May 2019

Mandatory disclosures of payments to governments by extractive & logging industries:

responses to the public consultation on the 'Fitness check on public corporate reporting' and main findings of the review commissioned by the European Commission

In 2013, the European Union (EU) passed game-changing new transparency legislation amending the Accounting and Transparency Directives to require oil, gas, mining and logging companies listed and registered in the EU to disclose their revenue payments to governments around the world.

The objective of companies disclosing payments to governments is to strengthen transparency and fight corruption, misuse of public money and illicit financial flows from resource-rich countries by enhancing the accountability of governments of host countries where extractive companies operate and of the companies themselves. The legislation also plays a critical role in encouraging greater stability in resource-rich countries, benefitting both citizens and investors.

Article 48 of the Accounting Directive mandates the European Commission (EC) to review the legislation. To comply with this obligation, the EC included questions on 'Country-by-country reporting' (CBCR) by extractive and logging industries in its consultation on the 'Fitness check on public reporting by companies' open to the public from 21/3 to 31/7 2018. At the same time, the EC commissioned a review on the implementation and effectiveness of the extractive and logging transparency framework from a consortium of consultants. The final report of this review was published on 26 November 2018.

We have analysed the responses to the relevant questions of the public consultation on the Fitness check and the main conclusions of the final report of the review. Our aim was to identify insights and recommendations for the EU's policy on promoting transparency in the extractive sector and for the future review of the relevant provisions of the Accounting and Transparency Directives.

What emerges from both the public consultation and the consultants' review is, on the one hand, the significant benefits of EU reporting requirements and, on the other, the need to improve the framework to make it more effective.

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I. Analysis of the responses on 'Country-by-country reporting' (CBCR) by extractive industries to the consultation on the 'Fitness check on public corporate reporting'

<u>Note</u>: On 14/5/2019, following a request for access to documents introduced on 25/1/2019, the European Commission gave access to <u>66 unpublished responses</u> to the public consultation, with the identity of respondents redacted for 64 of these responses. These responses were not incorporated in the present document. A preliminary analysis of these newly released documents broadly confirms the findings below.

1. Who responded? - Published vs unpublished responses

According to the EC's summary report of the consultation **338 stakeholders responded to the consultation**. Only 272 responses were published on the EC website however, implying **66 stakeholders or a fifth of respondents did not allow the EC to make their responses publicly available.** The lack of transparency on behalf of a large group of stakeholders raises concerns about the reasons why they would seek to escape public scrutiny while seeking to influence the fitness check.

The Commission warns that the consultation cannot be considered as statistically representative given the number, geographical distribution and typology of respondents. Its analysis is mostly qualitative and uses quantitative data to give indications of relative strength, disregarding non-responses. We subscribe to this approach in our own analysis.

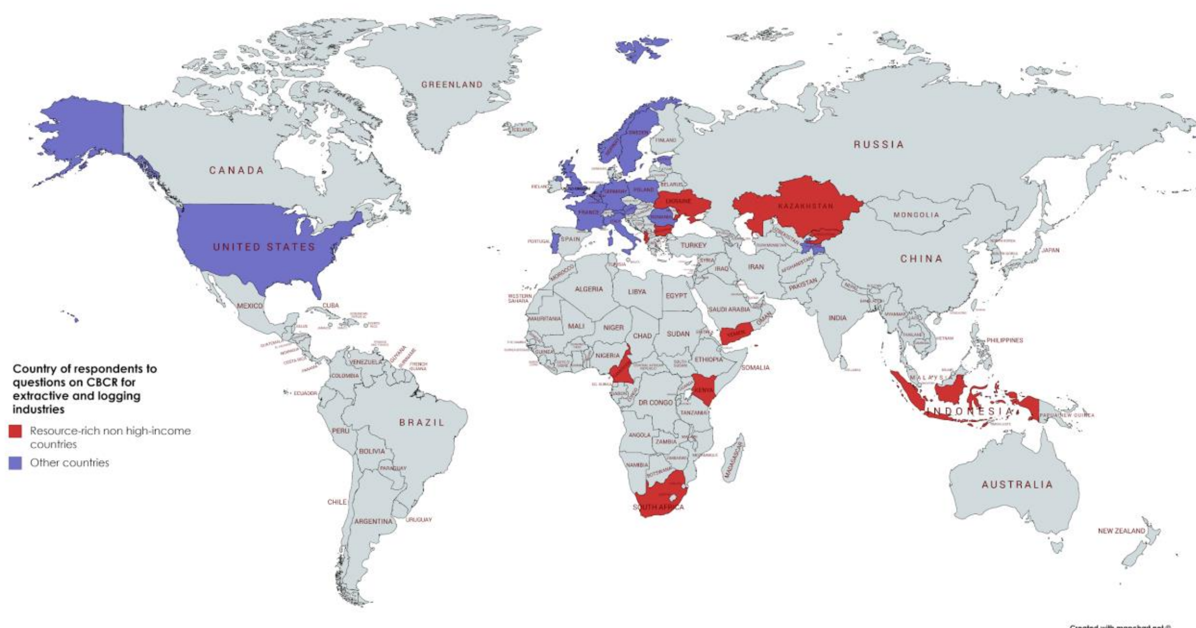

Fig. 1: Fitness check on public corporate reporting: country of respondents to questions 51-53 on CBCR for extractive and logging industries. Countries that are considered resource-rich and are not high-income countries according to the IMF are highlighted in red.

