Title: Implementation of Chapter 10 of EU Accounting Directive (2013/34/EU) **IA No:** BISBE777 **Lead department or agency:** Department of Business, Innovation & Skills **Other departments or agencies:** No	**Impact Assessment (IA)** **Date:** 14/07/2014 **Stage:** Final **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries:** Vickie Wood Tel: 0114 207 5308 Email: vickie.wood@bis.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
-£69.8m	-£69.8m	£0.75m (£6.41m-£5.66m)	Yes	IN

What is the problem under consideration? Why is government intervention necessary?

Across the world, natural resources are worth over a thousand trillion dollars[1] and make substantial contributions to the public budgets of many developing countries. However, the citizens of these countries often remain extremely poor. This is in part because many governments of developing countries have failed to responsibly manage the large payments made to them by extractives companies in return for access to natural resources. The absence of good governance and the lack of transparency around these payments reduce the positive impact that extractive industries can have on economic development. It also negatively impacts on, and increases the risk for, UK companies and investors active in the extractives sector through civil unrest and poor business environment.

What are the policy objectives and the intended effects?

The aim of this policy is to raise global standards of transparency in the extractives sector. This is intended to improve accountability by allowing citizens in these countries to access information about payments made, and increase their ability to hold their governments to account regarding use of the revenues. This relies on the assumption that the democratic processes in the relevant countries are robust enough to allow citizens to hold governments to account in the presence of information about payments. By improving accountability the policy aims to reduce the space for corruption and other illicit activities, and ensure that citizens of developing countries benefit appropriately from the extraction of their natural resources.
It is also expected to bring real benefits to UK companies operating in resource rich developing countries by reducing risk and improving the business environment, as well as to UK investors who will be better able to assess the risk profiles of extractives projects. The policy will apply to all large[2] UK incorporated extractive companies, and all UK incorporated extractive companies listed on the UK main market.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

As this is an agreed European Directive, the do-nothing option and alternatives to regulation are not available, and the provisions set out clear requirements for reporting so we have little flexibility to decide how to implement. Three options were considered:
0. Do nothing - not feasible as it is an agreed EU Directive, however this option is considered as the baseline
1. Implement Chapter 10 by the transposition deadline (20 July 2015).
2. Implement Chapter 10 early, with reporting requirements to apply to reporting periods commencing on or after 1 January 2015.
Our preferred option is Option 2. Early implementation will ensure benefits to UK extractive companies and investors accrue as soon as possible. In addition, a commitment has been given by the Prime Minister, and other EU Member States in the G7, to implement the reporting requirements quickly in recognition of the fact that these new requirements represent a significant step forward in fighting corruption in developing countries and in helping to ensure those countries' citizens benefit from the funds transferred for access to natural resources.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 07/2018

Does implementation go beyond minimum EU requirements?	Yes

1 World bank data on economic rents and GDP
2 Based on the Company Act 2006 definition

Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0	**Non-traded:** 0	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: Jo Swinson Date: 21st October 2014

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -107.1	**High:** Optional	**Best Estimate**:-61.6

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional		Optional	**Optional**
High	13.1		11.2	**107.1**
Best Estimate	11.9		5.9	**61.6**

Description and scale of key monetised costs by 'main affected groups'

The monetised cost of this proposal relates to the additional reporting costs imposed by the measure. This includes transition costs (£11.9m) for companies familiarising themselves with the requirements, introducing new processes and making changes to their financial reporting systems. There are also ongoing costs of £6.6m[3] per annum associated with the requirement for companies in scope to compile the relevant information and where applicable, produce an annual report.

Other key non-monetised costs by 'main affected groups'

It is possible that complying with this measure will place UK companies at a competitive disadvantage. Whilst disclosing payments to governments will not give direct insight into the levels of turnover, costs and profits that an extractives company generates in a particular area, there may be instances when confidential business data will be revealed or can be deduced from such data. There may be other indirect costs to companies operating in countries where disclosure of such information is prohibited by criminal law. Some companies believe that this could create a conflict in law and result in increased legal fees or fines, loss of business, forced divestment and even criminal sanctions; however evidence for this is weak.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

There will be benefits to UK businesses, including extractive companies and investors, but we have been unable to monetise these due to their intangible nature (see below).

Other key non-monetised benefits by 'main affected groups'

The non-monetised benefits to UK businesses from this measure include unquantified benefits to business and investors. These benefits are associated with an improved political and economic operating environment arising from promoting accountability and good governance. This will improve the operating environment and reduce operating risk for extractives companies, and improve transparency with in relation to company activity and project risk for investors.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

Estimates of the cost of reporting are based on a small number of responses and have been extrapolated across the industry using various assumptions set out in Annex A. This reduces the accuracy of these estimates, but provides our best estimate of the expected costs, and we consider it improves upon the methodology used in the EU IA, as the responses to the UK consultation provide an indication of the breakdown of costs between parent and subsidiaries allowing more accurate extrapolation, are more recent and up to date estimates, and are provided by companies which are known to be in scope of the UK transposition of the regulations.

The costs of this option will be lower if the US reporting regime is enforced before 1 January 2016 and the US regime is considered equivalent by the EU. In that case, the 27 dual listed US-UK which would already be reporting to the US will not incur additional costs of reporting in the UK. This possible reduction in costs has not been included in the cost estimates. This is because based on the planned US work timescale it is unlikely that the US regime will be implemented ahead of January 2016, and there remains a lot of uncertainty as to the detail of the US requirements and whether there will be equivalence with the EU regulations.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 5.66	**Benefits: 0**	**Net:** -5.66	No	NA

[3] Annual costs are incurred in years 2-10 of the 10 year appraisal period, with zero costs in year 1 as only Option 2 will incur costs in this year. This means that the average cost annual cost over the 10 year period is lower than the annual ongoing cost to business.

Summary: Analysis & Evidence — Preferred - Policy Option 2

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2014	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -121.3	**High:** Optional	**Best Estimate:** -69.8

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	14.5		12.4	**121.3**
Best Estimate	13.1		6.6	**69.8**

Description and scale of key monetised costs by 'main affected groups'

The monetised costs (comprising transitional costs and ongoing costs associated with reporting) are of the same nature as those identified in Option 1. However costs will be incurred a year early and transitional costs will be incurred by an additional 38 companies which have EU parents but will have to report in the UK in the first year before the EU parent is covered by legislation in their own Member State, resulting in a total transitional cost of £13.1m. Ongoing costs will be the same as in option 1 but will be incurred a year early. The total additional cost (£8.2m) associated with this option over and above the cost of Option 1 reflects the time value cost of early implementation, the additional report(s) that companies in scope will be required to compile, and the one year cost to the subsidiaries of EU parents.

Other key non-monetised costs by 'main affected groups'

The potential non-monetised costs are those identified in Option 1. However these will be incurred early in the case of the early implementation of the directive. For the firms which have a parent in other Member States, there will be some additional frictional costs associated transitioning from reporting themselves in the first year, to providing information to their parents to report once regulations are put into place in their own Member State.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

There will be benefits to UK businesses, including extractive companies and investors, but we have been unable to monetise these due to their intangible nature.

Other key non-monetised benefits by 'main affected groups'

The potential non- monetised benefits (UK and international) are those identified Option 1. However these will be realised early in the case of the early implementation of the directive. These include benefits to UK extractive companies and investors – for example early implementation will allow investors in UK companies to achieve certainty and therefore to make more optimal investments earlier. This in turn should lead to increased efficiency of UK companies.

