European Financial Reporting and Advisory Group
35 Square de Meeûs
B-1000 Brussels
Belgium

Sent by email

2 July 2010

Dear Sir or Madam

Extractive Activities – Comments on Discussion Paper issued by the International Accounting Standards Board on 6 April 2010

We write to make formal comment on your proposed response to the above noted discussion paper.

Tax Research LLP is a consultancy that works mainly on taxation and related accounting and economic issues. Its clients are mainly non-governmental organisations and civil society organisations. The objective of its work is the development of taxation and accounting mechanisms that can assist the relief of poverty both within domestic economies and internationally. Tax Research LLP is directed by Richard Murphy FCA, the creator of the country-by-country reporting concept for multinational corporations.

Attached to this letter, and to be considered an integral part of it, is a copy of a full discussion document prepared by this firm considering in detail the merits, or otherwise of the proposals made by the IASB panel tasked with issuing this consultation document (henceforth termed the "IASB panel" unless the context requires otherwise). Those comments relate in the main to Chapter 6 of the discussion paper relating to the proposals for country-by-country reporting made by Publish What You Pay, as does the rest of this letter. This letter of submission may be considered a summary of the major conclusions in that document, but does not replace it.

Based on our review of the discussion paper and your proposed response to the IASB we make the following observations for your consideration:

Registered office
The Old Orchard
Bexwell Road
Downham Market
Norfolk PE38 9LJ
United Kingdom

Phone	01366 383 500
Mobile	0777 552 1797
Email	richard.murphy@taxresearch.org.uk
Web	www.taxresearch.org.uk/blog
Skype	richardmurphy1572
Registered number	OC316294

1. We believe that in International Financial Reporting Standards for the extractive industries is needed As such we believe it essential that EFRAG request that this project continue so that an Exposure Draft of such a proposed IFRS might be issued in due course;

2. We are of the opinion that one standard is required for the oil, gas and mining sectors and as such request that EFRAG support this position;

3. It is our opinion that historical cost reporting is of most use for oil and mineral accounting since this best assists the user seeking to assess taxation payments made. As such we ask that EFRAG support this position.

4. The IASB discussion paper says in Chapter 5 that the project team believes that the disclosure objectives for specific extractive activities disclosures are to enable users of financial reports to evaluate:

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

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

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

   We do not agree for the reasons noted below and think that the IASB panel have made a fundamental error of judgment in coming to these conclusions.

   We also note that in your proposed submission letter you say:

   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 discuss this issue at length in the attached note. In our opinion this statement is incorrect. Indeed, it conflicts with the statement of objectives of the International Accounting Standards Board which says (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 and other users of financial information make economic decisions.

   It is our opinion that the IASB proposal and the proposed EFRAG response ignore the needs of these other users of financial information. We also believe that the IASB proposal is wrong in saying the only use made of accounts prepared under International Financial Reporting Standards is the appraisal of future cash flows. This is very obviously not true. The

Corporate Report[1] issued in 1975 by the UK's Accounting Standards Steering Committee and a pioneering work on the need for accounting standards, noted that published accounts should enable a user to appraise information on:

1. The performance of the entity;
2. Its effectiveness in achieving stated objectives;
3. Evaluating management performance, including on employment, investment and profit distribution;
4. The company's directors;
5. The economic stability of the entity;
6. The liquidity of the entity;
7. Assessing the capacity of the entity to make future reallocations of its resources for either economic or social purposes or both;
8. Estimating the future prospects of the entity;
9. Assessing the performance of individual companies within a group;
10. Evaluating the economic function and performance of the entity in relation to society and the national interest, and the social costs and benefits attributable to the entity;
11. The compliance of the entity with taxation regulations, company law, contractual and other legal obligations and requirements (particularly when independently identified);
12. The entity's business and products;
13. Comparative performance of the entity;
14. The value of the user's own or other user's present or prospective interests in or claims on the entity;
15. Ascertaining the ownership and control of the entity.

Of all of these objectives the IASB has chosen just one to make the entire focus of its work.

In the process it has also ignored those uses of accounts that have developed since 1975 including (but not exclusively) the assessment of:

- geo-political risk;
- environmental risk;
- risk arising from transfer mispricing;
- the abuse of tax havens / secrecy jurisdictions;
- the risk of involvement with corruption, wittingly or unwittingly;
- money laundering risk;
- corporate responsibility.

The demand for information made by Publish What You Pay falls into those areas foreseen in 1975 and since then, all of which are reasonable, anticipatable, actual and justifiable uses of financial statements and which cannot in any meaningful way be satisfied by information

[1] http://www.ion.icaew.com/ClientFiles/6f45ef7e-1eff-41ff-909e-24eeb6e9ed15//The%20Corporate%20Report2.pdf

supplied in any other form. To deny the validity of these uses of financial statements does, once again, mean that the IASB is acting in contravention of the obligation to prepare a framework for financial reporting in the public interest which it has accepted and which is the basis on which responsibility for doing so has been devolved to it.

On these grounds we request that EFRAG revise its submission and the comments it makes to properly reflect the actual usage of the financial statements prepared under International Financial Reporting Standards and that the needs of these users be reflected in the comments it makes.

5. We are of the opinion that the IASB project team have seriously misunderstood the PWYP proposals and have treated them as a request for disclosure, and not as a request for integrated accounting information that is the minimum needed to ensure necessary information to reasonably appraise the likely completeness and accuracy of the benefit payments made by reporting entities to host governments on a country-by-country basis. Given that IFRS are meant, according to the IASB panel and the IASB framework, to provide a complete set of financial statements this failure to recognise the requested data as constituting such data is hard to explain.

   As example, the IASB panel does consider it appropriate that the significant components of the total benefit streams paid to host to government and their agencies should be disclosed on a country-by-country basis. However, they then reject the notion that revenues arising from extractive industry production should be disclosed on a country-by-country basis, with separate disclosure of sales to external customers and intra-group transfers. This makes no sense at all. Unless sales and profit performance by country can be appraised there is no prospect of determining whether the disclosures made of benefit streams paid are meaningful when much of the latter will be made up of taxes on revenues in the form of royalties or taxes on profits, calculated as revenues less costs. Accounting information only ever makes sense in comparison, whether in absolute or ratio terms. By denying the opportunity for the creation of meaningful absolute or ratio comparisons with regard to benefit stream payments the IASB panel is undermining the usefulness of the information they agree might be disclosed. There is no accounting logic to this and as such the entire range of information requested by PWYP has to be adopted as a whole by the IASB if its obligation to produce "high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements" is to be fulfilled.

   We would ask that EFRAG support this view in its submission to the IASB.

6. The IASB panel has, in our opinion, made two fundamental errors with regard to materiality in making its recommendations. Unfortunately these are repeated in the draft EFRAG submission letter. Precisely because of the error the IASB team and EFRAG have made in determining the users or accounts and their needs for information, already noted, the IASB panel has failed to recognise the need for information to assess a wider range of risks –

including that demanded by Publish What You Pay with regard to the extractive industries – at a country by country level, without exception.

In the case of this data - as is also, for example, the case with data concerning disclosure of related party transactions, directors remuneration and other key data essential for the appraisal of regulatory and other compliance and which by themselves have no bearing whatsoever on the likely level of future cash flows – a qualitative measure of materiality has to be used. This, by definition, means that materiality has to be determined in these cases within the accounting framework i.e. it has to be set within either law or an appropriate International Financial Reporting Standards and the matter is not devolved to the reporting entity to determine for itself – at which point materiality is then assessed quantitatively.

Precisely because the IASB panel has failed to appreciate the need for information on a country-by-country basis is not based on materiality to the entity, but on materiality to the user, and the fact that the need is bound to be location specific, without exception, when it comes to assessment of the regulatory compliance of the entity then the data in question must be made available for all states in which a reporting entity operates without exception.

The Discussion Document is, therefore, wrong in suggesting that reporting entities be allowed to determine what disclosure is made by them according to the materiality of the disclosure in question to the reporting entity and not in accordance with the needs of users and this matter must be resolved by incorporating a qualitative requirement into any IFRS for the Extractive Industries that requires that country-by-country reporting take place for each and every jurisdiction in which the reporting entity operates, without exception.

In that case we would ask that the EFRAG submission be revised so that this call for a qualitative assessment of materiality with regard to the country-by-country reporting proposals be endorsed by EFRAG. This will necessarily mean that the EFRAG position on costs and benefits and on materiality of disclosure on these issues will need revision.

7. We note that EFRAG thinks that the cost of the disclosures proposed by PWYP cannot be justified by the benefits secured. We respectfully disagree because the proposed cost benefit analysis, along with the criteria for assessment adopted by EFRAG are inherently flawed since they do not take into consideration the significant benefits arising to the majority of users of financial statements in society. There are three reasons for this:

a. In appropriate assessment criteria

The proposed cost benefit analysis is intended to be based on the assumptions in the IASB panels' paper i.e. that financial statements are prepared solely for the benefit of capital providers and all else must make do with the information supplied for their benefit which has the sole purpose of allowing them to appraise the likely future cash flows of the entity. The PWYP proposals, asking for complete, coherent accounting data that could only be supplied within the context of a set of financial statements are designed primarily (although by no means exclusively) for other stakeholders and are intended to appraise past performance primarily in the context of regulatory compliance either of the entity itself or of the parties with which it engages. These are all entirely valid uses of accounting data, but all the benefits that might flow from this use are excluded from consideration by the IASB panel in the proposed cost-benefit analysis. That analysis does therefore include all costs but excludes almost all benefits form consideration and is, therefore, from the outset inherently biased as to outcome. This is despite the fact that all the intended benefits are in the public interest, as indeed IFRS are meant to be under the terms of the IASC constitution. This is because the intended benefits are intended to enhance tax and regulatory and legal compliance, reduce the risk of fraud and corruption, enhance corporate accountability and transparency, promote corporate responsibility and good governance as well as enhancing risk assessment on all these issues, all of which are, if the IASB panel proposal is to be believed, benefits that cannot be taken into consideration when appraising the benefit arising from an International Financial Reporting Standard.

It is recommended in the strongest possible terms that the basis of appraisal of benefits arising from implementation of the PWYP proposal for country-by-country reporting be amended so that all these benefits can be taken into consideration before any cost benefit analysis be undertaken or it will be inherently flawed and will seriously undermine the credibility of both the IASB and its standard setting process.

b. Data must be available

The IASB panel should also be asked to withdraw consideration of the possibility that the data required to produce country-by-country reporting of the type demanded is not available. If any reporting entity subject to IFRS did not have the data required to produce the financial reporting requested by PWYP it would, it is argued, have failed to maintain the necessary books and records required by the company law of the states in which they will be incorporated. Taking example from UK law it is necessary for an entity (and by definition its group) to maintain by law:

(1)Adequate accounting records means records that are sufficient—

> *(a)to show and explain the company's transactions,*
>
> *(b)to disclose with reasonable accuracy, at any time, the financial position of the company at that time, and*
>
> *(c)to enable the directors to ensure that any accounts required to be prepared comply with the requirements of this Act (and, where applicable, of Article 4 of the IAS Regulation).*

(2)Accounting records must, in particular, contain—

> *(a)entries from day to day of all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place, and*

(b)a record of the assets and liabilities of the company.

