ICAEW REPRESENTATION 73/14

CHAPTER 10: EXTRACTIVE INDUSTRIES REPORTING – CONSULTATION

ICAEW welcomes the opportunity to comment on the consultation paper *Chapter 10: Extractive industries reporting – consultation* published by the Department for Business, Innovation and Skills (BIS) in March 2014, a copy of which is available from this link.

This response of May 2014 has been prepared on behalf of ICAEW by the Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

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MAJOR POINTS

Support for the proposals

1. Country by country reporting for extractives industries aims to increase the transparency over payments made by companies to the governments of resource rich countries and therefore to hold these governments to account. These are laudable aims and ICAEW favours robust and concerted international action in this area.

2. We broadly supported the scope of the proposed reporting requirements for companies making payments to the governments of resource-rich countries which were eventually included in Chapter 10 of the revised EU Accounting Directive, published in June 2013. Our aim during the preceding debate was to ensure that the new financial information provided would be credible, relevant and internationally consistent, that the delivery mechanism was appropriate, and that the costs and efforts involved were likely to prove proportionate to the benefits. We welcome the Government's commitment to introducing the requirements of the Directive into UK law without undue delay, although we raise some significant issues that the Government should consider in paragraphs 17 to 18 below.

3. We welcome efforts to establish an equivalence mechanism for companies that are subject to more than one reporting regime. In our view it is important that the new UK regime is proportionate and workable for both: European Union (EU) groups with companies in different EU countries; and non-EU companies that have EU sub-groups and/or are listed on an EU regulated market.

4. We are also pleased to note that the 'extractives report' will not form part of the annual report and accounts. As we argued during the debate over the proposed new Directive, the annual report and accounts would not be the appropriate vehicle for the disclosure of information that is not investor-driven.

5. Notwithstanding our general support for the proposals, we have some major concerns with the current draft regulations and the timing of implementation, as set out below.

Consultation process

6. We acknowledge that BIS has been in close contact with industry and civil society organisations throughout the development of the draft regulations and that there is political pressure to expedite the implementation of these new requirements. However, we do not believe that this justifies the very short (6/7 week) consultation period, particularly over Easter. The public consultation process should provide an opportunity for interested parties who have not been involved in the prior discussions, and who the government may have not identified, to properly understand, assess and respond to the proposals in a timely manner, and we doubt that this has been the case here. We are concerned that this approach sets a dangerous precedent.

7. We support attempts made by BIS to draw attention to recent amendments made to the Transparency Directive which will, in time, expand the scope of regime to include non-UK registered entities listed on a UK regulated market where the UK is their home market. However, in our view it would have been significantly more useful for BIS and HM Treasury to produce a full consultation, at the same time, covering both the application of Chapter 10 of the Accounting Directive and the amendments to the Transparency Directive. We are concerned that as a result of the approach taken, those entities only affected by the Transparency Directive may not appreciate the significance of the BIS consultation – and therefore not respond – as they may consider themselves to be outside the scope of the regulations. Furthermore, it is unhelpful that apparently no decision has yet been made on the implementation of this aspect of the Transparency Directive, particularly when the Government has already taken action to allow implementation of other aspects early (namely the ability to abolish quarterly reporting or Interim Management Statements). We discuss further the interaction of the two regimes and the attractiveness of introducing both at the same time in paragraphs 17 to 18 below.

Drafting issues

8. To ensure a proportionate regime for companies in the extractives sector and to achieve the underlying aim of the new requirements - to improve transparency over payments to governments of resource-rich countries - it is incumbent on the Government to produce final regulations that are as clear as possible. This is made all the more pressing as a result of the lack of clarity over certain parts of the underlying EU Accounting Directive. We are aware that BIS is in the process of addressing certain drafting issues already identified with the draft regulations. As part of this process, we suggest that particular attention is paid to the areas outlined in the paragraphs below.

9. Under the new rules, payments made to governments must be reported on a cash (rather than an accruals) basis. This is not made sufficiently clear in the draft regulations. In our opinion, this is a critical point for companies to understand, not only because it will impact the figures reported but also because it is likely to represent a significant challenge when they start to collate the required information – company accounting systems are accruals based. Indeed, we think it likely that companies will need to consider introducing entirely separate systems to account for these payments; the inclusion of these requirements in the Accounting Directive may well have helped to give the impression that normal accounting systems will be able to deal with this reporting, which may not in fact be the case. It is important that this matter is made very clear in the regulations and that, where relevant, additional guidance is made available.

