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Part II

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT
for financial disclosures on a country-by-country basis

Accompanying the document

Proposal for a directive of the European Parliament and of the Council amending Council Directive 2004/109/EC on the harmonisation of transparency requirements
and
Proposal for a Directive of the European Parliament and of the Council on the annual financial statements and the consolidated financial statements and related reports of certain types of undertakings

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EXECUTIVE SUMMARY

1. INTRODUCTION

Multinationals have worldwide operations supported by many subsidiary companies. Until now all the activities of a group have been brought together, every year, into a single set of consolidated accounts. This allows investors, and other accounts' users to understand the financial position and profitability of the group as a whole.

Country-by-Country Reporting (CBCR) is a different concept of financial reporting, which would see certain financial information being presented at a country rather than a global level. CBCR is not a replacement for consolidated accounts, but a complementary scheme of reporting.

2. PROBLEM DEFINITION

2.1. What is the problem?

Multinational Corporations (MNCs) operate in many foreign jurisdictions but detailed information on their activities in the countries in which they operate is often not within the public domain. This lack of transparency in country-by-country financial data stands in the way of greater government accountability, in particular, in some resource-rich developing countries for the income received from exploiting natural resources such as oil, gas, minerals and forests. Proponents of CBCR state that if payments made to a particular government by MNCs were known, citizens and other interested parties would be better able to demand that the government accounts for how these incomes have been spent, which in turn can foster economic growth and help to reduce poverty, corruption and internal conflict.

2.2. What are the drivers of the problem?

Currently there is no obligation to provide financial information on a country-by-country basis.

MNCs could publish country-by-country information voluntarily, but few do so. Furthermore, there is an Extractive Industry Transparency Initiative (EITI) which a national government can voluntarily adopt and is relevant to extractive industry participants, but out of the 50 countries considered to be hydrocarbon or mineral rich by the IMF only 9 are currently EITI compliant. Only one country reports payments to governments in respect of forest activities.

2.3. How big is the problem?

In the absence of a CBCR requirement there is no reliable information available on the current level of payments made by extractive and forestry operators to host governments.

In a survey of 11 country reports, the EITI reported that the surveyed host governments annually received collectively US$43.5billion from the oil and gas, mining and timber industries[1]. To put this figure in context the payments represent, on average, 11.5% of these countries' GDP.

The Commission Services estimated that listed EU oil and gas companies could collectively have made payments (including taxes, bonuses and royalties) to governments worldwide of €362 billions in 2009. In its 2009 EITI report Liberia reported payments to government of US$ 1.9 millions derived from forestry, which represented 5.7% of the government's revenues from exploiting natural resource wealth.

2.4. Subsidiarity

It is preferable to legislate through EU law to ensure that all EU MNCs exploiting hydrocarbons, minerals and primary forests[2] are treated equally across the EU.

3. OBJECTIVES

The primary objective is to bring increased transparency to the operations of MNCs by increasing the disclosures they make on a country-by-country basis. This should provide relevant information to civil society in order for it to hold governments accountable for their receipts from allowing the exploitation of natural resources.

4. POLICY OPTIONS

In order to meet the objective set out above the Commission Services have identified and considered a number of policy options:

(1) No change;

(2) Support an international initiative to require country-by-country disclosures by MNCs in the extractive industry and loggers of primary forests. Under this policy option all MNCs (EU and non-EU) would be subject to new disclosure requirements;

(3) Require disclosure of payments to government on a country-by-country basis by EU MNCs in the extractive and logging of primary forest sectors;

(4) Require disclosure of payments to government on a country- and project-basis by EU MNCs in the extractive and logging of primary forest sectors;

(5) Require full CBCR by EU MNCs in the extractive and logging of primary forest sectors (payments to governments, revenues, costs, profits, tax charges and taxes paid, assets held and intra-group transactions).

The tables below provide an overview of the analysis of the policy options.

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[1] 2009 EITI overview of country reports, http://eiti.org/files/Overview%20EITI%20Reports.pdf.

[2] Defined in Directive 2009/28/EC as "naturally regenerated forest of native species, where there are no clearly visible indications of human activities and the ecological processes are not significantly disturbed."

Table 1: Assessment of the policy options:

Option	Impact on transparency	Impact on competitiveness and level playing field	Potential impact on costs	Estimates of year one compliance cost
0. No change	0	0	0	0
1. International Action	+	++	-	See note
2. Require CBCR of payments to government by extractive and primary logging EU MNCs	+	-	-	€573 millions
3. Require CBCR of payments to government on a country- and project- basis by EU MNCs in the extractive and primary logging sectors	++	-	-	€1,145 millions
4. Require full CBCR by EU MNCs in the extractive and primary logging sectors	++	--	--	€2,887 millions

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral

Note: The costs of this option would ultimately depend on the precise nature of the scheme of CBCR agreed upon internationally.

"Primary logging" refers to logging of primary forests.

Source: Commission Services analysis

Table 2: Acceptability to stakeholders:

Option	CATEGORY OF STAKEHOLDERS				
	Preparers	Users	Auditing/ accounting firms	Public Authorities	Other
0. No change	0	0	0	0	0
1. International Action	++	+	+	+	+
2. Require CBCR of payments to government by extractive and primary logging EU MNCs	+	+	-	++	++
3. Require CBCR of payments to government on a country- and project- basis by EU MNCs in the extractive and primary logging sectors	+	++	-	+	++
4. Require full CBCR by EU MNCs in the extractive and primary logging sectors	--	++	--	-	+

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral

Preparers: MNCs, other companies, associations of companies;
Users: Non-governmental organisations (NGOs), investors;
Public authorities: accounting standard setters or National Ministries.
Other: political party, law institute, private persons.