(3)If the company's business involves dealing in goods, the accounting records must contain—

(a)statements of stock held by the company at the end of each financial year of the company,

(b)all statements of stocktakings from which any statement of stock as is mentioned in paragraph (a) has been or is to be prepared, and

(c)except in the case of goods sold by way of ordinary retail trade, statements of all goods sold and purchased, showing the goods and the buyers and sellers in sufficient detail to enable all these to be identified.

The disclosures required by PWYP relate to reserves, which for this purpose might be considered stocks and therefore subject to disclosure requirement, whilst it would be impossible for the directors of the entity to meet the obligations in paragraph 2 without having available the data PWYP requests. Therefore no additional costs of preparing these basic records should be allowed to be taken into account in any costs-benefit analysis because they must already exist if legal requirements are being met.

c. Auditing costs

Whilst it is the case that country-by-country data is not prepared for disclosure at present, and this will be an additional cost, as will be the cost its explicit disclosure, the cost of auditing the underlying transactions should not be taken into consideration in any cost-benefit analysis. The settlement of legal obligations to make payment to governments under the terms of mineral and oil and gas extraction agreements will always be high risk transactions requiring particular attention from auditors within the context of the audit of the subsidiaries of any multinational corporation engaged in these activities. If it was to be claimed that additional cost was incurred in auditing these independent of the simple disclosure aspect then it would suggest that existing audits are not fulfilling their objective of assessing high risk transactions. As such no material additional audit costs, bar those of disclosure checking, should arise.

For these reasons we ask that EFRAG revise its observation that some of the data requested by PWYP may be hard to secure: if it is the problem is very serious indeed for the company in question and its auditors because it would imply non-compliance with the law, but that is no reason to object to a requirement for disclosure of information that a company should rightful have in its possession at this time.

8. We draw your attention to the Finance Minister's communiqué issued after their recent meeting in Seoul, South Korea, which was subsequently reflected in the Toronto G20 communiqué and which said:

We expressed the importance we place in achieving a single set of high quality, global accounting standards and urged the International Accounting Standards Board and the

Financial Accounting Standards Board to redouble their efforts to that end. We encouraged the International Accounting Standards Board to further improve involvement of stakeholders.

We do not see how EFRAG can be consistent with this demand unless it too heeds the needs of stakeholders when considering the work of the International Accounting Standards Board.

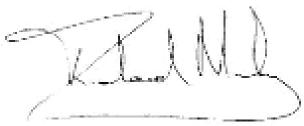
It would appear to us that the Finance Minister's would agree with us that the following comment in your draft submission is in this context quite inappropriate:

In this regard, EFRAG is of the view that there can be a distinction between the purpose of financial statements and the objectives of organisations with a socio-political agenda. We do, however, think it is possible that accounting standards can be developed that satisfy the needs of both such organisations and capital market participants since they do have similar interests. However, where there are divergent needs, the needs of investors and other capital market participants must take precedence.

We contend our needs are not socio-political: they are a need for data to appraise risk – just as is the need of all other users of financial statements a need for data to appraise risk. The differentiation you propose is artificial, and therefore wrong.

So too is your suggestion that when needs are divergent only one should be met wrong. As we note above, the International Accounting Standards Board is tasked with meeting the needs of all users of financial statements. As such we would ask that you revise your submission letter to remove this paragraph since it is clearly not in the interests of the people of the European Union that such observation be made.

Yours faithfully



Richard Murphy FCA
Director

Country-by-Country Reporting
and
The Extractive Industries

A review of the

International Accounting Standards Board

discussion paper on

Extractive Activities

published in April 2010

Richard Murphy FCA

Registered office
The Old Orchard
Bexwell Road
Downham Market
Norfolk PE38 9LJ
United Kingdom

Phone	01366 383 500
Mobile	0777 552 1797
Email	richard.murphy@taxresearch.org.uk
Web	www.taxresearch.org.uk/blog
Skype	richardmurphy1572
Registered number	OC316294

Contents

Summary	2
1. Background	11
2. Purpose of this paper	11
3. The IASB's recommendations	12
4. The IASB's response to Publish What You Pay's proposals	13
5. Summary of IASB response to PWYP requests	17
6. The basis for the IASB's responses to PWYP's requests	17
7. Are PWYP's requests for useful data that a set of financial statements can supply?	18
8. Are capital providers the only users of financial statements?	22
9. Materiality	25
10. Materiality with regard to inclusion in IFRS	27
11. Materiality with regard to inclusion in individual financial statements	33
12. Costs and benefits	37
13. Confidentiality	39
Appendix 1 - What country-by-country reporting would require of multinational corporations	41
Appendix 2 - The information Publish What You Pay has requested on a country-by-country basis	43
Appendix 3 - UK company law on the need to maintain proper books and records	45
Appendix 4 - About the author	46

Published in Great Britain in May 2010 by

Tax Research LLP
The Old Orchard
Bexwell Road
Downham Market
Norfolk PE38 9LJ
United Kingdom

+44 (0) 1366 383500
+44 (0) 777 552 1797

www.taxresearch.org.uk/blog

Registered at the above address.
Registered number OC316294

Summary

The International Accounting Standards Board (IASB) published a Discussion Paper on the Extractive Industries (EI) in April 2010. The purpose of that paper was to discuss future changes to the accounting requirements of companies and corporations (generally referred to as reporting entities in this paper) engaged in the extractive industries. For these purposes the extractive industries is considered to cover oil, gas and mineral extraction.

An entire chapter of the report is devoted to the requests made of the IASB by Publish What You Pay (PWYP) and other organisations for enhanced disclosure by reporting entities of the payments they make in cash and in kind to governments and their agencies in the states in which oil, gas or minerals are extracted. That request has been made so that those governments can in turn be helped to account for their use of those funds. Because such disclosure could only be meaningful if produced on a country-by-country basis country-by-country reporting of these payments has been requested by PWYP. PWYP has additionally requested disclosure of additional accounting material sufficient to ensure that a reasonable analysis of the likelihood of such payments being fairly stated can be formed on the basis of disclosure made in the financial statements (colloquially, the accounts) the reporting entities in question.

This report considers the response made by the IASB to the request made by Publish What You Pay.

The PWYP requests, in summary, are that the following be disclosed by each reporting entity in the extractive industries on a country-by-country basis:

1. Benefit streams paid to a government or its agencies during a period whether in cash or in kind, including for example royalties, taxes, dividends, bonuses and fees;

2. The opening and closing mineral, oil or gas reserves for each period;

3. Production volumes during a period;

4. Production revenues generated during a period;

5. The costs of production and development incurred during a period;

6. The names of key subsidiaries and properties.

In response to these requests the IASB has in summary said (paragraph 6.48):

> *On the basis of [our] analysis, country-specific information would be expected to be disclosed for reserve quantities, production quantities, development and production costs, together with a listing of key subsidiaries where that information is material to the entity. The disclosure of reserve values and production revenues would also be disclosed, but it is not expected to be on a country-by-country basis.*

The report also endorses disclosure of revenue stream payments, but subject to considerable additional research on the costs and benefits of doing so.

This summary by the IASB is, however, materially misleading. The IASB does not mention in this summary that it also concludes that:

1. Any reporting entity could opt not to disclose any required data if that reporting entity felt it prejudicial to its interests to do so, although admittedly a justification would have to be published;

2. Disclosure would only be required for any item when it was considered material to the reporting entity. This would provide complete discretion to any reporting entity to not disclose in most cases since most payments in most countries will fall well below this limit as conventionally calculated;

3. The cost / benefit analysis to which the IASB report refers specifically excludes from consideration in the calculation of benefits arising precisely those benefits that the users of financial statements that PWYP seeks to represent would secure from such disclosure because the IASB deems those users not to be users of financial statements for this purpose.

This report argues that in reaching its conclusions the IASB has failed in its public duty, acted in breach of its own constitution, has failed to ensure that coherent and comparable accounting data constituting a complete set of accounts will be disclosed, has failed to correctly apply the concept of materiality to the establishment of an accounting framework and to the subsequent requirement to report within that framework and has consistently failed to use logical or consistent argument in support of its conclusions.

In particular, this report argues that:

1. Civil society are users of financial statements whose needs must be met.

The users of accounts that PWYP seeks to represent, including employees, consumers, the public, civil society organizations and governments and their institutions are each in their own right valid user groups of accounting data. As a result their interest in financial statements must be recognised by the IASB.

These interests are independent of, and different to, the information needs of the suppliers of capital to the reporting entity and can only be met if information specific to their needs is made available for their benefit. Unless this is recognised it is argued that the duty the IASB has to ensure comprehensive accounts are prepared in the public interest will not be fulfilled.

In its response to PWYP's requests the IASB deny that these stakeholder interest groups are users of financial statements with their own separate and distinct information needs, arguing instead that only the interests of suppliers of capital need be taken into account in determining disclosure to be made in financial statements. As a result the IASB have biased their findings against PWYP.

2. Missing data on payments to governments out of financial statements is a material omission for all users

The IASB is failing in its public duty, as noted in the preceding paragraph, because it has failed to appreciate that the concept of materiality in accounting applies to both the establishment of an accounting framework as well as to the duty to report within it once it has been established. The IASB only consider the latter issue.

It is argued that if the IASB did correctly understand that concept of accounting with regard to the establishment of an accounting framework they would appreciate that the information requested by PWYP is essential information required for economic decision making purposes by valid and proper users of financial statements and as such the IASB would endorse PWYOP's requests.

Because the IASB have not endorsed the PWYP proposals it is argued that it must follow that they have either misunderstood or have misapplied the concept of materiality in the establishment of the accounting framework i.e. creating an International Financial Reporting Standard.

As a result it is argued that it is inevitable that if the proposals made in the IASB report are adopted then the resulting financial statements will include material misstatements, including omissions, individually or in the aggregate, that can reasonably be expected to adversely influence the economic decisions of users taken on the basis of the financial statements. Since the IASB states the purpose of financial statements is to enable users of them to make appropriate economic decisions this is a serious failure on its part.

As such it is argued that the IASB must revise its perception of materiality and include that information that all likely users of financial statements might require in financial statements produced under IFRS.

3. Materiality must be set at the country level

The IASB has failed to appreciate that materiality in the context of reporting payments to government must be set at the country level, and not at a discretionary level set by the reporting entity. As this report notes, the GDP of many states involved in the extractive industries (EI) is vastly smaller than the profit (let alone the turnover) of some EI companies.

As such payments to almost all states would be excluded from disclosure if materiality was established at the entity level. When reporting to government is the subject of disclosure then that reporting must be for each and every country to which payments are due, without exception, or misleading and incomplete information will be supplied by the resulting financial statements. Mandatory complete disclosure must therefore be required for this purpose.

4. IASB must not create perverse incentive to avoid tax

The IASB also ignores a perverse incentive created by their suggestion that materiality for disclosure be set at the entity level. If this is the case the reporting entity that is abusing tax law to minimise payments to a government, even if legally, will avoid its obligation to disclose the resulting non-payment even though this gives rise to legal and regulatory risk with regard to non-compliance. In this circumstance the IASB themselves not that even the suppliers of capital acknowledge that a quantitative standard for materiality is inappropriate. Despite this recognition a quantitative measure is endorsed by the IASB.

Materiality should instead be set at the country level which would require that if activity occurs in a jurisdictions disclosure will be required without exception.

5. Disclosure must never be at the option of the reporting entity

The IASB has recognised in its paper that there are unlikely to be legal constraints on a reporting entity making disclosure of the information requested by PWYP within its financial statements is required to do so by IFRS even if a contract confidentiality clauses say otherwise. It has also recognised the validity of PWYP's argument that it is only by making that disclosure mandatory that this situation can exist.

