



Review of country-by-country reporting requirements for extractive and logging industries

Executive summary

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Executive summary

The study '**Review of country-by-country reporting requirements for extractive and logging industries**' provides an assessment of the implementation of the country-by-country reporting (CBCR) requirements for companies from logging and extractive industries stemming from Directive 2013/34/EU¹ and Directive 2013/50/EU.

The study aims to:

- Review the implementation and assess the effectiveness of the European reporting requirements;
- Assess the impacts of other international regimes on the EU reporting requirements and on the activity of European companies;
- Assess the effects of the EU reporting requirements on the competitiveness of European companies and the security of energy supply for the EU; and
- Discuss potential amendments/policy recommendations to improve the compliance, effectiveness and efficiency of the reporting requirements.

The findings of the study are based on:

- An extensive desk research and a review of more than 248 sources both at EU/international and national level;
- A focus on a sample of nine countries of origin and 12 countries of operation;
- An in-depth analysis of 83 reports (81 reports from extractive companies and 2 from logging companies) with payments to governments from EU companies in 12 Member States³⁷ semi-structured interviews with NGOs, sector associations, companies, national authorities and academia completed with a company survey;
- Two case studies that assess the potential of introducing a compulsory audit of the report and adding further reporting requirements; and
- A workshop with representatives of the industry and reports' users to discuss the preliminary findings of the study.

Implementation of the reporting requirements

The study found that in the extraction sector a considerable amount of reporting is conducted. Although the study could not verify whether all companies in the scope of the Directives report their payment to governments, there is no evidence of widespread non-compliance either.

On the other hand, even though an extensive search for reports of logging companies was conducted only two reports could be identified. According to experts and stakeholders interviewed, the low rate of reporting in the logging sector could be explained by the following factors:

- The scope of the Directive is restrictive as it specifically targets primary forests and an important share of logging companies operate outside primary forests;
- Very few companies in the European logging industry fall in the scope of the Directive due to their small size and thus the payments to governments in this sector are frequently under the required threshold; and
- If logging companies sub-contract their operations to local entities, which is often the case in the sector, the reporting requirements are not applicable to the latter.

In the sample of reports examined, most companies have provided the required information, namely the payments to each government by project and by type of payment. The main errors and inconsistencies identified in the reporting related to unclear definitions of specific requirements such as the definition of projects, types of payments and the approach on joint-ventures. Due to the lack of implementation guidelines, companies have adopted different interpretations. For example, companies have adopted different approaches regarding the reporting of the payments of joint ventures: some report only payments when they are the controlling party while others report the payments even if they are not the controlling party; some companies report payments to governments in full, proportionally or do not report such payments. With these different interpretations, important sums may be completely excluded from the reporting or be reported several times in different companies' reports.

The study established that there is limited monitoring and oversight of the different national authorities on the compliance with the reporting requirements. Therefore, issues with the reporting requirements were identified mostly through the efforts of civil society organisations, focused on transparency and accountability, and of academics.

Our findings show that companies' reporting processes are deeply embedded in the data collection process of other financial reports. Accounting teams at a central or local level collect the necessary data and consolidate it for reporting, using corporate/governmental/sectorial guidelines and templates. While audit or assurance is not mandatory in the reporting requirements and their national transpositions, certain large multinational companies already use the services of independent auditors or provide additional assurance on a voluntary basis.

Effectiveness and efficiency of the reporting requirements

Public awareness of the reports from civil society is still low in most countries. Civil society organisations are optimistic that the influence of the reports will increase over the next three to five years, once more reports are available. Due to different national rules for the publication of the reports (national registry, company website), access to the reports can be challenging. The UK centralised repository for disclosures established by Companies House is a best practice example as it provides central free access to all the CBCR reports of UK-registered companies within the scope of the legislation, and the payments data are provided in XML format that outputs as a CSV spreadsheet, allowing the extraction and use of data. Some companies also provide additional methodological and contextual information in a separate PDF file.

Civil society from both countries of origin and countries of operations is using the information provided by the reports, mainly to compare figures with other sources, and to request clarifications from governments or companies. The extent of their use is dependent on the openness of the political system in the country of operation. The use of the reports can also be hampered by the lack of contextual information or the lack of comparability across reports, due to different interpretations of the requirements.

