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Part II

IMPACT ASSESSMENT
for financial disclosures on a country by country basis

Accompanying the document

Proposal for a Directive of the European Parliament and of the Council amending Council Directive 2004/109/EC on the harmonisation of transparency requirements
and
Proposal for a Directive of the European Parliament and of the Council on the annual annual financial statements, consolidated financial statements and related reports of certain types of undertakings

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1. INTRODUCTION

Europe's largest multi-nationals have hundreds of subsidiary companies, and worldwide operations in over 100 countries. Until now all the activities of a group have been brought together, every year, into a single set of consolidated accounts. This allows investors, and other accounts' users to understand the financial position and profitability of the group as a whole.

Country-by-Country Reporting (CBCR) is a different concept of financial reporting, which would see certain financial information being presented at a country rather than a global level. For instance, in the consolidated profit and loss account global revenues and global profits are reported. In a set of country by country (CbyC) accounts revenues and profits in every country in which the group operates would be shown. CBCR is not seen as a replacement for consolidated accounts, but a complementary scheme of reporting that can help to show the financial impact a multi-national has in the various countries in which it operates. CBCR can also take different forms including a full set of accounts as previously explained, or can be limited to certain key data, in particular payments to government, which are considered to be relevant for some stakeholders.

In recent years there have been regular calls for multinational companies[1] (MNCs) to provide more financial information on a country by country basis. Often these calls concerned a particular industry sector (such as the extractive industry). On several occasions, most recently in its *Communication on Tax and Development – Cooperating with Developing Countries on Promoting Good Governance in Tax Matters*[2], the European Commission supported ongoing research on CBCR requirement as part of a reporting standard for multinational corporations, notably in the extractive industry. In the recent EP Resolution[3] on Tax and Development the EP also reiterated its support for CBCR requirements for the extractive industries.

Advocates of CBCR consider that it would enhance government accountability on payments received from the primary extraction of natural resources in developing countries and in turn support development and growth in such countries.

On 22 September 2010 the Commission agreed with the European Parliament, in the context of the negotiations of the new European financial supervisory package, to evaluate the feasibility of requesting certain issuers of shares in the EU regulated markets to disclose key financial information regarding their activities in third countries[4]. This impact assessment considers the case for CBCR for MNCs, and whether CBCR could lead to better governance.

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1 MNC is a corporation that operates in two or more countries.

2 COM (2010) 163 final.

3 In Resolution 2010/2102 (INI) the European Parliament when considering extractive industries "*Calls for the introduction of country-by-country financial reporting obligations for cross-border companies, including pre- and post-tax profits, with the aim of enhancing transparency and access to relevant data for tax administrations; takes the view that, in order to ensure that all sectors and all companies are uniformly covered, the EU should introduce the principle as part of the upcoming revisions of the transparency directive and the EU accounting directives, while at the international level the Commission should exert pressure on the IASB swiftly to develop the corresponding comprehensive standard.*"

4 http://register.consilium.europa.eu/pdf/en/10/st15/st15650-ad01.en10.pdf

It is acknowledged that other policy options in the field of development (for instance making aid conditional upon improved governance and transparency) could also achieve some of the above objectives. However, this Impact Assessment focuses on the possible role that a CBC regime in financial reporting could have in achieving this objective.

2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

2.1. Internal Consultation Impact Assessment Steering Group

This Impact Assessment was guided and monitored by an Inter-Services Steering Group (ISC). The Group met on 15/10/2010, 01/04/2011 and 15/4/2011. The following services were consulted: Secretary General, Legal Service, Taxation and Customs Union, Development, Trade, Enterprise, Energy, and Environment. The minutes of the final meeting of the Group on 15/4 were provided to the Impact Assessment Board. A revised draft of this report was submitted to the ISC on 15/06/2011. Therefore an addenda to the minutes was prepared and submitted to the IAB.

This initiative has been included in the Commission's Work Programme (Reference number 2011/MARKT/030)[5].

2.2. Consultation of interested parties

The Commission conducted a public consultation on CBCR by multinational companies between 26 October 2010 and 9 January 2011[6] in order to obtain stakeholders' views on possible additional disclosure requirements. The summary of the results[7] is attached to this Impact Assessment (see Annex 6). The overall result of the consultation shows a rather diverse pattern of opinions depending on the category of respondents. Companies preparing financial statements and their representative bodies (hereinafter "preparers"), accountants and auditors were in general opposed to requirements to report on a country by country basis. However, a detailed analysis of the responses showed that preparers in the most concerned industries (oil and gas companies) expressed a constructive view as they consider this to be conducive to improving domestic accountability and governance in resource-rich countries. Users (mainly NGOs) were in favour of CBCR requirements. The opinions of public authorities were split and half of them had a neutral position on several of the questions.

During 2010 and 2011 the Commission services had a series of bilateral meetings with stakeholders. A list of these bilateral contacts is attached to this Impact Assessment (see Annex 7).

During both the public consultation and bilateral contacts various opinions were expressed and the Commission Services sought further views on detailed aspects of this policy area. Preparers (companies, representative bodies, etc) expressed their concern about the possibility of requiring disclosure of full accounts on a country by country basis. In their view, this type of reporting would be very burdensome, would reveal commercially

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5 http://ec.europa.eu/governance/impact/planned_ia/roadmaps_2011_en.htm#internal_market

6 The consultation document can be found at: http://ec.europa.eu/internal_market/consultations/2010/financial-reporting_en.htm

7 The complete summary report of the public consultation can be found at: http://ec.europa.eu/internal_market/consultations/2010/financial-reporting_en.htm

sensitive information, and would place EU industry at a competitive disadvantage. Preparers argued that such information is not useful to investors, and instead would make financial statements complex and unreadable.

The extractive industry (oil, gas, and mining) also viewed full accounts on a country by country basis as burdensome and disproportionate. Instead some extractive companies favoured initiatives like the EITI. Some extractive companies viewed a mandatory disclosure requirement of payments to governments at a country level as a tool for enhancing transparency and building trust. Certain extractive companies stated that they already voluntarily disclosed payments to governments and that it was not harmful to their competitive position. Listed companies suggested that in order to achieve a level-playing field, the scope should include listed and non-listed extractive companies. Extractive companies also suggested that CBCR should not form part of the financial statements, nor be subject to audit as this would be very costly. Finally they also expressed concerns over the publication of information on both a country- and project- basis as required under the US legislation.

During bilateral consultations with some parts of the forest-based sector, the view was expressed that it is different from the extractive industry because it uses renewable forest resources, and payments to government are much lower than in the extractive industry. It was argued that there are already initiatives (like the EU FLEGT Action Plan, including the Timber Regulation) in place, and that additional requirements would be burdensome to the industry.[8] Others viewed CbC disclosure requirements of payments to governments as a positive policy initiative, although few EU companies would be affected by it.

Users expressed their support for disclosures of *payments to governments* on a country- and project- level by all extractive companies (listed and non-listed). Some NGOs stated that although EITI was a very useful initiative, it was a voluntary initiative and that only a few countries were compliant. In their view, mandatory CBCR by MNCs in the extractive industry and loggers of primary forests[9] would contribute to better governance and accountability in resource-rich countries. NGOs supported the view that payments to governments should be disclosed at country- and project- level because it would allow for accountability even at the local level. They suggested that the costs would be outweighed by the benefits to investors and civil society. Some NGOs also expressed their support to go even further and disclose full accounts on a CBC basis.

2.3. Study on compliance costs of country by country reporting (CBCR)

The European Financial Reporting Authority Group (EFRAG) provided input on the evaluation of the administrative costs associated with possibly requiring country by country financial reporting (see Section 7).

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8 EC Public Consultation on "Additional options to combat illegal logging": Summary Report 2007 http://www.cc.cec/dgintranet/env/i/e2/doc/pdf_docs/forests/AddlOptionsSynthFinal.pdf

9 Whether clear-cutting, selective logging or thinning, on land classified as containing primary forest areas or other disturbance of such forest or forest land caused by mining, mineral, water, oil or gas exploration or extraction or other detrimental activities

2.4. Recommendation of the Impact Assessment Board

On 22 July 2011 the Impact Assessment Board gave its positive opinion on this impact assessment. The present document takes account of the comments expressed on the draft impact assessment, namely:

The report needed to establish more clearly the scope and core objective of the initiative. Secondly, it needed to provide a fuller baseline scenario. Thirdly, options needed to be better presented. Fourthly, the report needed to better consider the costs and benefits of the policy options and strengthen the proportionality analysis of the proposed measures. Finally, the report needed to provide more information on stakeholders' views.

3. POLICY CONTEXT

This section first looks at the EU extractive and logging industries in a global economy context. This section also looks at existing CBCR requirements in different jurisdictions as well as existing complementary requirements.

3.1. EU extractive and logging industries in a global economy context

Extractive industry

Within the FT rankings of the top 100 listed companies, seven companies are EU oil, gas or mining companies (BHP, Shell, BP, Total, Rio Tinto, Eni, Statoil) while 4 are US companies (Exxon, Chevron, ConocoPhillips and Occidental) and 9 BRICs (Brazil, Russia, India and China) companies (Petrochina, Petrobas, Vale, Gazprom, Sinopec, China Shenha Energy, Rosneft, Reliance and CNOOC). This illustrates the importance of the extractive sector in the EU economy but also its exposure to international competition, as half of the leading operators come from emerging economies. Major EU and US oil and gas companies[10] control approximately 12% of world production and reserves, whilst OPEC[11] and non-OPEC[12] national oil companies account for approximately 60% of oil and gas production and 70% of oil and gas reserves[13].

Three EU-listed companies feature among the top ten oil and gas companies according to Energy Intelligence 2010[14] which bases its ranking on operating metrics (oil production, gas production, oil reserves, gas reserves, product sales and refinery distillation capacity) rather than more traditional measurements such as market capitalisation or revenues. The top 100 companies control 87% of the world's oil reserves and 72% of its gas reserves. This ranking shows the growing influence of Asia's government-controlled national oil companies. Malaysia's Petronas (17), China's CNOOC (38), India's Reliance industries (40), Thailand's PTT (53) and Korea's National Oil Corp. (77) have been among the fastest rising companies in this ranking in recent years.

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10 ExxonMobil, Shell, BP, Chevron, ConocoPhillips, Total

11 Saudi Aramco, NNPC, Sonatrach, PDVSA, QatarPetroleum, NOC, ADNOC, NIOC, KPC, Sonangol, TAQA, PetroEcuador, Mubadala , Emirates Oil Company, Iraqi Oil Ministry

12 CNPC (inc. Petrochina), Petrobras, PEMEX, Gazprom, Statoil, Petronas, Sinopec, CNOOC, Rosneft, Ecopetrol, ONGC

13 Quoted from Total with reference to BP Statistical Review,Wood Mackenzie, Total estimates, IFP, Barclays Capital, PFC

14 NIOC, Exxon Mobil, PDV, CNPC, BP, Royal Dutch Shell, Chevron, ConocoPhillips, Total, Pemex

The emergence in recent years of three major Chinese NOCs also illustrates that EU (and US) companies face increasing competition within the global marketplace: China National Petroleum Corporation (CNPC), China Petroleum & Chemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC) have emerged as significant players in global competition for oil and natural gas[15]. According to International Energy Agency (IEA) data[16], in 2009, Chinese companies spent US$ 18.2 billion on mergers and acquisitions (13% of total global oil and gas acquisitions (US$ 144 billion) and 61% of all acquisitions by national oil companies (US$30 billion)). In 2010, they again spent approximately US$ 29 billion, with more than half invested in Latin American (US$ 15.74 billion). Chinese oil companies are now operating in 31 countries and have equity production in 20 of these countries. Their equity shares are mostly located in four countries: Kazakhstan, Sudan, Venezuela and Angola.

Logging industry

Exact industry data for the logging industry is difficult to come by, but in 2004, trade in all wood-based forest products accounted for an estimated 3.7% of the world trade in commodities, valued at US$327 billion (UN Food and Agriculture Organisation 2007 report). Europe accounts for nearly half of the world's trade in forest products with imports of US$158 billion and exports of US$184 billion (FAO 2007). The tropical logging industry in particular has seen the biggest demand for imports from China and India (80%, 2007-2009). During this same period, EU imports have fallen. Imports by France (the EU's largest tropical log importer) have witnessed a decline of 16% (at the same time there were greater export restrictions imposed by the host countries such as Cameroon, Gabon, Liberia and Congo).
The major timber exporting African states lie in the Congo River Basin and coastal regions of West/Central Africa. In some of these countries, revenues from forestry accounts for 8 - 12% of GDP (such as Guinea-Bissau, Chad, and Liberia).

Unlike the extractive sector, the logging sector is not characterised by very large listed companies (for instance, no logging companies feature in the top 100 listed companies), but the leading EU MNCs in this sector include (according to UNCTAD), Rougier[17], HFC, SIBAF *(Société Industrielle des Bois Africains)***,** Thanry and Sonae**,** all of whom have extensive operations in Africa. EU MNCs are more present in Africa than in Asia or Latin America.

3.2. Existing EU CBCR disclosure requirements

At EU level, MNCs are not required to disclose financial information on a country by country basis in their consolidated accounts. Some EU legal acts, however, refer to relevant disclosures that provide information below the group level:

- The Fourth Company Law Directive[18] on annual accounts and the Seventh Company Law Directive[19] on consolidated accounts set out accounting rules for all

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15 Examples also include national oil companies such as Saudi Aramco, National Iranian Oil Company. See also Attachment C to API submission to US SEC of 12 October 2010

16 IEA 2011

17 Which extends from forest exploitation and processing in Africa; international timber trade and imports to France; and timber processing in France.

18 Directive 78/660/EEC

19 Directive 83/349/EEC

limited liability companies incorporated in the EU. The Seventh Directive requires the parent company (whether listed or not) to disclose in its consolidated accounts its subsidiaries, jointly controlled entities and associates[20].

- The First Company Law Directive[21] requires all companies registered in the EU and incorporated with limited liability to file their annual accounts with national business registries, which are accessible to any interested party.

- The Transparency Directive (TD)[22] sets out the minimum transparency requirements for listed companies. Recital 14 of the Transparency Directive (TD) encourages EU countries to request their national listed extractive industry to disclose payments to governments. So far none of the EU Member States have made this requirement mandatory.

3.3. International Financial Reporting Standards (IFRS)

The International Accounting Standards Board (IASB) is an independent standard-setting body located in London, and is responsible for the development and publication of International Financial Reporting Standards (IFRS). IFRS are applied in more than 100 countries (including the EU Member States, Australia, Hong Kong, New Zealand, Singapore, South Africa, Brazil)[23]. The consolidated accounts of listed EU companies have to be prepared in accordance with IFRS issued by the IASB, and adopted by the EU[24]. Two IFRS are relevant in the policy context of CBCR.