Despite this the IASB has suggested that any reporting entity can decide not to disclose any information required by any new version of IFRS 6 so long as it makes a statement as to why it thinks it is not in its interest to do make that disclosure. The consequence is that whilst the IASB says it supports mandatory disclosure of some information that PWYP has requested it has, in practice, ensured that all disclosure is, in effect, voluntary and therefore unlikely to take place.

Mandatory disclosure must, therefore, be required, without exception or particular power will be given to those very jurisdictions where abuse is most likely to put pressure on reporting entities working in these places to make sure disclosure does not take place. This would be wholly unacceptable.

6. The IASB cost / benefit analysis must take into account the benefits PWYP envisages will arise for civil society from disclosure taking place

The IASB has said that a cost / benefit analysis must be undertaken to determine whether the information disclosure PWYP has requested is really necessary. However in so doing it has specifically excluded from consideration the benefit that any of the users PWYP represents might obtain from that information being available.

As such any benefit that might arise from disclosure of the requested information in ensuring tax and other revenues are properly declared when they arise and are properly accounted for in the country where they are paid and additionally in eliminating the culture of corruption with which the extractive industries are associated cannot be taken into account when undertaking the resulting cost / benefit analysis since the IASB suggests that these are not benefits accruing to the providers of capital from the disclosure of this information in financial statements.

In saying this the IASB does appear by implication to suggest that curtailing of abuse within the EI is not, in its view, in the public interest. This is an unusual position for it to take since it is contrary to all normal perception of the public interest with regard to these issues and suggests it has made a profound error of judgement in making this suggestion. As a consequence it must take these benefits into account when undertaking any cost / benefit analysis.

7. The IASB must insist on disclosure to prove that the necessary information is available in the reporting entity

The IASB has made an equally significant error of judgement in accepting the argument of some reporting entities that the information required to make the disclosures requested by PWYP is not available and would be costly to produce.

The reality is that all the information, except perhaps that on reserve quantities and valuation – which the IASB accept should be disclosed on a country-by-country basis – must be available within the general ledger of each and every member of a group controlled by a reporting entity subject to International Financial Reporting Standards if that reporting entity is to comply with the legal requirements imposed by almost every country in which major corporations are incorporated.

An example form the UK has been used in the report and this shows that a reporting entity must be able to disclose with reasonable accuracy, at any time, the financial position of the company at that time, and that the accounting records of the entity (and by definition, all its subsidiaries) must contain entries from day to day of all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place, and a record of the assets and liabilities of the company.

If this is the case then for an entity to argue that the data PWYP requests is not available suggests that they are not meeting the requirements imposed on them by law. This should not be an excuse for non-disclosure but should instead be an issue of profound concern to the IASB and should reinforce the demand that disclosure be made on a country-by-country basis precisely because of the risk inherent in these transactions if this difficulty exists.

As such it is recommended that the IASB dismiss this argument for non-disclosure.

8. The IASB must insist on disclosure of the data PWYP has requested to ensure that it is audited

The IASB is equally at fault in suggesting that an argument for non-disclosure might be the cost of auditing the transactions that are of concern to PWYP. In saying so it makes it very clear that it believes the transactions in question are almost certainly not audited now. This is despite the fact that investors have told the IASB that they are concerned about the risk that these transactions impose on a reporting entity and that they believe that this risk cannot be assessed quantitatively when it comes to materiality.

However, despite this risk and the obvious governance failure arising from these transaction's unaudited status, the IASB appears willing to offer this as justification for non-disclosure of data. As a result information on these high risk transactions is not available to the users of financial statements. This means that those users cannot assess the risks they face and their economic decision making will be impaired as a result whilst that risk – which is at the heart of the PWYP request – remains unaddressed.

This means that the IASB effectively condones that risk being transferred from the reporting entity, which is or should be aware of it, to investors and others who are unaware of its scale. By implication this means that the IASB condones a significant asymmetry in information supply within the IASB accounting framework which prejudices all users of the financial statements whilst benefiting reporting entity and those who abuse the funds those reporting entities pay to governments in the states that host their EI activities.

It is very difficult to reconcile this condoning of asymmetry of risk with the duty the IASB has accepted to ensure financial statements are prepared in the public interest. As such change is essential in this area, and disclosure and auditing is required precisely because containing this risk is worth the cost of the audit fee, as any cost /benefit analysis that was allowed to take those benefits into consideration would show. The IASB further condones the abuse that is taking place by refusing to allow these factors to be included in their proposed cost / benefit analysis.

The entire IASB approach to this issue must be changed as a result.

9. The IASB must provide all the data PWYP has requested – not some of it

The IASB has elected to consider each information request that the IASB has made as if they were entirely independent variables. This is completely illogical. They are not.

The information requested is, as this report shows, the minimum accounting data that can be supplied to provide a coherent perspective of the activity of an EI reporting entity in each of the countries in which it operates. So, for example, the request for information on production revenues is made to ensure that payments of royalties can be validated by comparison of one with the other; a consistent ratio between revenues and royalties being expected over time on the basis of most mineral extraction agreements.

Despite this the IASB recommends disclosure of benefit streams on a country-by-country basis (subject to all the caveats noted above, meaning that in the vast majority of cases data will not be disclosed) and yet suggests production revenues should specifically not be disclosed on this basis, so denying any opportunity for meaningful comparison of the two. As a result, despite the fact that the IASB is tasked with producing "high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements" they are not doing so.

The data that the IASB is recommending be supplied is not coherent, is not comparable and will not be of high standard as a result. Indeed, despite the fact that the IASB suggest that the criteria for assessment of the PWYP request is to assess whether or not they can be considered a part of a complete set of financial statements they appear to have deliberately compromised objective assessment using this criteria by recommending the supply of incomplete information. This makes no accounting sense.

10. The IASB must fulfil its special obligation to emerging economies

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

Despite this no consideration whatsoever of the needs of these economies has been shown in the recommendations made in the IASB report although the PWYP proposals are specifically intended to enhance the revenues of those countries, reduce the risk of corruption within them and promote good governance in developing countries. The IASB has as a consequence failed in its public duty in this regard by completely neglecting its particular, and overtly expressed duty to these countries.

Conclusions

In combination these observations suggest three things.

The first is that the IASB has ignored its duty to act in the public interest.

The second is that it has failed in its duty to act in the particular interest of emerging economies.

The third is that it has explicitly and openly evidenced that it will act in the interest of reporting entities when deciding what shall, or shall not, be included in International Financial Reporting Standards even when that disguises potential legal and governance failures in those reporting entities as a consequence of their apparently confessed failure to maintain the books and records required by law and even when that compromises, through the supply of overtly asymmetrical information, the best interests of the user group for whom the IASB considers financial statements are prepared i.e. the providers of capital.

In that case it may not be surprising that the IASB’s response to PWYP’s reasonable and limited request for essential information to ensure civil society and others can monitor the flow of revenues to governments in developing countries has been so incomplete, illogical and flawed both in logic and accounting coherence.

Recommendations

As a consequence urgent action is required of the IASB to remedy these defects in its review process. The key recommendations made based upon the observations made above and in the attached report are:

1. That the IASB should accept that the user groups for financial statements identified by Publish What You Pay and others have valid, appropriate and distinct information needs different from those of capital providers, and that it is the duty of the IASB to ensure that those needs are met;

2. The emerging economies and developing countries, those who live in them and those who lobby on their behalf, have particular information needs and that the IASB has a particular duty to respond to those needs;

3. That as a result of the above two recommendations the IASB change the terms of reference for its study of PWYP's requests, and if necessary its Framework for Financial Reporting to ensure that the needs for accounting information of civil society, developing countries and other user groups are embraced within International Financial Reporting Standards so that the IASB might properly fulfil its public duty obligations;

4. That the IASB should recognise that their failure to respond appropriately to the PWYP requests will result in material misstatements, including omissions, individually or in the aggregate in the resulting financial statements of reporting entity in the extractive industries that can reasonably be expected to adversely influence the economic decisions of users taken on the basis of those financial statements and as such those requests should be embraced in full by the IASB;

5. That the IASB recognise that the PWYP requests are for integrated financial data that is coherent and complete accounting information and that they must be considered as such as a whole and not in parts;

6. That the basis for the proposed cost benefit exercise for the introduction of country-by-country reporting as requested by PWYP should be revised so that the benefits that PWYP envisages arising from the adoption of their proposal can be included in the assessment process;

7. That the IASB recognise that the application of an entity based concept of materiality with regard to the proposed country-by-country disclosures would firstly mean that most would not be disclosed and secondly would mean that the disclosure made would be entirely at the option of the reporting entity, so entirely undermining the mandatory basis of disclosure that PWYP seeks if the governments of all jurisdictions engaged in the extractive industries, however large or small, are to be held to account for the revenues they receive from this activity. As such a change to the normal entity based concept of materiality is required in this case in favour of materiality assessed at the country level so that if activity takes place in a jurisdiction it must, mandatorily, be disclosed. This is necessary firstly in the public interest and secondly in the interests of emerging economies and as such is entirely within the mandate of the IASB to grant.

8. That the IASB require disclosure of data without exception, even when a company thinks it is prejudicial to its best interests to do so; when a confidentiality agreement says disclosure is

not allowed and when the government of a host state indicates that it would not welcome such disclosure. These circumstances will, almost without exception be the occasions when disclosure is most required. As a result no exceptions can be allowed to the principle of mandatory disclosure since any such exception would create asymmetry in information supply, create an unfair competitive advantage for those refusing to disclose and would leave those governments where corruption is most likely to be found in a situation of holding significant power in seeking to suppress data that might disclose that fact. As such any exceptions from disclosure are against the public interest and contrary to the best interests of emerging countries and must not be allowed.

9. The IASB should require disclosure of the information requested by PWYP to ensure that the legal, regulatory and accounting risks inherent in it, as highlighted by the IASB report, must be the subject of particular and focussed audit scrutiny to mitigate risk in this area.

Only if these recommendations are adopted can we be sure that complete, coherent, audited financial statements for reporting entities working in the extractive industries will be produced and as such they should be adopted, in full, and before IFRS 6 is issued as an exposure draft for further public consultation.

1. Background

The International Accounting Standards Board (IASB) published a Discussion Paper on the Extractive Industries (EI) in April 2010[1]. As the IASB said of the paper[2]:

> *A research team comprising members of the Australian, Canadian, Norwegian and South African accounting standard-setters analysed and discussed accounting for extractive activities with a wide range of stakeholders in order to identify a possible approach for a standard on the accounting for extractive activities. The discussion paper only contains the views of the project team – it does not represent the views of the Board. After considering the responses received on the discussion paper, the Board will decide whether to add the project to its active agenda.*

They also said:

> *[T]he International Accounting Standards Board (IASB) publishe[s] for public comment the results of an international research project on a possible future International Financial Reporting Standard (IFRS) for extractive activities in the form of a discussion paper – Extractive Activities.*

Whilst the paper the IASB has published is termed a discussion paper this is the normal first stage in the creation of a new International Financial Reporting Standard. As a result the document is of considerable significance in determining the likely content of any eventual IFRS for the EI. The importance attached to the work is reflected in the paper's six year gestation period.