Early implementation by the UK also aims to promote accountability and good governance, leading by example to improve the operating environment in developing countries by fighting corruption. This suggests strong international equity argument for implementing the directive early.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

As in Option 1

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 6.41	**Benefits:** 0	**Net:** -6.41	Yes	IN

Evidence Base (for summary sheets)

Executive Summary

(i) Problem under consideration and rationale for intervention

- Across the world, natural resources, such as oil, gas and minerals, are worth billions of dollars to developing countries.
- However, whilst many of the world's poorest countries have huge reserves of valuable natural resources, their citizens often remain extremely poor. This can be because many governments of developing countries have failed to manage successfully the large payments made to them by extractives companies in return for access to natural resources.
- The absence of good governance therefore significantly reduces the positive impact that extractives industries can have on local economies and local people.
- There is an **economic efficiency** rationale for intervention to help developing countries address the government failures in their own administrations. Even though this economic inefficiency originates outside UK jurisdiction, the benefits of addressing this failure are likely to have economic benefits to UK and are therefore in scope in terms of the Green Book. For instance, if the Directive effectively inspires greater transparency, less **information asymmetry** and less corruption through enabling citizens to hold their governments to account, and this results in more efficient use of resources by governments and less unrest among citizens. This will enable UK extractive companies to benefit from an improved operating environment. With greater political and economic stability in the countries they operate in, UK extractive companies will incur less disruption and be able to carry out extractive activity more consistently and at a lower cost than under the status quo. For example, as of July 2007, Royal Dutch Shell reported that 195,000 barrels of oil a day remained trapped in Nigeria, with a daily price tag for the company of nearly $16 million. Lack of economic opportunity, both real and perceived, is identified as one of the key factors contributing to violence and the disruption of operations in the region[1]. Greater stability and transparency will also enable UK investors to make improved investment decisions as there will be less information asymmetry between investors and local managers.
- There is also a strong political/societal rationale to intervene on **international equity** grounds to assist disadvantaged people in developing countries by increasing accountability and therefore promoting good governance. Increasing good governance is likely to lead to improved social outcomes[2] . Although the benefits associated with international equity accrue outside the UK (so are not strictly counted under Green Book guidance) this forms a major part of the rationale for intervention.

(ii) Options and policy objectives

- The aim of Chapter 10 is to raise global standards of transparency in the extractives sector by requiring companies to report publicly the payments they make to governments in all their countries of operation.
- **Option 1:** proposes implementing the Directive on 20 July 2015, the transposition date set by the Commission. Implementation on this date would require extractives companies to begin reporting any payments they have made to governments for financial years beginning on or after 20 July 2015.
- **Option 2:** This option proposes implementing the Directive early, by bringing regulations into force in 2014 to apply to financial years beginning on or after 1 January 2015.
- **Option 2 is our preferred option.**

1 The Role of the Extractive Sector in Expanding Economic Opportunity: http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_18_EO%20Extractives%20Final.pdf
2 Khan (2010) Governance, Growth and Development

(iii) Costs and Benefits

- Option 1 and Option 2 are the same apart from the timing of implementation, therefore the nature of the costs and benefits are the same for both options. The one difference to costs, other than timing, relates to costs falling on subsidiaries of EU parent companies, which would be required to report for the first year in the UK in the case of early implementation, but from 20 July 2015 will be reported on by their EU parent.
- The costs in both cases fall on the 251 UK incorporated large or listed companies which carry out extractive activity.
- The UK specific **benefits** associated with introducing this measure include unquantified benefits to business and investors associated with an improved operating environment.
- There is a monetised **cost** to business arising from increased reporting costs.
- To calculate these costs we have used estimated costs of reporting provided by companies in response to our consultation, and extrapolated across the total number of UK entities which fall within scope of the measure based on whether they are a parent company or subsidiary, and based on the number of subsidiaries as a proxy for the relative cost of reporting. (see Annex A for more detail)
- The number of entities in scope and information regarding their subsidiaries/parents has been obtained using the FAME database.
- There is also a potential non-monetised cost associated with the possibility that aspects of this measure put UK firms at a competitive disadvantage with respect to non-EU firms.
- The monetised costs of **Option 1** are £11.9m for transition costs and £6.6m per annum for ongoing costs. This leads to an NPV of -£61.6m and an EANCB of £5.66m. The costs of Option 1 do not count as an IN because it is an EU requirement
- The monetised costs of **Option 2** are higher due to the additional extractive reports companies will be required to compile under early implementation, and due to the first year report in the UK that subsidiaries of EU parents will be required to provide due to early implementation ahead of other EU countries. Transitional costs for this option are £13.1m and will be incurred a year earlier than in Option 1. On-going costs are £6.6m per annum, the same as in Option 1, but again will be incurred a year earlier. This leads to an NPV of -£69.8m and an EANCB of £6.41m.
- Therefore Option 2 counts as an 'IN' of £0.75m (£6.41m-£5.66m).
- The consultation sought further information on the costs and benefits of implementing the directive early. Industry offered a range of costs associated with setting up systems and on-going costs (as per above), rather than specifically quantifying any additional costs for early implementation.
- Comments were received in relation to problems associated with not knowing whether there would be equivalency with the US system. Equivalency will only be decided once the US regulations have been decided, likely to be late 2015 with implementation date uncertain. This IA therefore assumes non-equivalence, and attributes the full cost of developing systems and reporting will fall to this Directive. If US systems are deemed non-equivalent, there will also be some frictional costs associated with the management of the two approaches, for those companies which incur both a US and an EU reporting requirement.
- Additionally comments were made in relation to subsidiaries who would ultimately report through parents in other Member States. Businesses were generally of the view that setting up systems to comply with UK requirements for one year only would create additional costs. These costs are accounted for in the options analysis which includes the cost of a single year of reporting in the UK for these companies within the analysis for Option 2. However, we recognise that, there may be additional frictional costs associated with the transition from reporting as a parent to providing information as a subsidiary, which would be incurred in option 2. We have been unable to quantify these potential costs due to a lack of evidence relating to these specific impacts.
- Given that it is not possible to monetise the majority of the costs and benefits, it is not possible to

recommend either of the options on economic efficiency grounds alone. However, it is clear that there is a strong international equity argument for implementing the directive early.

- There are no concerns associated with the wider impact tests.

A. Background

This Impact Assessment relates to proposals to implement the provisions of Chapter 10 of the Accounting Directive (2013/34/EU). Chapter 10 (see paragraph 22 for a description) aims to increase transparency around the payments extractives companies (oil, mining, gas and loggers of primary forest) make to all governments.

B. Problem under consideration

1. Across the world, natural resources, such as oil, gas and minerals, are worth billions of dollars to developing countries. Africa's natural resources were worth $246 billion in exports in 2009 – a figure which is 6 times greater than Official Development Assistance (ODA).[3]
2. While there are variations from country to country, the proceeds from oil, gas and mineral extraction make substantial contributions to the public budgets of many developing countries. The IMF Revenue Transparency Report states that oil, gas and mineral resources account for over 50% of government revenue or export proceeds in many low and middle income resource rich countries[4], whilst in 2005 the Shell Group paid $18 billion in government taxes in its countries of operation throughout the world.[5]
3. However, whilst many of the world's poorest countries have huge reserves of valuable natural resources, their citizens often remain extremely poor. This can be because many governments of developing countries have failed to manage successfully the large payments made to them by extractives companies in return for access to natural resources.
4. The absence of good governance therefore significantly reduces the positive impact that extractives industries can have on local economies and local people. Whilst Nigeria is one of the top 10 oil producers in the world and the leading producer in Africa, with oil exports estimated to be worth more than $100 billion in 2011[6], 62.6% of its population continues to live below the poverty line.[7]
5. Transparency around the payments extractives companies make to governments will provide these citizens of resource-rich developing countries with the information they need to help hold their governments to account and help ensure that the income is invested in local people and services.
6. Publish What You Pay (PWYP), a global network of civil society organisations that campaigns for an open and accountable extractives sector, argues that "Citizens and civil society need to be able to access information about extractives revenues to hold governments and companies accountable, ensuring that natural resources generate benefits for the whole population. Resource transparency reduces corruption and the costs of capital for developing countries and encourages foreign direct investment through a more stable business climate".[8]
7. In addition, Shell states that "We believe that transparency promotes good government, helping to ensure that the billions of dollars the energy industry pays in tax benefits society as a whole, rather than a privileged minority."[9]
8. Badly functioning local economies can also create difficult and potentially damaging operating environments for UK extractives companies which is likely to impact on profits.

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[3] http://www.publishwhatyoupay.org/about/advocacy/eu-country-country-and-project-project-reporting-proposals-qa

[4] IMF Guide to Resource Revenue Transparency (2007)

[5] The Role of the Extractive Sector in Expanding Economic Opportunity:
http://www.hks.harvard.edu/mrcbg/CSRI/publications/report_18_EO%20Extractives%20Final.pdf

[6] http://eiti.org/Nigeria

[7] http://data.worldbank.org/country/nigeria

[8] http://www.publishwhatyoupay.org/about/advocacy/eu-country-country-and-project-project-reporting-proposals-qa

[9] http://www.shell.com/global/environment-society/society/business/payments-to-governments.html

9. The UK is an important actor in the global extractives industry, and many of the world's largest extractives companies have a presence here, including BP, Royal Dutch Shell, Rio Tinto and Anglo American. There are 251 large or listed extractive companies in scope of the directive.