IFRS 8 on Operating Segments

The IASB issued *IFRS 8 Operating Segments* on 30 November 2006 (adopted by the EU in November 2007 and effective from 1 January 2009). While IFRS 8 contains some geographical disclosure requirements, companies tend to organize and report on their operations on non-geographic lines (i.e. product or service lines)[25]. Even when a company opts to report on its operations on a geographical line, it may only be on a continental or sub-continental and not country level. The IASB has indicated to the Commission that it will start a post-implementation review of IFRS 8 later in 2011, as the standard only became mandatory for reporting periods starting on or after 1 January 2009.

IFRS 6 on the Exploration for and Evaluation of Mineral Resources

The IASB issued *IFRS 6 on the Exploration for and Evaluation of Mineral Resources* on 9 December 2004 (adopted by the EU in November 2005 and effective from 1 January 2006),

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20 Article 34 (2) of Directive 83/349/EEC

21 Directive 68/151/EEC: Article 1 for the types of companies covered by this obligation and article 2 for the obligation.

22 Directive 2004/109/EC

23 Some countries are in the process of adopting or converging towards IFRS by the end of this year (such as Canada, China and South Korea) while other countries like the US and Japan will announce in 2011 and 2012 respectively whether they will make IFRS mandatory in their countries.

24 Regulation (EC) No 1606/2002/EC

25 In its basis for conclusions on IFRS 8 (see IFRS 8 paragraph BC50) the IASB took the view that the issue of CBCR would need to be taken forward in discussion with agencies such as the UN, IMF and World Bank.

as an interim standard pending completion of a research project. Before that date, there were no standards to address the particularities of the extractive sector industry. In April 2010, the IASB published a Discussion Paper on IFRS 6 for comment in order to analyse the unique financial reporting issues applicable to extractive activities and to identify a basis on which a financial reporting model might be developed to address these issues. The Discussion Paper has a chapter on the *Publish What You Pay* (PWYP)[26] proposals on country-specific reporting of payments to governments, as well the reporting of reserves volumes, production volumes, production revenues and costs.

In the IASB Comment Letter summary[27] of October 2010, the staff states that the IASB clarified that "*the objective of financial reporting is directed towards meeting the needs of investors and lenders and that information that meets their needs may also be useful to other users. Consequently, assessing the PWYP proposals from the perspective of the benefits they provide to other users would appear to go beyond that objective*." Many of the commentators suggested that such disclosures are within the scope of corporate social responsibility. The IASB will only decide whether to pursue development of extractive industry-specific standards during the second part of 2011. Given that CBCR is not on the IASB's current work programme, any initiative on the part of the IASB is likely to take several years to reach the status of a final standard and there would be a further implementation period of at least two years beyond that.

3.4. Mandatory disclosure requirements in the USA

The US Dodd-Frank Act[28], which was adopted in July 2010, is the Wall Street Reform, whose purpose is to increase regulatory oversight of the banking and financial sectors in the US. Section 1504 requires extractive industry companies (oil, gas and mining companies) registered with the Securities and Exchange Commission (SEC) to publicly report payments to governments[29] on a country- and project-specific basis. The US rules will apply to many of the foreign, including 15 EU, oil, gas and mining companies, if they have securities listed on the New York Stock Exchange. The US rules build on the principles of payment transparency established by Extractive Industries Transparency Initiative (EITI). The proposed implementing rules were published in December 2010[30]. Once the final implementing rules are issued by the SEC (initially due in April 2011, but now expected during the second half of 2011) companies will have one fiscal year to implement the new requirements.

3.5. Practices in the other jurisdictions

From June 2010 the Hong Kong Stock Exchange introduced new listing rules to require new applicant mining, oil, and gas companies to disclose “payments made to host-country governments in respect of tax, royalties, and other significant payments on a country by

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26 Publish What You Pay (PWYP) is a global network of civil society organisations. See http://www.publishwhatyoupay.org/en/about

27 http://www.ifrs.org/NR/rdonlyres/DB7A2F15-3B38-493F-B295-FFE4CF6E4742/0/Extractives1010b07Aobs.pdf, p 29.

28 http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

29 Taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits.

30 http://www.sec.gov/rules/proposed/2010/34-63549.pdf

country basis,"[31] if relevant and material to the company's business. This rule applies to each new applicant whose major activity is the exploration and/or extraction of natural resources, or which has 25% or more of its total assets, revenues or operating expenses in natural resources. These are "one-off" disclosures on an initial listing, and companies would only be required to make similar disclosures if they were to conduct a major acquisition or disposal of mineral or petroleum assets. Otherwise, there is no such specific annual disclosure requirement.

Similarly, the UK Alternative Investment Market (AIM), a non-regulated stock market for smaller enterprises within the London Stock Exchange, also requires a one-off disclosure by the extractive industry companies of payments to governments on a CBC basis[32].

3.6. The Extractive Industry Transparency Initiative (EITI)

This is a process driven by national governments which means that all extractive companies (oil, gas and minerals) active in the country fall with the scope of the relevant national regulations and must comply. The Initiative was launched in 2003 by the UK government, with a view to ensuring that natural resource wealth serves as an engine for sustainable development and poverty reduction. Although the EITI is a voluntary initiative, participation in the process is mandatory for all extractive industry operators (including state-owned enterprises) once the host country endorses the initiative – thereby a level playing field is created for all extractive operators within the relevant country. The EITI applies to operators with activities in exploration and production. As of March 2011, 11 countries[33] are EITI compliant (fully implementing EITI and having undergone successful external validation in line with the EITI validation indicators - including the publication and distribution of an EITI report); 24 countries[34] have candidate status (starting the process, fulfilling at least four of the EITI criteria[35] but not having yet finished a full round of EITI reporting); and 4 have started the process but do not fulfil at the moment the four minimum criteria to be considered as candidate[36]. 50 of the world's largest oil, gas and mining companies have signed up to this process[37].

Out of the 11 compliant countries, 9 countries are considered as resource-rich countries by the IMF. Five are considered by the IMF as hydrocarbon-rich countries (Azerbaijan, Nigeria, Norway, Timor-Leste, Yemen) and these account for 4.6% of the world's oil reserves and 5.3% of the world gas reserves; four are considered by the IMF as mineral-rich

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31 http://www.hkex.com.hk/eng/rulesreg/listrules/mbrulesup/Documents/mb96_miner.pdf, p 10.

32 The AIM guidelines state that the new applicant 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." See AIM Note for Mining, oil & gas companies (2009), http://www.londonstockexchange.com/companies-and-advisors/aim/publications/rules-regulations/guidance-note.pdf , p. 4.

33 Azerbaijan, Central Africa Republic, Ghana, the Kyrgyz Republic, Liberia, Mongolia, Niger, Nigeria, Norway, Timor-Leste and Yemen.

34 Afghanistan, Albania, Burkina Faso, Cameroon, Chad, Côte d'Ivoire, Democratic Republic of Congo, Gabon, Guatemala, Guinea, Indonesia, Iraq, Kazakhstan, Madagascar, Mali, Mauritania, Mozambique, Peru, Republic of the Congo, Sierra Leone, Tanzania, Togo, Trinidad and Tobago, and Zambia.

35 Committing to implement the EITI; committing to work with civil society and the private sector; appointing an individual to lead implementation; and producing a Work Plan that has been agreed with stakeholders

36 Equatorial Guinea, Ethiopia, Sao Tome and Principe, Ukraine

37 http://eiti.org/supporters/companies

countries (Ghana, Kyrgyz Republic, Liberia, Mongolia); two countries (Central Africa Republic and Niger) do not feature on the IMF list of resource-rich countries[38].

Many resource-rich countries have not yet joined the EITI. The 2008 IEA statistics[39] indicate that only two EITI compliant countries are represented in the top ranking of net exporters for crude oil (Norway (4.6% of world net exports) and Nigeria (5.2%)) while countries like Saudi Arabia (18.2%), Russia (12.3%), Iran (6.1%), United Arab Emirates (5.5%), Angola (4.7%), Kuwait (4.6%), Iraq (4.5%)[40] and Venezuela (3.8%) account for 60% of world exports of crude oil. The 2008 IEA statistics also indicate that the only EITI compliant country represented in the top ranking of net exporters for natural gas is again Norway (13.6% of world net exports) while countries like Russia (21.7%), Canada (10.3%), Qatar (9.1%), Algeria (7.5%), Indonesia (4.9%), Netherlands (4.1%), Turkmenistan (3.7%), Malaysia (3.3%) and Trinidad and Tobago (2.9%) account for 67.5% of world exports of natural gas. Most of these countries' production is controlled by National Oil Companies (NOC), which are fully or partially owned by governments.

According to the EITI rules, the company and the government must make independent statements of the amounts paid to government by the company. The EITI suggests that the following revenue streams should be disclosed: production entitlements, profits taxes, royalties and licence fees, dividends, bonuses and other significant benefits to host governments (these payments are explained in more detail in Annex 4) as agreed by the country's multi-stakeholder group[41]. The payments and revenues must be reconciled by an independent administrator applying international auditing standards[42]. It is up to the country to define the materiality level for reporting payments or company participation (that is, the size of payment or the threshold size of company operations below which they are excluded from the process for reasons of cost/benefit). Although the company has to provide fully disaggregated statements to the independent administrator/auditor, the data can be published in an aggregated[43] or disaggregated form in the final EITI report published by the government of the relevant country[44]. The obligation to publish the information rests with the government. The EITI also requires civil society participation and oversight in the country through a multi-stakeholder group process. This inclusive process provides a forum for civil society to engage with corporate and government decision-makers and is thereby conducive in building trust among stakeholders as well as enhancing the domestic accountability of extractive sector activities.

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38 IMF data (2004). Out of the remaining 24 candidate EITI countries, only eight are considered by the IMF as hydrocarbon-rich countries (Cameron, Chad, Gabon, Indonesia, R. of Congo, Iraq, Kazakhstan, Trinidad and Tobago) and these account for 13.64% of world oil reserves and 5.3% of world gas reserves; six are considered by the IMF as mineral-rich countries (DR of Congo, Guinea, Mauritania, Peru, Sierra Leone, Zambia); and ten countries (Afghanistan, Albania, Burkina Faso, Côte d'Ivoire, Guatemala, Madagascar, Mali, Mozambique, Tanzania, Togo) did not figure on the IMF list.

39 Key World Energy Statistics, 2010, OECD.

40 Iraq is a EITI candidate country.

41 http://eiti.org/files/document/sourcebookmarch05.pdf , p. 27-28.

42 According to EITI (2005), "all payments and revenues under EITI should have been the subject of credible, independent audit. When companies submit payments data that has been verified by their own independent auditor, no other audit will normally be required. Where such audits have not been done – or the audit is not regarded as credible – then an audit will need to be undertaken." p. 32.

43 Payments made by individual companies are consolidated by revenue type so that individual company payments are not identified in a published EITI report.

44 World Bank (2008). Implementing Extractive Industries Transparency Initiative.

3.7. Existing complementary requirements in the EU

The Kimberley process

The Kimberley Process Certification Scheme (KPCS)[45] is an existing international governmental certification scheme for the diamond mining industry that was set up to prevent the trade in diamonds that fund conflict. Launched in January 2003 by the United Nations, the scheme requires governments to certify that shipments of rough diamonds are free from "blood diamonds". Countries that participate must pass legislation to enforce the Process[46]. Countries must also set up control systems for the import and export of rough diamonds. Companies in Participant Countries are only allowed to trade rough diamonds with companies from other Participant Countries, with the aim to prevent "blood diamonds" from entering the Kimberley Process system.

The KPCS can be viewed as a complementary scheme rather than overlapping with CBCR disclosure requirements. While the KPCS requires the country-participant to certify one particular mining product (diamonds) with the objective to stop the trade in conflict diamonds, CBCR would require diamond mining companies to disclosure certain financial information on a CbC basis, e.g. payments to government with the objective to enhance government accountability on revenues derived from permitting the relevant mining operations. Whilst the ultimate objective of KPCS is to eradicate the possibility of funding conflicts from the sale of diamonds, CBCR endeavours to bring transparency on government revenues in order to tackle corruption. Also, whilst the burden of proof with KPCS falls on the country-participant, CBCR would create mandatory reporting requirements for companies (not countries).

The Forest Law, Governance and Trade Program (FLEGT) and the EU Timber Regulation

The EU FLEGT Action Plan (Forest Law Enforcement, Governance and Trade)[47] set out a voluntary licensing system, which ensures that only legally harvested timber is imported into the EU from countries agreeing to take part in this scheme.[48] This system is being developed through the negotiation of bilateral Voluntary Partnership Agreements (VPAs) between the EU and timber exporting countries. Both parties commit to putting in place a scheme designed to guarantee that only licensed products from these partner countries will enter the EU. So far, VPAs have been concluded between the EU and Cameroon, Ghana, Republic of Congo, Indonesia, Liberia and Central African Republic.

Because VPAs are bilateral and voluntary, the EC proposed in 2008 legislation that would require all operators placing timber products on the EU market to put into place systems to ensure that their timber is of legal origin. In 2010, the EP voted in support of the Timber

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45 The Kimberley Process currently has 71 countries-participants: 46 countries and the European Union.

46 Council Regulation (EC) No 2368/2002 of 20 December 2002 implementing the Kimberley Process certification scheme for the international trade in rough diamonds
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:358:0028:0048:EN:PDF

47 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:347:0001:0006:EN:PDF

48 According to the UN, illegally harvested timber represents 20-40% of global production of industrial wood, or 350 million to 650 million cubic metres. The environmental group WWF estimated that in 2006 the EU imported around 30 million cubic metres of timber and wooden products made from illegal logging, mostly from Russia, China and Indonesia.

Regulation[49] to ban illegal timber imports to the EU in a bid to fight climate change, deforestation from the Amazon, Central Africa and Asia, and the loss of revenue to governments.

The EU Timber Regulation will be enforced by all EU Member States as of 3 March 2013. The law is aimed to break the supply chain of illegal wood from the world's forest-rich countries. It requires all operators who place timber products on the EU market to exercise *due diligence*. To ensure traceability along the supply chain, each timber operator will need to declare from whom they bought timber and to whom they sold it. Member States will be responsible for applying sanctions, ranging from fines to criminal law penalties.

These initiatives can be viewed as complementary rather than overlapping with CBCR disclosure requirements. Unlike disclosure of certain financial information on a CbC basis, the EU FLEGT and Timber Regulation will require traders of timber products to exercise *due diligence* in order to prevent illegal wood from entering into the EU market. The focus on the latter requirement is on trading companies, not extracting companies whilst in some cases companies may possibly be active in both areas.