2. Purpose of this paper

The IASB paper is important for the following reasons:

1. It relates to the EI, an activity of great significance in many developing countries;
2. Previous dialogue between the IASB and civil society organisations (CSOs) has resulted in the IASB paper devoting a chapter to consideration of the arguments submitted to it by the Publish What You Pay coalition (PWYP) and others. Those submissions call for country-by-country reporting (CBC)[3] within the EI;

[1] http://www.iasb.org/NR/rdonlyres/735F0CFC-2F50-43D3-B5A1-0D62EB5DDB99/0/DPExtractiveActivitiesApr10.pdf

[2] http://www.iasb.org/Current+Projects/IASB+Projects/Extractive+Activities/Discussion+Paper/Discussion+Paper+and+Comment+Letters.htm

[3] A definition of country-by-country reporting is attached as appendix 1 to this report. An explanation of the specific requests made with regard to the EI is attached as Appendix 2 to this report.

3. CBC for the EI is now explicitly supported by the European Commission[4] and European Parliament[5], has widespread support amongst CSOs and has received the backing of a number of governments, including those of the UK and France. It is currently under consideration by the OECD[6];
4. CBC for the EI would directly support existing initiatives tackling fraud, corruption and illicit financial flows resulting from EI activity, including the operation of the Extractive Industries Transparency Initiative.

This paper reviews the IASB paper in the context of the requests from CSOs for revenue transparency and accountability on a country-by-country basis. Where the matters discussed by the IASB paper do not relate to these issues they are not considered here.

In so doing this paper has the following objectives:

a. To report what the IASB recommends;
b. To summarise the arguments for country-by-country reporting;
c. To consider the arguments the IASB makes in response to those arguments;
d. To suggest possible responses to the questions posed by the IASB as the basis for consultation on this issue.

3. The IASB's recommendations

The IASB does, of course, make many recommendations in its paper with regard to accounting for the EI which are not considered here.

The following recommendations are considered key to the discussion that follows, each being referenced by the paragraph number in which it occurs, and not by page number.

The main body of recommendations by the IASB research team are as follows (Q8, Q9) :

That the disclosure objectives for extractive activities are to enable users of financial reports to evaluate:

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

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

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

4 http://ec.europa.eu/development/icenter/repository/COMM_COM_2010_0163_TAX_DEVELOPMENT_EN.PDF

5 http://www.taxresearch.org.uk/Blog/2009/11/02/eu-parliament-supports-country-by-country-reporting/

6 http://www.oecd.org/dataoecd/7/36/44493096.pdf

That the types of information that should be disclosed include:

(1) quantities of proved reserves and proved plus probable reserves, with the disclosure of reserve quantities presented separately by commodity and by material geographical areas;

(2) the main assumptions used in estimating reserves quantities, and a sensitivity analysis;

(3) a reconciliation of changes in the estimate of reserves quantities from year to year;

(4) a current value measurement that corresponds to reserves quantities disclosed with a reconciliation of changes in the current value measurement from year to year;

(5) separate identification of production revenues by commodity; and

(6) separate identification of the exploration, development and production cash f lows for the current period and as a time series over a defined period (such as five years).

4. The IASB's response to Publish What You Pay's proposals

The IASB considered PWYP's proposals as a separate chapter in their paper, after making their own recommendations, as if they were an afterthought. The IASB paper suggests there are six such proposals (see Appendix 2) and comments on them as follows:

1. Benefit streams:

The IASB has said of PWYP's demand hat payments to governments be disclosed (6.28):

> *Disclosing payments made to governments may provide users with additional information on an entity's taxation and royalty obligations. Respondents to the user survey indicated that understanding an entity's taxation and royalty obligations is particularly important in the extractive industries because of the generally higher tax or royalty rates relative to other activities and, in many cases, the complexity of the taxation or royalty regime. Most of the respondents indicated that disclosing the effect of taxation and royalty obligations is an area where financial reporting could make improvements.*

They add (6.30):

> *The project team expects that, if payments to governments were disclosed in financial reports, this information could be used by users to help validate their modelling of taxation and royalty regimes and to make better comparisons across entities.*

It therefore broadly endorses this disclosure, but adds (6.37):

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.

2. Reserves:

The IASB says (6.36 and 6.39):

PWYP is proposing the country-by-country disclosure of reserve quantities and reserve valuation (if required by the IFRS). As outlined in Chapter 5, the project team proposes the disclosure of minerals or oil and gas proved and probable reserve quantities. These reserve quantities should generally be separately disclosed at an individual country level because most of the non-geological risks associated with reserves are country-specific.

As such the IASB appears to have endorsed this aspect of the PWYP demand at this point. This impression is, however, inaccurate, as paragraph 6.42, discussed below, contradicts this impression.

However, despite this agreement the IASB does not agree that reserve valuation data need be disclosed at a country-by-country level. They reject disclosure at the entity level i.e. without any geographical differentiation on where those reserves might be, but then suggest regional data would be sufficient for this disclosure. Their reasoning is that (6.40):

Many users acknowledged that, in principle, the valuation should be disclosed at the same level of detail as reserve quantities, but said that the costs of preparing and presenting this valuation at this level of detail might exceed the benefits they would derive from this information. Users accepted that disclosing this information by major geographical region might be sufficient for their needs.

As the IASB says (6.40):

However, this disclosure would not be sufficiently detailed to be useful to PWYP.

This is true.

3. Production volumes:

The IASB says (6.41 and 6.42):

PWYP is proposing the country-by-country disclosure of production quantities for the current reporting period. Additional disclosure by key products and key properties is encouraged.

In Chapter 5, the project team proposes that current period production quantities should be disclosed as part of a reconciliation of changes between the opening and closing *estimates of reserve quantities. The reconciliation is to be disclosed at the same level of detail as the disclosure of reserve quantities and would identify the produced quantities by commodity. Reserves quantities, and therefore production quantities, would be shown by country (or property) where that is material to the entity. Consequently, the project team's proposals would not include separate disclosure of production quantities by country where those reserves were not material to the entity.*

It is immediately apparent that paragraph 6.42 is contradictory to paragraph 6.39. The latter says production volumes should be disclosed on a country-by-country basis since "*non-geological risks associated with reserves are country-specific"* and yet paragraph 6.42 contradicts this, suggesting that this need only happen where the reserves are material to the entity.

The consequence is that in practice the IASB is not agreeing to the PWYP requests on reserves and production quantities since they have offered reason for any company to exclude disclosure at its own discretion.

4. Production revenues:

The IASB say (6.43):

The project team does not propose that production revenues should be disclosed on a country-by-country basis.

It is readily apparent as a consequence that the PWYP demand has been rejected. The reasons given are (6.43 and 6.44):

As noted in Chapter 5, production revenue information is usually more relevant to capital providers if it is separately presented by commodity rather than by country. This is because production revenue is typically affected by commodity market factors that are generally international in nature. For this reason, the project team proposes that production revenue should be disclosed by commodity. Usually, disclosure of production revenue by country is useful to capital providers only when the commodity price is influenced by domestic factors (eg domestic gas sales). The project team therefore considers that the incremental benefit to capital providers of requiring the disclosure of production revenues by country would be small if information on production quantities is disclosed by country.

An entity's segment disclosures may provide some further detail on production revenues by possibly separately identifying sales to external customers from inter-entity transfers of the produced commodity to the entity's downstream operations. However, these disclosures are likely to be presented by commodity or business group rather than by country.

There is discussion of these objections later in this report.

5. Costs:

The IASB say (6.45):

> *The project team proposes that the exploration, development and production costs incurred over a period of, say, five years should be disclosed to provide users with a time series of these cash outflows. This cost information would be disclosed at the same level as the reserve quantities information and therefore would not include separate disclosure of costs by country where the reserves were not material to the entity.*

For the reasons noted in section 4 above, this does mean, in effect, that the PWYP demand has been declined.

6. Key subsidiaries and properties:

The IASB say (6.46 and 6.47)

> *The final PWYP proposal is for country-by-country disclosure of the names of key subsidiaries and the locations of key minerals or oil and gas properties. IFRSs already require the disclosure of information about an entity's significant investments in subsidiaries. This requirement is comparable to the PWYP disclosure proposal.*
>
> *The project team's research showed that information about the locations of key minerals or oil and gas properties is typically available in the management commentary section of annual reports or in other information issued by minerals and oil and gas entities, such as project factbooks. In addition, paragraph 138(b) of IAS 1 requires an entity to disclose a description of the nature of its operations and its principal activities, if that information is not disclosed elsewhere in information published with its financial statements. The project team thinks that these existing disclosures are sufficient for communicating the nature of an entity's operations in countries that are material to the entity. These disclosures would not specify the properties or operations that belong to individual subsidiaries within each country, but information at this level of detail has not been identified by capital providers as being necessary to make informed investment decisions. Accordingly, the project team does not propose that information by subsidiary should be required.*

This makes no sense: it assumes that materiality is assessed at the entity level and not at the country level and is noted extensively in this report this means that is most cases data to fulfil PWYP's request will not be disclosed. This means that in practice the PWYP requests have been declined, again.

5. Summary of IASB response to PWYP requests

Proposal number	Proposal	IASB accept or reject
1	The significant components of the total benefit streams to government and its agencies should be disclosed on a country-by-country basis.	Accepted, but with an opt out clause available for companies that do not wish to disclose meaning that any disclosure made will, in effect, be entirely voluntary in most cases.
2	Reserves volumes and valuation measures should be disclosed on a country-by-country basis.	Volume by country recommended if considered material by the reporting entity but revenue by country not recommended.
3	Production volumes for the current reporting period should be disclosed on a country-by-country basis.	Recommended but only if the reporting entity decides that the disclosure is material.
4	Revenues from production should be disclosed on a country-by-country basis, with separate disclosure of sales to external customers and intra-group transfers.	Rejected by the IASB.
5	Production and development costs should be disclosed on a country-by-country basis.	Recommended but only if the reporting entity decides that the disclosure is material.
6	The names and locations of each key subsidiary and property in each country should be disclosed.	The IASB says this should already be disclosed if material.

In summary, it might fairly be said that the IASB has not endorsed the PWYP requests and where it has recognised that they have merit have recommended ample opportunity for reporting entities to avoid their obligations to report, which are discussed in more detail below.

6. The basis for the IASB's conclusions on PWYP's requests

The IASB has rejected PWYP's requests using, broadly speaking, one of four arguments. In summary these are (with an example given in each case):

1. That the requests do not meet the needs of the IASB defined users of accounts (6.11);
2. That the information supplied is not material to reporting entities that prepare accounts (6.10);
3. That the information demanded should already be supplied to users of accounts (6.47);
4. That the material may be too costly to supply to users of accounts for the benefit they may obtain from supply of that information (6.31).

Other issues are touched upon by the IASB, but these are the main objections they raise to supplying the data that PWYP requests of financial statements for EI corporations. Each is important and will be considered in the sections that follow.

