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From:	General Secretariat
To:	Company Law Attachés
On:	3 February 2012

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Subject:	Proposal for a Directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings
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In view of the meeting of the Company Law Attachés on 3 February 2012, delegations will find attached a note by the Presidency.

Presidency discussion paper on payments to Governments – Chapter 9 in the proposal on the simplification of the accounting directives

With this paper the presidency wishes to provide for an orientation debate on the Competitiveness Council at the next meeting on February 20 to give guidance to the Working Party on key questions. Following this and based on this guidance, the Working Party will discuss the details as part of the overall compromise proposal on the Accounting Directive in March.

Introduction

On 25 October 2011 the Commission proposed a new directive to replace the existing accounting directives. This proposal is made with a view to lighten the regulatory burden on small undertakings and enhance the comparability and clarity of financial statements for undertakings in the EU which is characterized by extensive cross-border activity.

Chapter 9 in the proposal for a new accounting directive deals with reporting on payments to governments - also referred to as country-by-country-reporting.

At the moment the proposal is discussed in the Council Working Party, but in order to progress the negotiations, some guidance is needed from the political level.

In this context please note that the European Council has asked for a speedy examination of the proposals having the most growth potential - including the simplification of accounting requirements - by the end of June 2012.

Commission proposal

The overall objective of reporting on payments to governments is greater transparency. Basically greater transparency will benefit investors as well as the overall economy and provide relevant information to the civil society in order to hold governments accountable for their receipts from allowing the exploitation of natural resources. Reporting on payments to governments will enhance government accountability on payments received from the primary extraction of natural resources in developing countries and support development and growth in such countries.

According to chapter 9 in the proposal all large and listed undertakings (included undertakings from other countries listed within the EU) active in the extractive industry or the logging of primary forests must prepare and make public a report on payments made to governments on an annual basis.

International development

The proposal regarding payments to governments is not the only initiative in this area. The most important of these other initiatives is Section 1504 of the US Dodd-Frank Act (adopted by the Congress in July 2010), which requires all extractive companies (e.g. oil, natural gas, or minerals) listed on US stock-exchanges to publish payments made to governments on a per country and project basis. In order to enforce this legislation, final implementing rules need to be adopted by the US Securities Exchange Commission (SEC) (scheduled for the first half of 2012). Another important initiative is the voluntary Extractive Industries Transparency Initiative (EITI).

So far, there are two main differences between the Commission proposal and the country-by-country requirements of the Dodd-Frank Act (as mentioned before, the details of the legislation will be defined in the final implementing rules). First, the Commission proposal applies to large undertakings as well as to listed companies whereas the US legislation applies only to listed companies. Secondly, the Commission proposal covers undertakings with activities in both extractive and forestry sectors, while the US legislation applies only to the extractive industry.

Council position

Based on the expressions put forward by the member states in the Council working party there is a clear acceptance of the objective to improve transparency in this field. Some delegations, however, expressed their concern that the impact of the proposed legislation on the competitiveness of European undertakings should also be taken into consideration.

In this context, some specific issues of the proposal remain to be debated, of which the most important are:

1. Should disclosures be provided on a country by country level or on a country and project level?

2. Should the definition of materiality of payments be defined in the directive or should the Commission be empowered to specify the concept of materiality by means of delegated acts?
3. Should forestry be included in the proposal?

Question 1: Should disclosures be provided on a country by country level or on a country and project level?

According to the proposal, disclosure of payments to governments should be provided on a country-and-project basis.

A project is defined in Article 36 as equivalent to a specific operational reporting unit at the lowest level within the undertaking at which regular internal reports are prepared to monitor its business. This approach allows the company to disclose along the line that it already prepares its regular internal management reports (thus no additional administrative burden). As defined now it would not require a re-design of the accounting systems. Furthermore, the proposed definition tries to take into account the variations of the targeted industries, and the variations in what would be known as a "project" in each country.