10. Due to the nature of the work they are engaged in, the extractives industries have a much longer time horizon than many other industries. They are relatively immobile, given that they must locate themselves wherever minerals and energy deposits exist. They are therefore more easily affected by unstable economic and political environments than other sectors and have a particular interest in expanding economic opportunity and increasing political stability in their countries of operation.[10] Indeed, Tullow Oil states that "As long-term investors, we need assurance that the legal, fiscal and regulatory regime will remain stable over the life of the project".[11]

11. However, in the absence of an extractives reporting requirement, there is no reliable information available on the current level of payments made by extractives operators to host governments. This affects both the local community's ability to hold its government to account for its use of the funds, which directly influences the political and economic stability of the country. It also improves extractives companies' knowledge regarding the level of corruption in the country, which in turn will influence their degree of assurance as to the political and economic stability of the country This stability – in both senses - is likely to affect both forecast and actual costs and hence improve profits both directly and through better decision-making..

12. Importantly, transparency also affects companies' ability to demonstrate the size of the contribution they make to host countries and thereby boost their reputation and their "social licence" to operate. Tullow Oil believes that "Transparency creates the opportunity to more effectively manage expectations of what socio-economic impact the discovery of oil can have over what time frame. Further, it provides greater insight into how our industry operates and demonstrates the range of economic contributions that we can bring to a country."[12]

13. A lack of transparency around payments made to governments reduces the ability of investors to assess the level of corruption in the country related to extractive projects, which negatively impacts investors' ability to assess the risk profiles of extractives projects and make effective investment decisions. This is especially the case in countries where governance is weak, as the resulting corruption, bribery and conflict can negatively affect the sustainability of a company's operations and therefore the profitability of investments.

14. Currently available data suggests that payments are likely to run into many billions. In a survey of 11 country reports, the Extractive Industries Transparency Initiative (EITI) reported that the surveyed host governments annually received collectively US$43.5billion from the oil, gas, mining and timber industries.[13] To put this figure in context, the payments represent, on average, 11.5% of these countries' GDP. The European 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 billion in 2009.[14]

C. Rationale for Intervention

15. There is an **economic efficiency** rationale for intervention to help developing countries address the government failures in their own administrations. Even though this economic inefficiency originates outside UK jurisdiction, the benefits of addressing this failure are likely to have economic benefits to UK and are therefore in scope in terms of the Green Book

16. For instance, if the Directive effectively inspires greater transparency, less information asymmetry and less corruption, UK extractive companies will benefit from the improved operating environment. With greater political and economic stability in the countries they operate in, UK extractive companies will be able to produce more consistently and at a lower cost than under the status quo. Also UK investors will be able to make improved investment decisions. Greater

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[10] http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_18_EO%20Extractives%20Final.pdf

[11] http://www.tullowoil.com/files/pdf/reports/tullow_cr_2013.pdf

[12] http://www.tullowoil.com/files/pdf/reports/tullow_cr_2013.pdf

13 2009 EITI overview of reports, http://eiti.org/files/Overview%20EITI%20Reports.pdf

14 EU Commission Impact Assessment for Financial Disclosures on a Country-by-Country basis http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/SEC_2011_1289_2_en.pdf

transparency around extractive companies will reduce the **information asymmetry** between investors and extractive companies, thereby ensuring a more efficient allocation of capital. Moreover, if investors are more able to make effective investment decisions, capital will be more efficiently allocated, to the benefit of the companies with the greatest growth prospects.

17. Knowledge of a company and its operating environment is important in helping those who engage with a company to more accurately assess the risk of company transactions, and therefore their own engagement with them. Not knowing a company's full profile means that there is a greater inherent risk of investors making sub optimal investments. This makes economic transactions/activities less attractive[15] and hence less likely to go ahead or they will go ahead but at a higher cost or lower level. For instance, Easley and O'Hara (2004)[16] find that companies which keep a greater proportion of their information private require a greater compensating return for the lack of transparency, i.e. they face a higher cost of capital. This is a common finding in the economic literature[17].

18. In addition, when corporate information is not readily available, other parties must incur greater costs from conducting due diligence to mitigate this risk. They must, for instance, actively seek to 'profile' the company and also write, complete and monitor contracts[18]. Therefore a lack of information will increase transaction costs, which can serve as a serious barrier to entry in the market, discouraging economic activity and potentially harming growth.

19. There is also a strong political/societal rationale to intervene on **international equity** grounds to assist disadvantaged people in developing countries by increasing accountability and therefore promoting good governance. Increasing good governance is likely to lead to improved social outcomes[19] . Although the benefits associated with international equity accrue outside the UK (so are not strictly counted under Green Book guidance) this forms a major part of government's rationale for intervention.

D. Policy Objectives

20. The aim of Chapter 10 is to raise global standards of transparency in the extractives sector by requiring companies to report publicly the payments they make to governments in all their countries of operation.

    - This is intended to improve accountability, reduce the space for corruption and other illicit activities, and ensure that citizens benefit appropriately from the extraction of their natural resources.
    - It is also expected to bring real benefits to UK extractives companies by improving their operating environments, as well as to UK investors by improving their ability to assess risk and make more effective investment decisions.

21. As such, Chapter 10 supports the Government's ambition for strong extractives reporting requirements and represents a significant contribution to the development of a global standard for transparency in these industries[20].

22. The key requirements introduced by Chapter 10 are:

- Large EU registered extractives companies (mining, oil, gas and forestry) must report the payments they make to governments in all of their countries of operation.
- Reports must be prepared on an annual basis, and must:

(i) Be prepared on the basis of individual projects

15 Furthermore, considering adverse selection, if the share of 'bad' companies exceeds a certain threshold, the market will cease to exist as 'good' companies are driven out of business.
16 Easley, D. and O'Hara, M. (2004) 'Information and the Cost of Capital' The Journal of Finance, Vol. 59, No 4.
17 See Barry, C., and S. J. Brown (1985) "Differential Information and Security Market Equilibrium." Journal of Financial and Quantitative Analysis 20, no. 4: 407-22 for a model, which demonstrates that securities with relatively little information are of a higher systemic risk. See Merton, R. (1987) "A Simple Model of Capital Market Equilibrium with Incomplete Information." Journal of Finance 42, no. 3: 483-510. Finds that in a model where investors are not aware of all stocks available i.e. suffer from incomplete information, the equilibrium value of each company is always lower.
18 Nonetheless, knowledge is always imperfect to some extent: as noted by Miller and Whitford (2002)18 without all encompassing contracts, which account for every eventuality, some element of trust is implicit in every business contract.
19 Khan (2010) Governance, Growth and Development
20 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207771/Lough_Erne_2013_G8_Leaders_Communique.pdf

(ii) Include all payments made in money or in kind, whether made as a single payment or a series of related payments, totalling over €100,000 (approx. £84,000) or more.

(iii) Disclose the total amount of payments made to each level of government, including national, regional and local governments, and state owned organisations.

(iv) Disclose the total amount per type of payment. Types of payment covered are: production entitlements; taxes levied on the income; production or profits of companies (excluding taxes levied on consumption such as value added, personal income taxes or sales taxes); royalties; dividends; signature, discovery and production bonuses; licence fees, rental fees, entry fees and other considerations for licences and/or concessions; and payments for infrastructure improvements.

23. There will be no exemptions to reporting, even where companies are operating in countries that prohibit disclosure in criminal law. It is felt that providing exemptions in these cases would diminish the effectiveness of the reporting requirements in the Directive and would provide an incentive for corrupt countries to implement such laws. Furthermore, we have yet to be provided with convincing evidence that any criminal prohibitions on the reporting of payments to governments exist in other countries, or that disclosure of such information would result in any legal action or loss of business. All but two of the companies we have spoken to have indicated that they believe they could continue with their operations even without an exemptions clause.

24. EU listed companies will also be required to report according to Chapter 10 requirements as a result of the provisions in the Transparency Directive (TD).

E. Options Considered

25. The Accounting Directive (AD), published in July 2013, will replace the existing Accounting Directive. Chapter 10 introduces a new set of reporting requirements for extractives companies.

26. The content of the report is fixed by the Directive. As such, there are limited areas within which the UK can define requirements. These limited areas, along with their possible associated costs and benefits, are explored in this IA. As part of the consultation we sought views on areas where the UK has options. This included the proposed penalty regime, reporting mechanisms, and timescales.