7. Are PWYP's requests for useful data that a set of financial statements can supply?

The IASB says in its paper that (6.11):

> *In Chapter 1 the project team proposed that, for the purposes of this discussion paper, financial reporting should be regarded as including information that:*
>
> *(a) helps users of financial reports to make decisions;*
>
> *(b) can reasonably be viewed as being within the scope of a complete set of financial statements; and*
>
> *(c) meets a cost-benefit test.*

The IASB, however, notes (6.10):

> *the* Framework *indicates that financial reporting is primarily directed to meet the needs of existing and potential equity investors, lenders and other creditors (ie capital providers).* Information that is useful to capital providers for making decisions may also be useful to other users of financial reporting. These other users include suppliers, customers and employees (when not acting as capital providers), as well as governments and their agencies and members of the public.*

The Framework in question is the "Framework for the Preparation and Presentation of Financial Statements"[7], originally published in 1989 and updated when adopted by the International Accounting Standards Board in 2001. That Framework says:

> *The principal classes of users of financial statements are present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the general public. All of these categories of users rely on financial statements to help them in decision making. [F.9]*
>
> *The Framework concludes that because investors are providers of risk capital to the entity, financial statements that meet their needs will also meet most of the general financial information needs of other users. [F.10] Common to all of these user groups is their interest in the ability of an entity to generate cash and cash equivalents and of the timing and certainty of those future cash flows.*

[7] http://www.iasplus.com/standard/framewk.htm

In the opinion of the IASB, in other words, information that meets the needs of investors meets the needs of all other users of financial statements.

Although not yet adopted, this opinion is confirmed in the revised conceptual framework which was subject to an IASB discussion paper in 2008 in which the IASB defined *present and potential capital providers as the primary user group for general purpose financial reporting*.

This is despite the fact that the IASB notes in the paper now under discussion that (6.9):

> *The information provided by the PWYP proposals would be mainly used by:*
>
> *(a) citizens of resource-rich developing countries and non-governmental organisations, primarily to hold the governments of those countries accountable for the management of natural resource revenues; and*
>
> *(b) capital providers, to the extent that the information is useful for assessing an entity's exposure to country risk and reputational risk.*

In other words, the IASB explicitly recognises that there is in the case of the extractive industries a user group who have information needs that may be distinct and separate from those of the providers of capital but goes on to say that:

> *However, financial reporting is not directed to meeting the specialised needs of those other users. For this reason, the PWYP proposals have been assessed only from the perspective of whether capital providers would find the information useful. In this context, information may be regarded as useful if it is used to assess the future cash flows, including the riskiness of those cash flows.*

As a matter of fact the IASB note (6..12 – 6.25) that much of the information PWYP demand would also be useful to those users of financial statements who are providers of capital but, as will be noted below, to restrict the cost benefit analysis that might determine whether disclosure takes place to this category of users alone is a fundamental error on the part of the IASB. This is because whilst the IASB does recognise the existence of the users of financial statements whose needs PWYP information requests are designed to serve, the IASB say that the data required to assess future cash flows and their riskiness is sufficient and appropriate for their purposes.

This is quite obviously not true. The information needed to ensure that a government can be held to account for the natural resource revenues flowing to it requires three things:

1. That the revenue flows to the government in question be known;
2. That the underlying data to ensure that those revenue flows are fairly stated is known so that the truth and fairness of the reported revenue flows can be appraised. This therefore requires country specific statements on:

a. Revenues generated, since these are the base determinant for assessing royalty flows;
b. Opening and closing reserves, and production quantities since these in combination allow appraisal of i) goods sold if an estimate of sale value is available and ii) resources apparently wasted, which could alternatively give rise to unaccounted for revenues;
c. Reserve values, so that profit movements resulting from reserve revaluations can be differentiated from those arising from trading;
d. Production and development costs, since revenue arising less that due to stock revaluation less production and development costs is likely to give an indication of profit, which is essential if a base for assessment of the likely truth and fairness of taxes on corporate profits is to be available;

3. That the entities making these payments be identifiable with certainty so that the receipts from the corporation making declaration can be unambiguously identified in the records of the government being held to account.

Comparative data is also, of course required of other jurisdictions so that comparisons can be noted and trends spotted.

Note that this data can (to quote the IASB, as noted above, 6.9) *reasonably be viewed as being within the scope of a complete set of financial statements.* Indeed the data requested is intended to have a complete accounting logic inherent within it, without demanding more information that that required for assessing likely revenue streams from EI companies to the governments of the territories in which they operate.

This is apparent from the following table which indicates the data the information requested by PWYP would supply, matched to the accounting data needed to ensure that it can be properly appraised as to its likely truth and fairness:

Revenue stream on which data demanded	**Information needed to assess relevance of reporting**
Royalties and taxes paid in cash	• Sales revenues
Royalties and taxes paid in kind (measured in cash equivalents)	• Sales revenues, and • Gross profit as the determinant of “profit oil” and related concepts – which can be assumed to be sales revenues less productions costs • Reserves volume and value data to ensure production and cash production costs are fairly stated
Dividends	• Profits, assumed for this purpose to be sales less production and development costs, form the potential basis for these
Bonuses	• Accounting data cannot support this revenue flow

Licence and concession fees	• Accounting data cannot support this revenue flow

The following additional flows could be appraised with full country-by-country reporting data (per appendix 1):

Sales taxes	• Revenue
Payroll taxes	• Labour costs
Taxes on profits	• Profit

The point made is that the accounting data requested by PWYP is the minimum needed to appraise with some reliability most of the EI tax flows that a company in that sector will pay. If their total flows to governments were to be appraised full country-by-country reporting would add significantly to the available data to provide assurance that the reported data was credible when assessed against available comparative information.

It is also important to note in this context that the PWYP requests are designed to be part of a complete set of financial statements. The information requested is not considered (bonuses, licence and concession fees apart) to be simple disclosure information. The information requested is considered to be financial disclosure made upon performance providing data on economic activity, governance and corporate compliance with statutory and contractual obligations in a form that only integrated financial data can supply. The credibility of that data is in turn assessed by relating it to information requested on the underlying economic drivers of activity that give rise to it, as noted in the table above.

In that case the package presented is not one that contains a series of options, it is an integrated whole, and at that the smallest integrated set of data that can be disclosed to ensure accounting credibility exists. To view it otherwise is to misunderstand it. This is accounting information, not disclosure data, and to report accounting information without supplying the data needed to assess its credibility makes no sense at all, undermines the value of the information supplied and so unfavourably distorts any cost benefit analysis on the value of that data. This point is critical: users of data need to make decisions based upon the data supplied to them. Without having sufficient information to assess the credibility of the data supplied the range of decisions that a user might make based on the data is restricted, and its value with it. This is the last thing PWYP wants: it should be the last thing the IASB wants.

The IASB appear to have ignored this point in considering each PWYP demand separately. They cannot be treated in that way. They are a request for a complete set of financial statements on the issues of concern. They have to be considered as such. When they are, and taking into consideration the opinion noted by the PWYP, it is argued that in response to the noted criteria laid down by the IASB the information requested:

(a) helps users of financial reports to make decisions;

(b) can reasonably be viewed as being within the scope of a complete set of financial statements; and

Cost / benefit issues will be noted later in this report. It is next important to consider whether the requested data is that which it is reasonable to think the IASB should ensure is available to users of financial statements.

8. Are capital providers the only users of financial statements?

As long ago as 1975 the UK's Accounting Standards Steering Committee, a body that can be seen as a precursor of the current International Accounting Standards Board published a seminal document entitled the Corporate Report[8]. That report said that published accounts should enable a user to appraise information on:

1. The performance of the entity;

2. Its effectiveness in achieving stated objectives;

3. Evaluating management performance, including on employment, investment and profit distribution;

4. The company's directors;

5. The economic stability of the entity;

6. The liquidity of the entity;

7. Assessing the capacity of the entity to make future reallocations of its resources for either economic or social purposes or both;

8. Estimating the future prospects of the entity;

9. Assessing the performance of individual companies within a group;

10. Evaluating the economic function and performance of the entity in relation to society and the national interest, and the social costs and benefits attributable to the entity;

11. The compliance of the entity with taxation regulations, company law, contractual and other legal obligations and requirements (particularly when independently identified);

12. The entity's business and products;

[8] http://www.ion.icaew.com/ClientFiles/6f45ef7e-1eff-41ff-909e-24eeb6e9ed15//The%20Corporate%20Report2.pdf

13. Comparative performance of the entity;

14. The value of the user's own or other user's present or prospective interests in or claims on the entity;

15. Ascertaining the ownership and control of the entity.

It can, quite reasonably be argued that very little has changed since 1975 in this regard.

Those with interest in financial statements have almost certainly not changed much since either. The Corporate Report identified these as:

- The equity investor group (shareholders)
- The loan creditor group (banks and bondholders)
- The analyst-adviser group who advise the above groups
- Employees
- The business contact group
- The government
- The public.

It is curious to note that UNCTAD in their 2008 report entitled "Guidance on Corporate Responsibility Indicators in Annual Reports"[9] said that in their opinion financial statements might be used by:

- Investors and financial institutions;
- Business partners;
- Consumers;
- Employees;
- Surrounding community;
- Civil society organizations; and
- Governments and their institutions.

The groups are defined slightly differently in each case, but the overlap is almost identical and only differs in emphasis. It seems there is widespread agreement on this issue.

As, indeed, there appears to be on the part of the International Accounting Standards Committee Foundation (IASCF[10]) which is the trustee oversight body for the International Accounting Standards Board. According to the IASC Foundation constitution its objectives are*:*

[9] http://www.unctad.org/en/docs/iteteb20076_en.pdf accessed 15-8-08

[10] http://www.iasb.org/The+organisation/IASCF+and+IASB.htm

> (a) to develop, ***in the public interest*, a *single*** set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets ***and other users make economic decisions***;
> (b) to promote the use and rigorous application of those standards;
> (c) in fulfilling the objectives associated with (a) and (b), ***to take account of, as appropriate, the special needs of ….emerging economies***; and
> (d) …."

Abbreviation has taken placed and emphasis added but we note that:

1. The IASB is required to act in the public interest, not in the interest of capital markets alone;
2. The needs of other users are not considered supplementary to, or subordinate to the needs of the world's capital markets. The phraseology used by the IASC Foundation is specific. The single set of financial statements that the IASB must promote must meet the needs of the world's capital markets **and** the needs of other users who make economic decisions based on corporate accounting data.
3. The special needs of developing and emerging economies (which by definition will be country based) must be a particular concern when setting IFRS.

In the circumstances the IASB's claim that the data needs of the providers of capital to companies are paramount when assessing the benefits of information supplied in financial statements is wrong. The benefits other users derive must be considered as well, and in capacities other than as providers of capital. In addition, the IASB is also wrong to say it need only determine whether to include data on the basis of its usefulness to the providers of capital is also wrong. The single set of accounts it must promote must, according to its own constitution, meet the information needs of all who make economic decisions based on the activities of corporations, and supply them with the "high quality, transparent and comparable information" they need to do so.

Those who might demand that information are, to combine the list of stakeholders noted by The Corporate Report and UNCTAD:

- Employees;
- The business contact group;
- Consumers;
- Civil society organizations;
- Governments and their institutions;
- The public.

The PWYP demand is made in the interests of, and with the widespread backing of these groups, as might reasonably be interpreted from the widespread adoption of the Extractive Industries Transparency Initiative by many governments around the world with the backing of organisations such as the World Bank with the active participation of many civil society groups in a wide range of countries.

In that case the IASB is wrong to state, as it does (6.10):

> *For this reason, the PWYP proposals have been assessed only from the perspective of whether capital providers would find the information useful.*

They are also wrong to even hint as they do (6.12) that the information PWYP requests might be properly included in corporate social responsibility reports. These are additional to financial statements and the duty of the IASB is to provide a single statement that meets to need of economic decision makes, not two. This discussion is, therefore, beyond the parameters of their remit and inappropriate within the context of the current debate.