10. In our view there is a lack of clarity over the scope of the regulations for entities in a group context. In particular, the consolidated report regime does not appear to be compliant with the new Accounting Directive: it might, if applied as currently drafted, give rise to a number of loopholes and does not appear congruent with the purpose of the EU legislation. Also, we query why a parent has to be a large undertaking or public-interest entity to produce a consolidated report, when it should only be the size of the group that is relevant. For example, it seems counter-intuitive that a parent undertaking that is not a large undertaking or a public-interest entity but has more than one subsidiary that is involved in extractive or logging activity, would not be permitted to produce a consolidated extractives report. Instead, each affected subsidiary would be required to produce a separate report.

11. In addition, we recommend that further clarity is provided for the treatment of joint ventures and associates undertaking extractive activities. It is unclear whether or not they will be required to prepare a separate report if they fall within the scope of the regulations individually, rather than be included in any group consolidated report.

Penalty regime

12. We agree that as an initial starting point, the penalty regime should be similar to that in place for the failure to prepare and file statutory accounts and reports. In our view, it is difficult to see how a regime based on a tax or FSMA approach would be effective or appropriate given that there is no scope for the content of the ‘extractives report’ to be checked or reviewed in any way, and where it is the recipient government that is to be held to account for the use of the funds it receives, not the company that pays them.

13. In establishing the penalty regime, we think it is important for the Government to take into consideration that the new reporting requirements for extractive industries differ in nature from more conventional financial reporting. Not only are the payments to be reported on a cash basis; they must be reported according to a very different and specific set of criteria, for example by payment type, country, and level of government. In order to prepare and publish the required information, it is possible that companies will need to adapt their internal reporting systems or introduce new ones in order to capture information efficiently. This will take time and may involve considerable effort and cost. For this reason, it would be advisable that the penalty regime is not too heavy-handed in its approach, at least while companies become familiar with the new requirements.

14. We recommend that the regime is reviewed again within a suitable time frame – perhaps two or three years – to ensure that it is delivering the desired results. The review may also provide an opportunity for the Government to compare the regime with that adopted by other EU member states, and make improvements where necessary.

Industry guidance

15. While we support the development of industry guidance on the format of the report, we are concerned about the timing of its availability. In our view companies are likely to find it difficult to apply the draft regulations as they currently stand, particularly in terms of the definition of a project. Guidance on the new reporting requirements may be the best way to achieve a workable solution and should therefore be finalised as quickly as possible.

16. In order to be generally accepted, the industry guidance ought to be issued in exposure draft for comment, with a final version taking those comments into account. This will take time but is necessary for the guidance to be of good standing, an important issue considering that it is possible that other EU member states may refer to it in developing their own guidance. In addition, we believe it is important that BIS should publicly endorse the guidance once it is final to minimise legal uncertainty. It would also be important for the European Commission to indicate that it is content that the guidance complies with the Accounting Directive; a public statement to this effect would be helpful.

Implementation date

17. While we support the Government's commitment to implement the new requirements for extractive industries without undue delay, it is important that this goal be carefully balanced against the need (a) for the regulations to be introduced as smoothly as possible on a cost-effective basis (b) to ensure consistency with related initiatives, such as the forthcoming implementation of amendments to the Transparency Directive and (c) to address any problems with the interpretation of the Directive and how it will be applied in practice (in particular, the need for robust industry guidance that is generally accepted). With this in mind, we believe that the priority must now be for BIS to address the concerns raised during this current consultation. Given the significance of some of these matters it may well be necessary for BIS to settle for a slightly later implementation date.

18. We note that one advantage of converging the date of implementation with that of the amendments to the Transparency Directive would be a consistent framework across companies which are within the scope of both the Accounting and Transparency directives, thus reducing the scope for confusion. What might be ideal is for BIS to agree with HM Treasury and the FCA to implement both regimes for accounting periods beginning on or after 20 July 2015, which is the mandatory implementation date for this aspect of the Accounting Directive. This would mean those companies affected only by the Accounting Directive would not be disadvantaged compared to Transparency Directive-only companies, but it would also allow the Government to show that it is prepared to adopt early, as it would still be early for the Transparency Directive. This would also deal with the apparent problem BIS has in introducing only part of the new Accounting Directive early, when there is linkage with the rest of the Directive.

RESPONSES TO SPECIFIC QUESTIONS

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?

19. Yes, we believe that only whole year reports should be prepared.

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

20. We have some concerns over the proposed timing of implementation of the new requirements as set out in paragraphs 17 to 18 above.