27. The responses were split. In general the responses from the civil society supported the proposed timeframe and penalty regime although they did argue for harsher jail sentences. Whilst industry made clear its support for the reporting of such information, a few companies sought delays to the timeframe for one year in line with other Member States and the US. The decision to implement early was made independently of potential regulations in the US as the US reporting requirements have yet to be developed, and therefore carry uncertainty with regards to the specific details and timing. With respect to alignment with other Member States, early implementation is largely driven by the international equity argument – by implementing early, the UK aims to promote accountability and good governance, leading by example to improve the operating environment in developing countries by fighting corruption. This will impose some additional costs on subsidiaries of EU parents, due to the fact they will be required to report in the first year in the UK, but will subsequently be reported on by their EU parent. This cost has been included within the impact analysis of early implementation. The timing of implementation is the key difference between Option 1 and Option 2.

<u>Option 1:</u>

28. This option proposes implementing the Directive on 20 July 2015, the transposition date set by the Commission.

29. Implementation on this date would require extractives companies to begin reporting any payments they have made to governments for financial years beginning on or after 20 July 2015.

<u>Option 2:</u>

30. This option proposes implementing the Directive early, by bringing regulations into force in 2014 to apply to financial years beginning on or after 1 January 2015.

31. Implementation on this date would require extractives companies to begin reporting any payments they have made to governments for financial years beginning on or after 1 January 2015. See annex B for a detailed implementation timetable.

Option 2 is our preferred option:

32. In the communiqué and declaration published following the G8 summit at Lough Erne, the Prime Minister, alongside other EU G8 members, committed to implementing the extractives transparency requirements contained within the Directive quickly.
33. He gave this commitment in recognition of the fact that these new requirements represent a significant step forward in fighting corruption in developing countries, and in helping to ensure that the citizens of those countries benefit from the huge sums of money that extractives companies pay their governments for access to natural resources.
34. As we also expect the Directive to bring benefits to UK extractives companies operating in resource rich countries, as well as to UK investors, early implementation will ensure that some of these benefits accrue as soon as possible. It is difficult to determine the extent to which reporting by UK companies alone would achieve critical mass in terms of promoting accountability and promoting good governance thus increasing the profits of UK companies. However, it would allow investors in UK companies to achieve certainty earlier and so make more optimal investments.

F. Monetised and non-monetised costs and benefits of each option

35. The range of benefits arising from the measure will be the same whether we choose Option 1 or Option 2. However, early implementation (Option 2) will increase the discounted size of the costs and benefits. The costs of option 2 will also include the additional report that companies in scope will be required to compile under early implementation, and the report in the UK that subsidiaries of parents located in other Member States will be required to make, before the obligation will fall on their parent companies to report on their behalf from 20 July 2015.
36. The section below outlines the costs and benefits expected to arise from introducing the measure on the standard timescale (Option 1), before highlighting how these could change as a result of early implementation.
37. Costs and benefits are based on responses to the UK consultation, as well as a response provided to the US regarding the Dodd Frank requirements, which are expected to attract similar costs and benefits. Estimated costs are based on a total of 5 responses, as many companies felt unable to provide us with accurate cost estimates at this stage. This raises a risk that costs may be unrepresentative of the population of UK extractive companies. However, the estimates of costs received were of a broadly similar scale, once adjusted by company size, which provides some reassurance that estimates are reliable. We use information on the size and ownership of companies in scope to extrapolate the cost estimates across the industry in a meaningful way.

OPTION 1

BENEFITS:

Benefits to citizens of developing countries:

38. By disclosing details of the payments they make to governments, extractives companies will be making significantly more information available about what is specifically paid by them to host governments in exchange for access to the country's natural resources.
39. Publicising this information at project level should make host governments more accountable to their citizens for the way in which payments are spent. Citizens and civil society will have far greater insight into what governments (local and national) are being paid by extractives companies. This will give them the information they need to help demand that their governments account for how the monies have been spent locally.

40. In the absence of an existing extractives reporting requirement, it is difficult to quantify the size of these benefits with any precision. However, many stakeholders have commented that increasing transparency around the payments made to governments is likely to improve governance, reduce corruption and ensure that income from extractives companies is invested in citizens (see points 6 & 7).

41. There is also evidence to suggest that countries with greater extractives transparency are more attractive to investors. A 2013 study into the effect of the Extractive Industries Transparency Initiative (EITI) participation found that joining EITI (a voluntary global coalition of governments, companies and civil society working together to improve openness and accountable management of revenues from natural resources) is associated with an increase in the ratio of FDI inflows to GDP by two percentage points on average.[21]This is significant given that the average ratio of FDI inflows to GDP in the sample of 81 countries studied was five percent (ibid.).

Benefits to UK companies:

42. Due to the nature of work in which they are engaged and their relative lack of mobility, extractives industries are more easily affected by unstable economic and political environments than other sectors. They are relatively immobile, given that they must locate themselves wherever minerals and energy deposits exist.

43. They therefore have a particular interest in improving governance, expanding economic opportunity and increasing political stability in their host communities.

44. As mentioned earlier, many stakeholders have commented that transparency around payments to governments improves governance, reduces corruption and ensures investment in local communities. Whilst these benefits are difficult to quantify precisely, there is a consensus among both industry and civil society around these effects.

45. According to a study by researchers at Harvard and Queensland universities[22], lost extractive industry productivity and costs incurred due to conflicts can be highly significant: “as a result of conflict, a major, world-class mining project with capital expenditure of between US$3 billion and US$5 billion was reported to suffer roughly US$20 million per week of delayed production in net present value terms.”

46. A report by the Corporate Social Responsibility Initiative at Harvard University also found that expanding economic opportunity in host communities can reduce risk, decrease costs of production, and increase profitability for extractives companies.[23] It identified real and reputational costs of protests, work stoppages, boycotts and regulatory backlash where companies are not, or are not seen to be, investing in local communities.

47. As of July 2007, Royal Dutch Shell reported that 195,000 barrels of oil a day remained trapped in Nigeria, with a daily price tag for the company of nearly $16 million. Lack of economic opportunity, both real and perceived, is identified as one of the key factors contributing to violence and the disruption of operations in the region (ibid.).

48. The report also found that a more vibrant local economy can positively impact company bottom lines by reducing the cost of production inputs, which are materially affected by local economic conditions (ibid.).

49. To the extent that local individuals, communities and host nations are experiencing greater economic opportunity, companies’ production costs and local and regional sales may be positively affected. A well-functioning host country market can provide access to a continuous supply of labour at prices well below expatriate packages, materials that need not be imported, and innovation in products and processes that are appropriate to local operating environments (ibid.).

50. In addition, creating a business environment where less bribery and corruption takes place creates a more level playing field for companies that do not take part in such practices, whilst an absolute reduction in the levels of bribery and corruption would increase the level of profits available to be

21 http://eiti.org/files/Schmaljohann_2013_dp538.pdf

22 Franks,D.M.,Davis,R.,Bebbington,A.,Ali,S.H,Kemp,D.,Scurrah,M.,2014.Conflict translates environmental and social risk into business costs. Proceeding s of the National Academy of Sciences of the United States of America http://dx.doi.org/10.1073/pnas.1405135111.

23 The Role of the Extractive Sector in Expanding Economic Opportunity: http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_18_EO%20Extractives%20Final.pdf

paid to as dividends to company shareholders. This was supported by one company, which commented that "Transparency in conjunction with an appropriate tax regime allows all companies to operate on the same playing field. Open and accountable agreements are the basis for good governance and a kick starter for a significant reduction in corruption and bribery."[24]

51. By being seen to be making significant contributions to the economy themselves, extractives companies can boost their reputation and social licence to operate. They can also take advantage of the greater political and economic stability and opportunity greater transparency can bring. The degree to which the increased transparency of payments will deliver such results is uncertain and unquantifiable. In response to the consultation Publish What You Pay noted that payment transparency has wide support among the investor community. This response highlighted the two groups of institutional investors representing trillions of dollars of assets under management that submitted to the US SEC in April 2014

52. It could be argued that if making these contributions is beneficial to companies then it would be rational for them to do it themselves, without government compulsion. However, companies may not do this in practice because of co-ordination failure. If any one company were unilaterally to declare payments then this may not be recognised by wider society. However if firms took collective action then this culture change would be noticed and the benefits would be realised. Companies may find it difficult to co-ordinate this collective action due to imperfect information, transition costs and so on.