This conclusion is referred to again when cost / benefit analysis are considered, below as well as in the immediately following section of this report.

9. Materiality

As noted in section six of this report, above, those limited endorsements that the IASB has given to PWYP's requests have in most cases been caveated by comment that the data need only be supplied by the reporting entity in their financial statements when, in the opinion of that reporting entity, it is material to do so.

Materiality is an important concept in accounting. Since materiality is a concept of greatest relevance to auditing it is not defined by the IASB but by the International Auditing and Assurance Standards Board[11] – the IAASB – which is independent of the IASB but which operates under similar influence from the Big Firms of accountants, for example.

The IAASB says in its standard 320 on materiality[12] that:

> *The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.*

It adds:

> *• Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;*
>
> *• Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and*

[11] http://www.ifac.org/iaasb/

[12] http://web.ifac.org/download/a018-2010-iaasb-handbook-isa-320.pdf

> • *Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.*

Auditors have the duty to ensure no material item required to be reported in a set of financial statements are omitted from it. However, in this regard it is essential to note what IAASB standard ISA 200 on the Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing says about the duty of auditors, which it says are[13]:

> *To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling* ***the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework***

Emphasis is added to the second half of the statement because it is central to discussion in the context of country-by-country reporting: it makes clear that the auditor does not form their opinion on the truth and fairness of the financial statements, although that is what is commonly perceived to be the case. Instead they determine the truth and fairness of those financial statements in the context of the particular standards with which it is claimed they comply.

This difference in emphasis is very important. For example, if International Financial Reporting Standards require disclosure of a particular piece of information and the activity to which that disclosure standard applies is undertaken in the reporting financial entity then its omission is material, and its exclusion would be an error from the auditor's point of view. However, if IFRS did not require reporting of that data then its omission may well not be an error even if the activity takes place. In that case the financial statements might be considered true and fair without the data being disclosed.

For this reason the concept of materiality is multi- layered. First there is a decision required as to whether information disclosure is required by the financial reporting framework. Secondly, the decision has to then be made as to how to define materiality with regard to that disclosure i.e. is it mandatory or not. Thirdly, if disclosure is not mandatory but only required when material then criteria have to be set for determining what materiality means in this context. It is this last point which is referred to, incompletely, in the IASB discussion paper, as summarised in section 6, above. That paper does not, however, properly address the other two issues. All three are considered here within the context of the IASC Foundation statement of objectives noted in the preceding section of this report and the IAASB statements noted above.

[13] http://web.ifac.org/download/a008-2010-iaasb-handbook-isa-200.pdf

10.Materiality with regard to inclusion in IFRS

As the IAASB statement 320 noted above says:

> *Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.*

However according to the IASB (6.10):

> *the* Framework *indicates that financial reporting is primarily directed to meet the needs of existing and potential equity investors, lenders and other creditors (i.e. capital providers). Information that is useful to capital providers for making decisions may also be useful to other users of financial reporting. These other users include suppliers, customers and employees (when not acting as capital providers), as well as governments and their agencies and members of the public.*

There is an obvious dilemma here: the IAASB clearly think that the particular needs of individual users of accounts can be dismissed. This is probably reasonable. It is highly unlikely that the requests of all users of financial data could be met by any set of financial statements. However, it is not clear that the IAASB in saying so is endorsing the IASB position that there is just one group of users, with all having common information needs. As is noted in section 9, above, respected and authoritative bodies can easily identify seven or more user groups for financial statements. To argue that they all have the same information needs and that existing financial disclosures are relevant or useful to all of them is clearly wrong, as the previous discussion in this paper indicates, and as the requests by PWYP show. As a matter of fact PWYP would not be making their request if the information supplied to capital providers met their needs. It does not.

In consequence this paper first of all argues for explicit recognition that there are different users of financial statements and argues that the differing needs of all these groups have to be considered when creating an International Financial Reporting Standards. It does in addition argue that the IASC Foundation has recognised this in its own constitution. It further argues that the Trustees of that Foundation have a duty to ensure that this mandate is fulfilled.

It is further argued that this obligation has to be fulfilled in two ways. First information must be disclosed to ensure that the needs of these user groups are met. Secondly, the criteria for materiality with regard to disclosure of that information has to be established with regard to the likely use to be made of that information by the user group most likely to use it, and not just with regard to the information needs of the suppliers of capital with whom the IASB only concerns itself at present.

The first of these issues has been dealt with already: section 9 of this paper shows that there are more than seven (at least) easily definable user groups for financial statements.

Secondly, section 8 in particular shows that PWYP's requests are a proper part of the useful data financial statements can supply. The requests made are, therefore for data that financial statements can supply.

In fact they are for something more than that: they are a request for data that can only be supplied by financial statements. This claim needs broader consideration, and is the subject of the remainder of this section of this report.

Note the table in section 8 of this paper: PWYP needs data to ensure that royalties and taxes paid in cash and kind, dividends, licence fees, bonuses and concession fees due by companies are paid to the government with a right to receive them. The recipient of the revenue flows with which PWYP is concerned is always a government. Governments are by definition jurisdiction specific. Only country-by-country data can meet PWYP's needs.

Unfortunately, however, some governments are complicit in the processes of potential abuse of the revenue flows that PWYP wishes to monitor, a fact widely recognised as a cause of considerable suffering in many developing, and by coincidence, natural resource rich countries. For precisely that reason disclosure within the jurisdiction cannot be relied upon to ensure that the reporting entity makes the contributions required of it, or that they are accounted for properly when paid. Those jurisdictions where corruption is most likely ensure that data to monitor such payments is not available locally. That is why group financial statements of extractive industry entities are the only place where such disclosure may take place.

Those group financial statements are now, in most cases regulated by International Financial Reporting Standards. IFRS have the force of law in many locations: they do in the places of registration of almost all holding companies operating in the EI. If IFRS do not, their equivalent standards, such as those of FASB in the USA, have that same impact. As such local objection to disclosure can be overruled by a requirement that a parent company make disclosure. No voluntary disclosure arrangement in any other report can have this impact. Only IFRS issued by the IASB can have this impact.

Nor is it conceivable that data on turnover, gross profit, production and development costs, reserves and their valuation, profit, dividends and specific payments, plus in the context of broader country-by-country reporting, labour numbers and costs and detailed tax provisions, could be supplied by any other mechanism on a consistent and country-by-country comparable basis but in financial statements. After all, this is the data that financial statements are designed to supply, and which nothing else is.

Furthermore, financial statements are the basis for calculation of the very payments PWYP wishes to monitor. Royalties are based on sales; sales recorded in the general ledger of companies, the same general ledger that is used to prepare the financial statements. Profit is used as the basis for computing corporate taxes due. The starting point for that calculation is the profit declared in the jurisdiction, nothing more or less. That profit is declared in financial statements.

Financial statements, and the data that goes to make them up, are by definition as a result the basis for computing the data for which PWYP and many others in civil society wish to hold corporations and governments to account to ensure the best outcome for society as a whole – an outcome that is dependent on eliminating bribery, corruption, fraud and tax evasion to the greatest degree possible, all of which takes place on a country specific basis since to exist such abuse has to contravene the law of a jurisdiction.

All of which demonstrates three things. The first is the implausibility of saying that the requested information is not accounting data.

The second is the implausibility of suggesting that this accounting data should be disclosed somewhere other than in accounts.

Third is the implausibility of arguing that the data to be disclosed cannot exist, or does not exist in suitable form for disclosure. It has to exist to ensure that royalties and taxes, dividends, licence fees, bonuses and concession payments are all settled. They cannot be computed and contractual and legal obligations cannot be settled unless the data to compute the liabilities exists. That requires that the data to do so be in the general ledgers of the companies in question. Those general ledgers form the basis for IFRS financial statements. It follows that the required data is available for disclosure.

It is worth noting as a separate point that is the data PWYP request be disclosed is not available the issue is much more important than any consequent problem in reconciling payments made and due to government: failure to hold this information would indicate a fundamental failure to maintain proper books and records by the reporting entity. Without exception countries have a requirement that these books and records be kept. An example of the UK's legislation (section 386, Companies Act 2006) is attached as appendix 3. This, it should be noted, explicitly requires compliance with the regulations of the IASB ("IAS regulation") evidencing the importance of including country-by-country reporting in IFRS. It should also be noted that the company must have "a record of the assets and liabilities of the company." This will, by definition, mean that the records that record the data that PWYP request must exist since the disclosures to be made or of the settlement of liabilities owing, which the company by law must be able to ascertain.

The point is important: not only must the data PWYP request be available in the general accounting ledgers of the reporting entities within the EI that PWYP want to disclose it in their financial statements, this is also the only way it can be disclosed without investing what would, in effect, be a parallel set of accounting standards for this purpose alone. It is a bizarre idea that this would be the necessary consequence of the IASB refusing to consider the PWYP request within the context in which it has been made.

This, however, would appear to be the IASB position despite the fact that the IASB agree (6.11) that their research suggest much of the data demanded might be of use, bar the fact that they preclude the needs of those user groups from consideration in this debate.

In that case this paper contends that in doing so the International Accounting Standards Board is acting in breach of its duty to act in the public interest. Relevant and appropriate information that can be supplied by financial statements that is material data needed by users of financial statements that would alter the decisions they make if it were supplied is being denied to them as a consequence of the decision by the IASB to refuse to recognise their status as users of financial statements in their own right.

It is additionally contended that this recommendation on the part of the International Accounting Standards Board means that in any cost benefit analysis that might be undertaken on the PWYP request any benefits that might flow to PWYP and its supporters (including many governments) from using the data that country-by-country reporting would supply to them is excluded from consideration.

It is therefore important to note for what purpose PWYP has stated they need this data, which the IASB acknowledges (6.1 and 6.2) are:

- *helping citizens of resource-rich developing countries hold their governments accountable for the management of revenues from the minerals and oil and gas industries.*

- *providing information on the scale of the entity's operations within individual countries. Citizens of resource-rich developing countries can compare this information with the amounts an entity has paid to governments of those countries.*

In saying in response (6.9) that "*the PWYP proposals have been assessed only from the perspective of whether capital providers would find the information useful"* and that as a consequence that "*information may be regarded as useful if it is used to assess the future cash flows, including the riskiness of those cash flows"* the IASB does three things.

First it is saying that the financial statements for holding governments (and maybe) corporations to account for the management of natural resources and the funds flowing from their exploitation is not, in their opinion, an appropriate use of financial statements, even though there is very obviously no other source of information for this purpose.

Secondly, it is by implication saying that these issues are ones that are not in the public interest, since they have a duty to ensure financial statements are prepared in that interest, and yet they are declining to do so.

Thirdly, and perhaps most importantly, they are in offering this opinion appearing to say that the public interest with regard to financial statements is the same as that of capital providers. This, very obviously, is wrong. Quite clearly entities preparing IFRS compliant financial statements are often in conflict with government, over taxation and other issues, employees over wages and other issues, the public at large over environmental and other issues, consumers on occasion, and more besides. There are numerous occasions when clearly recognisable groups of users of financial statements have interest in the activity of corporations for which they need information where there is likely to be conflict over the interpretation of the data, and the resulting responsibility of the reporting entity. However, to decide, as the IASB has, that to supply data to one interest group but not another is not in this case indication of acting, as the IASC Foundation constitution requires, in the public interest, but of action in a particular interest – that of the capital provider.

