

Disclosure instead of hide and seek

A fair chance for the poor people of resource-rich countries

A summary of CIDSE's response to the EU consultation by DG MARKT on Country-by-Country Reporting (CBCR), January 2011

As an international alliance of Catholic development agencies with partner organisations in many of the poorest countries of the world, CIDSE is acutely aware of the need for greater transparency and accountability in relation to global revenue flows. Our partners in resource-rich countries such as the DRC, Cambodia and Peru have said how difficult it is for them to get accurate data about payments made by multinational corporations (MNCs) to their governments.

} The facts:

- Research for the Tax Justice Network in 2009 showed that only 33 of the 100 largest companies in the UK filed the information required by UK company law stating the names of each of their subsidiaries and the country in which they were located.
- The adoption of a new international accounting standard in the form of International Financial Reporting Standard 8 (IFRS 8) has meant that MNCs can choose the basis for their reporting depending on their own internal management systems and fewer companies now structure their financial reporting by geographical segment. This has also led to a situation where it is more difficult for users to compare the financial data provided by MNCs.
- Although more than 60% of world trade according to OECD estimates is intra-group trading, current disclosure requirements do not provide sufficient data on such trading

The risk of corruption is well-documented in relation to extractive industries but also affects other sectors. Creating disclosure rules for MNCs which reduce the risk of corruption or bribery and make tax revenues more transparent are consistent with the development objective of strengthening good governance. This point was highlighted by the Angolan Catholic Bishops way back in 2004:

“Oil and diamonds, almost exclusively, fed the conflict we suffered for the last twenty-five years. And since the war has ended, many people have been very surprised that these same resources have not been able to feed our internally displaced people ... In this public examination of conscience, we ask the competent authorities correctly to inform Angola's citizens about the profits coming from the exploration of oil and other natural resources, as well as provide information about how they are used. ... It is essential that the exploration of oil and other natural resources leads to investment which can generate wealth for the country. If this does not happen, the country will become poorer still and will end up with no oil, no diamonds and no lasting benefit whatever.”

Statement of the Catholic Bishops of Luanda, 24 March 2004

The need to improve accountability is not limited only to developing or transition economies. The financial crisis raised questions about the extent to which existing financial reporting requirements provide sufficient data about the operations of MNCs. The introduction of country-by-country reporting requirements will mean that MNCs can provide an accurate picture of their contributions to national economies. Increased corporate transparency and accountability is a legitimate concern for citizens when the costs of state aid to MNCs are borne by taxpayers. EU governments are also seeking to support business models which are sustainable. It is important that political discussions and future policy decisions are based on clear, comparable and robust data about how MNCs operate at a national level.

Disclosure of financial information on a country-by-country basis is also crucial to investors. As early as 2003, a number of high profile institutional investors signed a public statement supporting the EITI principles and payment disclosure and calling for mechanisms to promote transparency. By 2009 80 institutional investors representing approximately US \$16 trillion supported this position.

Capital providers commenting on the US Dodd-Frank act enforcing greater transparency of transnational companies and the International Accounting Standards Board's consultation on its Discussion Paper on Extractive Activities have stressed the value of country-specific information. For example, in May 2010 Calvert stated that country-by-country reporting "could be used by investors to account for material, country-specific, tax/regulatory, reputational risks and would substantially improve investment decision-making regarding the extractive industries sector."

CIDSE therefore welcomes the timeliness of the consultation launched by the Directorate General for the Internal Market and Services of the European Commission on country by country reporting. At the same time we are concerned by its limited scope.

CIDSE's submission to the consultation on 9 January 2011 calls on the EU to use this opportunity to examine country-by-country reporting a international standard which would apply for all countries which a MNC operates rather than only considering it in relation to non-EU member state 'third countries'.