Benefits to UK investors:

53. The US Securities and Exchange Commission's (SEC) impact assessment for its own extractives transparency rules included comments from a range of investors who suggested that the information disclosed in the transparency report would benefit investors by among other things, helping them model project cash flows and assess political risk, acquisition costs, and management effectiveness. [25]

54. Investors stated that the disclosures required have value to investors and can "materially and substantially improve investment decision making", namely by reducing information asymmetry and providing more security and certainty to investors as to extractives companies' levels of risk disclosure. This is particularly the case in countries where governance is weak, as the resulting corruption, bribery and conflict can negatively affect the sustainability of a company's operations. Disclosure will therefore improve investors' ability to more effectively make investment decisions (ibid.).

55. Project level reporting means that investors can also better understand the risk profiles of individual projects within a given country, which may vary greatly depending on a number of factors such as regional unrest, personal interest by powerful government figures, degree of community oppression and environmental sensitivity. Unusually high signing bonus payments for a project may be a proxy for political influence, whereas unusually low tax or royalty payments may signal that a project is located in a zone vulnerable to attacks or community unrest (ibid.).

56. We do not have sufficient evidence to put a monetary value on the impact on risk and the required rate of return.

COSTS:

Costs of reporting:

57. The requirement to produce an annual extractives transparency report will result in both transition and ongoing compliance costs. These costs will differ between those companies which are will undertake the final reporting for themselves and for any subsidiaries, and those companies which will only be required to provide information to a parent who will report on their behalf.

- **Transition costs:**

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[24] http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/SEC_2011_1289_2_en.pdf

[25] http://www.sec.gov/rules/final/2012/34-67717.pdf

58. It is expected that extractives companies responsible for reporting will need to make changes to their financial reporting systems to allow them to capture and report payment data at project level, for each type of payment, government payee, and currency of payment. This could include establishing additional granularity to existing coding structures, developing a mechanism to appropriately capture data by "project", building new collection tools within financial reporting systems, establishing transaction types to accommodate types of payment, and developing a systematic approach to handling "in kind" payments e.g. investing in infrastructure.

59. There will also be familiarisation costs involved in understanding and interpreting the requirements in Chapter 10, and parent companies will are expected to incur costs in supporting their subsidiaries in understanding the requirements. Subsidiaries themselves will also incur costs of familiarisation and implementing new data gathering processes.

60. However, many multinational extractives companies are already subject to reporting requirements in some jurisdictions, for example the EITI. Some also already report some of the information required on a voluntary basis. In these cases, they will already possess internal systems capable of recording at least some of the payments required under Chapter 10, and the changes they will need to make are unlikely to be as wide ranging or costly.

61. The equivalence mechanism included in the Accounting Directive allows the EU to designate 'equivalent' reporting regimes, and thereby exempt companies already complying with these 'equivalent' regimes from producing an additional report to comply with Chapter 10. If the decision is taken to designate the US extractives reporting regimes as equivalent, there will be no additional cost to dual listed US-UK companies. This decision will be taken by the EU once US reporting regimes have been finalised, which is not expected until late 2015.

62. We estimate that transition costs for UK parent companies and UK subsidiaries combined would be **£11.9m** (see Annex A)

- **Ongoing costs:**

63. Once systems have been put in place to collect the necessary data, companies responsible for final reporting will face ongoing costs associated with the requirement to collate data from any subsidiaries within scope and produce an annual report. Subsidiaries will face on-going costs of gathering and providing data to parent companies to report.

64. We estimate that the ongoing costs for UK parent companies and UK subsidiaries combined would be **£6.6m** (see Annex A)

Wider costs

(i) Competitive disadvantage:

65. Whilst disclosing payments to governments will not give direct insight into the levels of turnover, costs and profits that an extractives company generates in a particular area, there could be instances when confidential business data could be revealed or can be deduced from such data.

66. Some companies have suggested that EU extractives companies would not be operating on a level playing field when compared with non-EU registered or with state owned companies, many of which have foreign operations.

67. BP's operations in Angola have been cited as an example of this. In 2002, BP disclosed a signature bonus of $111 million in a US SEC filing. The Angolan state oil company threatened to take action if material damage was caused by the disclosure. Nonetheless, BP remains operational in the country and considers itself one of the largest investors in the economy. In addition, BP has advised that it continues to making filings at the US SEC and with UK authorities and this has not caused any problems with the Angolan authorities.[26]

68. A number of extractives companies already disclose certain country by country payments (some even at project level) on a voluntary basis – for example, Statoil, Tullow Oil, Rio Tinto. This indicates that they do not consider any loss of competition to be significantly damaging.

[26] http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/SEC_2011_1289_2_en.pdf

69. Importantly, companies have not been able to produce any convincing evidence that disclosure of payment information negatively affects their ability to win contracts.

70. Furthermore, companies registered outside the EU but listed on an EU regulated market will have to comply with the same reporting requirements via the TD.

(ii) Costs arising from the lack of exemptions clause:

71. The Accounting Directive does not provide any exemptions to reporting, even where companies are operating in countries where disclosure of such information is prohibited by criminal law.

72. Some companies believe that this could create a conflict in law and result in increased legal fees or fines, loss of business, forced divestment and even criminal sanctions.

73. Although companies express concern about differing legal regimes in relation to transparency, and conflicts of law, we have yet to be provided with convincing evidence that any criminal prohibitions on the reporting of payments to governments exist in other countries, or that disclosure of such information would result in any of the above consequences. The majority of companies we have spoken to have indicated that they believe they could continue with their operations even without an exemptions clause.

OPTION 2

BENEFITS

Benefits to citizens of developing countries

74. As with Option 1 except some of these benefits will be realised 12 months early

Benefits to UK companies

75. As with Option 1 except some of these benefits will be realised 12 months early

Benefits to UK investors

76. As with Option 1 except some of these benefits will be realised 12 months early

COSTS

Costs of reporting

77. The reporting costs incurred under Option 2 will be greater than under Option 1 due to implementation 12 months earlier, and due to the additional annual report that subsidiaries of EU parents will be required to produce.

- **Transition costs**

78. The transitional costs will of the same nature be as Option 1 but will be incurred 12 months early, and will be incurred by an additional 38 companies which are subsidiaries of EU parents and will be required to report on themselves in the UK in the first year. We estimate that transition costs for UK parent companies and UK subsidiaries combined would be **£13.1m** (see Annex A)

- **Ongoing costs**

79. Ongoing costs will be as Option 1, but companies will need to compile an additional report over and above what is required in option 1, which raises the total costs of this option accordingly (see Annex A)

Wider costs

80. As with Option 1 except these potential costs will be incurred 12 months early. There may be additional frictional costs for subsidiaries of EU parents in moving from reporting themselves to providing information for their EU parent for subsequent reports.

G. Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

81. We believe that the analytical approach taken in this IA is proportionate. The table below sets out the data we would have required to have obtained a full monetised analysis and why we were not able to include this. More evidence will be gathered as part of the consultation.

Cost/ Benefit	Evidence/ Data gap	Why this evidence has not been included in the IA
Benefits		
Benefits to UK companies	Quantified and monetised evidence that accountability and governance will increase political and economic stability Quantified and monetised evidence that improved political and economic stability will improve the profitability of UK firms	Analytical challenges associated with: accurately defining and measuring accountability and governance, addressing confounding factors and the external validity of country specific studies Cost of commissioning the research (proportionality)
Benefits to UK investors	Quantified and monetised evidence that the improved political and economic stability would benefit UK investors Evidence on better information leading to more optimal investment choices	As above
Costs		
Wider costs	Evidence of the extent to which UK firms would be disadvantaged due to having to disclose commercially sensitive information and additional reporting costs Evidence around the costs of a lack of exception clause	Analytical difficulties associated with obtaining accurate estimates Need more in-depth qualitative engagement with extractive companies during the consultation to understand the issue in more detail

H. Risks and assumptions

82. Estimates of the cost of reporting are based on a small number of responses and have been extrapolated across the industry using various assumptions set out in Annex A. This reduces the accuracy of these estimates, but provides our best estimate of the expected costs, and we consider it improves upon the methodology used in the EU IA.

I. Direct costs and benefits to business calculations (following OITO methodology)

83. The direct costs to business are calculated based on the reporting costs estimated in Annex A. Notably, the early implementation of the Directive (i.e. under our recommended option 2) is

classified as gold plating under the better regulation guidance. The scale of the IN is therefore the value of this gold plating (i.e. the EANCB of option 2 less the EANCB of option 1).