Oddly, in so doing the IASB has also specifically ignored the interest of the owner of capital in the entity. In its most recent review of the IASB framework, undertaken in 2008, the IASB argued that the reporting entity stands independent of the owners, saying[14]:

> *Under the entity perspective (also known as the entity theory) the reporting entity is deemed to have substance of its own, separate from that of its owners. Economic resources provided by capital providers become resources of the entity and cease to be resources of the capital providers. In exchange for the resources provided, capital providers are granted claims on the economic resources of the reporting entity. Claims of different capital providers have different priorities and different rights with respect to the reporting entity, but they all represent claims on the economic resources of the reporting entity. Therefore, financial reporting from the perspective of the entity involves reporting on the economic resources of that entity and the claims on those resources held by its capital providers.*

This makes sense: a modern multinational corporation is a complex entity and there is ample evidence to reject the notion (called 'the proprietary perspective') that says a corporation does not have an existence independent of its proprietors or owners; it clearly does.

But in that case for the IASB to argue, as it does, that only capital providers (a class including proprietors and owners, but also including loan capital providers, and, according to the IASB those owed money by the reporting entity) are real users of financial statements seems prima facie to be wrong. Once the notion that there is a special relationship between proprietors and a corporation is, correctly, dropped and the corporation is, also correctly, seen as a free standing organisation in its own right then its relationship with all those with whom it interacts have to be considered to be representatives of the public interest. No other position is tenable.

Indeed, recognising the claim of all users of financial statements appears to be a prerequisite for the continuing logic of issuing financial statements. At one time the logic for issuing such statements was based on the argument that the corporation had a duty to its owners on whose behalf it held assets in a stewardship function, and that the account the corporation's directors submitted to the owners was indication of how they had fulfilled that stewardship obligation.

The IASB has now said that this obligation to owners is no different to that which the reporting entity has to provide information to any provider of capital, but that is illogical. Many providers of capital that the IASB recognises as having an interest in the financial statements of reporting entities quite clearly have no contractual right to data from it. Others, like the providers of loan capital, can usually secure substantially more, and significantly faster, data than that supplied in the annual

[14] http://www.iasb.org/NR/rdonlyres/464C50D6-00FD-4BE7-A6FF-1BEAD353CD97/0/conceptual_framework_exposure_draft.pdf

financial statements. Only the shareholders as owners have any legal right to have data sent to them by the reporting entity, and even that has now been reduced in scope in many countries.

Despite this the obligation to report remains, and the IASB Foundation recognise that this is in the "public interest", as indeed it is. That, however, only makes sense when a broad understanding of the public interest is accepted.

That interest is inherent in the concept of the "licence to operate" which is familiar to many who engage with the extractive industries. The limited liability corporation has a licence to operate. After all, it has no natural existence and must, therefore, owe its existence to the statute and regulation that facilitates its creation.

This statute and regulation has its foundation in the law of the jurisdiction in which the reporting entity was incorporated. The right to incorporate has been created in the public interest. In exchange for the privileges they grant legislatures impose obligations on at least some of the entities that they permit to exist; obligations in turn imposed in what they perceive to be the public interest. One of those obligations is that multinational corporations report their financial statements in a form that is widely accessible and at low cost for the benefit of any party that wishes to access them. This duty is imposed in the public interest as part of the licence to operate that must have now supplanted the duty originally envisaged to report to the members alone, usually without that information being available to any other party.

In the light of this logic restricting the data available in those financial statements reported in pursuit of the public interest so that data of interest to just one group of users alone is published, as the IASB suggest appropriate, is a fundamental and material error of judgement.

First of all in acting in this way the IASB are acting contrary to the public interest.

Secondly, they are, within the relevant concept of materiality, restricting the information that is needed by users of financial statements who have a right to access financial statements produced by reporting entities in such fashion that (to quote the IAASB) "m*isstatements, including omissions, [that] are considered to be material .... individually or in the aggregate, [occur that] could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.*

For this reason it is argued that the International Accounting Standards Board is explicitly wrong to say that the benefits that the user groups anticipated by PWYP for the data it requests cannot be considered in determining the benefits that might arise from its disclosure when undertaking a cost / benefit analysis on this issue. As is clear, these are not the specialist needs of a minority group. They are instead the generic needs of the widest group of users possible – the public at large; the most comprehensive category of users of all.

In that case it is extraordinary that the benefit of ensuring that companies fulfil their obligations to society and that governments be accountable for the funds entrusted to them be considered by the International Accounting Standards Board objectives which they have no duty to consider and which they deem financial statements unsuitable to assist, when very clearly nothing else but (to quote the IASC Foundation's objectives) "high quality, transparent and comparable information in financial statements" can secure this goal.

It is on consequence argued that the IASB has failed to understand the concept of materiality with regard to establishing an appropriate accounting framework and consequently has to revise its approach to this whole issue of who the users of accounts are to ensure that the public interest is served, as is their duty.

11.Materiality with regard to inclusion in individual financial statements

There is a second issue with regard to materiality on which the IASB needs to revise its approach. Because the International Accounting Standards Board is dedicated to producing financial statements that embrace the entity approach i.e. that the reporting entity is a free-standing organisation independent of all other parties, it has adopted one approach to materiality with regard to reporting within the resulting financial statements. This approach says that materiality is assessed by the corporation itself and only with regard to what it considers users of its financial statements might need to know to make appropriate economic decisions.

This concept of materiality is inappropriate with regard to the disclosures requested by PWYP for a number of reasons.

Firstly, this approach to materiality almost invariably assumes that a small number is not significant. For a number of reasons small numbers may be very significant when it comes to reporting financial flows for extractive industry entities to the governments that host their activities. This may, for example, indicate that tax and other revenue flows are not being paid when it might be expected that they should be. In that situation it is very obviously necessary that disclosure be made or non-payment by corporations will not be indentified and this will have material impact upon the users of financial statements taking an interest in the country in question if they do not know this.

In addition, the sum may be small for the entity but may be extremely material for the country to which payment is made. For example, Shell's turnover in 2009 was $278 billion. According to the IMF this would make it the thirty third biggest country in the world[15]. Major EI countries listed below[16] (the list is not comprehensive) are much smaller. Indeed, as will be noted, most have GDP significantly smaller than Shell's pre-tax profit in 2009 of US$21,020 million.

	$m
United Arab Emirates	229,971
Colombia	228,836
Nigeria	173,428

[15] http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal) accessed 5-5-10

[16] ibid

Kuwait	111,309
Kazakhstan	109,273
Qatar	83,910
Angola	68,755
Iraq	65,838
Oman	53,395
Azerbaijan	43,111
Uzbekistan	32,816
Yemen	25,131
Tanzania	22,318
Cameroon	22,223
Bahrain	20,214
Ghana	15,513
Paraguay	14,668
Honduras	14,268
Zambia	13,000
Senegal	12,738
Equatorial Guinea	12,222
Botswana	11,630
Democratic Republic of the Congo	11,108
Brunei	10,546
Mozambique	9,831
Republic of the Congo	9,532
Namibia	9,459
Mali	8,965
Niger	5,261
Rwanda	5,245
Tajikistan	4,982
Kyrgyzstan	4,570
Guinea	4,394
Mongolia	4,203
Suriname	2,962
Central African Republic	1,986
Liberia	876
The Gambia	736
East Timor	590
São Tomé and Príncipe	191

The significance of this disparity should not be overlooked: an entity frequently assesses materiality in proportion to its profit. Using this criteria any payment made by many of the world's major EI companies to these jurisdictions will be immaterial from their perspective and therefore the vast majority of reporting on a country-by-country reporting basis will fall out of view.

This, of course, completely defeats the objective of the PWYP request. For example, it has been reported that "The Gambia is one of the least transparent about the mining activities going on in the country"[17]. The Gambia, it will be noted, has total GDP of just $736 million. As a result almost any payment to the Gambian government is going to be immaterial; in the accounts of almost any EI company. And yet for the people of the Gambia, and those in that country who would like it to become a member of the Extractive Industries Transparency Initiative, which to date it has not joined, need the information on financial flows from corporations operating in The Gambia to their government to have any chance at all of holding the latter to account for their use. This is never going to happen if materiality is set at the level of the reporting entity with regard to country-by-country reporting in the forthcoming IFRS 6.

As a result it is clearly inappropriate that materiality be set at this level. Unlike a number of other disclosures required in financial statements the mere existence of an operation in the extractive industries in a jurisdiction to which the proposed IFRS 6 might apply should be sufficient requirement for disclosure to be required to be made, irrespective of the amount actually paid. No other criterion makes sense if the user group PWYP have identified are to secure the information they need.

This also happens to be true if the information the suppliers of capital to the reporting entity require is to be made available for their use as well. As the IASB note in their report (6.13):

> *Users told the project team that country-level information helps in assessing the risks that an entity is exposed to from operating in those countries. The PWYP proposals are expected to be useful to capital providers to the extent that they provide information that can be used to make judgements about the entity's exposure to:*
>
> *(a) country-specific investment risks; and*
>
> *(b) reputational risk.*

In this respect these capital providers make exactly the same point that PWYP does.

As the IASB also says:

[17] http://www.thegambiajournal.com/Top-News-and-Analyses/368.html

Most of the PWYP proposals provide information about the scale of an entity's operations within individual countries. This information could be used to assess the effect that country-specific investment risks may have on an entity. Country-specific investment risks may include:

(a) economic risks relating to changes in foreign exchange rates and cost inflation;

(b) political and social risks relating to changes in government, expropriation of assets and civil unrest; and

(c) legal and regulatory risks relating to changes in the taxation or royalty regimes and rates and changes to other legal rights and obligations that may affect the entity.

Although these types of risks are not unique to the extractive industries or to resource-rich developing countries, they are generally viewed as being more prevalent and more pronounced in these industries and countries.

Again the IASB reiterates arguments as easily made by PWYP as by providers of capital.

Despite this the IASB then argues (6.15):

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

This conclusion does not flow from the observations that have preceded, and cannot do so. Every single risk they identify is country specific. Whilst it is true that those that are economic e.g. those relating to foreign exchange rates and inflation, might be capable of assessment for materiality purposes at the corporate level, this is not true of politic al and social risks, risks arising from legal and regulatory abuse, or reputational risks. In each of these cases mere presence is enough to expose a company to these risks which it has a duty to report upon to ensure it is seen to be mitigating that risk to the greatest degree possible. This will, of course, be evidence by tax payment in most cases and yet, as noted above, if the IASB logic were to be applied non-tax payment, which indicates potentially heightened risk, would grant opportunity for non-disclosure.

As such the criteria for corporate level assessment of materiality i.e. that disclosure be made for each and every relevant country without exception, applies equally well to the needs of the providers of capital as it does to the user groups PWYP represents and the IASB reasoning is illogical and unsustainable.

Curiously the IASB make this point themselves (6.24):

Unlike investment risks, an entity's exposure to reputational risks and the associated potential economic loss is not correlated to the scale of the entity's investment in a particular country. This

> *is an important point, particularly for large diversified minerals and oil and gas entities that may have operations in countries that are immaterial in size to the entity. Although immaterial to the entity in quantitative terms, the entity's operations in some of those countries could be material to the entity in qualitative terms (eg material to the entity's reputation) if, for example, the country was economically dependent on the investments made by the entity or if the political, social or environmental conditions in that country could be reasonably viewed as exposing the entity to reputational risks.*

However they added:

> *It will not always be clear whether a country is material to the entity in this way, but ultimately this decision rests with the entity.*

This is obviously illogical and again cannot possibly follow from the statements that precede it. The IASB offers no explanation for this obvious logical error which provides opportunity for any company wishing to hide any of the risks the IASB itself identifies from the users of financial statements at its own discretion. This is obviously wholly unacceptable, creating an asymmetry in information supply that is bound to be prejudicial to all users of the financial statements.

