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Our ref: ICAEW Rep 151/13

Your ref: CBCR Consultation

Ali Uppal
CBCR Consultation
Financial Services Group
Floor 1, Red
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

Via email: CBCRconsultation@hmtreasury.gsi.gov.uk

Dear Ali,

Capital Requirements Directive 4: Country-by-country reporting

ICAEW is pleased to respond to your request for comments on *Capital Requirements Directive 4: consultation on country-by-country reporting*.

Please contact me should you wish to discuss any of the points raised in the attached response. We would be pleased to meet with you and your colleagues to discuss our thoughts on the audit requirement for CBCR if it is felt this would be of assistance.

Yours sincerely

Philippa Kelly – Technical Manager, Auditing and Reporting

T +44 (0)20 7920 8446
E philippa.kelly@icaew.com



ICAEW REPRESENTATION

CAPITAL REQUIREMENTS DIRECTIVE 4: CONSULTATION ON COUNTRY-BY-COUNTRY REPORTING

Memorandum of comment submitted in October 2013 by ICAEW, in response to HM Treasury consultation paper Capital Requirements Directive 4: consultation on country-by-country reporting published in September 2013.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Capital Requirements Directive 4: consultation on country-by-country reporting* published by HM Treasury on 20 September 2013, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services and provides a monthly magazine FS Focus.

MAJOR POINTS

5. We support the tax transparency goals pursued by this initiative. However, we believe that those who are interested in assessing groups' activities in different jurisdictions together with the tax borne are focussed on multinational groups rather than individual entities or groups which operate and pay tax solely within one country. With this in mind we feel that the requirements are unnecessary for entities and groups which operate within a single country.
6. We would encourage HMT and the European Commission to bear in mind the work of the OECD on changes to the international tax regime, one strand of which is to establish a common template so that multinational companies can report to country tax administrations "their global allocation of the income, economic activity and taxes paid among countries". This work, which is at an early stage, may have a bearing on what is considered useful information to be reported publicly on economic activity and tax.
7. In addition, we note that draft amendments have been included in the Accounting Directive which would result in country-by-country reporting requirements being introduced outside the extractive and financial services industries.
8. We strongly believe that disclosure required by the directives should be subject to due process to ensure that users' reasonable information needs can be met as cost effectively as possible. We encourage HMT to work with the Department for Business, Innovation and Skills in both developing this legislation and in ensuring that views of users, preparers, and auditors are fully taken into account in the development of any further country-by-country disclosures.
9. We have serious concerns about the CRD 4 text with regard to the involvement of auditors. In the UK an audit is defined as expressing an opinion on the financial statements. If the CBCR disclosures are not included in the financial statements (or cannot be included in the financial statements in the case of private reporting to the Commission), then they cannot be subject to audit. Given the very long and detailed nature of the disclosure and the fact that it is not a

Companies Act requirement, we are unconvinced of the merits of including the CBCR disclosures in the financial statements and therefore in the scope of the audit.

10. If any external assurance is considered necessary, and we note that the extractive industries requirement does not include any such assurance, then additional work will be needed to better define this reporting. We address this issue in more detail within our response to question 9.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Question 1: Do respondents believe that it would be proportionate to apply the CBCR rules to all institutions captured by CRD4? If not, please describe what specific difficulties arise for particular categories of firms, and what approach you believe would be more proportionate whilst complying with Article 89.

11. As noted in the consultation, CRD 4 covers a very large number of financial institutions, including 1,709 small firms out of 1,922 total investment firms. Given that the disclosure is targeted at groups that operate in more than one country, we have serious doubts as to whether the reporting requirements will provide information in addition to their existing financial reporting for those institutions which operate within a single country.

Question 2: Do respondents agree that the CBCR requirement should apply equally to UK subsidiaries and to UK branches of institutions which are established in third countries?