84. The EANCB of option 2 (early implementation) is estimated to be £6.41m in contrast to option 1 which is estimated to be £5.66m. The value of the gold plating and indeed the IN on this basis is £0.75m (£6.41m -£5.66m).

J. Wider impacts

Statutory Equality Duties

85. No obvious concerns in this area given that this measure regulates businesses rather than individuals.

Economic Impacts

Competition Impact Test

86. As mentioned in the main body of the IA paragraphs 65 to 70, there is anecdotal evidence around the potential for the measure to limit the geographic area (i.e. in resource rich foreign countries) in which UK firms can operate. There is also the potential that by disclosing high level commercial information about payments to governments, this could lead to implicit collusion between firms.

87. We have been unable to quantify these potential impacts due to weak level of evidence, but the impacts on UK firms of this kind of risk would constitute indirect costs (being directly dependent on the behaviour of the governments concerned) and would thus be out of scope of EANCB because the direct market effects will of course occur outside the UK and therefore would not have direct implications for allocative efficiency in UK markets.

Small and Micro Business Assessment

88. The scope of Chapter 10 of the Directive extends to all UK incorporated large and/ or listed extractive companies. This definition includes small and micro companies listed on the UK main market, however it is based on current information from the FAME database, there are only 2 small companies which will be in scope. Small extractive subsidiaries of large extractive companies will not be required to feed information into the parent's report.

89. For completeness, below we outline our assessment against the advised considerations, none of which apply:

- **Full exemption**
  Small companies are already exempt under the Directive, other than small listed companies. However it is judged that all listed companies should be subject to the same reporting requirements, in order to provide assurance to investors. In addition, given there are currently only 2 small listed companies identified as in scope, further exemption or special requirements for small companies was not considered appropriate or proportional.
- **Partial exemption**
  As above
- **Extended transition period**
  As above
- **Temporary exemption**
  As above
- **Varying requirements by type and/or size of business**
  As above
- **Direct financial aid for smaller businesses**

As above

- **Opt-in and voluntary solutions**

  As above

Environmental Impacts

90. Although this policy is around extractive industries, there are no obvious direct concerns in this area. Although this measure may lead to an increased level of output, therefore potentially increasing pollution, we assume that extractives companies will comply with existing environmental frameworks in the country in which they operate.

Social Impacts

Health and Well-Being:

91. No obvious concerns in this area.

Human Rights:

92. No obvious concerns in this area.

Justice System

93. The proposal is likely to introduce new criminal sanctions or civil penalties for non-compliance. However, the precise nature of these measures is yet to be determined and will be explored at consultation. We would not expect this to place a disproportionate burden on the court system because the measure only covers a small number of firms (251 companies). Also these firms are large or listed and relatively high profile which would mean that the reputational costs of non-compliance would generally outweigh any benefits.

Rural Proofing

94. No obvious concerns in this area.

Sustainable Development

95. No obvious concerns in this area.

K. Summary and preferred option with description of implementation plan.

96. The summary and preferred option are set out below:

(i) Summary

97. A Multi-Criteria analysis is used to compare the costs and benefits set out in Section F.
98. In the absence of alternative information regarding criteria weights, each of the costs and benefits has been assigned an equal weight. A more sophisticated approach to weighting, which elicits input from key stakeholders such as NGOs and large extractive companies, will be developed during consultation.

99. The table below indicates that based on the pre-consultation evidence base, the economic efficiency case for choosing Option 2 rather than Option 1 is inconclusive. Essentially early implementation will lead to costs being incurred early, but also benefits being realised early as well. All of the benefits and much of the costs are unquantified and there is no consensus around criteria weights, so it has not been possible to determine which option is superior on economic efficiency grounds.

100. However, **Option 2 is still the preferred option. This is due to the early realisation of the international equity benefits** arising from promoting accountability, incentivising good governance and therefore encouraging improved social outcomes.

Cost/ Benefit	**Option 1**	**Additional impact from reporting early**	**Option 2**
Benefits to UK companies	Unquantified benefit	Some of the benefit would be received early	Greater unquantified benefit(√)
Benefits to UK investors	Unquantified benefit	Some of the benefit would be received early	Greater unquantified benefit (√)
Costs of reporting	£61.63m	Cost (£8.19m) would be received early	£69.82m(X)
Wider costs	Unquantified cost	Cost would be received early	Greater unquantified cost(X)

(ii) Implementation plan

TRANSPOSITION PROJECT PLAN / MILESTONES			
26 June 2013	Date the EU legislation was adopted		
29 June 2013	Published in the Official Journal of the EU: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:182:0019:0076:EN:PDF		
Dependencies and Issues	None known.		
Method of Transposition	Free standing regulations, using copy-out where possible.		
October 2013	Pre-consultation RRC clearance		
November 2013	Consultation		
Spring 2014	Lay regulations		
Spring 2014	Expected date for transposition in NI/Scotland/Wales		
July 2015	Expected date for transposition in Gibraltar		
N/A	Expected date for publication of guidance		
Summer 2014	Planned date for notifying the Commission of transposition		
Summer 2014	UK legislation enters into force		
20 July 2015	Final transposition deadline (from the EU legislation)		
OTHER MILESTONES POST-IMPLEMENTATION			
2018	European Commission review of Chapter 10		
October 2019	Proposed date for Ministerial review		
Lead Official:	Vickie Wood	Contact No:	0114 207 5308
Lead Lawyer 2:	Georgia Brown	Contact No:	020 7215 6315

Annex A: Cost calculations

(i) The EU Impact Assessment calculations

101. The European IA estimates costs (transition and on-going) by using European Securities and Market Authority (ESMA) data to calculate the number of entities (defined as parent companies and subsidiaries) and then multiplying this by a cost per entity figure. See link:http://ec.europa.eu/internal_market/accounting/sme_accounting/review_directives/index_en.htm

102. The cost per entity figure was calculated by consulting 4 multinational companies (MNCs) on their set up and annually re-occurring costs from reporting at company group level. This estimate was made on the basis of reporting payments to host countries on a country and project basis.

103. ESMA data was then used to identify the number of entities in these four company groups. This allowed a cost per entity figure to be calculated. These per cost estimates are given in Table A1 below.

Table A1

Set-up costs per group Entity	**Annual recurring costs per group entity**
€212,244	€74,490

104. The EU impact assessment then extrapolated the estimates across the listed extractive sector, on the basis of the number of group companies (parent and subsidiary companies) identified by ESMA data. They excluded dual listed companies firms which face no reporting obligation from an EU reporting requirement over and beyond that stemming from the Dodd Frank Act. This gave the following estimated costs.

Table A2

Year 1 (€millions)			**Year two and successive years (€ millions)**	
Set-up costs	**Recurring costs**	**Total**	**Recurring costs**	**Total**
548	192	740	192	192

(ii) Consultation evidence

105. The UK government consultation provided additional evidence regarding the estimated costs of complying with the regulations.

106. Estimates of the costs of complying with the EU requirements were provided by 4 companies in response to the UK consultation. 3 of these were MNCs, while the 4th was a smaller solely UK based company. A further one company which will be required to report on both the Dodd Frank Act and the EU directive provided estimates of the cost of complying with the Dodd Frank Act in response to the US Securities and Exchange Commission (SEC) consultation. The reporting requirements for complying with the Dodd Frank Act are expected to be very similar to those for complying with the EU directive, so this estimate has been also been used within our analysis to supplement the responses to the UK consultation.

107. Estimates of costs provided by stakeholders are mostly aggregated, providing an estimate of costs at the group level. For the MNCs these cost include the cost to the Global Ultimate Owner (GUO) as well as the costs incurred by individual subsidiaries, the majority of which are located outside of the UK and therefore will not contribute to UK costs. These estimates are provided below:

Table A3: Cost estimates from companies in scope

Company	Source	No. of subsidiaries in scope	One-off cost ($m)		Per annum cost ($m)	
			Parent	Subsidiaries	Parent	Subsidiaries
1	UK consultation	250	3.5	3	2.5	
2	UK consultation	200	10		2.5	
3	UK consultation	30	3		-	
4	UK consultation	1	0.06		0.06	
5	SEC	120	-		0.12	2.9

108. Converted to £ by multiplying by 0.58[27]:

Table A4

Company	Source	No. of subsidiaries in scope	One-off cost (£m)		Per annum cost (£m)	
			Parent	Subsidiaries	Parent	Subsidiaries
1	UK consultation	250	2	1.7	1.5	
2	UK consultation	200	5.8		1.5	
3	UK consultation	30	2		-	
4	UK consultation	1	0.04		0.04	
5	SEC	120	-		0.07	1.7

(iii) Companies in scope

109. The UK transposition of the EU directive will impose costs on all UK registered extractive companies, which are either large or listed in the UK. This includes both parent companies and UK subsidiaries. Subsidiaries will not be required to report on their own payments if these are reported by their parent company, but it is considered that they will nonetheless incur some costs in compiling the data and providing this to their parent.