PWYP identified only 83 public responses of stakeholders covering these questions 51 to 53 on mandatory reporting for extractive industries while the EC states that between 153 and 164 stakeholders responded to these questions. The private sector and civil society make up the majority of these respondents, and public authorities only a small minority. Private sector actors with an interest in extractive transparency are mainly companies and industry associations. Civil society organisations include a majority of NGOs and some trade unions and think tanks.

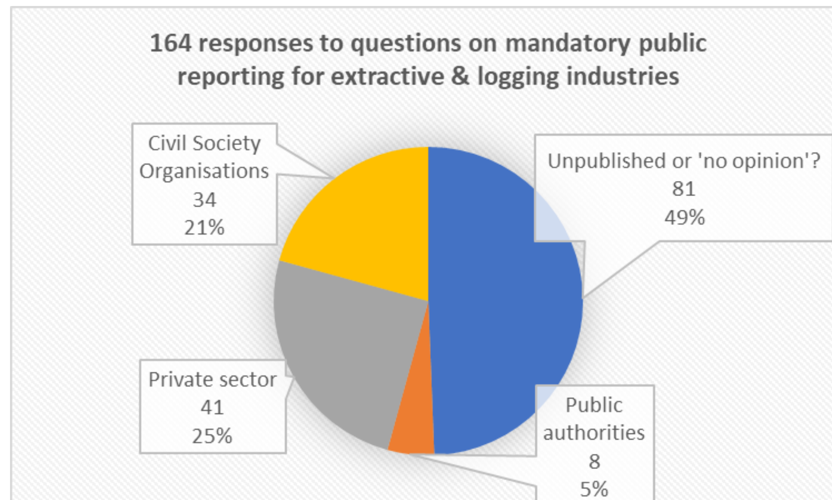

Fig. 2: Typology of respondents

It is striking that the Italian transnational **ENI** and the **International Association of Oil and Gas Producers (IOGP) are the only responses of a company and industry association from the extractive sector that were published.** BASF also responded publicly as it has oil and gas assets, but its main activity is not extractives. Is this because mandatory reporting is seen as a non-priority or non-controversial issue by the sector, because most companies in the oil and gas sector chose to speak through the IOGP or because many extractive industry companies and associations chose not to make their responses public?

2. Are mandatory public reporting requirements for extractive and logging industries efficient, relevant, coherent and designed at the appropriate level?

The EC reports that "***a vast majority of respondents saw the country-by-country reporting (CBCR) by extractive and logging industries as efficient, relevant and coherent***". An analysis of the published responses shows indeed that over 70% of respondents totally agree or mostly agree that EU mandatory public requirements for extractive and logging industries are efficient, relevant and coherent. Only a handful of stakeholders mostly or totally disagree with this.