There are several examples of civil society using the reports to raise awareness with reports and infographics or to request clarifications to governments and companies, thus holding both governments and companies to account, which is an unintended impact of the Directive. However, it is still too early to notice significant changes in government accountability and resource governance in resource-rich countries. In addition, the impacts depend on the freedom of the civil society to use the reports to hold their governments accountable. Indeed, unless civil society and media can use

the information disclosed for public debate and to query governments, transparency cannot automatically translate into accountability and in equitable revenue sharing. In comparison with other existing reporting schemes, the CBCR is found to be more reliable and thus effective than data published by some governments and more up to date than EITI in the extractive sector. However, in the logging sector, stakeholders consider that the EU Timber Regulation and Voluntary Partnership Agreements are more relevant and with that effective in increasing transparency.

Overall, in line with their main objective, the reporting requirements have been deemed effective in increasing the transparency of payments made by companies to governments for the exploitation of natural resources. The EU CBCR, which provides data that were not available before, offers a new source of information that enables the civil society to compare data on payments to governments across several sources and therefore make it better equipped to hold government representatives to account.

The long-term impacts of the reporting requirements on reducing illegal logging and extractive operations also remain limited since the disclosure is still recent. As very few logging reports have been identified, the impact on illegal logging is even more limited. Where progress was noted, it was also due to the EITI, the EU Timber Regulation or national initiatives.

The reporting requirements entail additional compliance costs, but the companies did not consider that they represent a disproportionate burden.

Impacts of other international regimes

The EU reporting requirements present similarities with the following other international reporting schemes:

The Extractive Industries Transparency Initiative (EITI):

The EITI is a voluntary regime while the EU CBCR is compulsory. The EITI reports the payments received by governments, as reported by each government whereas the EU reports are prepared by companies and cover their payments to governments. The EITI reports provide more contextual information but are usually published two years after the payments occurred, while the EU reports are published annually. The EITI only targets the extractive sector. EITI was there before the EU requirements and has thus eased the adoption of the latter, however there is no concrete example of countries joining the EITI due to the EU CBCR. The EU requirements have also influenced the EITI with the adoption of project-by-project reporting. There is potential for mainstreaming extractive industry transparency with more synergies between the two regimes.

The Canadian Extractive Sector Transparency Measures Act (ESTMA):

The EU and the Canadian reporting requirements are equivalent and fully substitutable with each other. The extractive industry welcomed this equivalence because it will avoid double reporting for companies operating in Canada and the EU. The ESTMA does not cover the logging sector.

The US Dodd-Frank Wall Street Reform and Consumer Protection Act:

The Dodd-Frank Act has many similarities with the EU CBCR, although it is focused solely on the extractive sector. Since the implementation rule of Section 1504 of Dodd-Frank Act has been invalidated by the current US administration American, US companies no longer have reporting obligations, until a new rule is adopted by the Securities and Exchange Commission (SEC).

Overall, extractive companies would favour the adoption of a unique reporting standard applicable to all stakeholders in the sector, for instance one designed by an international organisation. However, companies deem unified standards to be unrealistic and favour equivalence between the reporting standards.

Impacts of EU reporting requirements on competitiveness and energy supply

EU Member States are heavily dependant on a few supplying countries for both crude oil and gas. Therefore, any limitations of the operations of EU companies in strategic resource-rich partner countries due to the reporting requirements would have an impact on energy security.

There is no evidence that competitors from third countries benefit from substantial competitive advantages by not being required to report on payments to governments. In addition, so far European companies have not reported that they suffered material damages or losses of opportunity due to the introduction of the reporting requirements. The requirements entail compliance costs, but they are not seen as highly disproportionate by the industry. Similarly, companies did not find it harder to operate in third countries. An analysis of recent contracts in the extractive sector in some country of operation shows that EU companies have maintained or increased their presence in countries where they were operating.

Despite the shared opinion that EU reporting requirements do not represent a competitive disadvantage, some European companies nevertheless expressed concern about the absence of similar reporting requirements for US companies. It is too early to tell whether this has created an unlevel playing field, but some EU stakeholders suggested that this risk could materialise if EU companies remain the only ones complying with such reporting requirements.

On the other hand, a number of stakeholders interviewed believe EU reporting requirements may even present a competitive advantage. These requirements may enhance the reputation of the company, making them attractive to civil society and investors.

Overall, stakeholders have not noted cases of third countries limiting the operation of EU companies due to reporting requirements. Thus no impact can be reported on the energy security of Member States.