4. PROBLEM DEFINITION

This section outlines the problems associated with the lack of transparency in the operating activities of multinational companies (MNCs), which have led to calls for CBCR. It then explores the causes of this lack of transparency, which will inform the policy alternatives discussion following later in this impact assessment.

MNCs, by definition, operate in many foreign jurisdictions but detailed information on their activities in the countries in which they operate is not within the public domain. MNCs include both listed and non-listed companies as non-listed companies also have cross-border activities and operate in countries other than their country of registration through subsidiaries, associates, joint ventures or branches. Interested parties[50] promoting development argue that this lack of transparency in country by country financial data stands in the way of greater Government accountability in some resource-rich countries for the income received from exploiting natural resources. Proponents of CBCR state that if payments in aggregate made to a particular Government by MNCs were known, citizens and other interested parties would be better able to demand that the Government accounts for how these incomes have been spent, which reduces the potential for corruption and therefore increases government revenues and can in turn foster economic growth, help to reduce poverty and internal conflict[51].

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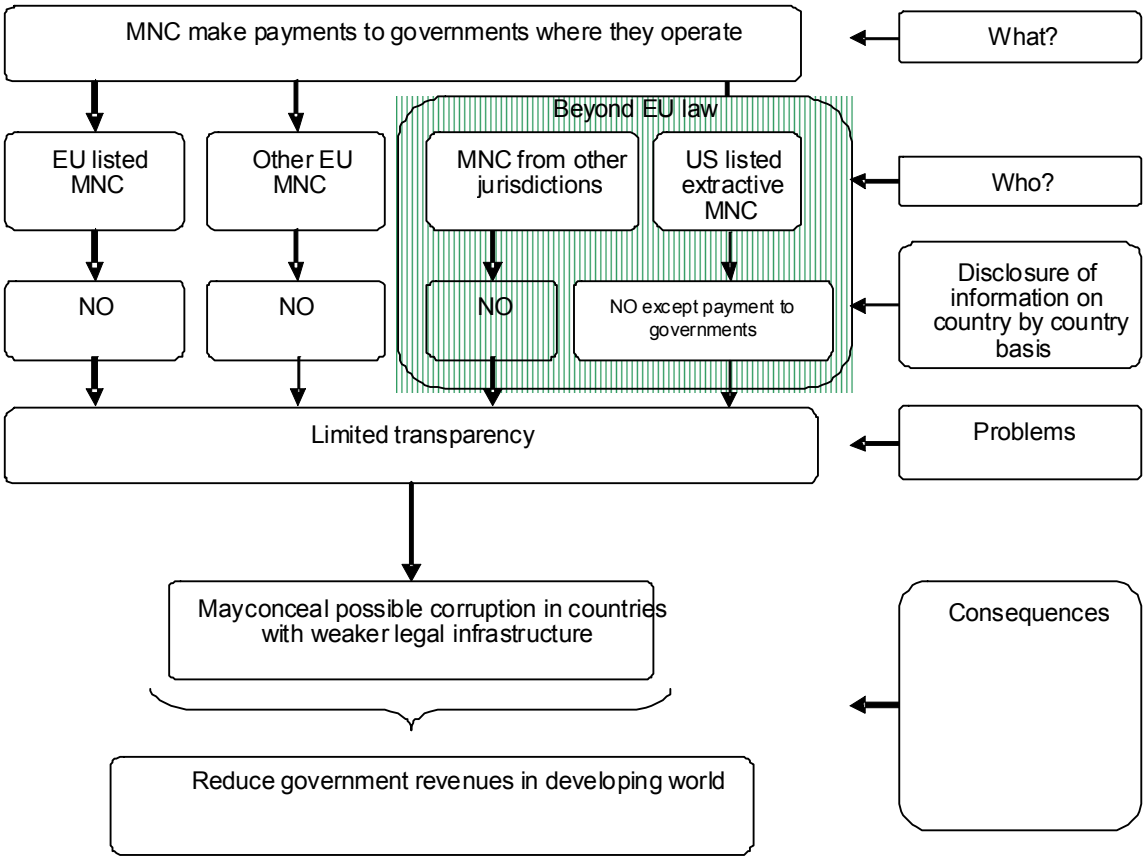
49 Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010. Companies that import wood products under EU voluntary agreements will be exempt from this requirement.

50 Different categories of stakeholders are concerned: civil society, public authorities, the EITI which gathers all partners inc. governments of resource-rich countries and MNCs.

51 See EITI fact sheet of 25 November 2010; and 30 March 2011

The problems are depicted visually in the following problem tree.



The weakness with current statutory reporting requirements

Both listed and non-listed EU MNCs have an obligation, coming from the EU Accounting Directives, to publish yearly financial statements reporting worldwide revenues, profits and assets. Whilst there is an obligation to identify subsidiaries, associates and joint ventures and their country of residence there is no obligation to provide other information on a country by country basis within the Accounting Directives.

Companies listed on EU regulated markets are required to prepare their consolidated financial statements in accordance with IFRSs which require the reporting of revenues, profits etc. on a segmental basis (IFRS 8). In practice this means that reporting segments are typically identified on the basis of different products or services, or different regulatory environments. Segmental reporting on a strict country by country basis would only happen where a MNC manages its operations globally on such a basis – which is not the experience of MNCs reporting under IFRS 8[52].

[52] The European Securities and Markets Authority (ESMA) reviewed the accounts of 33 issuers who represent 90% of the EU extractive industry stock market capitalization. It found that whilst in all but 3 cases geographical areas of operation were disclosed there were divergent categories covering parts of countries, countries, sub-continents and continents. ESMA reported that "*none of the issuers*

4.1. Voluntary initiatives

The EITI (see section 3.6) can provide, in those jurisdictions where it is in force, a considerable amount of information to stakeholders on the various types of payments MNCs operating in the extractive industry make to host governments. EITI encompasses all companies operating in the country, creating a level playing field between all companies active in that country. Further, it respects foreign governments' sovereignty.

However, the EITI is a voluntary scheme and as long as a country chooses to remain outside the scheme, EITI can offer no improvement in local transparency. Furthermore, until now the EITI has focused on the extractive sector although some countries have decided to extend the scope of such reporting to other sectors which they consider to be relevant to their economy[53].

MNCs could also voluntarily publish CBCR financial data, but this has only happened in a few cases. Statoil, Rio Tinto plc and Anglo American plc voluntarily publish some CbyC financial but not to the same level of detail as under EITI but none of the EU-listed forestry companies voluntarily publish CbyC information.

4.2. How large is the problem?

There have been calls for CBCR in respect of all jurisdictions where MNCs operate, however they have been especially strong with regard to MNCs operations in resource-rich countries (whether listed or non-listed). The World Trade Organisation reports that total exports of all natural resources in Africa were worth roughly US$390 billion in 2008, nearly 9 times the value of international aid to the continent (US$44 billion), and over 10 times the value of exports of agricultural produce (US$38 billion)[54]. Exports of natural resources represented 71% of Africa's total goods' exports in that year.

Targeting the extractive and loggers of primary forest sectors is justified on the grounds that these sectors are engaged in primary exploitation of natural resources that are considered to belong to society at large and are often associated with a great source of wealth in resource-rich countries[55]. An initiative in the extractive and logging of primary forest sectors is also seen as complimentary with other EU initiatives in those sectors (see Section 3.7).

Revenues derived from the extractive and logging of primary forest sectors result from countries' natural resource wealth. They are managed by governments on behalf of citizens

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reviewed provided country-by-country information in their financial statements". ESMA "The European extractive industry: Country-by-country reporting and segment reporting". (February 2011)

53 Summary of LEITI First Report, 1 July 2007 - 30June 2008; Final report of the administrators of the second LEITI reconciliation, 1 July 2008 - June 2009

54 World Trade Organisation - International Trade Statistics 2009 - Merchandise trade by product (table II.2)

55 In its *Guide on Resource Revenue Transparency (2007)*, the International Monetary Fund (IMF) defines a resource-rich country as a country in which the total average fiscal revenues, or the total average export proceeds from the oil, gas, and/or mining sectors, has been at least 25 % during the previous three years. According to the same report during 2000-05, the average annual hydrocarbon revenues accounted for 79.8% of total fiscal revenues in Angola, 78.9% in Nigeria, 60% in Gabon, 85.2% in Equatorial Guinea, 69.6% in Rep.Congo (p.62) http://www.imf.org/external/np/pp/2007/eng/051507g.pdf

for the benefit of the country's citizens however there is no mechanism to provide the public with an understanding of governments' revenues from the exploitation of such resources despite the importance of these two sectors to the economies of many developing countries.

In many resource-rich developing countries extractive industry and loggers of primary forest payments to host governments indeed represent a significant proportion of total government income. The IMF revenue transparency report states that oil, gas and mineral resources account for over 50% of government revenue or export proceeds in many low- and middle-income resource-rich countries[56]. In some developing countries, forestry accounts for between 8 and 12% of GDP (including Guinea-Bissau, Chad, and Liberia). In a survey of 11 country reports, the EITI reported that the 11 surveyed host governments annually received collectively US$43.5billion from the oil and gas, mining and timber industries[57]. To put this figure in context the payments represent, on average, 11.5% of these countries' GDP[58]. Measures addressing the oil, gas, mining and logging of primary forest sectors would therefore seem to be of considerable importance.

A minority of resource-rich countries are currently compliant with the EITI. The IMF designates more than 50 countries as rich in hydrocarbons[59] (they control 91% of world oil reserves and 85% of world gas reserves) and mineral resources[60]. Whilst 23 of the designated countries are EITI compliant or EITI candidate countries[61], not all of them currently publish a yearly report under the EITI scheme. Moreover, whilst some developing countries feature among the top exporters of hydrocarbons they do not belong to EITI compliant or candidate countries (e.g. Algeria, Angola and Venezuela).

In the absence of a CBCR requirement there is no reliable industry information available on the current level of payments made by extractive operators to host governments. Statoil (operating in the oil and gas sector) does voluntarily disclose payments in its Annual Report. For the three years to 31 December 2009, 30% of its revenues were paid to host governments in the form of indirect and direct taxes (excluding VAT), profit oil in kind (production entitlement) and signature bonuses. Extrapolating this ratio of payments to government to revenue to all listed EU oil and gas companies would suggest that collectively payments to government worldwide by the sector in 2009 would have been €362 billion[62].

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56 IMF: Guide to resource transparency (2007)

57 2009 EITI overview of country reports, http://eiti.org/files/Overview%20EITI%20Reports.pdf.

58 Commission services analysis

59 Hydrocarbon-rich countries (2000-05): Algeria, Angola, Azerbaijan, Bahrain, Brunei Darussalam, Cameroon, Colombia, Republic of Congo, Ecuador, Equatorial Guinea, Gabon, Indonesia, Iran, Iraq, Kazakhstan, Kuwait, Libya, Mexico, Nigeria, Norway, Oman, Qatar, Russia, Saudi Arabia, Sudan, Syria, Trinidad and Tobago, Turkmenistan, United Arab Emirates, Uzbekistan, Venezuela, Yemen. Countries with potentially large medium-and long-term hydrocarbon revenue: Bolivia, Chad, Mauritania, Sao Tome and Principe, Timor-Leste.

60 Mineral (2000-05): Botswana, Chile, Dem. Republic of Congo, Ghana, Guinea, Indonesia, Jordan, Kyrgyz Republic, Liberia, Mauritania, Mongolia, Namibia, Peru, Papua New Guinea, Sierra Leone, South Africa, Uzbekistan, Zambia.

61 23 countries made of 9 EITI compliant countries and 14 candidate countries

62 Source: Commission Services analysis. Extrapolation based upon Statoil Overview of activities by country statement in 2009 Annual Report. Revenues of listed oil and gas listed companies for the 2009 accounting period drawn from ESMA analysis of listed extractive companies – total revenues for oil and gas companies were €1,208 billion.

As far as the Commission Services are aware, no logging companies voluntarily report payments made to governments in respect of their logging activities. In its 2009 EITI report Liberia reported payments to government of US$ 1.9 millions derived from forestry. Whilst this amount does not appear to be significant in absolute terms it does represent 5.7% of the revenues made from natural resources wealth by the Liberian Government.

4.3. How will the problem evolve without action?

Without coordinated EU action it is unclear whether there will be any significant improvement in government or company accountability:

– There are currently no mandatory CBCR requirements except for the limited disclosures requested by the Hong Kong Stock Exchange and the AIM which only apply to new applicants in the extractive sector.

– In April 2005, the IASB held its first discussions on the extractive activities project. The Board considered a CBC regime for extractive companies. However there are indications that the implementation of a global CBC regime for the extractive industry will not be achieved through the IASB in the foreseeable future. Firstly, the IASB concluded that such a disclosure requirement was not within the scope of accounting regulation. Secondly, the IASB decided to postpone the development of the accounting standard for extractive industries.

– In 2003 the EITI was launched. There are now 11 compliant countries and 24 candidate countries. 23 of them feature among the 50 developing countries which are considered to be resource-rich by the IMF. EITI is an innovative scheme which foresees a validation process for prospective countries (on average the validation process takes 2 years). It is therefore understandable that participation is progressive and the number of compliant countries in 2011 is still limited. To date major EU listed extractive MNCs active in the 11 EITI compliant countries and preparing country reports under EITI include Anglo American, Areva, BG Group, BHP Billiton, BP, Eni, Gaz de France, Lukoil, Repsol, Rio Tinto, Shell, Statoil, Total and Vale. EU non-listed extractive companies include Central African Gold (AIM)[63], Cluff Gold (AIM)[64], Perenco[65], Sterling (AIM)[66]. Only one non-listed EU timber-logging MNC (EuroLogging) reports payments to government in Liberia, the only country where EITI reports are also prepared for the forestry sector. The EITI is widely known in resource-rich countries but governments choosing to remain outside it until now appear willing to resist pressure for greater transparency around their receipts from extractive operators.

– Section 1504 of the Dodd-Frank Act was adopted in July 2010. In April 2011, the SEC postponed the initial due date for the final implementing rules (15 April 2011) to the second half of 2011. Also, under the Dodd Frank Act only 15 EU dual-listed companies would be required to disclose payments to governments on a

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63 Ghana EITI report 2008

64 Sierra Leone EITI report 2006-2007; Burkino Faso EITI report 2008-2009

65 Democratic Republic of Congo EITI report 2007; Gabon EITI report 2006

66 Gabon EITI report 2004

country- and project- basis. Moreover the Dodd-Frank Act would only cover the extractive sector.