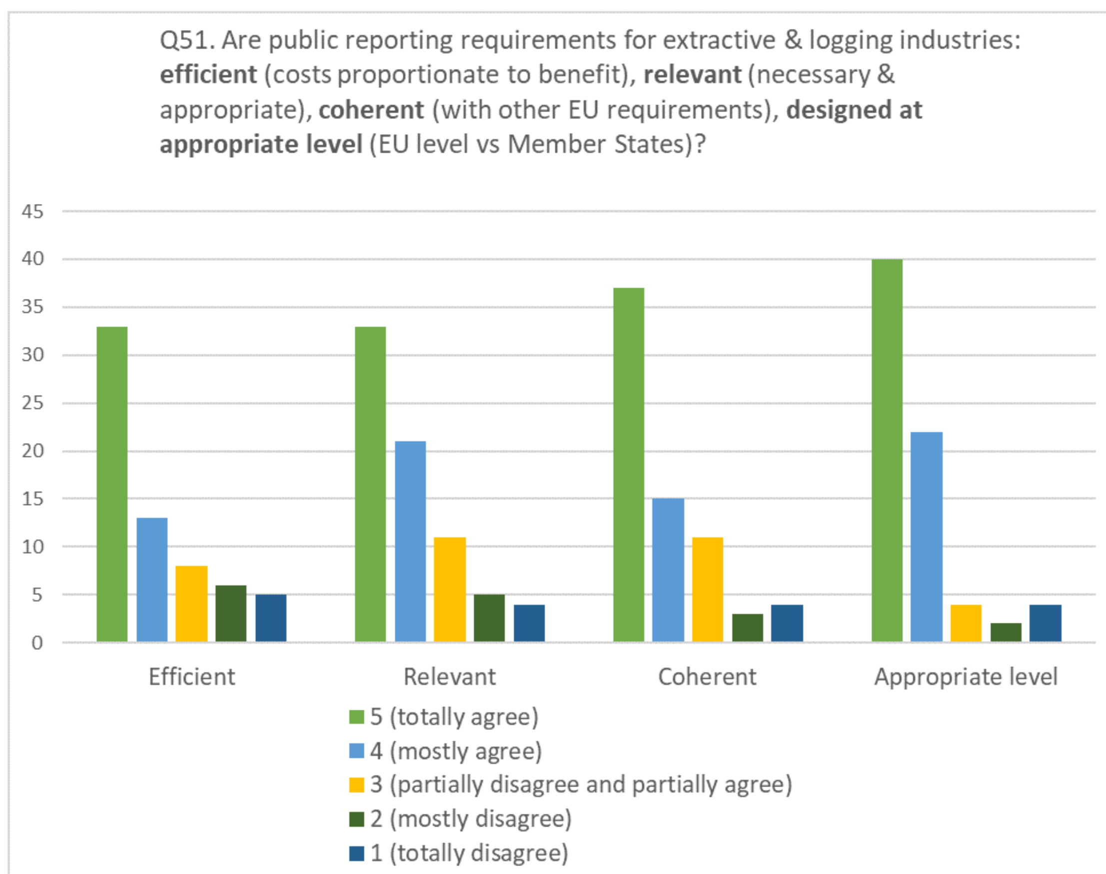

Fig. 3: Answers to question 51: efficiency, relevance, coherence, design at EU level

An even larger share of respondents - close to 90% - are of the opinion that the EU level is the right level for rules governing mandatory disclosures to be designed in order to add the highest value as compared to actions at Member State level. A few respondents - companies and industry associations - highlighted that a global mandatory reporting regime would be desirable and singled out the fact that the extractive transparency provisions of the Dodd-Frank Act in the US have not been implemented, which, they allege, could put European companies at a disadvantage in the long run although no rationale was provided for why this might be the case.

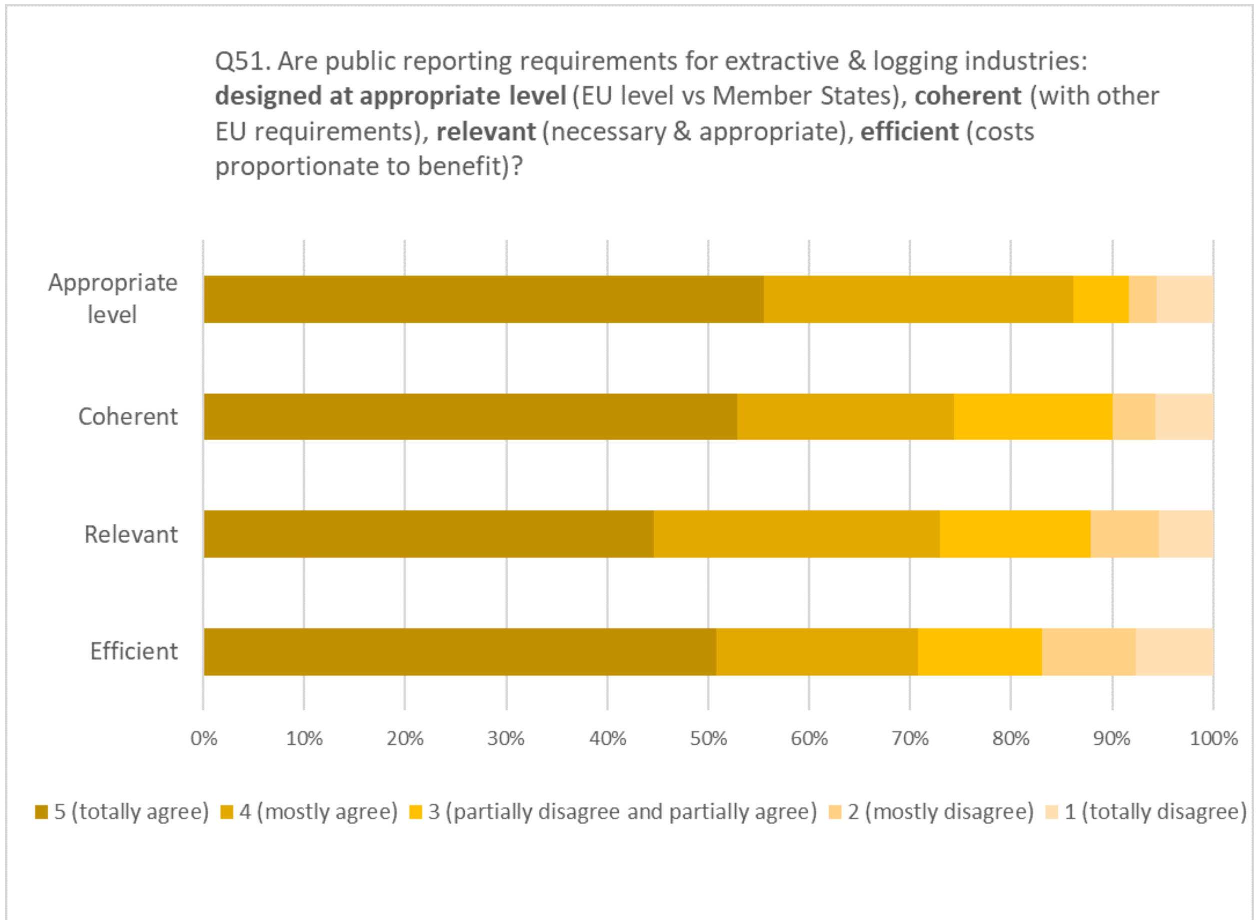

Fig. 4: Responses to question 51: efficiency, relevance, coherence, design at EU level