Recommendations

The findings of the study led to a set of recommendations and an assessment of their added value.

Improve the unclear aspects of the requirements and additional steps to improve compliance

The industry and NGOs agree that the lack of clarity of some definitions in the reporting requirements can lead to different interpretations. The main issues in terms of interpretation are the definitions of project and of payment types, as well as the approach on joint-ventures. Thus, there are discrepancies in the way companies report their payments for similar operations. On a similar note, in the logging sector, the definition of primary forest is often interpreted in a restrictive way. One

consequence is that very few logging companies consider themselves to be in the scope of the Directives.

In the absence of EU guidelines, extractive companies have used several strategies: while some have defined their own interpretation, others have discussed their interpretation with other companies in informal working groups. Given this room for interpretation, most stakeholders would welcome the following measures:

- Guidelines at EU or national level to clarify, in particular, the definitions of projects, types of payments, the approach on joint-ventures and the scope of logging activities;
- Obligation for companies to include a "basis of preparation" section, to explain their interpretation of the reporting requirements;
- Better national authority oversight and more effective sanctions to improve compliance; and
- Awareness raising in the logging sector of the reporting requirements among forestry associations and companies in the scope.

Extension of reporting requirements to other sectors

While government representatives remain cautious about extending the CBCR reporting requirements of the extractive and logging sectors to other sectors, NGOs are generally in favour of adopting similar requirements in other sectors involving national resources or substantial payments to governments (e.g. agriculture, fisheries, telecoms, construction). Some logging stakeholders are also in favour of having all logging operations in the scope instead of only logging operations in primary forests, or at least extending the scope to forests that have been commercially logged once or twice since their official natural state. It is worth noting though that the lack of reporting in forestry is also linked with the industry structure as EU companies are very often not the holder of the logging concession. If reporting requirements were to be extended to other sectors, they need to be tailored to the sectors in question as both the effectiveness and the costs of the measure depend heavily on the size of operating firms and the extent to which the sector has direct financial interactions of large firms in the EU with governments.

Benefits and costs of a compulsory audit of the reports

A full audit of the reports could increase the confidence of users in the accuracy of the figures and the compliance of the reports with the reporting requirements. However, an independent audit would also increase significantly the compliance costs. National authorities advise that costs and benefits should be carefully assessed before introducing any compulsory auditing. To strike a balance between the current absence of formal verification and a full audit, introducing limited assurance is more likely to be found acceptable by the industry, and could also improve the reliability of reports as advocated by NGOs. The framework regarding limited assurance would however need to be tailored to the specific reporting regime to define the scope. Another option would be to include the payment reports in annual reports or corporate social responsibility reports, which would carry more weight and imply some consistency checks with the financial statements by the auditors.

Relevance of additional payment information

The potential addition of new payment information to the requirements, namely the average number of employees, the use of subcontractors, the pecuniary penalties administered by a country, the effective tax rates and the recipient's details such as bank account information received mixed support. While NGOs would welcome the introduction of all above items to increase accountability and contextual information, companies are reluctant to add any more information, arguing that it would incur additional compliance costs and is not necessary to achieve the objectives of the Directives. National authorities also do not see added value in adding these extra

items. Overall, adding information requirements which help users to assess the total size of the operations in a country (e.g. subcontractors or effective tax rate) would provide some added value to users as they would get a better comparator for the payments that the government receives. However, civil society representatives do not deem the above items to be the most important ones and noted that each additional requirement on its own would not be sufficient to provide a comprehensive picture of the company's activities. On the other hand, the compliance costs are likely to be highest for the disclosure of the number of employees and the use of subcontractors, since information systems vary greatly across countries and company accounting systems are not consistently set up to gather information centrally.

Other relevant information or recommendations

To facilitate access and use of the reports, NGOs call for a central repository of reports, either at Member State or EU level, with machine-readable data. There could be further synergies between the EU reporting requirements and other initiatives to enhance consistency and increase transparency on payments to governments such as EITI, the EU Timber Regulation and the EU FLEGT, and more awareness raising in countries of operation.

NGOs propose to include information on trading activities of commodities, the clear identification by name of the government entity that received payment, the exchange rate used by currency, the name of all projects (even below EUR 100,000 payments) and contextual information on the projects. In the logging sector, payment information for connected operations could be included. This extra information would improve understanding of the reports and facilitate their use in holding governments accountable.

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