ActionAid comments on the European Financial Reporting Advisory Group (EFRAG)'s draft comment letter on the IASB Discussion Paper on Extractive Activities

Martin Hearson, Policy Adviser, ActionAid UK
martin.hearson@actionaid.org // +44 20 7561 7559

July 2010

ActionAid is an international development agency operating in over 50 countries worldwide. We have affiliates in several European Union member states: the UK, Italy, the Netherlands, France, Greece, Sweden and Denmark.

We welcome the IASB's public consultation on its discussion paper on a new standard for extractives, as well as the possibility to comment on EFRAG's draft response to that consultation. We are pleased that time and space has been devoted by both organisations to considering the proposals set out by Publish What You Pay.

ActionAid is both a preparer of financial statements and a capital market participant, in that we invest in equities. Many of the communities with which we work are touched by extractive industries either through the direct impact on them of extractive activities, or indirectly as citizens of countries in which such industries contribute a significant proportion of national income and public resources.

Our comments here are made in the light of the European Commission's emphasis on Policy Coherence for Development, set out in its recent communication on that topic. In its Communication on Tax and Development, the Commission has also emphasised the potential of the proposal for country-by-country reporting (CBCR) set out in the IASB's discussion paper as a tool to assist developing countries in mobilising domestic resources for development:

> [T]he Commission supports research work currently undertaken by the International Accounting Standards Board towards the possible inclusion of CBCR in an International Financial Reporting Standard for extractive industries.

We also refer EFRAG to the staff working paper accompanying that Communication, which elaborates further as follows:

> Country-by-country reporting would require multinationals to disclose details of their commercial transactions by country and therefore enhance transparency. Such reporting could also be an additional source of information for the assessment of taxpayers, especially when they are multinational corporations with complex and sometimes insufficiently transparent financial structures. However, the usefulness of country-by-country reporting depends on the definition of what information is to be disclosed and this is currently the subject of discussion in a number of fora such as the OECD. According to many observers, introducing country-by-country reporting in international accounting standards for all major multinational corporations operating in developing countries could be beneficial.
>
> It has been suggested that country-by-country reporting could be alternatively included as a principle for Corporate Social Responsibility (CRS). This is certainly useful but, since these principles are voluntary, advocates of a more mandatory approach hold that there would probably not be a strong incentive for application. Including these standards, however, in the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) would indeed represent a more global and, above all, mandatory Country-by-country reporting requirement where use of IFRS is compulsory.

> However, IFRS would need to be proposed by first the IASB and then adopted by the EU as a reporting standard, which could be a lengthy process.
>
> The IASB is currently undertaking a cost-benefit analysis of such a standard for the extractive sector and is considering its inclusion in IFRS 6. The Commission encourages developing countries and non-governmental stakeholders to actively contribute to this project.

EFRAG's draft comment letter invites constituents' views on its response to the IASB's analysis of the PWYP proposals. We have a number of points to make:

1. Users of accounts

EFRAG's view is summarised in the Appendix to its draft comment letter as follows:

> The objective of financial statements is to provide decision useful information to investors and other capital market participants. Where these objectives overlap with those of other organisations they should be included in the financial reporting framework.

We believe there is an omission in this statement. The IFRS Foundation's constitution defines the purpose of the IFRS as follows (emphasis added):

> These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets <u>and other users of financial information</u> make economic decisions.

ActionAid believes therefore that in order to be coherent with the stated purpose of the IFRS, the PWYP proposals should be considered from the perspective of their usefulness to these other users, which include civil society organisations and tax authorities.

This is of particular relevance because the same omission is made in the IASB's discussion paper, in which:

> the PWYP proposals have been assessed only from the perspective of whether capital providers would find the information to be decision useful.

The PWYP proposals would benefit a broad range of stakeholders, including tax authorities and regulators in developing countries. While there are clear benefits to these other users of accounts arising from the PWYP proposals, ActionAid believes that the proposals are also justified in terms of their usefulness to capital market participants.

This, we believe, is underlined by the interest in such proposals from the European Commission, Council and Parliament, and the OECD and G20. It is also underlined by moves towards a country-by-country standard for extractive industries contained in the United States Energy Security Through Transparency Act 2009 and recent amendments to the rules governing the listing of securities on the Stock Exchange of Hong Kong.

Recommendation 1: Significant concern (h) and paragraph 103 of EFRAG's draft comment letter and its response to Question 10 should be amended with the addition of "other users of financial information" to the groups for whom the objective of financial statements is to provide decision-useful information, and the removal of the distinction between these users and capital providers. EFRAG should raise a concern that the PYWP proposals are not considered in this light in the IASB's discussion paper.

2. Cost benefit analysis

ActionAid welcomes EFRAG's conclusion in Paragraph 104 of its draft comment letter:

> Our initial assessment of the additional disclosures is therefore that cost of their preparation will not outweigh the benefit of their inclusion in the financial statements.

We suggest that it would be useful to clarify what is meant by "additional disclosures" beyond those recommended elsewhere in the Discussion Paper.

In ActionAid's view, it is essential that the new Extractive Activities standard includes the disclosure of benefit streams to governments on a country-by-country basis. In addition to the usefulness of such information to other users of financial statements, the IASB Discussion Paper highlights its usefulness to capital providers, for the purposes of country-specific risk assessment and reputation management.

Furthermore, for benefit streams information to be meaningful, further disclosures are needed to allow it to be interpreted. These are the other disclosures in the PWYP proposals. We believe it essential that the benefits to all users of accounts of the full package of disclosures far outweighs the preparation costs.

Recommendation 2: Paragraph 104 should spell the additional disclosures for which EFRAG considers that the cost of preparation does not outweight the benefit. This should be the disclosures proposed by PWYP which are not provided by provisions elsewhere in the discussion paper:

a) Benefits streams (payments) to governments for each country and broken down by payment types

b) Reserves, production quantities and costs on a standard country-specific basis.

c) Production revenues on a country-by-country basis

d) The names and locations of each key subsidiary and property in each country.

3. Additional recommendations

There are two further areas of concern with the IASB Discussion paper that are not mentioned in EFRAG's draft comment letter.

First, we are concerned by the proposal in the Discussion paper that the materiality threshold for disclosure be set in terms of what is material for the company based on the size of national reserves relative to their international operations. The paper is not entirely consistent on this point, stating first that:

> [T]he potential economic loss (or gain) to the entity arising from country-specific investment risks would be expected to be correlated to the relative value of the entity's investments in that country.

And subsequently that:

> [A]n entity's exposure to reputational risks and the associated potential economic loss is not correlated to the scale of the entity's investment in a particular country.

Second, the Discussion Paper proposes a discretionary exemption from any country-specific reporting as follows:

> One approach could be to require the disclosure subject to an exemption similar to that in IAS 37 Provisions, Contingent Liabilities and Contingent Assets, which as explained in Chapter 5 provides an exemption in cases when disclosing the required information could be expected to prejudice seriously the position of the entity. In genuine cases where the disclosure of payments to governments is considered either to breach confidentiality requirements that a host government is expected to enforce or is expected to prejudice seriously the position of the entity for other reasons, the project team recommends that the entity should disclose why it is unable to disclose the information.

In ActionAid's view such an exemption would undermine the consistent, global nature of IFRS, which is necessary both to build accountability at national level and to protect companies from pressure exerted on them at national level to withhold information.

Recommendation 3: In its comment letter, EFRAG should recommend that the minimum level of disaggregation required for all country-specific disclosures be set at the individual country level. The proposals for discretionary exceptions to this, both in terms of the materiality threshold and the possibility for exemptions from disclosure of information pertaining to individual countries, should be removed.