Public authorities from six Member States responded to questions 51 to 53. The European Securities and Markets Authority (ESMA) also responded and provides a good summary of their contribution: "*Whilst ESMA notes that only few national enforcers have experience with the supervision of such requirements, those who do agree that public reporting requirements on payments to governments are mostly effective, efficient and relevant.*"

3. Are mandatory public reporting requirements for extractive and logging industries effective, i.e. successful in achieving their objectives?

A majority of all stakeholders, both from the private sector and civil society organisations, are of the opinion that progress remains to be made to achieve the goals of the policy, i.e. promoting good governance of natural resources and accountability of governments and business in resource rich countries.

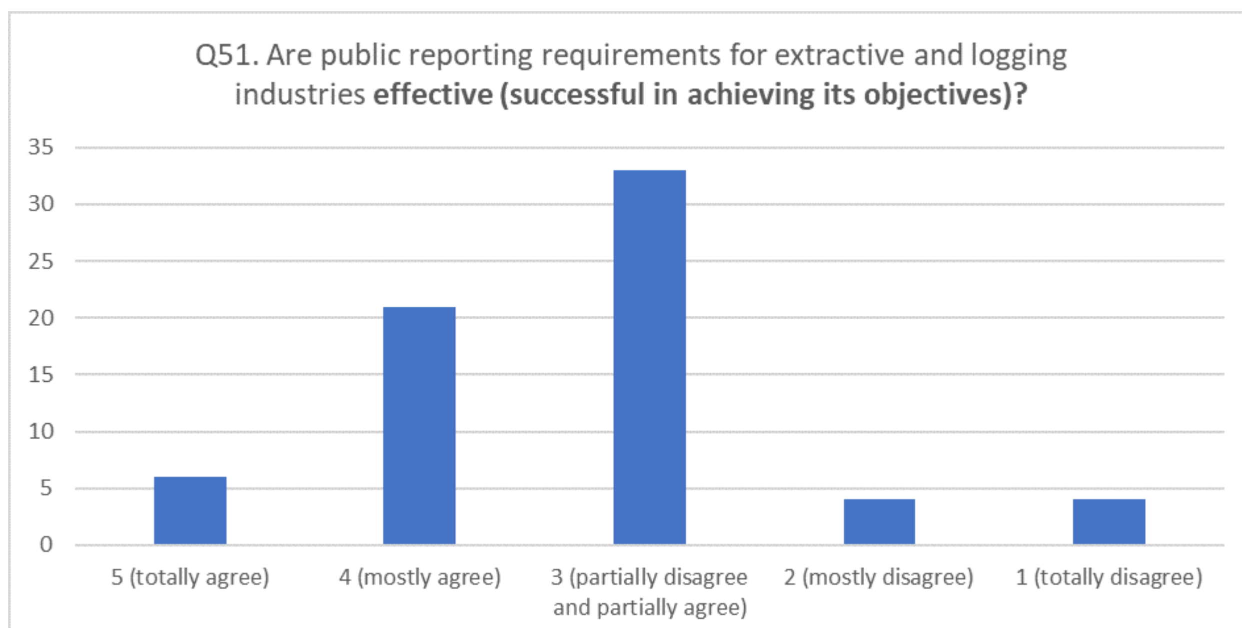

Fig. 5: Responses to question 51: effectiveness

Companies only started to report in 2015 in the UK and France and in 2016 in the rest of the EU, so many stakeholders highlight that it is still early to assess the policy. However, **clear benefits of the policy have already emerged from the responses to the consultation as well as recommendations to improve its effectiveness**:

The policy is seen as effective by important investors. **Norges Bank Investment Management**, the manager of the largest sovereign wealth fund in the world, is of the opinion "*that the existing reporting requirements have been effective in ensuring greater transparency on payments from extractive companies to host governments. From an investment decision standpoint, transparency on payments to governments on a country-by-country basis increases our understanding of a company's access to markets, risk profile and cost of resources, and improves evaluation of companies' use of funds for investment*."

Publish What You Pay and other **civil society organisations** from the EU countries and from several resource rich countries described the positive impacts of EU reporting requirements in their responses while at the same time calling for several improvements to the directives and their implementation to enhance their effectiveness.

Information available to citizens to hold governments and companies to account for their use of revenues from natural resource exploitation has hugely increased as a result of mandatory reporting. EU legislation on country-by-country reporting and equivalent legislation in Canada and Norway have resulted in hundreds of billions of government entity- and project-level payments being disclosed and brought into the public domain. The Natural Resource Governance Institute has systematically tracked and published this information on www.resourceprojects.org, although it should be noted that because of the lack of a central and easily accessible registry this has been at great time and cost expense to the organisation.

