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By email to extractivesconsultation@bis.gsi.gov.uk

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Our ref: DB/SJJ/KR

Dear Vickie

UK IMPLEMENTATION OF THE EU ACCOUNTING DIRECTIVE

Chapter 10: Extractive industries reporting – Consultation

We welcome the opportunity to comment on the UK implementation of Chapter 10 to the EU Accounting Directive, and have set out our comments below and in the Appendix to this letter.

Our main points are as follows:

- We are of the view that there is some merit to delaying the operative date of introduction, to bring the UK into line with the majority of the EU member states. This would allow affected companies longer to design and implement the system changes necessary to produce accurate and timely extractive reports, thus not putting UK companies at a disadvantage compared to EU competitors in terms of the cost of reporting.

- As you have identified, the draft regulations need to be amended in some key areas. Most importantly, Regulation 7(2) as drafted appears to exclude overseas subsidiaries from their UK parent's extractives reporting (and, indeed, if the UK parent does not itself have relevant activities then the UK parent's subgroup appears to fall outside the scope of reporting altogether).

If you would like to discuss any of these points further, please do not hesitate to contact the undersigned or Sally Jones (saljones@deloitte.co.uk).

Yours sincerely

David Barnes
For Deloitte LLP

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Deloitte.

APPENDIX 1 – DETAILED RESPONSE

Question 1.1: Do you agree that companies should only be required to produce whole year reports and should not be required to provide a partial year report for the period between the regulations coming into force and 31 December 2014?

Yes. We expect that companies within the scope of the regulations will need to make changes to their financial reporting systems to allow them to comply with these additional requirements, and it would be extremely difficult for them to introduce those changes, and test them thoroughly, in time to allow for partial year reporting for 2014.

Question 1.2: Do you agree that the first reports should relate to financial years commencing on or after 1 January 2015?

We envisage two key issues. The first is whether companies will have had sufficient time to introduce the necessary changes to their reporting systems, and subject them to adequate testing, to allow for compliance. Although many companies will already be taking steps to ensure compliance, it is nevertheless the case, in our experience, that systems changes take many months to design, implement and test.

The second issue relates to whether there are significant benefits of early adoption for public transparency. We could envisage that there might be some merit to early adoption if all of the member states in the EU were also introducing reporting requirements with effect from 1 January 2015. However, we understand that there is little consensus within the EU as to the most appropriate implementation deadline, and therefore much of the benefits for the public in reporting 2015 figures will be lost (i.e. it will not be possible for users of the information to gather EU-wide information).

Bearing both points in mind, we are of the view that there is some merit in delaying the operative date to bring it in line with the majority of other EU member states.

Question 2.1: Do you agree that UK registered companies should be allowed an additional two months beyond the time limit to publish their annual financial statements to in which to prepare and publish their extractive reports, that is a maximum of 11 months after the end of their financial year?

Yes, we agree that this is a sensible suggestion and that an additional two months is a reasonable ‘extension’ to allow for extractive reports.

Question 2.2: If a shorter period for reporting was imposed, what impact would this have on UK-registered extractives companies?

The information required for the extractive report differs from the information required for the financial statements, in terms of granularity, materiality, cut-off (i.e. it is on a paid rather than accruals basis) and aggregation. A shorter period, perhaps to align the deadline for the extractive report with the time limit to publish the financial statements, would put additional pressure on already pressed finance teams. It seems to us that this additional pressure is unnecessary for the sake of an additional two months.

Question 2.3: If this approach would impose costs on business, please provide an estimate of the costs with an explanation of how these are derived. Would such costs be reoccurring costs or transitional costs in the first year only?

As set out above, we envisage that a shorter period may cause not insignificant administrative difficulties.

Question 3.1: What issues might arise from a later transposition of the Transparency Directive? Please describe any possible impacts and, if appropriate, provide details of any costs or benefits that might result from this.

We found your illustrative examples in Annex 3 to the consultation document to be helpful.

Our basic premise is that once companies have published their audited financial reports, then they will turn their attention to extractive reporting. As your proposal permits all companies to prepare their extractive reports within two months of the deadline for publishing their accounts, we see no particular issue regarding the fact that listed companies reporting under the Transparency Directive will have less time in absolute terms to report than unlisted companies reporting under the Accounting Directive. Clearly if a company decides to list then it will need to accelerate all of its reporting, but this is an inevitable consequence of flotation.

Question 4.1: Please provide information on any issues that arise for UK-registered subsidiaries of EU-registered companies. If appropriate please provide details of any costs that arise as a consequence of being unable to (fully) exercise the exemption in 2015. (All EU Member States are required to implement the reporting requirements by July 2015.)