110. We identify those companies in scope using the following methodology:

111. First FAME data was used to identify the total number of large (based on standard Companies Act 2006 (updated in 2008) classification) and listed UK extractive companies (defined as SIC classification 05-08, rather than 05-09 as extractive services which represented by SIC code 09 are unlikely to face a reporting requirement)

112. In calculating the number of companies the following further assumptions were made:

113. Ownership is indicated by the country of the 'Global Ultimate Owner' (GUO). The minimum percentage of ownership for a parent company to be recorded as the GUO is 25.01% of the subject company. Where no shareholders are identified, the highest listed company is considered the GUO.

114. When identifying listed companies we include all companies listed on the London Stock Exchange main market. This includes the FTSE350, FTSE Small Cap and FTSE Fledgling but does not include AIM.

115. We split the total number of companies in scope, based on their GUO to identify which will need to report themselves, and which will be reported on by their GUO.

[27] Bank of England, 4 July 2014

116. Based on these assumptions, a total of 251 companies have been identified as in scope, of which 49 are ultimate owner companies, 60 are subsidiaries UK parents, 38 are subsidiaries of EU parents outside of the UK and 104 are subsidiaries of non-EU parents. We assume that the UK ultimate parents will report on themselves, and subsidiaries of parents located outside of the EU will also report on themselves as their parents won't be obliged to report on their behalf (US parents may at some stage report on UK subsidiaries, but there is currently not sufficient information regarding the timing or detail of the US regime to make an assessment regarding equivalence). We assume all UK subsidiaries of UK or EU parents will only incur the costs of gathering the relevant information and providing it to their parent companies, who will report on their behalf, and not incur the cost of the final reporting. Under option 2, subsidiaries of parents in other EU Member States will be required to make a one-off report in the first year, but will subsequently be reported on by their EU parent.

Table A5

No. of parent companies*	No. of subs. of UK GUO	No. of subs. of GUO in EU (outside UK)	No. of subs. of GUO based outside of EU*	Total no. of UK companies having to report	Total no. of UK subs. required to prepare information
49	60	38	104	153	98

*treated as parents

117. We estimate costs to parent companies (and all those reporting themselves) and subsidiaries (those only compiling information) separately, as parent companies will incur the costs of compiling and consolidating reports from all subsidiaries and preparing the final disclosure. Subsidiaries will each incur costs in compiling and preparing information to be submitted to the parent.

118. The aggregate estimates make it difficult to accurately disaggregate between parent and subsidiaries and extrapolate across all companies impacted by the regulation. However one company (company 1) provided an estimate of the one-off costs incurred centrally to familiarise with legislation and develop processes and systems, as well as a separate estimate of the cost of implementation across all subsidiaries. Another (company 5) estimated the on-going cost per annum split between parent and subsidiaries. In both these cases however, the cost to the parent will depend on the number of subsidiaries and therefore cannot simply be multiplied up by the number of parent companies.

119. We assume that the one-off costs and on-going annual costs will be the same in Option 1 and Option 2, and that the difference in costs will result only from the timing of implementation. We therefore calculate the one-off cost and on-going cost for both options, before making estimating the NPV and EANCB separately for each option based on when costs will be incurred.

(iv) One-off costs (year one costs)

120. The "year one" costs estimated by companies include all costs of making the first report in year 1. This will include transitional costs of familiarisation and changes to systems and processes, as well as the cost of compiling information and reporting, where applicable, which will be incurred annually. In order to estimate the total one-off costs we first estimate the total year one costs and then total on-going annual cost for the industry and subtract the later from the former. In this section we consider the year one costs as one-off costs, and will adjust for the on-going reporting costs later.

Year one cost to parent companies

121. Only one company provided a split of costs between parent and group subsidiaries. Therefore, in order to estimate the one-off costs to parent companies from the estimates we have been provided with, we use the aggregate estimates provided and assume that the split of costs between the parent and subsidiaries will be in line with that estimated by Company 1, weighted by the number of subsidiaries.

Assumption 1: The split of year one costs between the parent and subsidiaries identified by Company 1 is representative of the split of year one costs for other companies, adjusted for the number of subsidiaries.

Table A6: Split of one-off costs between parent and subsidiaries

Company	Source	No. of subsidiaries in scope	One-off cost (£m)	
			Parent	Subsidiaries
1	UK consultation	250	2	1.7
2	UK consultation	200	3.5	2.3
3	UK consultation	30	1.8	0.2
4	UK consultation	1	0.04	0.00
5	SEC	120	-	

122. In order to extrapolate across the companies which will need to report, we assume that the cost to the parent will be broadly proportionate to the number of subsidiaries they are required to report on. We would however expect some minimum fixed costs which we assume are equal to the costs estimated by the smallest of the companies which responded (Company 4).

123. There is not information available on the number of subsidiaries of the extractive companies in scope, which are also involved in the extractive activity, therefore we weight based on the total number of subsidiaries and assume that the proportion of subsidiaries of each company which are in scope are broadly similar across companies.

Assumption 2: The cost to the parent company is proportionate to the number of subsidiaries, down to a minimum cost based on the estimated cost provided by Company 4.

Assumption 3: The number of subsidiaries a parent company has which are within the scope of the directive is proportionate to their total number of subsidiaries.

OPTION 1

124. Based on assumptions 1-3 we estimate year one costs to all 153 companies having to report in Option 1 of **£17.60m**. This comprises cost of familiarisation with regulations, developing and inputting new systems and processes, and producing the first report. The upper band of expected costs is **£23.61m** which assumes all that all estimated costs provided by respondents (other than where stated otherwise) are borne by the parent company and that the minimum cost per parent is £0.05m based on the upper end of the estimated cost range provided by Company 4.

OPTION 2

125. Option 2 will also impose year one costs on 38 subsidiaries of EU parents, which following the first report will be reported on by their parent in line with the EU Directive which will take effect from 20 July 2015.

126. This increases the estimated year one costs in Option 2 to **£19.17m**, reflecting the same nature of costs but incurred by more companies. The upper band of expected costs for this option is **£25.71m** based on the same assumptions as option 1.

Year one cost to subsidiary companies:

OPTION 1

127. In order to calculate the cost to all subsidiary companies in scope, we take the estimated costs to subsidiaries for those companies which provided estimates, shown in Table A6, and divide by the number of subsidiaries of the relevant companies which are in scope:

Cost per subsidiary = (Sum of costs to subsidiaries of companies) / (Total number of subsidiaries) = (1.7 + 2.3+ 0.2 + 0.01) / (250 + 200 + 30 + 1) = £9,000

128. We then multiply the cost per subsidiary by the total number of subsidiaries in scope which will not be required to report themselves – for option 1 this will be all subsidiaries of UK or EU parent companies = 60 + 38 = 98 companies.

Total year one cost to subsidiaries = £9,000 * 98 = **£0.86m**

129. We obtain a high estimate by assuming that all estimated costs provided by respondents (other than where stated otherwise) are borne by their subsidiaries. This approach produces an estimated cost per subsidiary of £20,000.

High estimated cost per subsidiary = (Sum of total costs to companies) / (Total number of subsidiaries) = (1.7 + 5.8 + 2.0 + 0.04) / (250 + 200 + 30 + 1) = £20,000

130. As for the central estimate, we then multiply the estimated cost per subsidiary by the total number of subsidiaries in scope which will not be required to report themselves.

Total year one cost to subsidiaries = £20,000 * 98 = **£1.94m**. This comprises the costs of gathering the relevant data and providing it to the parent company to report.

OPTION 2

131. Option 2 uses the same assumptions as option 1 regarding cost per subsidiary, but apply them only to the 60 subsidiaries of UK parents. The nature of the costs are the same as option 1.