Project-level reporting has been particularly effective in increasing information for local communities. In November 2017 Publish What You Pay (PWYP) compiled a set of 28 case

examples of civil society using mandatory payment disclosures in over 20 countries to hold industry and governments to account and for citizen empowerment. Industry and government actors are increasingly aware that disclosures are monitored by civil society, which should strengthen their effectiveness.

Civil society organisations called for the following improvements to the extractive transparency framework:

- Improving data accessibility by requiring companies to publish payments reports in open/machine-readable and 'human readable' format directly to a central European online repository that is freely accessible to the public.
- Clarifying essential elements of the framework. This includes: a) spelling out the definition of *substantially interconnected legal agreements* to avoid over-aggregation of projects; b) specifying that companies must report all payments larger than €100,000 including when made indirectly to governments via a third party operator or agent; c) clarifying that companies must report the volume as well as the value of each in-kind payment, disaggregated by commodity type and disaggregating cash from in-kind elements; d) clarifying that companies must report different types of tax payments separately; e) requiring companies to disclose the exchange rate between the reporting currency and the currency in which the payment was made; f) clarifying that companies should name each government entity receiving payments; and g) requiring companies to explain their interpretation of payment categories consistent with article 41 (definitions) and article 43.4 (principle of substance rather than form).
- Data availability should be increased by including an additional category for payments to governments related to the sale of oil, gas and minerals (commodity trading).
- Data should be assured by requiring an audit or a limited assurance report and aggregate reconciliation with accrued figures in annual reports.
- Logging sector reporting requirements should apply to companies operating in forests where legal commercial operations take place, as defined in the forest laws of producing countries.

Recommendations put forward by civil society organisations are supported by other stakeholders.

Norges Bank Investment Management for example support the inclusion of an additional category for payments to governments related to the sale of oil, gas and minerals (commodity trading): "*The reporting requirements are currently limited to payments that extractive companies make in exchange for exploration and production of oil, gas and minerals. These requirements could be expanded to include payments that companies make to governments for the purchase of crude oil and minerals. Such payments are currently non-transparent to investors. However, they may be economically significant and – without transparency – can present the same corruption risk as other types of payments to governments."* Norges Bank Investment Management also emphasised the need to clarify elements of the framework: "*While we recognise that the EU Directive sets out minimum equivalent requirements for company disclosures, diversity in reporting and differing interpretations of what constitutes an "operationally and geographically interconnected project" result in a lack of comparable data. Standardised reporting templates in open data formats and implementing guidance could help*

address inconsistencies in reporting. This would increase the value and usefulness of the reports to investors by ensuring comparability of information."

Another example is the call of the **Institute of Chartered Accountants in England and Wales (ICAEW)** for an improvement of the framework in relation to joint ventures: "*we would encourage a review of how the country-by-country reporting requirements work in group situations and for joint ventures. In our experience, the interaction of the rules with these common business structures has resulted in considerable confusion, potentially reducing the relevance of the resulting information. For example, the legislation does not deal with activities outside of the group structure but where there is an element of control by entities within the group.*"

4. Private sector views: investors, accountants, extractive industry

In its summary of the consultation, the EC states: *"The industry generally saw the policy as inefficient and called either for the repeal of the policy or, at least, for maintaining the status quo but with reduced complexity."* PWYP believes this statement is not supported by the publicly available responses to the consultation. A quantitative and qualitative analysis of the responses from private sector actors, including industry associations, investors, accountants and extractive industry representatives, reveals a much more nuanced set of views.

The graph below shows that the private sector's overall perception of mandatory public corporate reporting of payments to governments by extractive and logging industries is fairly positive even though the views are more dispersed when it comes to assessing the efficiency of the policy.