Question 2.1: Do you agree that UK registered companies should be allowed a maximum of 11 months after the end of their financial year in which to prepare and publish their extractive reports?

21. Yes, we agree with the proposed period of time allowable for the preparation and publishing of the extractive report.

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

22. We do not support the introduction of a shorter reporting period for UK-registered extractives companies. At this stage, with new system requirements to implement for example, we think companies must be given a reasonable period of time to publish.

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.

23. Please see our response to question 2.2 above.

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.

24. The later transposition of the Transparency Directive will lead to inconsistency between those entities only within the scope of the Transparency Directive and those within the scope of the Accounting Directive. For those companies affected by both, there will be uncertainty about how the reports will be 'made public' under the Disclosure and Transparency Rules regime, which may introduce different requirements later; there are also different liability/penalty regimes to be considered. We think both regimes should be introduced at the same time if possible, with coherent interaction between the two. Please see our comments in paragraph 18 above.

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.) Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

25. Implementing the new rules in advance of the timetable required by EU legislation will, for some UK companies, result in reporting requirements which exceed those applying to their counterparts elsewhere in Europe. For example, a UK-registered subsidiary of a EU parent company may need to prepare an 'extractives report' in 2015 under the current proposals, but then be exempt in later years as the EU regulations are brought into force under the national law of other EU member states. Our understanding is that most of those who have been particularly vocal in calling for this information are more interested in group reports covering all controlled entities, not reports for just parts of a group. We therefore think that an exemption might be considered for such companies for the first year, assuming the UK implements early for all other companies, allowing them to be included in their parent's consolidated reports only from the mandatory application date of the Accounting Directive. We note that if the relevant member state fails to implement the requirements by the due date, affected UK companies would nevertheless have to produce a separate entity report for that year.

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?

26. Yes, we believe that the availability of industry-led guidance on the new reporting requirements may be the best way to achieve a workable solution and should be finalised as quickly as possible. It should be exposed for comment before being finalised and then approved by BIS (with at least tacit approval from the European Commission too). Please see our comments in paragraphs 15 to 16 above. The time this will take argues for some slight delay to the first mandatory period of reporting, as discussed in paragraphs 17 to18 above.

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?

27. Yes, we agree that the reports should be published electronically with Companies House only. However, we are uncertain whether Companies House will be ready in time with appropriate mechanisms for tagged electronic filing. This will presumably depend on the industry guidance to some extent and so can only be completed once that guidance has been finalised.

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?

28. Yes, we agree that the penalty regime should reflect that in place for failure to prepare and file statutory annual accounts.

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

29. Yes, we believe that the proposed penalty regime is effective and proportionate. However, in order to prepare and publish the ‘extractives report’, companies may need to adapt their internal reporting systems in order to capture information efficiently or even introduce new systems. This will take time and may involve considerable effort and cost. For this reason, it may be advisable to ensure that the penalty regime is not implemented in a heavy-handed way, at least while companies become familiar with the new requirements. Please see our comments in paragraphs 12 to 14 above.

Question 6.3: Are there any special circumstances that the Government should take in to account when determining the penalty regime?

30. Yes. Please see our comments in paragraphs 12 to 14 above.

Question 6.4: Are there any other issues that the Government should consider in developing the penalty regime?

31. Yes. Please see our comments outlined in paragraphs 12 to 14 above.

Question 7.1: Do you have any comments on the draft regulations included at Annex 4?

32. We have a number of concerns regarding the current drafting of the draft regulations. Please see our comments in paragraphs 8 to 11 above.

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.

33. As discussed in paragraphs 9 and 13 above, companies may well incur significant costs in putting in systems to capture the information required, because of substantial differences with the usual accruals-based accounts systems. Differences in materiality, having to collect information by project and also on a cash basis, may produce significant costs, but until companies see the final industry guidance and get some clarity – for example getting a workable approach to what a 'project' is that satisfies the legal requirements – they will not know what additional costs are likely to be incurred. Importantly, this may well take some time to implement.

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

34. Any matters for consideration have been outlined in our major points section to this representation letter.

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**

35. We can only offer anecdotal evidence, for example we are aware that a number of companies are already taking legal advice because of the difficulties of interpreting the legislation. In terms of international competitiveness, we are not in a position to assess whether the regime will make the UK (and EU) less attractive as listing regimes for non-EU companies. This is however an international issue, so as other countries, particularly those with major capital markets, introduce similar requirements competitive disadvantage may become less of an issue.

36. We welcome the fact that the regime will be reviewed within a few years and, when it happens, the UK should press for that review to be holistic and properly consider evidence of costs and benefits.