As indicated above, we regard differing implementation dates across the EU as a matter of regret, albeit one not entirely within the control of the UK government, not least because it seems to us that mismatched implementation dates will cloud the level of public transparency achievable in the early years.

Although of limited temporal effect, it will be inevitable that UK-registered subsidiaries will be obliged to report as solo entities in respect of 2015, and then be exempted from reporting for subsequent years, once their EU parent prepares consolidated extractives reporting. Regulation 8(1)(c) provides an exemption for a subsidiary from preparing a consolidated report if its parent is itself within the EU and preparing consolidated financial statements. In a similar way, regulations 9 and 10 deem a company to have met its reporting obligations if a parent entity has included the company's extractives reporting within its own. However Regulations 8, 9 and 10 require that the parent entity is actually making such reports, which will not be the case if the UK adopts extractives reporting earlier than other member states (until such time as the other member states also adopt extractives reporting).

Presumably this will also have implications for Companies House, which will be obliged to handle more extractives reports in the first year than in subsequent years.

On the one hand, it seems reasonable to assume that the UK subsidiaries' financial reporting systems will need to be upgraded to provide the same information irrespective of the person to whom the information is being provided to (i.e. Companies House or the EU parent) and so there will be little if any cost implication, other than the cost of making systems changes a year earlier than might have been the case.

On the other hand, one can envisage a scenario where a group consisting of, say, five UK subsidiaries of an EU parent may find its UK subgroup challenged as to why its members reported in respect of 2015 but 'failed' to do so in subsequent years, particularly if the EU parent's extractive reporting is not readily available in the UK. We should emphasise that we do *not* think that this is a sensible reason to deny UK subsidiaries an exemption for reporting once their relevant activities are reflected in the parent's own reporting – but as a general observation we note that once information is in the public domain then it very rapidly becomes expected.

Question 5.1: Do you agree that it is appropriate that industry should be encouraged to lead in the production of best practice guidance to support the production of extractive reports and encourage consistency?

Yes. We view guidance as helpful to increase the likelihood that matters of judgement (eg, whether activities fall within the scope of the rules or the definition of types of payments) are treated consistently across the industry.

Question 5.2: Do you agree that reports should be published (filed) electronically with Companies House only i.e. the submission of paper reports is not required or permitted?

We do not envisage issues with electronic filing per se.

The electronic format needs to have sufficient flexibility for management to include commentary alongside the submission – and, indeed, to file a voluntary assurance report within that commentary if they wish. (This would also be true of paper reporting.)

Question 6.1: Do you agree that it is appropriate for the penalty regime here to reflect that in place for failure to prepare and file statutory annual reports?

We agree that there should be penalties for late filing.

However, there are clearly differences between filing financial statements and reporting extractives, the critical one being that financial statements of affected entities are typically subject to an audit and reporting under the Regulations will not be. We are uncertain as to the limit of resources, within Companies House or otherwise, responsible for reviewing the accuracy of reports filed, much as tax inspectors examine and challenge self-assessment returns. Absent such independent scrutiny then any penalty regime based on errors may be practically very difficult to enforce.

Nevertheless, the Accounting Directive does require that penalties must be imposed on companies failing to report their relevant activities in accordance with all of its terms.

Question 6.2: Do you consider that the proposed penalty regime is effective, proportionate and dissuasive?

We refer to our answer to Question 6.1 above.

Question 6.3: Are there any special circumstances that the Government should take in to account when determining the penalty regime? If so what are they, and do you have any suggestions about how these might be dealt with within the penalty regime?

It must be remembered that some extractives groups operate in the most challenging jurisdictions in the world. We have several clients with subsidiaries in war zones where they have simply lost access to the subsidiary and its underlying records during the year. Reg 12(1) mirrors the Companies Act provision which would apply if a company tried to consolidate such a subsidiary and could not because it could not access the subsidiary's records, and so seems reasonable.

We would also argue Reg 12 should be read so that a criminal conviction should not be applied if another country had made it an offence to disclose a payment made to it, although we acknowledge that failure to disclosure in those circumstances should be subject to a high threshold test to be deemed to be reasonable.

Question 6.4: Are there any other issues that the Government should consider in developing the penalty regime? If yes, please provide an explanation and supporting evidence where appropriate.

We refer to our answer at Question 6.3 above.

Question 7.1: Do you have any comments on the draft regulations included at Annex 4? If so, please provide details.