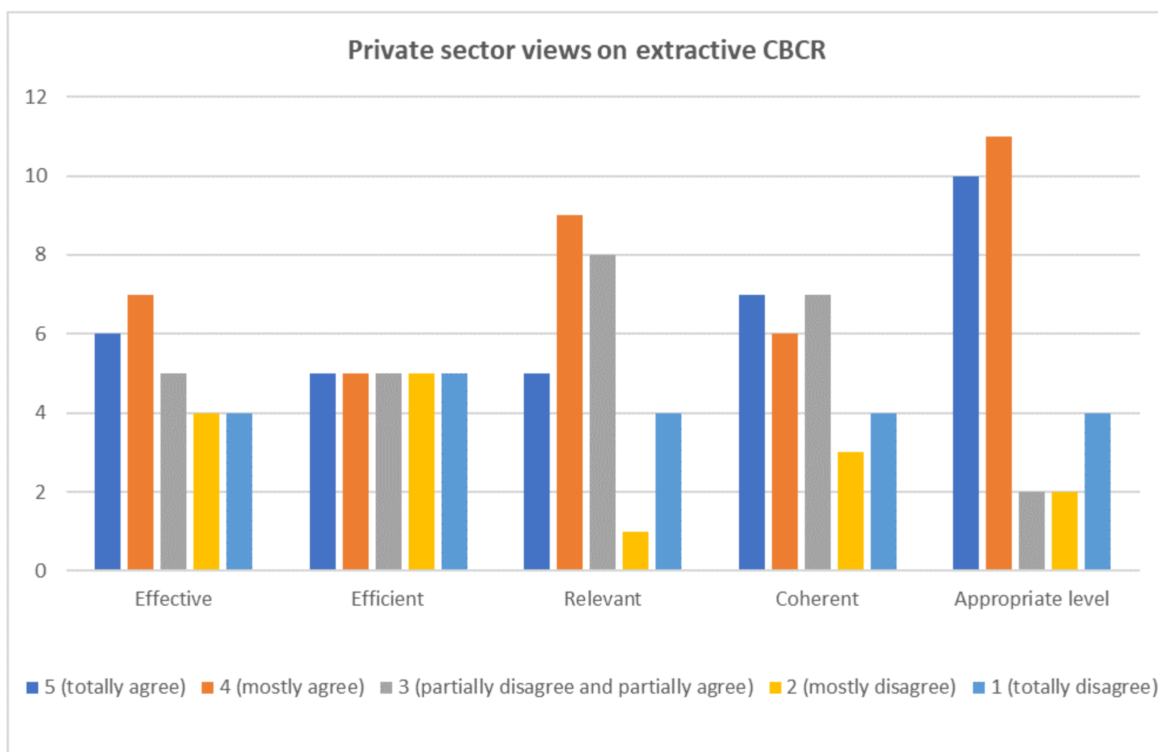

Fig. 6: Answers of companies, industry associations, investors, accountants and other private sector stakeholders to question 51 on the effectiveness, efficiency, relevance,

coherence and EU level design of public reporting requirements for extractive and logging industries

Efficiency: costs vs benefits of the policy

The majority of private sector stakeholders are positive regarding the effectiveness, relevance, coherence and design at EU level of the policy. When it comes to efficiency - whether the costs of the policy are proportionate to the benefits it has generated - an equal number of respondents have positive, negative and mixed views of the policy. The actors with the most negative view in this respect are not from the extractive sector. Only one respondent explicitly calls for the repeal of the legislation: **AFEP**, a multi-sector industry association representing large French companies. AFEP erroneously argues that the US Dodd-Frank Act has been repealed to support its call. In fact, only the implementing SEC rule has been vacated – and is required to be remade – and not the Act itself.

ENI assesses the efficiency of the policy positively ("mostly agrees") while IOGP which represents the oil and gas industry is neutral on the issue. In contrast, **Deloitte**, a global auditing and accounting firm, "totally disagrees" that the policy is efficient and states: "*Considering the various aspects underlying the EU public good, evidence of the overall benefits of this additional reporting requirement remains to be seen, while administrative costs are obvious.*" The accounting sector does not share Deloitte's position. Other prominent representatives of this industry such as **Accountancy Europe** and national accounting industry representative bodies have a neutral or positive view on the issue of efficiency and are supportive of mandatory reporting requirements: "*We believe that country-by-county reporting of payments to government enhances transparency, which can strengthen the reputation of the affected EU companies and thereby improve competitiveness.*" (Accountancy Europe).

Only three companies have provided evidence about **preparation costs**: BASF (chemicals, owns oil and gas assets), ENI (oil and gas) and Adicontafin (accounting). The figures provided vary widely: BASF reports a start up cost of €47,000 and an annual cost of €26,000, ENI reports a start up cost of €1,000,000 and annual costs of €500,000. No valid conclusion supporting a negative assessment of the cost effectiveness of the policy can be drawn from this very limited set of data.

Impacts on industry competitiveness

The public consultation asked stakeholders their opinion on the impact of the public reporting of payments to governments in the extractive and logging sectors on the competitiveness of EU companies. Overall a majority of stakeholders are of the opinion that transparency has a somewhat positive impact on the competitiveness of companies. This view is held not only by NGOs but also by the accountancy sector and investors.