"Primary logging" refers to logging of primary forests.

Source: *Commission Services analysis*

Having compared the broad policy options above, the best alternative on grounds of competitiveness, transparency and acceptability to stakeholders is action to support a worldwide initiative to foster the disclosure of payments to governments by the extractive industry and loggers of primary forests. However, there is no certainty that an international agreement on CBCR of payments to governments can be achieved.

The preferred policy option is therefore to require EU MNCs active in the extractive and logging of primary forest sectors to disclose payments to governments on a country- and project- basis. The policy would be to target MNCs listed on EU regulated stock markets and EU unlisted large companies active in the extractive and logging of primary forests sectors, to ensure a level playing field between these categories of companies.

The development of and support of an international initiative on CBCR remains crucial as EU action alone on CBCR will not result in a full picture of government receipts from the exploitation of natural resources being shown. In particular EU action alone will not capture the activities of the national oil companies which globally control the largest share of oil and gas reserves and production.

5. ANALYSIS OF MAIN IMPACTS OF THE PREFERRED POLICY OPTION

5.1.1. Increased transparency

In general terms, CBCR of payments to government on a country- and a project- basis by the extractive industry and loggers of primary forests should provide investors and civil society with significantly more information than today, on what is paid by EU MNCs to host governments in exchange for the right to exploit the relevant countries' natural resources. Publicising this information should have the effect of making governments more accountable. With a project approach, civil society local to a mine, oil field, forest etc. would know what government receives for exploiting such local resources.

5.1.2. Potential strengthening of the Extractive Industries Transparency Initiatives (EITI)

With increased levels of data on payments to host governments entering the public domain, there will be increased pressure on national governments from civil society to account for how the revenues derived from extractive and loggers of primary forest MNCs have been spent. Some governments may respond to such calls by implementing EITI locally. This would mean that potentially more countries would be within the scope of the initiative. Finally, a significant expansion of EITI reporting countries may capture non-EU state-owned companies, thus reducing any negative competitive effects for EU MNCs *vis-à-vis* the competitive situation with state owned companies.

5.1.3. Improved operating environment for the extractive industry and loggers of primary forests

More accountable governance in resource-rich countries would bring increased political stability which creates a more stable business environment for MNCs making significant investments locally.

5.1.4. Increased administrative costs

There will be increased administrative costs from the preferred policy option. The Commission Services estimated the following costs:

Table 3: Administrative costs of proposed policy

	Estimated Number of companies	Year one cost (€ millions)	Subsequent years' costs (€ millions)
Listed extractive MNCs	171	740	192
Unlisted large extractive MNCs	419	397	103
Forestry (listed and unlisted large MNCs)	26	8	2
Total	*616*	*1,145*	*297*

These costs assume the information will be unaudited. A requirement to audit would be estimated to increase annual recurring costs by approximately €90 millions. Furthermore, the cost estimates are based on the assumption (made by the surveyed companies) that information would be disclosed only if it is material.

5.1.5. Competitive disadvantage

Whilst disclosing payments to government would not give direct insight into the levels of turnover, costs and profits that a MNC generates in a jurisdiction, there may be instances when confidential business data will be revealed or deduced from CBCR data. EU MNCs exploiting natural resources would also not be on a level playing field in terms of disclosure when compared with non-EU state owned companies and this may affect their ability to complete existing contracts and win new ones.

It is not possible to place a monetary value on the loss of competitive position. However, given that some extractive industry operators have voluntarily decided to disclose some country-by-country information and a majority of extractive industry respondents to the public consultation were in favour of disclosing CBCR of payments to governments as a means to improve government accountability it has been judged that the loss of competitive position from this policy would be limited. Furthermore, a number of factors affect the competitive position of EU MNCs in the extractive industry especially, namely the level of engineering know-how and technical efficiency.

The strengthening of the EITI would also militate against any possible short-term loss of competitive position, as it may lead to a more global application and enhanced reputation of compliant companies.

5.1.6. Public authorities

The revision should have no budgetary consequences for public authorities. .

5.1.7. International relations

Where an EU MNC would have to disclose payment information, the disclosure of which is prohibited by the domestic law of a foreign country, the relevant governments could perceive there to be a breach of their national sovereignty. This point is not clear-cut and industry and NGOs dispute the point.

5.1.8. Energy security

Where a country opposes reporting of payments to government, EU extractive operators may find it harder to operate locally which might have consequent effect on oil and gas resourcing. In practice, however, this has not been the case as some companies already disclose payments to governments on a country basis without impediments to their activities.

5.1.9. Social impacts

Within the EU there will be limited social impacts as EU governments publish national accounts which provide information on government revenues. However, in other parts of the world, citizens may have limited information on government revenues. The main social impacts would therefore be outside the EU.

6. Monitoring and evaluation

The Commission will monitor the implementation of the CBCR requirement in cooperation with the Member States. An evaluation of the effects of the preferred policy will be carried out to see to what extent the anticipated impacts (increased payments' transparency, strengthened EITI, improved business environment, increased administrative costs, and increased competitive pressure) materialise.