12. We agree with the proposal that reporting is made at the highest reporting company level for all entities, with reference in subsidiary financial information to where the CBCR can be found. However account must be taken of circumstances where this may not be possible, as discussed below. We encourage HMT to work with other national authorities on implementation of the directive to ensure a harmonised approach operates across the EU. There will be additional cost and decreased comparability should a harmonised approach not be followed.
13. The interpretation of the directive by this consultation includes UK branches of third country head quartered banks, which we understand are outside the scope of CRD 4 and therefore should not be included in the legislation implementing these requirements. We would like to point out that there would be added complexity should such branches be required to report, as there may not be the information required at the requisite level of consolidation. Information put together solely for this purpose without commercial or structural rationale is likely to be misleading and potentially distortive. In addition there will not be an annual report at branch level, meaning there is no mechanism for transmission of the required information. There may also be challenges associated with compelling third country businesses to provide information. These considerations taken in sum lead us to question the proportionality of such a requirement.
14. Article 89 of CRD IV simply requires each institution to provide CBCR disclosures “on a consolidated basis” without specifying at which level the consolidated disclosures should be provided. We believe the HMT guidance should provide the option of preparing the CBCR disclosures either at the top EU parent company level or at the regulated institution level, or a mixture of both depending on the group structure of the organisation.
15. When considering the above, HMT also need to consider the requirements where a UK legal entity has utilised an exemption under UK Companies Act 2006 and does not prepare consolidated accounts, for example where a regulated entity has subsidiaries, but has taken an exemption from preparing consolidated accounts under s400. The HMT guidance should make it clear whether it expects the CBCR consolidated information required by Article 89 to be published as an annex to the entity’s financial statements given that the published financial

statements will only contain standalone financial information for that entity. We believe website disclosure would be especially effective in such circumstances.

16. Similarly, HMT guidance should make it clear whether it is appropriate for EU parent holding companies that have taken a consolidation exemption under UK Companies Act 2006 s401, to make the CBCR disclosure on the basis that only standalone financial information for that entity is prepared and disclosed in the financial statements, or whether in this situation the CBCR should be prepared by each of the individual regulated entities instead.

Question 3: Which approach to consolidation (prudential or IFRS accounting) do respondents believe is more appropriate?

17. We believe the accounting basis of consolidation is more appropriate to apply in these circumstances and is likely to be more line with users' expectations. It is important for there to be a consistent basis on which the numbers are reported for comparability purposes. and The scope of the accounting consolidation more easily facilitates this compared to prudential consolidation which can be subject to changing requirements. We also note that prudential consolidation is conceptually different to IFRS accounting
18. We believe the CBCR reporting should be based on the GAAP applied by the parent company in the group, rather than the local GAAPs that may be used by subsidiaries. We note that these accounting standards may be IFRS or may be other GAAPs, such as UK GAAP

Question 4: Do respondents believe the above approach for reflecting consolidation adjustments is satisfactory? If not, please describe an approach that you believe would be more suitable.

19. A consolidation is more complex than just ensuring that all subsidiaries report under the same GAAP. There are different types of consolidation adjustments which will take place at different points in a business' reporting process. Subsidiaries provide results in accordance with group accounting policies and GAAP to head office and then elimination of investments and intragroup dividends and transactions takes place at the head office level. Where consolidation adjustments are not allocated to individual countries, the total by country may not agree to the group totals.
20. We do not feel that information which reconciles to the consolidated financial performance will necessarily be of relevance or additional benefit to users interested in CBCR and there is no requirement in CRD4 for such a reconciliation. Such a requirement would add another layer of information to be prepared and audited or assured which would increase cost for no perceived benefit.

Question 5: Do respondents agree that the appropriate definition of the term "establishment" in this context should be both subsidiary and branch?

21. There may be certain instances where legal establishment is different to tax jurisdiction or country of incorporation. Indicators such as tax residence, place of incorporation, place of business and location of the parent entity where applicable may also need to be taken into consideration when defining establishment in certain circumstances.

Question 6: Do respondents think there should be a standard template for disclosures?

22. Given the nature of the reporting, we do not feel a template would be necessary.

Question 7: Do respondents agree with the above approach? If not, please describe an approach that you believe would be more suitable.

23. We do not support material being included in the financial statements or annual report merely because this is a convenient repository. CBCR disclosures could be very long and detailed and will only be of use to a relatively narrow interest group. Therefore, it seems inappropriate for

inclusion in the financial statements or annual report, which is a public document for all investors and stakeholders. In addition, we note that bringing the requirement into the scope of the annual report would mean a much earlier deadline for December year ends in the first year of application, even as early as February.

24. A more suitable approach for public disclosure could be disclosure on the institution's website within the investor relations section, for example. This approach would be congruent with the streamlining of the information within the annual report, and could avoid confusion as to whether the disclosure is part of the financial statements or not. (See also question 9.)