– Finally, MNCs are aware of the interest that some stakeholders have in the payments that extractive or forestry operators make to host governments. Despite this interest, as pointed out by the ESMA study[52], there are as far as they are aware no explicit CBCR disclosures to the level of detail foreseen by the EITI in the annual reports of listed companies which usually divulgate more information than non-listed companies. Companies operating in EITI compliant countries are disclosing payments data in respect of payments to the local host government, but no MNC has chosen to voluntarily go further and disclose equivalent data in respect of non-EITI countries that they operate in.

The EITI has had some success but there appears to be a need for action to accelerate the process by which payments to governments in developing resource-rich countries fall into the public domain.

4.4. Subsidiarity and proportionality

According to the subsidiarity principle the EU should act only where it can provide better results than intervention at Member State level. In addition, the preferred options identified in this document should be limited to what is necessary in order to attain the objectives laid down in Section 5, and comply with the principle of proportionality.

Several policy options have been considered in this document (see section 6). They mainly differ in terms of additional information requested on a country basis. In all cases, in order to ensure that all companies are treated equally across the EU, it appears preferable to legislate through EU law rather than at Member State level.

Local regulations on country by country disclosures have already been put in place (see section 3.5). Some Member States recently expressed support for EU binding rules on payments to governments by the extractive industry[67], but want coordinated EU action. There is the risk that national initiatives lead to differences in terms of targeted companies or type of disclosures, which would undermine the ability of civil society to compare data. EU instruments appear to be more suitable in assuring consistency than individual action by the Member States.

Without coordinated EU action there is also the risk that Member States action alone could lead to distortions in the internal market in Securities. For instance, a Member State unilaterally introducing regulations to bring greater transparency for securities issued within its jurisdiction could see local issuers migrating to a Member State without equivalent regulation. EU action is justified to maintain a level playing field for all EU MNCs.

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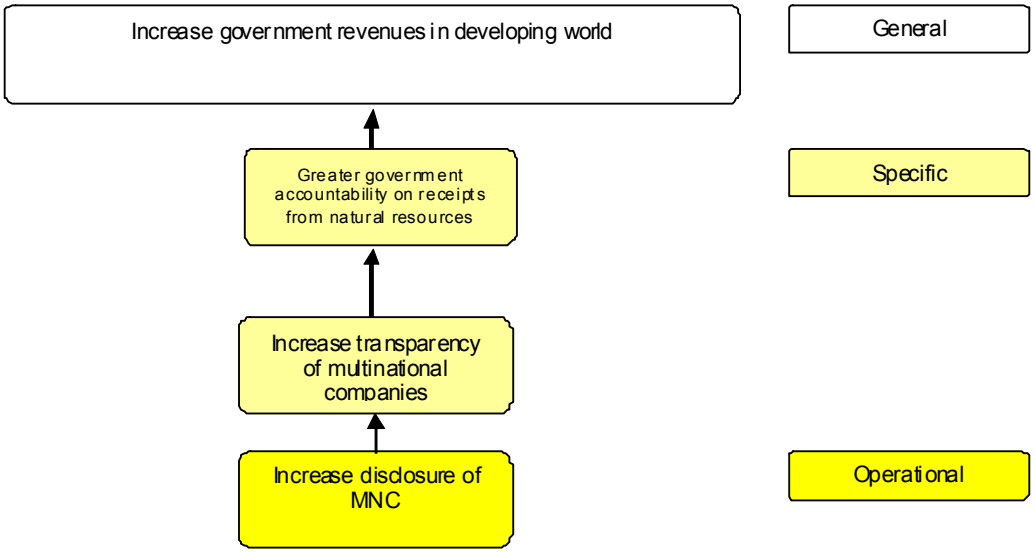
[67] On 19 July 2011 in Nigeria UK Prime Minister David Cameron said: "… Alongside this the US has gone a step further, introducing legally binding measures to require oil, gas and mining companies to publish key financial information for each country and project they work on. And I'm calling on Europe to do the same. We want to disclose the payments our companies make to your governments so you can hold your governments to account for the money they receive…"

5. OBJECTIVES

The operational policy objective is to bring increased transparency to the operations of MNCs in the extractive industry and loggers of primary forests by increasing the disclosures they make. The extractive industry covers all companies with activities which involve exploring for and finding minerals, oil and natural gas deposits, and extracting them[68]. The loggers of primary forests cover those activities of companies which involve the clear-cutting, selective logging or thinning of timber from primary forests[69]. The specific objectives are to provide relevant information to civil society in order for them to hold government and business to account on receipts from MNCs for exploiting natural resources (oil and gas, minerals and primary forests). This specific objective would in turn increase government revenues.

These objectives are summarised in the following objectives tree:



The disclosures which would be relevant for the purpose of making governments accountable for the revenues derived from the exploitation of oil, gas, mines and primary forests would be the payments made to governments by companies on a country basis. Other disclosures, in particular payments to government on project basis, may also be very relevant as they would increase the granularity and usefulness of the information at local level. The publication of payments to governments should create transparency in the management of the natural resources which have been at the centre of conflicts in some countries and should also allow civil society to engage in dialogue with their governments. If payments to government were disclosed on a project basis, local communities would be

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68 Like the EITI, the focus is on upstream activity because it is exclusively extractive activity. Payments to governments associated with so-called "midstream" and "downstream" operations (transport, refining and storage) would not be reported as such activities do not necessarily have to take place in the same country, and their value added has less to do with the intrinsic value of the raw material.

69 Defined in Directive 2009/28/EC as "naturally regenerated forest of native species, where there are no clearly visible indications of human activities and the ecological processes are not significantly disturbed."

able to question how the monies received are subsequently spent, and whether a fair return was received in respect of the exploitation of the relevant natural resources.

CbC information could be limited to payments to government but could also be extended to a broader set of data (e.g. full accounts on a country basis). All costs and revenues generated by the activities of a MNC would then be allocated to each country where the MNC operates. Whilst such disclosures provide more information it needs to be considered as to whether such information would better help achieve the objectives depicted in the objectives tree above.

It is acknowledged that other policy options in the field of development could achieve some of the above objective, for instance making aid conditional upon improved governance and transparency – including national governments signing-up to EITI. However this Impact Assessment concentrates on the possible role that financial reporting by requiring country by country disclosures has in achieving the objectives of enhancing governance in resource-rich developing countries. It summarises the possible forms of CBCR and assesses their effectiveness, benefits and the costs.

6. POLICY OPTIONS – DESCRIPTION AND ANALYSIS

A wide range of possible voluntary or mandatory policy options can be considered relevant when contemplating a requirement for CBCR. The Commission Services have considered a broad range of different policy options (5 policy options), initially considering the "no change policy option", which would leave the decision to disclose CbyC information to MNCs (therefore, it would in effect be a voluntary scheme) (**policy option 0**).

The Commission Services next examined possible schemes that would result in a global agreement for CbyC reporting for EU and non-EU MNCs (here below referred to as "an international action"). Different schemes are considered under **policy option 1** – in particular existing international initiatives such as the EITI - which would oblige EU and non-EU MNCs to disclose CBC information. Instead of concentrating on the merits of particular CBCR schemes *per se* the analysis is on the merits of the EU acting in concert with international partners, instead of unilaterally. This reflects the reality that a reporting scheme agreed internationally would be the result of negotiation and compromise between the EU and its international partners, and the outcome of such negotiations would be difficult to foresee.

Finally, the Commission Services assessed several policy options that would oblige only EU companies to disclose CbyC information (hereinafter referred to as "an EU action") (**policy options 2 to 4**). These policy options vary in the type of disclosures which extractive companies and loggers of primary forests would have to provide. Possible disclosures could range from payments to governments to a full set of financial data on a country basis. Policy options 2 and 3 mainly require the disclosure of payments to governments from the extractive and logging of primary forest sectors. Policy option 2 requires the disclosure of payments to governments on a country basis, whilst policy option 3 requires the disclosure of such information on a country- and project- basis. Policy option 4 requires the disclosure of a much broader set of data. In addition to a report on payments to government, policy option 4 requires a complete set of CbyC accounts to be prepared by companies active in the extractive and logging of primary forest sectors. The targeted

companies include listed and non-listed MNCs[70] in the extractive and logging of primary forest sectors. The policy options are summarised below:

- Option 0: no change
- Option 1: support an international initiative to require country by country disclosures by MNCs in the extractive industry and loggers of primary forests. Under this policy option all MNCs (EU and non-EU) would be subject to new disclosure requirements.
- Option 2: require disclosure of payments to government on a country by country basis by EU MNCs in the extractive and logging of primary forest sectors
- Option 3: require disclosure of payments to government on a country- and project- basis by EU MNCs in the extractive and logging of primary forest sectors
- Option 4: require full CBCR by EU MNCs in the extractive and logging of primary forest sectors (disclosure of payments to governments, revenues, costs, profits, tax charges and taxes paid, assets held and intra-group transactions)

The policy options are assessed on their effectiveness in meeting the objective of increased transparency by MNCs and limiting factors, including their acceptability to stakeholders; the effect on competitiveness and the level playing field, and their compliance costs. Whilst enhanced transparency is seen as generally desirable, there needs to be recognition that providing additional information to stakeholders has a cost. Costs include the resources that MNCs would need to devote to collecting data (redesigning accounting and IT systems, training staff, etc.) and potentially having it audited, but also the potential loss of competitive or commercial positions. Such costs are discussed in this section for each policy option.

6.1. Analysis

Option 0. No change

This policy option constitutes the business as usual scenario. Under this option, no specific initiative is taken by the EU.

Transparency This policy option is unlikely to trigger the public disclosure of additional information and enhance transparency. The operations of extractive and forestry MNCs have been the subject of considerable interest from civil society for many years, and it has always been possible for them to voluntarily disclose information on their activities according to or beyond what is required by the Transparency Directive, the Accounting Directives and IFRS. Some extractive companies do disclose already some financial information on a per-country

[70] This scope includes all MNCs registered in the EEA and all listed companies in the EEA. The latter would include non-EEA registered companies listed on EEA markets.

basis[71] but only a few have chosen to do so, but not to the level of detail foreseen by the EITI. As far as the Commission Services are aware no loggers of primary forests disclose such information on a voluntary basis. If companies were to voluntarily provide more information there is unlikely to be consistent and comparable disclosure as requested by users in the Commission's public consultation. Increased transparency in the trading of diamonds and timber has been achieved with the adoption of KPCS and the EU timber regulation however they do not make mandatory the publication of payments to government. Finally, although the EITI has achieved significant steps, the impact of the initiative is still rather limited (see section 4.3).

Competitiveness and level playing field — EU business would remain on a level playing field, as transparency requirements elsewhere in the world are limited[72]. However, disclosures requirements are foreseen under the Dodd Frank Act. Therefore the current regime would not allow for a level playing field between EU companies themselves as some EU companies active in the extractive sector are listed in the US, and would have to comply with the US rules.

Compliance costs — Companies would not be forced to incur additional administrative burden or costs.

Acceptability to stakeholders — The result of the public consultation carried out by the Commission Services (see Annex 6) have demonstrated that whilst preparers seem most satisfied with the current rules on disclosure requirements, users (especially NGOs) are strongly in favour of mandatory country by country reporting. The European Parliament and some Member States have also called for mandatory CBCR for the extractive industry. Even though this policy option would not be acceptable to stakeholders calling for additional disclosures, it would be acceptable to preparers.

Option 1. An International Action: Support an international initiative

This policy option relates to narrower initiatives requiring the disclosures of payments to governments only, or broader ones looking at full CBCR. It would require coordinated international action through, for example, the IASB or G20 to implement at a global level the policies examined (in an EU context) under options 2 to 4 below.

Transparency — The overall effect on transparency would depend upon the policy choice followed. A policy of full CBCR adopted at international level would provide more transparency than a narrower form of reporting payments to government in the extractive and logging of primary forest sectors. Overall a positive international action would result in improved transparency.

Competitiveness and level — The advantage of an international initiative is that it would overcome the distortions in competition between trading blocs, as all MNCs wherever they were listed or headquartered would be within the scope. In their responses to

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[71] Such as Norway's Statoil Hydro, Canada's Talisman Energy, US-based Newmont Mining Corporation, UK-based Anglo-American, and UK-based Rio Tinto.

[72] On the Hong Kong Stock Exchange new extractive issuers are required to report payments to government on first listing. There is, however, no annual reporting requirement.

playing field	the Commission consultation preparers expressed the concerns that mandatory disclosures for EU MNCs active in the extractive sector could place the EU industry at a disadvantage vis-à-vis National Oil Companies (NOCs) in the global competition for resources and this could ultimately impact energy security. An EU regulation requiring the disclosures of payments made to host governments would give an incomplete picture of payments made to resource-rich countries (even if complementing the US requirements) because the obligations would apply only to companies registered in the EU. Many NOCs could continue to operate without making equivalent disclosure either because they are listed outside the EU (and the US) or because they are not listed at all. In terms of production and reserves these are amongst the largest oil producers in the world[73]. In their responses to the Commission consultation preparers also expressed the views that the level of payments to government could give indirect insight into the levels of turnover, costs and profits that a MNC generates in a jurisdiction; there could be instances when confidential business dealings will be revealed; and companies having to disclose payments will not be able to operate in countries where public disclosure of the terms of commercial agreements would be prohibited. As regards the loggers of primary forests the major international competition for EU MNCs, especially in Africa, comes from Chinese companies. Therefore, it would be essential to have, at least, China as part of an international approach.
Compliance costs	There will be increased administrative burdens in line with the scope of the policy. The disclosure of a full set of accounts on CbyC basis would be more costly than reporting only payments to government.
Acceptability to stakeholders	International coordinated action is a preferred policy option, especially for preparers as it would maintain a level playing field. However, the timescale in which action could be achieved would be of concern to users, especially NGOs. Practically, the IASB is the only body that could deliver a coercive instrument dealing with the disclosure of financial information whilst maintaining a level playing field, but no development from the IASB in the short to medium term can be expected. As noted in 3.3 above it is only in the recent past that the IASB has completed its project on company segmental reporting (IFRS 8), in which it decided against any scheme of CBCR despite clear requests from NGOs to the contrary. Given that CbyC is not on the IASB's current work programme, any initiative on the part of the IASB is likely to take several years to reach the status of a final standard and there would be a further implementation period of at least two years beyond that. Whilst the Commission would support worldwide harmonisation, there is no certainty that

[73] For instance Transparency International states that Saudi Aramco, the National Iranian Oil company, Petroleos Venezuela and Petroleos Mexicanos all produced over 1,000 million barrels of oil equivalent (MMBOE) in 2006. To put this in context only 2 EU oil producers (BP and Shell) produced over 1,000 MMBOE in the same year.

a global consensus on the issue would be found, and the expected timeframe for such action is long.