Arguments in favour of disclosure on a project basis (a similar disclosure is required in the Dodd-Frank Act) is that it will ensure a greater level of transparency and that the local communities would have a better insight on the payments made to governments for exploiting local natural resources. It will also allow for the reconciliation of sub-totals (projects) with totals (countries) and therefore support the reliability of the information published.

Arguments against disclosure on a project basis are the following. First, some argue that disclosure at the country level is more relevant to the recipient country rather than disclosure at the project level. Secondly, reporting on project basis could be burdensome to the undertakings and it is relevant to inquire whether the additional burden of preparing a project based report is proportionate to the expected extra benefits arising from a project based disclosure. Thirdly, a project based report might reveal commercially sensitive information, and may place companies in a competitive disadvantage. Finally, excessive information could blur the overview of the report.

Are you in favour of disclosing of payments to governments on a project basis? If so, do you agree with the definition of the term "project"?

The presidency envisages:

Reporting on a country and project level as stated in Articles 36-38 of the Commission proposal. The presidency remarks that as defined the term "project" does not add additional administrative burden to the companies. However, it is important to choose an appropriate materiality level in order to avoid creating disproportionate costs and burdens for companies, and to prevent the preparation of complex and unreadable reports.

Question 2: Should the definition of materiality of payments be defined in the directive or should the Commission be empowered to define the concept of materiality by means of delegated acts?

According to the proposal, payments to governments must be disclosed when they are "*material to the recipient government*." Article 38 (4) of the proposal states that the Commission shall be empowered to adopt delegated acts in order to specify the concept of materiality of payments.

A meaningful threshold would ensure legal certainty, prevent the preparation of unreadable reports, and protect commercially sensitive information. A level of materiality must also be defined regarding the payments that should be disclosed when balancing the usefulness of the disclosures against the burdens of supplying them. The level could be based on:

- an absolute figure (e.g. an amount denominated in Euro) or
- a relative figure (e.g. a percentage of the country's GDP).

In terms of the absolute figure, there have been conflicting views on the appropriate level of materiality between the extractive industry and the NGOs: some extractive companies suggest a materiality threshold of €1,000,000, while NGOs suggest the amount of €10,000. In terms of a relative figure, there risks to be inconsistencies and extra administrative burden (by each company defining a different materiality percentage in each country of operation).

The Dodd Frank Act requires all "*not de minimis*" payments to be subject to disclosure but it remains unclear if there will be further clarification in the SEC final implementing rules.

Do you agree with empowering the Commission to define the concept of materiality by means of delegated acts? Do you prefer a precise figure of materiality to be set out in the directive itself? In your view, what would be an acceptable materiality threshold? Should there be a different threshold for the extractive industry and the forestry sector?

The presidency envisages:

An introduction of a specific figure on materiality in the directive ideally in terms of an absolute figure.

Question 3: Should forestry be included in the proposal?

The proposal requires undertakings with activities in the logging of primary forests – e.g. the Brazilian rainforest - to disclose payments to governments because in some resource-rich countries the exploitation of primary forests delivers an important contribution to the country's GDP. Furthermore, the EU proposal is seen as complimentary with other EU transparency initiatives¹ in this area which endeavor to support governance and legality in the procurement and trade of wood in the EU market.

In the context of EITI, one country (Liberia) already reports payments to governments by the forestry sector because it is an important sector for this country. The Dodd-Frank Act does not include a similar requirement for the forestry sector.

Do you agree with the proposal as drafted to include logging of primary woods?

The presidency envisages:

To keep the text as proposed by the Commission because it is consistent with other EU transparency initiatives, but make clear that there should not be more sector-specific reporting requirements.

¹ The "Timber Regulation" (Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010) intends to ban illegal timber imports to the EU. The law is aimed to break the supply chain of illegal wood from the developing world's forest-rich countries and complements the Forest Law, Governance and Trade program (FLEGT).