132. This provides a central estimate of total year one cost to subsidiaries = £9,000 * 60 = **£0.53m**

133. The high estimate of total year one costs to subsidiaries is = £20,000 * 60 = **£1.19m**.

Total year one costs:

Table A7

	OPTION 1		OPTION 2	
	Best estimate	High	Best estimate	High
Year one cost to parents £m	17.60	23.61	19.17	25.71
Year one cost to subsidiaries £m	0.86	1.94	0.53	1.19
Total year one cost	**18.5**	**25.6**	**19.7**	**26.9**

(v) On-going costs

On-going costs to parent companies:

134. In terms of the on-going costs, we have estimated costs provided by four companies, including Rio Tinto's estimate of the cost of complying with the Dodd-Frank requirements, which we assume to be broadly in line with what the EU regulations will require.

135. Rio Tinto is the only company to provide an estimated breakdown of annual on-going cost between parent and subsidiaries. As with the year one costs, we use the aggregate estimates provided and assume that the split of costs between the parent and subsidiaries will be in line with that estimated by Rio Tinto (Company 5), weighted by the number of subsidiaries.

Assumption 4: The split of on-going costs between the parent and subsidiaries identified by Company 5 is representative of the split of on-going costs for other companies, adjusted for the number of subsidiaries.

Table A8: Split of on-going costs between parent and subsidiaries

Company	Source	No. of subsidiaries in scope	On-going cost (£m)	
			Parent	Subsidiaries
1	UK consultation	250	0.03	1.47

2	UK consultation	200	0.04	1.46
3	UK consultation	30	-	
4	UK consultation	1	0.03	0.01
5	SEC	120	0.07	1.7

OPTION 1

136. As with the year one costs, in order to extrapolate across all 153 companies which will need to report, we extrapolate up based on the total number of subsidiaries, applying a minimum level of fixed costs based on the costs estimated by the smallest of the companies which responded (Company 4). See assumptions 2 and 3.

137. Based on these assumptions we estimate on-going annual costs to all companies having to report of **£5.8m**. This comprises the cost of compiling information from any subsidiaries and analysing and preparing information for disclosure. The upper band of expected costs is **£11.6m** which assumes all that all estimated costs provided by respondents (other than where stated otherwise) are borne by the parent company and that the minimum cost per parent is £0.05m based on the upper end of the estimated cost range provided by Company 4.

OPTION 2

138. The ongoing costs to parents will be the same as for option 1 as after the first year, subsidiaries of EU parents will be reported upon by their parent company, in line with the parent's own Member State's reporting requirements.

On-going costs to subsidiaries:

OPTION 1

139. We follow the same approach to estimating the on-going cost for subsidiaries as we did for the year one cost. We take the estimated costs to subsidiaries for those companies which provided estimates, shown in Table A6, and divide by the number of subsidiaries of the relevant companies which are in scope:

Cost per subsidiary = (Sum of costs to subsidiaries of companies) / (Total number of subsidiaries) = (1.47 + 1.46 + 0.01 + 1.7) / (250 + 200 + 1 + 120) = £8,100

140. We then multiply the cost per subsidiary by the total number of subsidiaries in scope which will not be required to report themselves.

Total on-going cost to subsidiaries = £8,100 * 98 = **£0.80m**

141. This comprises the costs of gathering the relevant data and providing it to the parent company to report.

142. We obtain a high estimate by assuming that all estimated costs provided by respondents (other than where stated otherwise) are borne by their subsidiaries. This approach produces an estimated cost per subsidiary of £8,300.

High estimated cost per subsidiary = (Sum of total costs to companies) / (Total number of subsidiaries) = (1.7 + 5.8 + 2.0 + 0.04) / (250 + 200 + 30 + 1) = £8,300

143. As for the central estimate, we then multiply the estimated cost per subsidiary by the total number of subsidiaries in scope which will not be required to report themselves.

High estimate for on-going cost to subsidiaries = £8,300 * 98 = **£0.81m**.

OPTION 2

144. The ongoing costs to subsidiaries will be the same as for option 1 as it includes the subsidiaries of EU parents which will only be required to provide information to their EU parent after the first year, rather than reporting themselves.

Total on-going costs:

Table A9

OPTIONS 1 and 2	Best estimate	High
On-going cost to parents £m	5.8	11.6
On-going cost to subsidiaries £m	0.80	0.81
Total on-going cost	**6.6**	**12.4**

Note, figures may not sum due to rounding.

(vi) Total transitional costs:

145. As discussed previously, the year one estimated costs obtained from companies include the cost of producing the first report, therefore, in order to separate out the transitional costs from the on-going annual reporting costs, we subtract the annual on-going cost from the estimated year one cost.

Table A10

	OPTION 1		OPTION 2	
	Best estimate	High	Best estimate	High
Total year one cost £m	18.5	25.6	19.7	26.9
Total annual cost £m	6.6	12.4	6.6	12.4
Total transitional cost £m	**11.8**	**13.1**	**13.1**	**14.5**

Note, figures may not sum due to rounding.

(vii) Summary costs for Options 1 and 2

146. The nature of the costs for options 1 and 2 are assumed to be equivalent, with the timing of the costs being the only difference in the cost between the options.

147. Under our preferred option (Option 2) we would be implementing the directive 6 months early. In this case, the relevant entities would incur the full costs a whole year early due to the implications of timings of reporting requirements. See Annex B for a detailed implementation timetable, which compares option 1 with option 2.

148. Using the IA calculator we therefore estimate the costs of the two options by using a 10 year appraisal period for both options, from 2015 to 2024, but applying the costs for option 1 from 2016 and applying the costs for Option 2 from 2015.

149. This provides the following estimated costs:

Table A11

Option	NPV (£m)	EANCB (£m)
1	-61.6	5.66
2	-69.8	6.41

150. This indicates that the additional annual net cost to business of implementing early will be **£0.75m**.

151. These costs are below those estimated in the EU impact assessment. This is partly the result of more recent cost estimates which have been provided in response to the UK consultation – which are on average below those provided for the EU impact assessment, and cover larger companies with more subsidiaries which are in scope of the directive. Based on additional evidence provided regarding the breakdown of costs, we have also been able to make a better estimate of the relative costs for parents companies compared to subsidiaries.

152. These costs may still overestimate the additional cost to companies of complying with this legislation over and above what they will do or are doing already. Many of the multinational companies affected by the Directive will already be required to report some of the information required by Chapter 10 by the EITI, which has now been adopted by 39 countries. Some extractives companies also already report some of the information required by the Directive on a voluntary basis. In these instances, the costs imposed by the Accounting Directive will be lower because companies will already possess some of the internal systems capable of recording payments to governments, and will already be producing reports that include some of the information required. The changes they will need to make are therefore unlikely to be as wide ranging or costly.

153. We are unable to calculate how much it already costs companies to produce EITI or voluntary reports. In order to do this we would need to have a full list of the countries in which each UK company is operating. This would allow us to cross reference the list with the list of countries that have implemented EITI. We would then be able to make some calculation about the likely cost of EITI reporting.

(viii) Wider impacts

154. The monetised costs of complying with the regulations do not include wider costs and benefits to business. More detail on the nature of these non-monetised costs and benefits is included in the main body of the impact assessment.

Annex B: Illustration of Key Milestones for Production of Extractives Reports

155. Although option 2 implies the implementation is 6 months before option 1, in practice, companies will not have to report until January 2016. This is exactly one year before companies would be required to report under option 1 in January 2017.

Option 1 - Latest	Timeline	Option 2 - Early
	2014	
	Oct	Regulations come into effect for financial years commencing *on or after* 1 Jan 2015.
	2015	
	Jan	**1st: First reporting period (2015) commences**
Regulations come into effect for financial years commencing *on or after* 20 July 2015.	July	
No extractive companies expected to have financial years commencing in this period.		
	Sept	
	Dec	31st: First reporting period (2015) ends
	2016	
1st: First reporting period (2016) commences	Jan	1st: Second reporting period (2016) commences
	Sept	30th: Financial statements for 2015
	Nov	31st: Extractives reports for 2015 – **FIRST EXTRACTIVE REPORT PRODUCED**
31st: First reporting period (2016) ends	Dec	31st: Second reporting period (2016) ends
	2017	
	Jan	
30th: Financial statements for 2016	Sept	30th: Financial statements for 2016
31st: Extractives reports for 2016 – **FIRST EXTRACTIVE REPORT PRODUCED**	Nov	31st: Extractives reports for 2016 – SECOND EXTRACTIVE REPORT PRODUCED
	Dec	

156. Assumptions:

- Extractive company financial years are calendar years, 1 Jan – 31 Dec
- Two months permitted after deadline for publication of annual financial statements to prepare and publish reports on payments to governments.