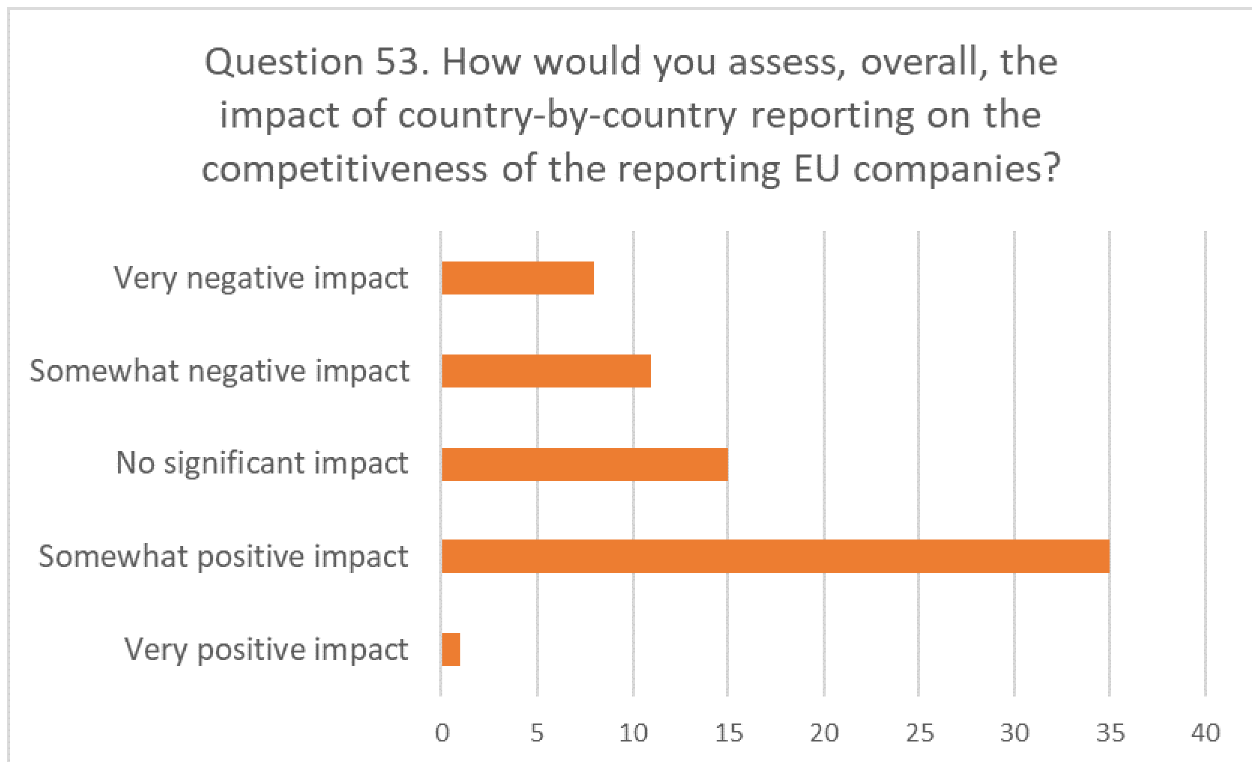

Figure 7: Answers to question 53 on impacts on competitiveness of public reporting requirements for extractive and logging industries

In its response, **Publish What You Pay** supports its view that the EU's extractive transparency legislation can have a positive impact on EU companies with evidence from the UK Government's 2018 Post Implementation Review (PIR) of the Reports on Payments to Governments Regulations. Based on survey responses from 32 companies covered by the regulations, the review report concluded that "*this type of reporting does not disadvantage company business interests, including their relationships with governments*" and noted that one company had already experienced a positive impact on its competitive position. (UK Department for Business, Energy & Industrial Strategy, 2018, 'The Reports on Payments to Governments Regulations 2014', PIR Report).

Accountancy Europe, which represents 51 professional organisations across Europe, states: "*We believe that country-by-county reporting of payments to government enhances transparency, which can strengthen the reputation of the affected EU companies and thereby improve competitiveness.*" **APG**, a large Dutch institutional investor providing pensions to 4.5 million people, sees a positive impact on competitiveness of transparency, referring to long term benefits in terms of "*brand value, stakeholder relations and social licence to operate".*

While some industry associations such as the **French Association of Large Companies (AFEP)** and the **German Insurance Association (GDV)** attributed a very negative impact on competitiveness to CBCR they failed to provide any evidence of competitive harm to European companies. Other industry associations, in some instances from the same country, hold the opposite view. The **Deutscher Industrie- und Handelskammertag e. V. (DIHK)** for example states: "*We do not perceive any impact on competitiveness.*"

Representatives of the extractive industries are themselves very cautious to ascribe any negative impact on competitiveness to public reporting of payments to government. The **International Association of Oil and Gas Producers (IOGP)** states: "*As the current regulation has just been implemented, we have no evidence of the impact on competitiveness. We believe more time is needed to assess that*." The Italian oil and gas company **ENI** mentions: *"We have not yet perceived any significant impact on the competitive position of EU companies. However, as all mandatory reporting regime that do not apply globally, we cannot exclude that in the long run EU reporting companies may suffer increased competition compared to companies not subject to same reporting obligations."*

II. Main conclusions of the EC commissioned report: *'Review of country-by-country reporting requirements for extractive and logging industries'*

The report of the consortium of consultants (VVA, Ecorys and Deloitte) is based on an extensive literature review, an analysis of 83 company payment to governments reports, interviews with a wide range of stakeholders (international and local civil society organisations, extractive companies and industry associations, national authorities and academia), two case studies to assess the relevance and impact of additional reporting requirements and two stakeholder workshops.

Overall, the report found that a considerable amount of reporting was conducted in the extractives sector and that there was no evidence of non-compliance. However, in the logging sector only two reports could be identified.

The main finding, confirmed by civil society and industry representatives, is that **the EU reporting requirements have increased the level of transparency on payments to governments in the extractive sector**. On the one hand, revenue transparency provides civil society with important information to hold their government representatives accountable and to advance good governance. On the other hand, the requirements can be a deterrent against corruption since companies and governments know that the payments will be disclosed and open to public scrutiny.