Within the extractive industry (with a potential for extension to the forestry sector) the EITI is the only recognised scheme of reporting currently with worldwide applicability. EITI brings together all partners, including NOCs and sovereign host governments. The Commission financially supports and has endorsed the objectives of the Initiative[74]. However ultimately it is the decision of nation states to join EITI and whilst the Commission and other EU institutions could further encourage more countries to join and obtain EITI compliant status it is unclear whether this would have any noticeable impact in bringing more countries into the Initiative.

Option 2. An EU Action: Require CBCR of payments to government by EU multinational companies (MNCs) in the extractive and logging of primary forest sectors

This policy option would require disclosure of payments to governments (as defined by EITI - see Annex 4) by the extractive industry and loggers of primary forests in view of making governments (in particular in developing resource-rich countries) more accountable for the revenues received from exploiting natural resources. The simplest way to achieve the policy option is to require companies to publish data on payments made to host governments in accordance with the EITI framework. Under this policy option MNCs would have to disclose the payments made to governments by country (see Annexes 3, 4 and 5 for further detail on the EITI framework).

Transparency

This policy option would have the effect of putting into the public domain the information that would be available in respect of EU MNCs payments' to government if there was complete and unanimous signup to the EITI by all oil, gas, mineral producing and timber logging countries where EU MNCs operate. Using the EITI framework will produce information that users will find useful, as a number of civil society organisations, foreign governments and EU MNCs participate in the EITI initiative and assisted in designing the reporting framework.

Competitiveness and level playing field

In terms of competitiveness, the policy would offer competitors only limited insight into financial performance and profitability of the company in the host country, as payments to government only represent one element of the operating cost base. Total revenues, profits, and production levels would not be known, although those with knowledge of how the various payments to government locally are computed may be able to extrapolate the data to arrive at estimates for revenues etc. This is especially the case where a company has only one project (e.g. one mine) in a particular country. In terms of worldwide competitive position the measure would be seen to bring more in line EU listed extractive MNCs with those listed in the US (except for the requirement for project based accounting). Though it is acknowledged that non-EU MNCs

[74] In 2010 the Commission co-financed two EITI expert and high-level meetings (€200,000), and in 2011 it has foreseen to further finance EITI capacity building seminars to strengthen the implementing capacities of EITI stakeholders.

listed outside the EU or the US (and state-owned companies) would not have to comply. EU MNCs in the logging of primary forest sector would have to comply though non-EU logging companies would not be subject to such requirements. Preparers have expressed concerns regarding the potential risk of losing contracts or not being invited to tender for new contracts if new rules were to force them to disclose information that is regarded as confidential by host governments of resource-rich countries.

Compliance costs For companies not already operating in an EITI compliant country such a policy may involve accounting systems and procedure changes at Head Office level and at host country level to collate and report the data on relevant payments to government. However this would be the least burdensome way to implement the policy, as those MNCs currently providing CBCRs who are already reporting under the EITI scheme could replicate the systems' and procedure changes they have implemented locally in EITI compliant or candidate countries to their worldwide operations[75]. The year one cost of this option is estimated to be €573 millions, with subsequent years' costs estimated to be €149 millions (see Annex 8 for further detail).

Acceptability to stakeholders The results of the public consultation have shown that preparers are in general opposed to country by country reporting requirements, however a detailed analysis shows that the extractive industry (in particular, oil and gas companies) considers CBCR to be conducive to improving domestic accountability and governance in resource-rich countries (see Annex 6). Where industry provided comments on the practicalities of a reporting regime, a preference was also expressed for one aligned with EITI, rather than one based on project by project accounting as required by the Dodd Frank Act in the USA. Though NGOs would prefer a broader approach (such as policy option 4 considered below) some already acknowledge that this would be a first significant step.

Option 3. An EU Action: Require CBCR of payments to government on a country- and project- basis by EU MNCs in the extractive and logging of primary forest sectors

This policy would see extractive and logging companies reporting payments to governments on a country- and project- basis. Compared with policy option 2 this option requires disclosure by project (and not only by country). It is argued that disclosure of payments on a project basis should be required as it is foreseen in other jurisdictions (see for instance section 1504 of the Dodd Frank Act). A project would be defined as the level at which the company prepares regular internal management reports to operate and monitor its activities. This could be at the level of a particular geological basin in the extractive industry or geographical province for loggers of primary forests, or by reference to legal rights such as a concession or licence.

Transparency This policy would achieve a greater level of transparency than option 2 as information would be disclosed on a country- and project- basis. This would mean that civil society local to a mine, oil field, and forest etc. would have

[75] Major EU listed extractive MNCs active in the 11 EITI compliant countries and preparing reports under EITI include Anglo American, Areva, BG Group, BHP Billiton, BP, Eni, Gaz de France, Lukoil, Repsol, Rio Tinto, Shell, Statoil, Total, Vale

information on the payments being made to government in respect of the extraction of local resources. Disclosing payments to governments on a project basis would also provide more detailed information, allow for reconciliation of sub-totals (projects) with totals (countries) and therefore support the reliability of the information published.

Competitiveness and level playing field A disclosure requirement on a project by project basis would mean that companies have to disclose a greater level of business sensitive information than with option 2 above. For instance, where signature or discovery bonuses were paid in respect of particular oil fields competitors may be given insight into the pricing or profit structure that a company is willing to accommodate. This option however creates a near identical regime to the Dodd Frank regime and in doing so avoids any competitive distortion between EU only listed companies and EU/US dual-listed companies.

Compliance costs At a company level this option would be more costly than option 2, as payment information would need to be presented at project level in addition to a country level. However, a reporting threshold or materiality level below which the disclosure of information on a project basis would not be mandatory would mitigate the increased level of costs. The year one cost of this option is estimated to be €1,145 millions, with subsequent years' costs estimated to be €297 millions (see Section 7 and Annex 8 for further details).

Acceptability to stakeholders Preparers would prefer option 2 as it would result in less commercially sensitive information entering the public domain, and in terms of preparation effort would be more straightforward and hence less costly. NGOs would generally prefer this option to option 2 as it would provide information to civil society at a local level.

Option 4. An EU Action: Require full CBCR by EU MNCs in the extractive and logging of primary forest sectors

This policy option would provide more information than the options to disclose payments to governments made by extractive industry and loggers of primary forests (options 2 and 3), and require, in addition to a report on payments to government, for all extractive and logger of primary forests MNCs a disclosure on a CbyC basis of a set of accounts (revenues, costs, profits, tax charges and taxes paid, and assets held). Revenues and costs would be split to identify those arising on transactions with third parties and those with other group companies (see Annex 2). Advocates of this policy option believe such a CbC regime would also help tackle tax avoidance as they argue the lack of financial data on country by country basis makes it possible for MNCs to conceal tax avoidance and/or transfer pricing abuse.

Transparency Some NGOs support this approach which would provide a greater insight into precisely where a MNC operates, its profitability in different countries and the assets deployed there as well as the impact of its activities on local employment, output and taxes paid to host governments. For capital providers, this would allow a better assessment of geo-political risk, and relative performance and return on capital within the MNC. This being said, investors and capital providers have not expressed strong support for the disclosure of

such detailed information. Responses to the IASB's consultation on IFRS 8 demonstrated that they did not consider CbyC reporting useful in the financial statements of companies. The IASB therefore decided that only segmental reporting would be required (and not country by country reporting).

It has also been argued that the publication of a potentially enormous amount of data may make it harder to analyse a MNC's financial report whilst many claim that annual financial statements should be shorter not longer[76]. Additionally, respondents to the EFRAG study on the costs of implementing CbyC reporting (see Section 7) raised a concern that a requirement to provide information about *all* countries could result in overly detailed and voluminous reports where a MNC operates in numerous countries, which would obscure rather than provide any useful information to users.

A majority of the respondents to the Commission consultation expressed the view that CBCR would not be useful to improve tax governance at a global level. To tackle tax avoidance more effective and proportionate measures should be deployed, involving capacity building in developing countries' tax administrations, greater worldwide cooperation on tax rules and information sharing by national governments[77].

Competitiveness and level playing field

The Commission conducted a series of interviews with different categories of stakeholders (users, preparers and public authorities) where the view was expressed that this policy option would place EU MNCs at a significant competitive disadvantage relative to their peers in the rest of the world, as non-EU competitors would have significant insight into their operations and would not bear the costs of such extensive disclosures.

Compliance costs

EU MNCs would have an obligation to disclose a very large amount of data, which would be more costly than other options. Some respondents to the Commission public consultation referred to costs of US$10 million or more if new systems were required; one company referred to US$100 million for a company not organised on a geographical basis. Although these estimates were very different, they were subsequently borne out by the EFRAG study on the costs of implementing CbC reporting. Companies whose reporting systems are not configured on geographic lines would face significant costs in making the changes in order to report on a CBCR basis. Using EFRAG data the Commission Services estimated the year one cost of this option to be €2,887 millions, with subsequent years' costs estimated to be €877 millions (see Annex 9 for further detail). These estimates are approximately $2^1/_2$ the estimated costs per company of implementing CBCR on the basis of payments to government (see Section 7.1.3 and Annex 8). They are based upon the survey respondents' comments and cannot be assumed to be representative for all extractive MNCs. The companies surveyed were also amongst Europe's largest, and the costs for smaller companies may be less than these averages.

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76 Louder than Words (in Short) (2009) Financial Reporting Council

77 See also COM (2010)163 "Tax and Development: Cooperating with Developing Countries on Promoting Good Governance in Tax Matters"

Such a level of cost could result in an unwillingness on the part of extractive or loggers of primary forests MNCs to locate Head Office functions, and issue securities in the EU, which would have a negative long term effect on EU employment and investment prospects. At a time that the discussion about the competitiveness of European industry is high on the agenda, a decision to implement such a policy would be very costly for European industry and not proportionate in meeting the targeted objectives.

Some supporters of policy option 4 have suggested to limit the disclosures on a CbC basis to a *summary* set of accounts comprising payments to governments, revenues (distinguishing intra-group transactions from others), and pre- and post-tax profits in order to make the compliance costs more bearable for the industry as they argue this information could be readily available. The Commission conducted a series of consultations with different categories of stakeholders where the view was expressed that publishing information on a country by country basis even if limited to a set of key financial data would also result in significant additional costs because such disclosures would necessitate the detailed allocation of all items of income and expenditures to arrive at pre/post tax profits on a country basis. Therefore the financial reporting systems would have to be improved and the costs incurred for such improvements would be as high as those for producing a full set of accounts on a country basis. In effect it is almost as costly to present a full profit and loss account, as it is to present only revenues and profits or losses - the cost burden lies in calculations, not presentation. This concern was confirmed by the EFRAG study undertaken on the costs of implementing CbC reporting (see Section 7). One participant in the study whose reporting system is not set up on geographic lines reported a year 1 cost of €46 millions for this method of CBCR, which would be nearly three times more costly than the average cost of reporting payments to government under option 3. Additionally, some participants to this study indicated that although some of the required information might be available in the individual entity's accounting system, these accounting systems generally maintain information in accordance with the local accounting regulation, and that information might not necessarily be compliant with international accounting standards, and therefore not be comparable or meaningful for users.

Acceptability to stakeholders

The results of the public consultation have shown that this policy option is strongly opposed by a number of stakeholders (inc. preparers, accountants and auditors, see Annex 6) because there seems to be limits to the additional benefits that can be expected from such a policy option, whilst the costs would be high. Users in the same public consultation expressed a supportive view.

6.2. Summary comparison of broad policy options

Policy option 0 does not appear to be a realistic one for dealing with the problem. Current reporting practices by MNCs demonstrate that there is a need for action in order to enhance disclosure practices. Whilst the preferred approach would be policy option 1 there is no certainty that an international agreement can be achieved in the foreseeable future. Policy

option 3 is preferred to policy option 2 because it would produce more payments information; information will be produced at a local level for civil society; whilst a matrix presentation by country and by project will enhance the reliability of the data. The disclosure of payments to government on a country- and project- basis would better satisfy the demands of stakeholders calling for enhanced disclosures whilst the costs of such policy option (compared to policy option 2) would remain acceptable if an appropriate materiality threshold (below which detailed disclosure at project level would not be mandatory) is introduced. In addition, an obligation for companies to disclose all payments on a project-by-project basis may raise issues of proportionality. A possible sub-option to address this issue would be to slightly amend Policy option 3 so that only information on payments by project which is already available within a given company would be disclosed. While this would somewhat reduce the effectiveness of option 3, it may not diminish its efficiency as costs would also be reduced. Policy option 4 would meet the demands of NGOs calling for greater transparency around the worldwide operations of MNCs, however the potential benefits associated with such enhanced transparency cannot be seen to be outweighing the loss of competitive position and the considerable administrative burden for EU multinationals, even with the lower granularity of data envisaged by some supporters of such policy. Having compared the broad policy options above the best alternative on grounds of competitiveness, transparency and acceptability to stakeholders is therefore "support for an international initiative". However there is no certainty that EU action will deliver an international agreement on enhanced transparency measures, so the policy option to be followed is to require the disclosure of payments to government on a country- *and* project- basis by EU MNCs in the extractive and logging of primary forest sectors (policy option 3). This approach would strike a balance between more transparency without overburdening companies, and without excessively putting EU companies at a competitive disadvantage. It would not compromise future efforts by the EU to obtain international agreement, and could assist in negotiations if international partners agree that there should be a worldwide level playing field.

The table below summarises how each policy option is assessed against the attributes of increased transparency; the effect on competitiveness and the level playing field; and compliance costs.

Table 1: Assessment of the Policy Options				
Option	**Impact on transparency**	**Impact on competitiveness and level playing field**	**Potential impact on costs**	**Estimates of the compliance costs (year one cost)**
0. No change	0	0	0	0
1. Support an international initiative	+	++	-	See note below
2. Require CBCR of payments to government by extractive and primary logging EU MNCs	+	-	-	€573million (see annex 8)
3. Require CBCR of payments to government on a country- and project-basis by EU MNCs in the extractive and primary logging sectors	++	-	-	€1,145 million (see 7.1.3 and annex 8)
4. Require full CBCR by EU MNCs in the extractive and primary logging sectors	++	--	--	€2,887 million (see annex 9)

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral

Note: The costs of the international option would depend on the precise nature of the scheme (see commentary for option 1).

"Primary logging" refers to logging of primary forests.

Source: Commission Services analysis

The table below summarises how each category of stakeholder would view each of the policy alternatives.