It is, therefore, apparent that mandatory disclosure is therefore a pre-requisite for proper reporting on these issues.

Having established this, all the points noted above with regard to the perverse incentive for non-payment if an economic materiality criteria were to be applied means that disclosure of all required data has to be mandatory by country as well.

For all these reasons the complete accounting disclosure package requested by PWYP must be disclosed if the relevant information needed by users of financial statements is to be available to support their decision making.

12.Costs and benefits

The IASB concludes its discussion of PWYP's requests by offering comment on the costs and benefits of publishing this data.

For reasons noted above, this entire analysis is inappropriately constructed because any benefit PWYP anticipates from user groups on whose behalf it has made its requests is eliminated from consideration in the IASB paper. As such the analysis offered by the IASB can at best be described as highly subjective and incomplete with an inherent bias being built into the assessment that is likely to find against granting the requests made.

It should also be noted that the IASB prefaces almost all its observations with the over-riding comment (6.31)

There will be a cost associated with preparing and presenting this information in a financial report. Some entities indicated that significant changes to accounting systems and reporting processes would be required to capture those data and to collate them on a country-by-country basis.

The examples they give of transactions where this might be the case are:

(a) taxes or royalties paid in kind rather than cash;

(b) indirect taxes and excise duties that are included in the cost of goods or services purchased from third parties; and

(c) net payments to governments that include both a tax or royalty component (ie a non-reciprocal transfer) and a purchase or sale transaction component (ie reciprocal transfer). These types of payments could be even more difficult to identify if it is unclear from the general ledger whether the recipient of the payment is a government agency.

This is an extraordinary argument to make: if true the reporting entity would be failing to keep the books and records required to prepare financial statements by the law of almost all countries in which their group consolidated financial results will be published, an example of which from the UK is set out in appendix 3. To use the argument that a group of companies is failing to maintain the records required to properly explain (a) entries from day to day of all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place, and (b) a record of the assets and liabilities of the company is very difficult to credit as representing reasonable argument.

Indeed, if this problem exists the argument for requiring disclosure precisely because risk of accounting, legal and regulatory risk with regard to these transactions must be high as a consequence of their nature seems to, in itself, justify disclosure. It is also more than sufficient reason to ensure that auditors of any entity where this risk exists should pay considerable attention to them to ensure that such risks have been properly mitigated. Despite this the IASB says (6.32):

The separate disclosure of these types of payments would also increase audit costs. Auditors consulted by the project team explained that reaching an audit opinion on the accuracy and completeness of a complete set of financial statements that included country-by-country disclosure of different types of tax payments would require a more precise and detailed (and costly) examination of those payments than if the information were aggregated in the consolidated financial statements as, for example, income tax expense or a production cost.

The implication is clear: the IASB does not believe that these high risk transactions that it has identified are being audited at present. The consequence is as obvious: the risk arising from them is being transferred in its entirety from the reporting entity to its providers of capital and other users of its financial statements. This is wholly unacceptable, and it unacceptable for the IASB to endorse the maintenance of this situation in the comments it makes on the grounds of cost alone when accounting, legal and regulatory risk have the potential to impose reputational risk quite disproportionate to the size of transactions involved.

All the commentary the IASB makes suggests three things. Firstly, that a true cost / benefit will not be undertaken on this issue. Secondly, that the IASB is seemingly unaware of the duty of reporting entities to maintain proper books and records which should include all the information PWYP have requested be disclosed and thirdly they are willing, along with the audit profession it would seem, to turn a tacit blind eye to the inherent risks in the transactions which PWYP has requested be disclosed and that as such they are effectively ensuring that users of financial statements do not have the information they need to make decisions on these issues which are of considerable significance to them.

13.Confidentiality

The final reason the IASB gives as to why publication of the information PWYP requests is that the data in question may be confidential and should not, therefore, be published by the reporting entity. As they say (6.34):

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

The IASB acknowledge that PWYP has commissioned research on this issue, to which they refer. As they note with reference to that research (6.35):

> *Most [contracts confidentiality] clauses indicated that no party to the contract could disclose any information flowing from the contract without the written consent of the other parties, but typically the clauses include some standard exceptions that would permit the disclosure of information for compliance with the law and regulations. This would include compliance with IFRSs in those jurisdictions that incorporate IFRSs into their law or regulations.*

In other words, it is very unlikely that a reporting entity could not disclose if IFRS required that it did.

Despite this unambiguous conclusion the IASB proceed to say (6.36):

> *A concern that has been raised by some preparers in response is that an entity may be discouraged from disclosing this information, even if its contract with a host government indicates that it is legally permissible to do so.*

The IASB give this statement serious credibility, which is unfortunate, but none the less goes on to say (6.38):

> *The project team does not consider that the existence of confidentiality clauses that may prevent this level of disclosure in particular cases, or the perceived threat of the loss of existing assets or*

future opportunities that may discourage such disclosure, justifies not requiring this information to be provided. Instead, 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.*

This appears disingenuous. On the one hand the IASB says that disclosure will be compulsory and immediately proceeds to give the company complete discretion as to whether it discloses any information or not, the protection of commercial interests being in each and every case a no doubt sufficient justification for not doing so. In other words the position the IASB appear to reject in paragraph 6.36 is actually both embraced and endorsed in its conclusion on the issue.

This is wholly unacceptable. PWYP are deliberately and appropriately demanding disclosure under IFRS because this is the only available mechanism that can over-rule the confidentially clauses in many mineral extractive agreements, a point the IASB acknowledge (6.36).

As the IASB also acknowledge in their report (6.7):

PWYP's primary concerns with the [requested] information being reported in [CSR reports is] that it is:

(a) voluntary—which makes it difficult to estimate reasonably how much natural resources income a host government is receiving if most entities that operate in the country are not disclosing the relevant payments;

(b) not standardised—which makes it difficult to compare and compile the information provided by different entities;

(c) not audited or traceable back to the financial statements—which means that the information reported is perceived to lack the reliability and credibility associated with financial reports.

Tellingly it added:

These concerns would be overcome if an IFRS were to require the disclosures.

Despite this at the close of its discussion the IASB endorses an approach that would make any disclosure voluntary and therefore unaudited. The paradox is obvious.

Appendix 1

What country-by-country reporting would require of multinational corporations

Country by country reporting is a form of segment reporting for multinational corporations promoted by civil society organisations[18]. Discussion of country-by-country reporting is well advanced and it has been or is currently subject to active discussion by, amongst others, the International Accounting Standards Board, the Organisation for Economic Cooperation and Development and the European Parliament.

Country-by-country reporting differs from existing standards on segment reporting by multinational corporation (US Standard SFAS 131 and ISAB standard IFRS 8) in that it would require disclosure of the following information, without exception and without exemption on the grounds of claimed immateriality by each Multinational Corporation (MNC) in its annual financial statements:

1. The name of each country in which it operates;
2. The names of all its companies trading in each country in which it operates;
3. What its financial performance is in every country in which it operates, without exception, including:
    - It revenues, both third party and with other group companies;
    - Its cost of sales, split between third parties and intra-group transactions;
    - Labour costs and employee numbers;
    - Financing costs split between those paid to third parties and to other group members;
    - Its pre-tax profit;
4. The tax charge included in its accounts for the country in question split as noted in more detail below;
5. Details of the cost and net book value of its physical fixed assets located in each country;
6. Details of its gross and net assets in total for each country in which operates.

Tax information would need to be analysed by country in more depth requiring disclosure of the following for each country in which the corporation operates:

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.

[18] For a more detailed explanation see http://www.financialtaskforce.org/2009/06/17/country-by-country-reporting-holding-multinational-corporations-to-account-wherever-they-are/ accessed 21-1-10

Revenue information will also require additional analysis. If sales too any state are more than 10% different from the figure from any state then data should be declared on both bases so that there is clear understanding of both the source and destination of the sales a multinational group makes.

In addition, if the company operated within the extractive industries we would also expect to see a full breakdown of all those benefits paid to the government of each country in which a multinational corporation operates broken down between these categories of reporting required in the Extractive Industries Transparency Initiative[19].

[19] http://eitransparency.org/ accessed 13-5-09

Appendix 2

The information Publish What You Pay has requested on a country-by-country basis

1. Benefit streams:

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

- royalties and taxes paid in cash
- royalties and taxes paid in kind (measured in cash equivalents)
- dividends
- bonuses
- licence and concession fees.

2. Reserves:

Reserves volumes and valuation measures (if required by the future IFRS) should be disclosed on a country-by-country basis.

3. Production volumes:

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

4. Production revenues:

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

- sales to external customers
- transfers to downstream operations

5. Costs:

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

- production costs

- development costs.

6. Key subsidiaries and properties:

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

Appendix 3

UK company law on the need to maintain proper books and records

s386 [Companies Act, 2006] Duty to keep accounting records

(1)Every company must keep adequate accounting records.

(2)Adequate accounting records means records that are sufficient—

(a)to show and explain the company's transactions,

(b)to disclose with reasonable accuracy, at any time, the financial position of the company at that time, and

(c)to enable the directors to ensure that any accounts required to be prepared comply with the requirements of this Act (and, where applicable, of Article 4 of the IAS Regulation).

(3)Accounting records must, in particular, contain—

(a)entries from day to day of all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place, and

(b)a record of the assets and liabilities of the company.

(4)If the company's business involves dealing in goods, the accounting records must contain—

(a)statements of stock held by the company at the end of each financial year of the company,

(b)all statements of stocktakings from which any statement of stock as is mentioned in paragraph (a) has been or is to be prepared, and

(c)except in the case of goods sold by way of ordinary retail trade, statements of all goods sold and purchased, showing the goods and the buyers and sellers in sufficient detail to enable all these to be identified.

(5)A parent company that has a subsidiary undertaking in relation to which the above requirements do not apply must take reasonable steps to secure that the undertaking keeps such accounting records as to enable the directors of the parent company to ensure that any accounts required to be prepared under this Part comply with the requirements of this Act (and, where applicable, of Article 4 of the IAS Regulation).

Appendix 4

About the author

Richard Murphy is a chartered accountant and graduate economist. He was senior partner of a London firm of accountants for more than ten years. He has also been a serial entrepreneur.

Since 2000 Richard has worked mainly on taxation policy. He is director Tax Research LLP and advises the Tax Justice Network (of which he was a founder), the UK Trade Union Congress and many other organisations on tax policy issues. He has been a consultant to the World Bank and a visiting fellow in tax and political economy at a number of UK universities.

Richard created the concept of country-by-country reporting, writing the first paper to propose this form of accounting in 2003[20].

Richard is the author of the leading work on country-by-country reporting - Country-by-Country Reporting: Holding Multinational Corporations to Account Wherever They Are[21].

According to the Accountancy Age Financial Power List for 2009 Richard is the 25th most influential person in UK finance.

Richard writes a daily blog at www.taxresearch.org.uk/blog.

He is co-author of 'Tax Havens: How Globalization Really Works' published by Cornell University press in January 2010.

[20] http://visar.csustan.edu/aaba/ProposedAccstd.pdf

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