We note from the supplementary document published on 2 May 2014 that you are already aware of the deficiencies in the proposed definition of "undertaking" and the current drafting of Reg 7(2). We agree that these areas are currently flawed in the way the supplementary document described.

We also note from the Deloitte hosted event during April that you are already aware that draft regulations are flawed with regard to the reporting on individual projects in that the draft legislation does not reflect the Accounting Directive – again, we do not comment any further other than to note our agreement.

Our other comments are as follows:

- Regulation 2 – definition of director. This should, we think say "(b) in relation to a limited liability partnership, a member; and (c) in relation to a partnership, a partner."

  We note that in relation to financial statements it is the *members* of an LLP who are in default if they do not *prepare* financial statements, but the *designated members* who commit an offence and are liable if they do not *file* the financial statements. If the government's intention is that the designated members of the LLP should be the persons who commit an offence of failing to file the extractives report then the Reg 2 would need to be amended to read "(b) in relation to a limited liability partnership, the designated members…."

  We also recommend that Regulations 3 and 6 make clear that "These regulations apply to the directors of an undertaking that is a company within the meaning of s1 Companies Act 2006, a limited liability partnership within the meaning of s1 Limited Liability Partnerships Act 2000, and a qualifying partnership as defined in Regulation 3 of SI 2008/569. This would mean that those entities required to prepare financial statements under the law enacting the Directive would, where relevant, be required to also file an extractives report.

- Regulation 7(2) as drafted does seem to cause some issues, as you have already identified. The point that particularly caught our attention is this. It seems a UK parent need only include those things that would be included in a report under Regulation 3. As Regulation 3 only applies to UK companies, it seems that overseas subsidiaries would not be included. Your supplementary consultation document makes it clear that this was not your intention, but we felt it was worth clarifying the point.

- The Regulations do not apply to overseas companies; but neither do they need to. One point which may be worth considering further is the status of *Societas Europea*. It is not clear whether an SE would be obliged to comply with the Regulations or not; it would be unfortunate if such an entity fell outside the reporting obligations all together, as we cannot envisage that that was the intention.

- On a practical point, we note that in accordance with the Accounting Directive, unlimited companies exempt from filing accounts with Companies House will nevertheless be required to file extractives reports. It will be important that Companies House's systems are able to cope with this eventuality (i.e. their taxonomy does not depend on having accounts filed in order to file the extractives report).

  Perhaps more importantly, late filing penalties are triggered by reference to the date two months after the filing deadline for financial statements. Companies exempt from filing may, therefore, have no deadline for filing their extractives report, and the Regulations need to be updated to reflect this.

- Regulation 8 is drafted such that the Regulations will need to be updated every time the size limits in the Companies Act are amended. We recommend that it be amended to incorporate whichever size limits are in force at the time of filing.

- Section 5 of the consultation paper suggests that a fee will be charged to cover Companies House costs, but the regulations do not make provision for that and nor do the existing regs (SI 2012/1907 made under s1063 CA 2006).

- Schedule 1 to the draft regulations obliges *all* logging companies and groups within the scope of the Accounting Directive to file extractive reports, but Chapter 10 only applies to the logging of *primary forests*. Unfortunately we have not found a straightforward means of correcting this because there is not a SIC code distinction between primary and secondary logging. This point does need to be addressed, however, to prevent secondary logging operation falling into scope; perhaps the best way of doing so is to accept that SIC codes are not appropriate for the logging industry in this one regard?

Question 8.1: We would welcome views on the impacts (costs and benefits) arising on business from this new reporting obligation. It would be particularly helpful if you could provide monetised information relating to any additional costs or benefits you identify. Where possible, please indicate if these additional costs are transitional or recurring costs.

There will clearly be costs associated with adapting financial reporting systems to allow for the requirements of extractives reporting. However, we feel that the affected groups are better placed to comment than we are in this regard.

Question 8.2: Please describe any other issues associated with this requirement that you would like to draw to our attention.

None.

Question 9.1: Please outline any quantifiable costs and benefits specifically relating to the following issues: economic impact; legal implications; practical implications; competitiveness impact including the position of the UK as a centre for international listings.

Our response to the remainder of the consultation covers these points.

Question 10: The Government would welcome any other comments on the implementation of Chapter 10 within the scope of this consultation.

We understand that the Government does not intend to consult separately on implementation of the amended Transparency Directive and we agree that, given s89A Financial Services and Markets Act 2000, no further amendments to legislation appear necessary and it can be left to the Financial Conduct Authority (FCA) to consult on implementing rules.