Table 2: Acceptability to stakeholders					
Option	**CATEGORY OF STAKEHOLDERS**				
	Preparers	**Users**	**Auditing/ accounting firms**	**Public Authorities**	**Other**
0. No change	0	0	0	0	0
1. Support an international initiative	++	+	+	+	+
2. Require CBCR of payments to government by extractive and primary logging EU MNCs	+	+	-	++	++
3. Require CBCR of payments to government on a country- and project-basis by EU MNCs in the extractive and primary logging sectors	+	++	-	+	++
4. Require full CBCR by EU MNCs in the extractive and primary logging sectors	--	++	--	-	+

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral

Preparers: MNCs, other companies, associations of companies;
Users: NGOs, investors;
Public authorities: accounting standard setters or National Ministries.
Other: political party, law institute, private persons.
Source: *Commission Services analysis*

"Primary logging" refers to logging of primary forests.

Preparers: In contacts with the Commission Services, preparers firmly expressed the view that they would prefer an international agreement on CBCR to avoid the impacts of an EU unilateral approach on competitiveness and the level playing field (option 1). Nevertheless, they had a constructive approach and demonstrated their readiness to accept a mandatory CBCR set at EU level if an international agreement was difficult to achieve. They also considered that a CBCR requirement should not be unduly burdensome for companies. Therefore, companies strongly opposed option 4. Consequently, for preparers, option 1 receives "++", options 2 to 3 "+" and option 4 "--".

Users: users (mainly represented by NGOs) expressed their preference for a broader approach (policy option 4) though some already acknowledged that the implementation of policy options 2 or 3 (with a preference for policy option 3 as it provides for the disclosure of information on a project basis) would be a first significant step. Investors have shown interest in the disclosures of CBCR but consider that policy option 4 would be extremely burdensome for companies.

Auditing/accounting firms: auditing/accounting firms strongly opposed policy option 4 and expressed some concerns regarding policy options 2 and 3 if audit requirements were to be imposed.

Public authorities: Public authorities expressed their preference for an EU initiative limited to payments to governments in the extractive industry (policy option 2).

6.3. Choice of instrument

The available legal instruments would be a Directive or a Regulation.

The following points are relevant when considering the case for a Directive – the Transparency Directive (TD)[78] or the Accounting Directive (AD)[79]:

- The scope of the TD covers *all* companies listed on EU regulated markets (including companies incorporated outside the EEA but listed on EU regulated markets such as Gazprom and Glencore. These constitute about 15% of the extractive issuers identified by ESMA).

- The scope of the AD is EU registered companies both listed and non-listed.

  - The TD has previously addressed the subject matter by means of a recital (recital 14).

  - A revision of the TD is planned for the second half of 2011.

  - A revision of the AD is ongoing whose primary objective is to reduce the administrative burden for small and medium-sized entities (SMEs).

An alternative would be drafting a Regulation, which would have the advantage of being directly applicable and so would not need to be transposed into national law. However the creation of a separate Regulation to deal with this single policy objective alone does not appear proportionate, when the policy could be legislated for within separate sections of the AD and TD.

Self-regulation is not considered as an option because this information has been of interest to many NGOs throughout the years, but very few companies have actually disclosed this type of information.

In the light of the above considerations the inclusion of a series of provisions within the Transparency Directive and the Accounting Directive is the preferred choice in order to cover all large companies which are listed and registered in the EU. In order to avoid undue administrative burden on small and medium sized companies (in the context of the simplification objective of the AD revision) only large extractive companies and loggers of primary forests would be targeted, using the existing AD definition of large company, that is a company that exceeds two of the three following criteria in two successive years: turnover in excess of €40 millions; assets in excess of €20 millions; in excess of 250 employees.

7. CUMULATIVE IMPACTS OF THE PREFERRED OPTION

The preferred policy option of disclosure of payments to governments on a country- and project- basis by the extractive industry and loggers of primary forests is inspired by the

[78] Directive 2004/109/EC
[79] Directive 78/660/EEC

EITI, which has a proven record and would avoid the duplication of numerous different disclosure requirements. The preferred option is also seen as an EU initiative which would contribute to reinforcing the existing EITI scheme.

The Commission believes that only companies of a certain size with activities in the extractive industry and logging of primary forests should be targeted by the new rules, therefore the scope of the reporting requirements will include companies listed on EU regulated stock exchanges and large unlisted companies. Several arguments support the inclusion of non-listed companies: first, large non-listed companies could potentially make significant payments to governments in developing countries; second, imposing a CBCR regime on listed and non-listed companies would maintain a level playing field in the EU. These two categories of companies (EU listed and large unlisted companies) would normally pay the largest amounts to governments. Requiring small and medium-sized companies to provide disclosures would not be in line with the Commission's current policy of making administrative burdens proportionate – smaller businesses proportionately spend more time and resource dealing with administrative tasks than their larger counterparts. The size criteria used to define large companies in the Accounting Directive would be used.

As mentioned earlier, the Commission supports the definition of payments to governments as defined by the EITI revenue streams (see Annex 4). The Commission recommends that the disclosure of payments to governments should be reported by companies in a separate and non-audited report on an annual basis (see Annex 5). Stakeholders in the public consultation referred to auditing costs as one of the major costs of possible disclosure requirements, a point confirmed in the study carried out by EFRAG. By not requiring the auditing of payments to governments, transparency can be improved while keeping the costs at a reasonable level. Under the preferred policy option, payments would be disclosed on a project basis which would also support the reliability of the data provided by the targeted companies.

7.1. Expected primary impacts of the preferred policy option

7.1.1. Increased transparency

In general terms, CBCR of payments to government by the extractive industry and loggers of primary forests should provide investors and civil society with significantly more information on what specifically is paid by EU companies to host governments in exchange for the right to extract the relevant countries' natural resources.

In 2010, the EITI reported on the benefits of its initiative where it has been implemented[80]. Whilst acknowledging that measuring the impact of the EITI is a difficult task[81] it reported that its activities had contributed to reducing corruption, improving public financial management and the business operating environment because EITI generates data on revenues that are otherwise not available to the public. Publicising this information should have the effect of making governments more accountable. Citizens and NGOs will have a

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[80] EITI: Impact of EITI in Africa. Stories from the ground (2010), http://eiti.org/files/EITI%20Impact%20in%20Africa.pdf

[81] The report recounts one case where public monies have been recovered: an estimated US$ 4.7 bn owed to the government by the state-owned Nigerian National Petroleum Corporation for payments of domestic crude.

better (but incomplete) picture of the revenues local governments receive from extractive operators and will be better able to demand that governments explain how the revenues have been spent. In its 2009 report into its adoption in Liberia, the EITI quotes the country's President as saying[82]: "*LEITI (*the national scheme*) represents an important step in advancing our efforts to engage with stakeholders, to talk about our resources, and to build trust in our communities*".

By requiring disclosure of payments at a project level, where material, local communities would have insight into what governments are being paid by MNCs for exploiting local oil/gas fields, mineral deposits and forests, and allow these communities to better demand that government account for how the monies have been spent locally. A degree of MNC accountability would also be created, as over the life of a project the total payments to government would be known so that civil society would be in a position to question whether the contracts entered into between the government and extractive and loggers of primary forests delivered adequate value to society and government.

7.1.2. Potential strengthening of the EITI

Due to the limitations in present information availability it cannot be estimated precisely how much more government revenue will be subject to increased scrutiny, but in its overview of country reports[83], the EITI reported that US$43.5 billion of payments (representing on average 11.5% of those countries' GDPs)[58] annually were made by oil, gas, mining and forestry companies in 11 countries it surveyed. Given that the EITI report concerned 11 resource-rich countries, whilst the IMF designates more than 50 countries as rich in hydrocarbon and mineral resources[84], significantly more information would be within the public domain if a policy of disclosing all payments to host governments was implemented.

23 countries which are designated "resource-rich" by the IMF are currently compliant or candidate countries under the EITI scheme. Whilst this could be seen as rather significant (about 40% of payments to governments being disclosed) not all "candidate" countries already publish EITI reports. Also, whilst it is acknowledged that a EU/US CBCR regime on large extractive companies would not provide a complete picture of payments to government per country, as EU and US-listed companies control 29% of worldwide oil reserves and production and 12% of worldwide gas reserves and production[85], the level of data on payments to host governments entering the public domain following the EU and US requirements would be significantly increased.

More importantly, the EU and US requirements would affect countries which have until now decided to remain out of the EITI scheme. In those countries there will be increased pressure on national governments from civil society to account for how the revenues derived from extractive and logging of primary forests MNCs have been spent. Some governments may respond to such calls by implementing EITI locally e.g. Algeria, Botswana or Venezuela which feature among the main exporters of crude oil, gas and minerals. In 2009, 60% of government revenues and 30% of GDP stem from oil, gas and

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82 http://eiti.org/document/case-study-liberia

83 2009 EITI overview of country reports, http://eiti.org/files/Overview%20EITI%20Reports.pdf

84 IMF: Guide to resource transparency (2007)

85 The Energy Intelligence Top 100: Ranking the World's Oil Companies. Energy Intelligence Research

mineral rents in Algeria; with the equivalent figures respectively 50% and 33% in Botswana, and 90% and 33% in Venezuela[86].

The major EU MNCs which would be subject to the EU requirement to disclose payments to governments are active in many countries (beyond the 50 resource-rich countries as designated by the IMF): Shell operates in 90 countries, Total in 130 countries. This means that potentially there would be pressure to disclose such information in many more than 50 countries. A significant expansion of EITI reporting countries would capture non-EU state-owned unlisted companies, thus reducing any negative competitive effects for EU companies *vis-à-vis* the competitive situation with non-EU state owned companies.

7.1.3. Improved operating environment for extractive industry and loggers of primary forests

More accountable governance in resource-rich countries would bring increased political stability which creates a more stable business environment for companies making significant investments locally[87]. The extractive industry and loggers of primary forests are typically capital intensive with long project cycles (with upfront investment, and profits and revenues at the end of the cycle). Increased political stability gives greater assurance about being able to see a project through from start to finish without having to face political turmoil. Transparency of payments made to a government can also help to demonstrate the contribution that their investment makes to a country, and reduce the demand for business to contribute to local infrastructure projects. Creating a business environment where less bribery and corruption takes place creates a more level playing field for companies that do not engage in such practices, and an absolute reduction in the level of bribes and corrupt payments would increase the level of profits available to be paid as dividends to MNCs' shareholders.

7.1.4. Increased administrative costs

There will be increased administrative costs from the preferred policy option. The Commission Services, using and following-up on initial questionnaire and interview data obtained by the European Financial Reporting Advisory Group from four listed MNCs operating in the (oil, gas and minerals) extractive sector (all of whom have either prepared country reports under the EITI or voluntary disclosed some CbyC information), estimates that for the four surveyed MNCs the average group global set-up cost would be €10.4 millions, with average annual recurring costs of €3.6 millions.

Extrapolating these findings to cover the 171 EU listed companies identified by ESMA in the extractive industry, indicates that the one-off costs/set-up costs for the EU listed sector would total €672 millions, with annual recurring costs of €236 millions. The "year one" costs of the policy would therefore be €908 millions, with costs in subsequent years falling to €236 millions. To put the "year one" figure in context, it would represent 0.05% of annual revenues for the 171 companies concerned.

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86 Max Khamis, Abdelhak Senhadji, Maher Hasan, Francis Kumah, Ananthakrishnan Prasad, and Gabriel Sensenbrenner, Impact of the Global Financial Crisis on the Gulf Cooperation Council Countries and Challenges Ahead, International Monetary Fund, 2010 & Central Intelligence Agency (CIA) , The World Factbook 2010

87 See: http://eiti.org/eiti/benefits

Extrapolation has been conducted on the basis of the number of subsidiary companies. It is assumed that the use of this number is relevant as it indicates the number of countries where companies operate and therefore the volume of additional information/disclosures they would have to prepare and publish under a CRCR regime. The number of subsidiaries also reflects the size and the complexity of the organisational structure of the company, which have an impact on the costs of enhancing and maintaining IT and reporting systems to track and compile information.

Whilst costs estimates were provided by only a few companies, the surveyed companies already report some CbyC information, which gives more confidence in the costs that businesses would have to incur under the preferred option. However, none of the companies surveyed report on a project basis, nor to the level of detail required by EITI in respect of their entire global operations, so there will be significant implementation costs for these companies with the CBCR requirement. It was therefore considered appropriate to extrapolate the sampled companies' figures to all listed and large EU companies (which do not report CbC information at present). There may be a degree of over estimation in the overall cost to the sectors as large companies usually have simpler accounting systems given that they have fewer subsidiaries and a narrower range of global operations; so the costs burden for an unlisted company may be lower than that of a listed company.

The costs assume the information will be unaudited. A requirement to audit would be estimated to increase annual recurring costs by approximately €90 millions.

Furthermore, the costs estimates are based on the assumption (made by the surveyed companies) that information would be disclosed if it is material[88]. Surveyed companies provided data on information that they considered material. Whilst the surveyed MNCs were asked to consider all the incremental costs they may face, until the policy is implemented it is difficult to calculate precisely what costs will be incurred. For example, companies may face an increased level of press and NGOs questioning about the disclosures they make which would result in increased levels of spending on press and public relations activities. They may also face an increased level of interaction with foreign governments and NOCs to explain why disclosures were being made. The estimates given above are based upon respondents' comments and cannot be assumed to be representative for the extractive industry as a whole.

It should also be noted that 15 of the 171 companies identified by ESMA have a listing in the USA, and will be required to report payments to government in accordance with SEC rules. As such it is therefore considered that not all the increased administrative costs faced by these companies can be attributed to EU action alone. Approximately 18% of the estimated set-up and annual recurring costs estimated above can be attributed to these 15 companies (see Annex 8).

On the assumption that dual-listed companies face no additional reporting obligations from an EU reporting requirement beyond those imposed by Dodd Frank Act the estimated year one costs for the EU listed extractive sector would be €740 millions, and annual recurring costs thereafter would be €192 millions.

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[88] Materiality is a financial reporting/audit concept. Information is considered material when its omission would distort the understanding of the annual reports – International Auditing Standard 320.

Using data drawn from national company registries the Commission Services estimate there to be 419 large unlisted (which are not members of EU listed groups) extractive companies in the EU. It was not possible to establish how many of these would be MNCs so for the purposes of producing an estimate an assumption has been made that all these companies would be within the scope of the preferred policy. Applying the same methodology and the same entity set-up and annual recurring costs obtained from the surveyed companies gives an estimated year one cost for the unlisted extractive sector of €397 millions, with subsequent years' costs falling to €103 millions.

In terms of the number of companies the EU forestry sector is much smaller than the extractive sector. The Commission Services identified six listed companies and 20 large unlisted companies. Applying the same entity set-up and annual recurring costs obtained from the surveyed extractive MNCs gives a year one cost for the combined listed and large unlisted forestry companies of €8 millions, with subsequent years' costs of €2 millions.