In the sample of reports examined by the consultants, most companies provided the required information and the main inconsistencies identified related to unclear definitions of specific requirements, such as the definition of project, types of payments and the approach on joint venture reporting, as previously identified by civil society organisations on numerous occasions. Moreover, **there is very limited monitoring and oversight by national authorities of companies' compliance with the reporting requirements**. Once again, concerns regarding the reporting have been mostly identified through the work and analysis undertaken by civil society instead of public authorities.

Main findings

- Implementation: Overall, European companies falling under the scope of the Directive tend to be compliant. However, **neither national authorities nor the European Commission have a comprehensive list of all companies covered by the reporting requirements**. Authorities usually rely on the proactiveness of civil society. The consultants, therefore, compiled an extensive list of the most influential companies required to report and identified 114 extractive and 71 logging companies. Out of these companies no reports from 44 extractive companies and 69 logging companies could be identified.

- Effectiveness: The main finding of the research is that the **EU reporting requirements have increased the level of transparency on payments to governments by extractive companies without having excessively increased overall compliance costs for companies**. However, the impact on reduction of corruption is not yet tangible, as the requirement is still too recent. An important element hampering the effectiveness of the legislation, which emerged from the research and interviews, is the lack of a common approach to the publication of reports and to different reporting templates across Member States. Rules for publication of the reports are not harmonised, as in some cases reports have to be submitted to a national registry, whereas in others they have to be published on companies' websites or in other cases to be published in companies' annual reports. In the absence of a common approach, a concrete recommendation by civil society on this issue is to **establish a central repository of reports, free for public access and holding both open/machine-readable and human-readable format reports**. A further issue that was highlighted with regard to the effectiveness of the legislation was the lack of contextual information, as report users noted that the raw data in many reports did not allow them to fully understand the context and that additional information on the specific extractive projects would be needed.

- Impacts of other international regimes: The report provides an overview of similar requirements in other regions, in particular the Canadian Extractive Sector Transparency Measures Act (ESTMA), which was deemed fully equivalent to the EU requirements, and Section 1504 of the US Dodd-Frank Act, whose implementing rule, however, was invalidated in February 2017 by a joint resolution under the US Congressional Review Act. Particular attention was given to the comparison between the Extractive Industries Transparency Initiative (EITI) and the EU requirements. The latter have been found to be **more reliable and effective as well as resulting in more up to date information than data published under the EITI system**. However, it was stressed that there was potential for mainstreaming extractive industry transparency with more synergies between the two regimes.

- Competitiveness: According to the interviewees, **there is no evidence that the EU reporting requirements place European extractive companies at a competitive disadvantage** compared to their competitors based in other regions that are not subject to the requirements. On the contrary, some respondents highlighted how companies often use transparency initiatives, such as the one mandated by the EU, to boost their corporate image, as increased transparency enhances a company's 'social licence to operate' and trust among citizens. However, some companies were still concerned that, depending on the level of detail and the number of projects in the country of operation, competitors may be able to use the information disclosed to identify the terms of the contracts and margin, and adapt their strategy when negotiating contracts in host countries. Despite this concern,

it appears that companies interviewed by the consultants did not find it harder to operate in third countries following the introduction of the EU requirements. And research shows that, among international extractive companies active in resource-rich countries, EU companies have tended to maintain their presence or increase it since the new EU legislation came into force.

- Effects on security of energy supply: The research did not bring up cases of third countries raising infringement actions or limiting the operation of EU-reporting companies due to the reporting requirements. Since **there is no evidence of countries restricting the operations and imports of EU companies due to the reporting requirements**, no impact can be reported on the diversification and concentration of imports and on energy security.

- Additional reporting requirements: The potential introduction of the following additional reporting requirements was assessed: the average number of employees, the use of subcontractors, the pecuniary penalties administered by a country, the effective tax rates, recipient details such as bank account information. **The two elements that were deemed most useful by civil society were information on companies' use of subcontractors and their effective tax rates.** In the former case, CSOs argued that the amount of payments outsourced to contractors and subcontractors was potentially as high as USD $1 trillion annually and that this was an often overlooked area of extractive industry operations. In the latter case, effective tax rates would need to be disaggregated at the project level, where possible, and by type of tax. This information could be extremely important to determine the host country government's share of natural resource revenues. With regard to the bank account details, it was highlighted that the main objective of having this information disclosed would be to know the name of each recipient government entity rather than the bank account details per se.

- Lack of clarity of definitions: The consultants stress that **stakeholders agree that the lack of clarity of some definitions in the reporting requirements could lead to different interpretations** and highlight the **need for clarification** in the following areas:
  - The definition of project due to the wording relating to "substantially interconnected" agreements, which is open to different interpretations;
  - The definition of payment types due to differences in national transpositions, or different accounting rules of companies, e.g. on royalties;
  - The requirement for companies to provide volume data for each payment in kind (omitted from the French transposition and perhaps by some other Member States) and clarification that payments in kind data should not be aggregated between different commodities or aggregated with cash payments;
  - The approach to reporting payments made indirectly to governments via a joint venture (JV) operating partner, which varies depending on the company;
  - The need for a degree of oversight on the part of national authorities as well as more effective sanctions for non-compliance.

  The above are issues that civil society has been highlighting ever since the publication of the first payments to governments reports.