IASB should reconsider the value of disclosure of production revenues, benefit streams to governments, and subsidiaries and properties.

6. Answers to the questions posed by the IASB

Question 1 – Scope of extractive activities
We recommend that the reporting issues discussed in Chapter 1 should apply to all the countries of operation and to all operations of a company which has any engagement in the extractive industries, whether upstream or downstream, to optimise revenue transparency.

Question 2 – Approach
We recommend a single accounting and disclosure model that applies to extractive activities in the minerals and the oil and gas industry.

Question 5 – Minerals or oil and gas asset recognition model—unit of account selection
We recommend that all units of account are delineated on a country-by-country reporting basis as a significant part of the risk associated with any operation occurs at a national level. In addition accountability to civil society and government stakeholder must also occur at the national level..

Question 6 – Minerals or oil and gas asset measurement model
It is our opinion that historical cost reporting is of most use for oil and mineral accounting since this best assists the user seeking to assess taxation payments made.

Question 8 – Disclosure objectives
In Chapter 5 that the disclosure objectives for extractive activities described is to enable users of financial reports to evaluate:

(a) the value attributable to an entity's minerals or oil and gas properties;

(b) the contribution of those assets to current period financial performance; and

(c) the nature and extent of risks and uncertainties associated with those assets.

We recommend that the objectives of this standard are expanded as outlined in point 3 above.

Question 9 – Types of disclosure that would meet the disclosure objectives
We recommend that the disclosure requirements should comply with the PWYP proposals. If not, the proposal will not comply with the objectives of strengthening accountability at the national level, particularly to other users of financial information besides capital providers.

Question 10 – Publish What You Pay disclosure proposals
These issues have been addressed in the points above.

References

1. www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2010-0034&language=EN, para 63.
2. "Amendments to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited", www.hkex.com.hk/eng/rulesreg/listrules/mbrulesup/Documents/mb96_miner.pdf, sect. 18.05, 6(c).
3. http://ec.europa.eu/development/icenter/repository/COMM_COM_2010_0163_TAX_DEVELOPMENT_EN.PDF, sect. 2.2.2.
4. Ibid., sect. 3.
5. www.oecd.org/document/51/0,3343,en_2649_33749_45240563_1_1_1_37427,00.html
6. www.publishwhatyoupay.org/en/about/advocacy/accounting-standards-regulations
7. www.iasb.org/NR/rdonlyres/B611DD9A-F4FB-4A0D-AEC9-0036F6895BEF/0/Constitution2010.pdf, para 2(a).
8. www.unctad.org/en/docs/iteteb20076_en.pdf, page 6.

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