In summary the administrative cost to EU business of the proposed policy would be:

Table 3: Administrative costs of proposed policy

	Estimated Number of companies	Year one cost (€ millions)	Subsequent years' costs (€ millions)
Listed extractive MNCs	171	740	192
Unlisted large extractive MNCs	419	397	103
Forestry (listed and unlisted large MNCs)	26	8	2
Total	*616*	*1,145*	*297*

Further details on how these estimates have been arrived at are provided in Annex 8.

7.1.5. Competitive disadvantage

Whilst disclosing the level of payments to government would not give direct insight into the levels of turnover, costs and profits that a MNC generates in a jurisdiction, there will be instances when confidential business data will be revealed or can be deduced from such data[89], especially when project level disclosure would result in information being provided in respect of individual mines, oil fields, etc.

Preparers have argued that EU MNCs would not be on a level playing field when compared with non-EU state owned companies, many of which have foreign operations (see section 6.1). The example of BP in Angola has been cited as an example. In 2002 BP disclosed a signature bonus of US$111 millions in a US SEC filing. The Angolan state oil company, reacting to press coverage, threatened to take "appropriate action" if "material damage" was caused by the disclosure. This was seen as a threat to curtail BP's activities in the country by the business community. However, BP has remained operational in the country since and considers itself one of the largest investors in the economy. Furthermore, BP advised that they continue to make such filings at the US SEC and with UK authorities and this has not caused problems with the Angolan authorities. However, the company advised that in

[89] http://www.sec.gov/comments/s7-42-10/s74210-12.pdf

2006 the Angolan Ministry of Petroleum issued Directive (Despacho) 385/06 which states in the most relevant part that: "Companies active [in the petroleum industry] in the country are prohibited from divulging any information without formal authorisation of the Ministry of Petroleum."

Statoil which is majority owned by the Norwegian State (with ample Norwegian resources) but listed in the European Economic Area (and hence would be subject to any requirement to disclose) currently discloses certain country by country payments voluntarily, and did not report a loss of competitive position as an issue in its response to the public consultation.

Rio Tinto publishes a country by country tax report where the payments made to governments in each of the country in which it operates are detailed[90].

EU legislation has previously recognised the confidential nature of the oil and gas industries, and the risk to business from publishing business sensitive information. In Directive 94/22/EC on granting and authorising prospection, exploration and production of hydrocarbons there is a requirement for Member States to publish an annual report on geographical areas opened up for exploration etc. However, there is *no requirement* for the Member States to publish information of a commercially confidential nature. The industry would argue that the preferred policy option should foresee a similar exemption from disclosing commercially confidential payments information.

It is not possible to place a monetary value on the loss of competitive position. However, given that some extractive industry MNCs have voluntarily decided to disclose some CbyC payments and a majority of extractive industry respondents to the public consultation were in favour of disclosing CBCR of payments as a means to improve government accountability it is judged that the loss of competitive position from this policy would be limited. The strengthening of the EITI (see 7.1.2) would also militate against any possible short-term loss of competitive position, as it may lead to a more global application and enhanced reputation of compliant companies.

The point was made in some bilateral meetings that many factors are involved in successfully winning or negotiating a new contract with a host government. In the extractive industry technological expertise can be very important, and this is an area in which some major EU MNCs have an advantage due to their engineering know-how. In a ranking of relative technical efficiency of major oil companies (2002-2004), EU and US privately owned companies were far ahead of their international competitors: Exxon Mobil (efficiency score: 0.84), BP (0.75), Conoco Phillips (0.71), Shell (0.67), Chevron (0.67), Total (0.39), Saudi Aramco (0.36), Petroleos de Venezuela (0.32), Pemex (0.16), National Iranian Oil Company (0.05), PetroChina (0.03)[91]. In this respect, investment efforts are a critical area, yet one in which EU and US privately-held businesses also clearly outweigh state-owned companies. In 2006, the top companies for upstream capital expenditures comprised Exxon Mobil (14.470 billions of dollars), Shell (12.046), BP (10.237), PetroChina (10.160), Total (10.040), Conoco Phillips (8.844), Chevron (8.389) Petrobras

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90 Rio Tinto, Taxes paid in 2010. A report on the economic contribution made by Rio Tinto to public finances

91 The rentier state national oil companies: an economic and political perspective; Essay of the Middle East Journal, June 22 2010

(7.194), EnCana (6.650) and Statoil (6.423)[92]. Conversely operators from other trading blocs are more inclined to fund major infrastructure works in return for being awarded a contract. To summarise, there are many factors relevant in assessing the competitive position of EU MNCs and giving greater transparency on payments to government would be one factor amongst others to be considered.

7.2. Other impacts

7.2.1. International relations and public authorities

International relations: the policy might be considered within the administrations of certain foreign governments as impinging domestic law making powers. Where an EU MNC also has to disclose payment information whose disclosure is prohibited by the domestic law, foreign governments could perceive there to be a breach of their national sovereignty. However this is a contested point – one respondent to the Commission consultation reports that it has received legal advice that disclosure would be illegal in certain countries whilst an academic at Columbia Law School, reports that in a global survey of mining and hydrocarbons laws' confidentiality and disclosure provisions, no examples were uncovered of an explicit prohibition of disclosure of payments[93]. The Commission considers that once a critical mass of MNCs and countries apply this system, it is less likely that countries claim infringements on their domestic laws, however an exemption is foreseen within the proposed legislation to exempt companies from disclosing payments to governments, where such a disclosure would result in the company or its employees being considered to have committed a crime under host government law.

Government opposition parties, and NGOs active in resource rich developing world countries are, however, likely to welcome the policy. For instance the Ugandan shadow Finance Minister, Albert Oduman, has called[94] for EU legislation to require the disclosure of payments by oil companies as Uganda is not a member of EITI, and the companies involved in exploiting recently found oil reserves are all EU listed.

Public authorities: the revision will not have budgetary consequences for public authorities. Nor will there be consequences for the EU budget.

7.2.2. Energy security and environmental impacts

Energy security: The security of EU energy supply figures high on the EU's agenda for several reasons inter alia because energy generated in EU member states does not cover current demand[95]. In 2006, 54 % of energy consumption was sourced from imports. According to estimates, this share may rise to 70 % by 2030. The majority of Europe's energy import is made-up of oil (60 %) and natural gas (26 %). At present, renewable

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92 The rentier state national oil companies: an economic and political perspective; Essay of the Middle East Journal, June 22 2010

93 Royal Dutch Shell plc, in its submission of 28 January 2011 to the SEC, states that it had received legal advice that disclosure of payments to governments in Cameroon, China and Qatar would be illegal. See also Susan Maples JD (an academic at Columbia University) letter of 2 March 2011 to the US SEC.

94 http://www.one.org/blog/2011/01/18/albert-charles-okello-oduman-on-transparency/

95 The Treaty of Lisbon contains such objectives, from energy supply security through efficiency to renewable sources.

energies constitute 16 % in the Union's own energy production, while oil (14.2 %) and natural gas (19.5 %), are still dominant. In addition, DG Energy reports that the EU is currently heavily dependent on a few suppliers both for crude oil and gas. Among these countries the position of Russia should be noted as it currently provides 35% of crude oil and 40% of gas imports; by comparison, current EITI candidate and compliant countries provide 33% of crude oil and 43% of gas imports[96].

Where a country opposes reporting of payments to government (see above), EU extractive operators may find it harder to operate locally which could have a consequent effect on security of oil and gas supplies to Europe. However, as is the case for the competitiveness of EU MNCs, as explained in section 7.1.5 above, disclosing payments to government would be one factor to be considered in assessing overall security of energy supply.

Environmental impacts: Whilst specific environmental concerns are an important issue within the extractive and logging of primary forest sectors ordinarily, no environmental impacts were identified from bilateral contacts with stakeholders, nor did any respondents to the public consultation suggest any.

7.2.3. Social Impacts and fundamental rights

Social impacts: Within the EU there will be limited social impacts as EU governments publish national accounts which provide information on government revenues. However, in other parts of the world, citizens may have limited information on government revenues. The main social impacts would therefore be outside the EU.

In 2007, the total number of employees in the energy sector was 1.6 million, representing 1.3% of the EU economy[97]. These often represent highly qualified jobs (average personnel costs per employee in the energy sector were 40% above the EU average). However bilateral contacts and responses to the public consultation did not identify a risk that EU extractive companies would seek to move their operations or Headquarters outside the EU in response to new regulation in this field. But the risk cannot be excluded that some MNCs may choose to relocate or list outside the EU in response to new disclosure requirements.

Fundamental rights: There will be no impacts on fundamental rights of EU citizens.

8. MONITORING AND EVALUATION

In light of the policy objectives set out in Section 5, the following arrangements are proposed in order to set up an appropriate monitoring and evaluation framework.

8.1. Monitoring

The Commission will monitor the implementation of the revised Directives in cooperation with the Member States throughout the implementation period which is expected to last possibly until the end of 2014. In compliance with the principle of subsidiarity, the relevant information should be gathered primarily by the Member States through Securities Markets' Regulators, and the Accounting Regulatory Committee (ARC). It is expected that the costs

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96 Eurostat 2010

97 Source: Eurostat 2011

of such activity would be met from existing operational budgets, and would not be significant. Monitoring activity should involve sample reviews of CbyC reports, to ensure compliance with the requirement of the revised Accounting and Transparency Directives and a comparison between issuers with similar operations to ensure they are reporting in a consistent manner.

During this time, implementation workshops can be organised by the Commission and/or ESMA to deal with questions/issues that might arise in the course of the implementation period. Where questions are common to the whole extractive and logging of primary forest sectors guidance on how to deal with the issue could be issued by the Commission/ESMA.

8.2. Evaluation

The evaluation of effects of the preferred policy will be carried out to see to what extent the anticipated impacts (increased payments' transparency, improved business environment, increased administrative costs, availability of information on payments by project, increased competitive pressure, and strengthened EITI) and possible impacts such as threats to security of energy supply materialise. Improved disclosures by governments of resource-rich countries on their sources of revenues would be an indicator of better transparency. A significant increase in the number of EITI compliant countries from the current 11 would be an indication that the policy has been successful. Full compliance with the EITI can take a number of years to achieve, as specific rules need to be agreed between stakeholders in each country applying the initiative, and Government accounting systems may need to be improved to allow full reconciliation of receipts to payments. Therefore, a significant increase in the number of candidate countries from the current 24 would also be an indication of success.

In terms of possible downsides it will be necessary to assess whether any non-EU registered MNCs have chosen to de-list from EU regulated stock exchanges as a consequence of the policy. Equally if non-EU stock markets experience more listing activity for extractive issuers that would be indicative of negative consequences for the EU. The ability of EU MNCs to compete in third countries for exploration/production contracts will be evaluated via bilateral contact. The number of new contracts awarded or continued will be followed through bilateral contacts. The share of EU MNCs within global production will also be monitored. If MNCs point to specific problems a review will be undertaken to see if the policy would need refinement.

Evaluation could be carried out by the relevant Commission Services (DGs Internal Market and Services, Development, Energy and Enterprise) and/or ESMA, as a follow up to the 2011 study by ESMA on CBCR. The evaluation should be carried out within five years of the entry into force of the Directives, and it will form the basis of the report to the EP and Council, foreseen within the proposed legislation, on the implementation and effectiveness of CBCR. The report should also consider international developments in the intervening period, and consider broadly the overall scope of CBCR.

Annex 1: Payments to government on a country- and project- basis by all EU listed and EU registered large extractive industry and loggers of primary forests

This policy option would apply to all companies engaged in oil, gas or minerals extraction and those engaged in logging of primary forests which are either listed on EU regulated stock markets or EU registered large companies. Therefore both listed and unlisted companies would be within the scope.

The payments to be reported would be the EITI revenue streams listed in Annex 4, on a country- and project- basis. Where particular payments (such as certain profits taxes and dividends) cannot be allocated to a specific project they would be reported in respect of the country alone. A reporting format in the following form is envisaged:

Country A	Project Y	Project Z	Total payments to government
Royalties	X	x	x
Licence fees	X	x	x
Dividends	--	--	x
Profits taxes	--	--	x
Total	*X*	*X*	*X*

A materiality criterion would be necessary as the largest extractive operators in the EU can have thousands of projects and related payments, and reporting payments in respect of all of them would result in reports of unmanageable proportions, where the key information could easily be obscured.

IAS 1 on the Presentation of Financial Statements requires a preparer to consider the characteristics of the users of financial information in assessing what is material. Given that civil society and NGOs will be taking a particular interest in the content of CbyC reports the Commission Services consider that materiality thresholds set by a company when preparing the annual financial statements may not necessarily be appropriate when preparing a CbyC report, and the materiality of the payment to the host government will need to be considered.

Annex 2: Full CBCR for all listed MNCs

As mentioned in section 6.1 (option 4) full CBCR would require a summary financial statement being presented for the consolidated activity in every country that a company operates in. Revenues, costs, taxes paid, assets and liabilities would be reported on a country by country basis, with disclosures split to identify transactions with third parties and those with other group companies.

An example of such a scheme was included in the Task Force on Financial Integrity and Economic Development 2009 paper "Holding multinational corporations to account wherever they are"[98]. The suggested scheme would require the disclosure of the following information in respect of all a MNC's operations in a given country.

1. The name of the country;

2. The names of all group entities operating within the country;

3. Its financial performance in the country, without exception, including:

    - Sales, both third party and to other group entities;
    - Purchases, split between third parties and intra-group;
    - Labour costs and employee numbers;
    - Financing costs split between those paid to third parties and to other group members;
    - Pre-tax profit;

4. The tax charge split as noted in more detail below;

5. Details of the cost and net book value of physical fixed assets located in the country;

6. Details of gross and net assets in total in the country.

Tax information would need to be analysed between:

1. The tax charge for the year split between current and deferred tax;

2. The actual tax payments made to the government of the country in the period;

3. The liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;

4. Deferred taxation liabilities for the country at the start and close of each accounting period.

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98 http://www.financialtaskforce.org/2009/06/17/country-by-country-reporting-holding-multinational-corporations-to-account-wherever-they-are/

Other advocates of full CBCR would call for further information including details of finance income, dividends paid, intangible assets and third party/intra-group liabilities. The provision of this additional information, if desirable, would not pose further burden as the information would have been collated in order to present the information otherwise disclosed.