} Salient points from the submission:

Coverage

CIDSE supports the following criteria for deciding which MNCs would be required to report on a country-by-country basis:

1. The company trades in more than one jurisdiction or the company and the members of its group trade in more than one jurisdiction, and,
2. The company is a very large company (i.e. only those companies with substantial economic impact would be required to report in this way. For convenience this category of 'very large companies' should be subject to automatic updating of its definition. The thresholds for being a very large company might be four times those of a medium-size company, as defined in EU regulations.) And/or

3. The company is a public company operating in the financial services or extractive industries sectors.

Thus, all listed, and very large unlisted, extractive companies should be required to disclose on a country-by-country basis if they trade in more than one jurisdiction.

Excluding large, medium and small companies makes sense for lower risk sectors to reduce compliance costs for lower risk areas. However, extractive companies operate in a high risk sector so the requirement is set commensurately higher.

Pre-conditions for effectiveness

In order to be consistent and useful, the country-by-country reporting standard must be:

1. Mandatory, so as to be effectively implemented over time
2. Comprehensive and credible in producing the necessary information
3. Comparable across companies and countries
4. Readily accessible to, and usable by, all key users of information.

Disclosure requirements

CBCR would require disclosure of the following information by each 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. Its financial performance in every country in which it operates, without exception, including:
 - Its sales, both third party and with other group companies;
 - Purchases, 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.

In addition, companies in the extractive industries should also disclose:

1. a full breakdown of all those benefits paid to the government of each country in which a multinational corporation operates broken down between the categories of reporting required in the Dodd-Frank Act or EITI (whichever is more extensive)
2. the quantities and quality of resources extracted
3. reserves (to be in line with the work of the IASB's Working Group on Extractive Activities)

To be in line with the US Dodd-Frank Act, the information on payments to government should also be broken down for each 'project'.

In the interests of serving the needs of national users of financial reports (like government agents, citizens,) thresholds for reporting should relate to the country and the extractives project, rather than in relation to the scale of corporate activities, given that MNC economies can dwarf that of many countries. In the US, the Dodd Frank follows a de minimis approach which we support for the extractives sector.

As stated before, information should be disclosed for all jurisdictions - without exception - in which a MNC operates, to avoid transactions being lost to view.

Country-by-country reporting standard: A win-win for all

The model of country-by-country reporting which CIDSE is recommending would only apply to a relatively small number of companies with operations in more than one country. The vast majority of EU enterprises would not be required to provide this data.

By introducing such a reporting requirement, the EU will ensure that companies are operating with a level playing field. Some of the largest EU MNCs including Total, Shell, BP and ENI will be required to report on a country-by-country basis anyway because they will be covered by the new Securities and Energy Commission rules for enforcing the Dodd-Frank Act.

A mandatory approach will mean that companies which take an ethical and transparent approach to their operations will not be disadvantaged. There are also likely to be economic benefits to tackling illicit practices. In 2007 the UN Office on Drugs and Crime (UNODC) and the World Bank stated that “the cross-border flow of the global proceeds from criminal activities, corruption, and tax evasion is estimated at between \$1 trillion and \$1.6 trillion per year.”

Comparable, robust data about company performance and specific risks would be available to many more investors for their decision-making processes. This point is discussed in more depth below. At a time when all EU governments are seeking to reduce administrative costs and increase efficiency, country-by-country reporting by MNCs would provide comprehensive data for public officials so that any investigations, e.g. on tax issues, could be much more targeted.

Common EU rules on country-by-country reporting will increase corporate transparency and accountability. Such information will support active oversight by the Board and shareholders and enhance internal control systems. There will be clearer expectations on company directors regarding the information that MNCs are required to disclose. Common EU rules could also bring broader benefits by contributing to improved corporate governance at a global level. Almost three-quarters of the world’s 100 largest companies have their headquarters in just five countries – the US, France, Germany, the UK and Japan. Therefore the adoption of country-by-country reporting by the EU, building on the recent steps taken with the Dodd-Frank Act, would pave the way for the development of an international standard of disclosure for MNCs.

The full submission can be found [here](#).



CIDSE is an international alliance of Catholic development agencies. Its members share a common strategy in their efforts to eradicate poverty and establish global justice. CIDSE's advocacy work covers global governance; resources for development; climate justice; food, agriculture & sustainable trade; and business & human rights www.cidse.org

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