The summary financial statement would be prepared using IFRS recognition and measurement criteria (with the exception of actual tax payments) which would allow reconciliation of the aggregate CBCRs to the group consolidated income statement and statement of financial position (actual tax payments could be reconciled to cash flow statement disclosure of "taxes on income", as required by paragraph 35 of IAS 7). The scope would extend to subsidiaries, associates and joint ventures whose results would be included in the consolidated financial statements

To give the same confirmatory value as the consolidated accounts, the summary financial statement would be subject to audit, in accordance with the auditing standards applied to the group consolidated financial statements. Likewise the materiality criteria used in preparing the group consolidated financial statements would be used to give financial information with the same degree of precision as that included in the group accounts.

In terms of publication, given the possibility that information disclosed could be extensive for groups with operations in many countries, electronic means of publication would be encouraged (for example XBRL), and where electronic filing at the Company Register is permitted within a Member State it would be expressly provided that there would be no need for any other form of public filing required.

Annex 3: Comparative table of types of payments to governments

	Types of revenue streams	EITI	US DODD-FRANK *(proposed)*	EU *(preferred)*
Payments to government	**Production entitlements: Host governments & National State owned company**	√	√	√
	Profits tax	√	√	√
	Royalties	√	√	√
	Dividends	√	X	√
	Production, signatory, discovery and other Bonuses	√	√	√
	License fees (and other consideration for licenses and concessions)	√	√	√
	Other significant benefits to government	√	√	√
Other	**Reserves**	X	X	X
	Production volumes	X	X	X
	Production revenues	X	X	X
	Production and development costs	X	X	X
	Names and location of each key subsidiary and property	X	X	√[2]

Source: Commission Services Analysis (2011)

Notes:

1. In IASB Discussion paper DP/20active Activities", pp 146-147
2. Already required by the EU Accounting Directives

Annex 4: EITI revenue streams (payments to governments)

Revenue stream	Further description
Host government's production entitlement	This is the host government's share of the total production. This production entitlement can either be transferred directly to the host government or to the national state-owned company. Also, this stream can either be in kind and/or in cash.
National state-owned company production entitlement	This is the national state-owned company's share of the total production. This production entitlement is derived from the national state-owned company's equity interest. This stream can either be in kind and/or in cash.
Profits taxes	Taxes levied on the profits of a company's upstream activities.
Royalties	Royalty arrangements will differ between host government regimes. Royalty arrangements can include a company's obligation to dispose of all production and pay over a proportion of the sales proceeds. On other occasions, the host government has a more direct interest in the underlying production and makes sales arrangements independently of the concession holder. These "royalties" are more akin to a host government's production entitlement.
Dividends	Dividends paid to the host government as shareholder of the national state-owned company in respect of shares and any profit distributions in respect of any form of capital other than debt or loan capital.
Bonuses (such as signature, discovery, production)	Payments related to bonuses for and in consideration of: • Awards, grants and transfers of the extraction rights; • Achievement of certain production levels or certain targets; and • Discovery of additional mineral reserves/deposits.
License fees, rental fees, entry fees and other considerations for licenses and/or concessions	Payments to the host government and/or national state-owned company for: • Receiving and/or commencing exploration and/or for the retention of a license or concession (license/concession fees); • Performing exploration work and/or collecting data (entry fees). These are likely to be made in the pre-production phase. • Leasing or renting the concession or license area.
Other significant benefits to host governments	These benefit streams include tax that is levied on the income, production or profits of companies. These exclude tax that is levied on consumption, such as value-added taxes, personal income taxes or sales taxes.

Source: EITI: Source Book (2005), pp. 27-28.

Annex 5: Comparison of CBCR disclosure approaches

		Country-based	Company-based	
		EITI	**US DODD-FRANK** *(proposed)*	**EU** *(preferred)*
WHO	**Type of company**	All extractives	All extractives registered on the SEC	Extractive and primary logging [1]
	Type of activities	Upstream	Upstream - downstream	Upstream
WHAT	**Payments to government**	See Annex 4	See Annex 4	See Annex 4
	Materiality of payments	All material	*Not de minimis*	Material
	Reporting basis	Cash not accrual basis	Cash not accrual basis	Cash not accrual basis
WHERE	**Location**	EITI reports, publicly available	Separate annual, electronic format (along with reports filed with the SEC)	Separate annual report
	Audit requirements	Where companies audited, no further audit requirement	None	None
	Reporting level	*Country decides:* Aggregated or company by company	*Company:* Country by Country & by project	*Company:* Country by Country & by project
	Timeframe	Countries decide	Fiscal year	Annually

Source: Commission Services Analysis (2011)

Notes:

1. All extractive companies and loggers of primary forests that are issuers in EU regulated markets, and large non-listed companies with activities in the extractive and logging of primary forest sectors.

Annex 6: Outcome of the Public Consultation [99]

The Commission conducted a public consultation on country by country financial reporting by multinational companies between 26 October 2010 and 9 January 2011[100] in order to obtain stakeholders' views on possible additional disclosure requirements.

During the 10 week consultation period the Commission received 73[101] responses from various stakeholders, almost half of them coming from the UK and DE (36) and seven from pan-European organisations.

Most of the responses (43) came from preparers (23 companies and 20 associations of companies), 17 responses came from users (13 NGOs promoting development and/or tax justice, three investors and one taxation institute), five responses came from public authorities (LU, UK, DK, HU, BE; three accounting standard setters and two national Economy Ministries), five came from accountants and auditors and three came from "other groups" (a political party, a law institute, a private person). As regards preparers contributing to the consultation, they came from financial institutions (banks and insurance companies: 18.5%), the extractive industry (oil companies: 10%, mining companies: 7%), the chemical and pharmaceutical industry (11%), other energy industries (4.5%). Miscellaneous preparers made up the rest. All companies that contributed to the public consultation have operations in third countries, and 91% are listed companies which prepare reports according to IFRS.

The overall result of the consultation shows a rather diverse pattern of opinions, reflecting the opinions of several categories of respondents: where preparers, accountants and auditors were in general opposed to requirements to report on a country by country basis, users and other respondents were in favour. The opinions of public authorities were split and half of them expressed "no opinion" in response to several of the questions. A majority of the respondents were preparers (43 companies and industry associations out of 73 contributions) who expressed a rather dismissive view on most of the questions. However, a detailed analysis shows that the industry most directly concerned – the extractive industry, in particular oil and gas – expressed in general a constructive view as they consider this to be conducive to improving domestic accountability and governance in resource-rich countries. The NGOs were of a similar view. As regards the type of companies which should fall under the scope of any future instrument, among the respondents who considered that some companies should be targeted a majority considered listed companies to be the appropriate group.

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99 The complete summary report of the public consultation can be found at : http://ec.europa.eu/internal_market/consultations/2010/financial-reporting_en.htm

100 The consultation document can be found at: http://ec.europa.eu/internal_market/consultations/2010/financial-reporting_en.htm

101 There were actually 76 responses, but four responses came from the same organisation (and in one case the same person) so they were counted as one sole contribution in the statistics. However, all contributions have been published on the website. For more information see the methodology section.

Annex 7: Meetings with stakeholders

1. ActionAid
2. AFEP (Association Françaises des Enterprises Privées)
3. Anglo American
4. ArcelorMittal
5. Association Technique Internationale des Bois Tropicaux (ATIBT)
6. BHP Billiton
7. BP
8. Business Europe
9. Canada Mining Council
10. CBI (Confederation of British Industry)
11. CCFD Terre Solidaire (a development NGO)
12. CEPI (Confederation of European Paper Industries)
13. CICERO
14. CIDSE
15. Christian Aid
16. Cookson
17. Citigroup
18. ENI
19. ENI Norway
20. Eurodad (a network of development NGOs)
21. Euromines
22. European Timber Trade Federation (ETTF)
23. EITI Secretariat (Extractive Industries Transparency Initiative)
24. Financial Centre Forum (IFC)
25. General Electric
26. German Institute for International and Security Affairs

27. Gplus
28. Global Witness
29. ICAEW (Institute of Chartered Accountants in England & Wales)
30. International Chamber of Commerce (ICC)
31. IBM
32. Maples and Calder Law Firm
33. OGP (International Association of Oil & Gas Producers)
34. ONE (a development NGO)
35. Open Society Foundations
36. OSCE (Organisation for Security and Co-operation in Europe)
37. Oxfam
38. Philips
39. Publish What You Pay (PWYP)
40. Revenue Watch
41. Rio Tinto
42. Shell
43. Statoil
44. Tax Justice Network
45. Total
46. Transparency International
47. Unilever
48. Vale
49. Vodafone
50. Xstrata

Annex 8: Compliance cost of the preferred option

Four listed MNCs in the extractive industry provided detailed estimates on the group set-up costs and annual recurring costs they would expect to incur with a requirement to report payments to host governments on a CbyC, as well as on an un-audited basis. Follow-up discussions with the companies indicated that a requirement to additionally report in respect of material projects could result in up to a 100 % uplift in costs. The estimates below are on the basis of reporting payments to host governments on a country- and project- basis.

The information provided is business sensitive, and the MNCs participated in the cost estimation exercise on the basis that their individual estimates would remain confidential. Hence the information below is anonymised.

	Group set-up costs (€ millions)	Group Annual recurring costs (€ millions)
Company A	17.2	1.8
Company B	3	0.6
Company C	14	7
Company D	7.4	5.2
Total	*41.6*	*14.6*
Average	*10.4*	*3.6*

According to ESMA data these four companies collectively had 192 subsidiary companies, giving a total number of entities in the four groups of 196 (4+192). The cumulative set-up and recurring costs for the four groups of €41.6 millions and €14.6 millions were divided amongst the number of group entities to give an estimated cost per group entity:

Set-up costs per group entity	Annual recurring costs per group entity
€212,244	€74,490

ESMA reported that there were 171 companies extractive companies with shares listed (depository receipts are not included) in the EU (as at 30 September 2010), which between them had 2,999 subsidiary companies (i.e. 3,170 group entities).

Extrapolating the estimates across the listed extractive sector, on the basis of the number of group companies (parent and subsidiary companies), gives the following estimated costs for EU business:

Year one (€ millions)			Year two and successive years (€ millions)	
Set-up costs	Recurring costs	Total	Recurring costs	Total

672	236	908	236	236

If dual-listed companies (*15 companies with 570 subsidiaries i.e. 585 group entities*) were to face no reporting obligation from an EU reporting requirement over and beyond that stemming from the Dodd Frank Act, the estimated costs for EU business would be:

Year one (€ millions)			Year two and successive years (€ millions)	
Set-up costs	Recurring costs	Total	Recurring costs	Total
548	192	740	192	192

The data takes into account the fact that some EU MNCs already report under EITI, as the surveyed companies included those with and without direct experience of reporting under EITI. However, MNCs reporting information under EITI do not report all payments made to government in all the countries where they operate. They provide this information only in relation to EITI compliant countries, so they will incur additional cost with a requirement along the lines of the preferred policy option.

419 unlisted large EU companies active in the extractive industry were identified by the Commission Services. These constituted 85 parent companies (which collectively had 968 subsidiaries) and 334 "solus" companies. To arrive at a cost estimate for this sector the entity costs referred to above have therefore been extrapolated over 1,387 entities (85+968+334) to give the following estimated costs for the sector:

Year one (€ millions)			Year two and successive years (€ millions)	
Set-up costs	Recurring costs	Total	Recurring costs	Total
294	103	397	103	103

The Commission Services identified 26 EU forestry companies (listed and large unlisted companies) potentially within the scope of the proposed rules. Applying the same level of estimated costs to these companies gives the following estimated costs for the sector:

Year one (€ millions)			Year two and successive years (€ millions)	
Set-up costs	Recurring costs	Total	Recurring costs	Total
6	2	8	2	2

The costs of reporting only payments to government are estimated to be 50% of the anticipated cost of reporting on both a country- and project- basis. This would mean that the estimated cost for option 2 – reporting payments to government in the extractive industry only (see section 6.1) would be:

Administrative costs of extractive and forestry industry MNCs reporting payments to government only		
	Year one cost (€ millions) (50% of the estimates provided above)	Subsequent years' costs (€ millions) (50% of the estimates provided above)
Listed extractive MNCs	370	96
Unlisted large extractive MNCs	199	52
Forestry MNCs	4	1
Total	573	149

Annex 9: Compliance cost of full CBCR and payments to government for MNCs in the extractive and forestry industries

The four MNCs in the extractive sector referred to in Annex 8 provided estimates to EFRAG of the group set-up costs and annual recurring costs they would expect to incur with a requirement for full CBCR, together with a requirement to report payments to government.

	Group set-up costs (€ millions)	Group Annual recurring costs (€ millions)
Company A	46.6	18.8
Company B	17.9	4.7
Company C	14.0	8.5
Company D	7.5	5.5
Total	*86.0*	*37.5*
Average	*21.5*	*9.4*

Company D provided its estimates on the basis that disclosures would only be required for a limited number of countries, those being most material to the company. Given that materiality criteria will need to consider the materiality of operations from the country perspective, it is possible that the costs it foresees have been under-estimated.

Following the same methodology as in Annex 8, the set-up and recurring costs per group entity of this option are estimated to be:

Set-up costs per group entity	Annual recurring costs per group entity
€438,776	€191,327

Extrapolating these estimates to the number of companies within the targeted sector, as identified in Annex 8, gives the following estimated costs for the policy option.

Administrative costs of full CBCR and reporting payments to government (on a project basis) for extractive and forestry industry MNCs		
	Year one cost (€ millions)	Year two and subsequent years' costs (€ millions)
Listed extractive MNCs (171 companies)	1,997	607
Unlisted large extractive	874	265

MNCs (419 companies)		
Forestry MNCs (26 listed and large unlisted companies)	16	5
Total	*2,887*	*877*

Annex 10: Acronyms

AD: Accounting Directive

AIM: Alternative Investment Market

ARC: Accounting Regulatory Committee

BRIC: Brazil, Russia, India and China

CBC / CbyC: Country by Country

CBCR: Country by Country Reporting

EFRAG: European Financial Reporting Advisory Group

EP: European Parliament

EITI: Extractive Industries Transparency Initiative

ESMA: European Securities Market Authority

FAO: Food and Agriculture Organisation

FLEGT: Forest Law, Governance and Trade Program

GDP: Gross Domestic Product

IAS: International Accounting Standards

IASB: International Accounting Standards Board

IEA: International Energy Agency

IFRS: International Financial Reporting Standard

IMF: International Monetary Fund

ISC: Inter Services Steering Group

KPCS: Kimberley Process Certification Scheme

MNC: Multinational Corporation

MMBOE: Million Barrels of Oil Equivalent

NGOs: Non-Governmental Organisations

NOCs: National Oil Companies

PWYP: Publish What You Pay

SEC: Securities Exchange Commission

TD: Transparency Directive

UN: United Nations

VAT: Value Added Tax

VPA: Voluntary Partnership Agreement

XBRL: eXtensible Business Reporting Language