Question 8: Can respondents identify any serious impediments to institutions reporting the relevant information by July 2014?

25. The current proposals will not be achievable for institutions reporting to a March or June 2014 year end due to the close proximity of the deadline to the financial year end. We suggest an alternative deadline, such as the statutory reporting deadline is adopted for such institutions which aligns to the filing deadline for their financial statements, allowing them 6 (public companies) or 9 (private companies) months from their year end.
26. Though achievable the requirements will still be potentially onerous for institutions with a December 2013 year end. The timing issues noted indicate that there is a lack of suitable transition provisions in the CRD 4 text. We would encourage HMT to work with BIS, as they will be responsible for implementation of the Accounting Directive, to ensure an effective and consistent approach is taken if the disclosures will be extended to other industries in the future.
27. We would also strongly encourage HMT to work with the Financial Conduct Authority to contact smaller entities captured by the requirements (with the exception of single country operators as suggested above) to ensure they are aware of their reporting responsibilities.

Question 9: Do these auditing requirements pose any difficulties?

Statutory audit vs assurance

28. We acknowledge that the EU refers to 'audit' in the directive, however we believe that the way in which it is implemented in the UK could foster a more efficient and effective method of achieving the goals of the legislation through requirement of an assurance engagement as opposed to an 'audit'.
29. In the UK the word 'audit' is frequently limited in scope by reference to a 'true and fair' audit of the financial statements under the provisions in the Companies Act. In addition to Companies Act audits, firms also perform a large amount of other work, generally assurance engagements, to provide an opinion on financial and non-financial information. We feel the work required as described in the consultation would be an assurance engagement, as the 'auditor' (assurance practitioner) would not be expressing an opinion as to the truth and fairness of the CBCR, but a conclusion on the presentation of the information under the relevant CBCR headings which are not a part of the Companies Act financial statements.
30. We would discourage HMT from 'annexing' elements to the financial statements, and therefore the audit opinion, which is a document with a very clear and specific purpose. Should this proposal be followed through, we would emphasise that any opinion within the audit report would have to be separately expressed, not simply falling under the truth and fairness of the financial statements. Given these factors, we believe that the work performed on CBCR by the auditor would be subject to a separate conclusion or opinion. Should a reasonable level of assurance be required, this would give the user a similar level of comfort to a statutory audit.
31. We are happy to further discuss our proposals regarding the merits of non-audit assurance with HMT and would be able to assist in the establishment of a framework for assurance of CBCR disclosure should this be required. We would seek to further point out that any audit or

assurance engagement will require specifically articulated criteria or rules against which the assurance practitioner can report and express a conclusion.

Materiality

32. There are multiple materiality figures used in the execution of an audit of a financial institution, especially where the institution is part of a group. For example, the turnover of a single financial institution will be audited to that institution's own materiality, whereas the consolidation will be audited to a different materiality. Depending on the nature of the conclusion that the auditor (assurance practitioner) is being required to draw, there would need to be a clear understanding of the type of materiality used and why this was considered appropriate. We believe that this judgement is best made by the practitioner based on their understanding of the balances and the risks facing that particular institution or group of institutions.
33. Materiality may also have a different meaning within the institution itself for management and for reporting purposes. It would be helpful if it were made clear that disclosure is not required of immaterial items.

Publication

34. Paragraph 5.9 states that the audited information includes the confidential disclosures made to the European Commission by systemic institutions. We would seek to point out that once the information is audited, or considered by an assurance practitioner, that it is no longer confidential and that the auditor or assurance practitioner will have legal responsibilities regarding that information which may require it to be disclosed or referred to another body.
35. As noted above with regard to timing of publication, an audit requirement will also have consequences for companies being able to comply with the requirements in 2014 since those with December year ends will need to prepare the CBCR disclosures by the deadline for their annual report, which could be as early as February, rather than 1 July 2014.

Question 10: Do respondents agree with the above definition of turnover?

36. We agree that a definition of turnover consistent with financial reporting requirements will be most efficient and easily understood.

Question 11: Do respondents agree to limit the scope of "tax on profit and loss" to corporation tax payments?

37. We agree that a clear definition of 'tax on profit and loss' is important, and do not take exception to using corporation tax payments. Withholding tax could also be included for this purpose.

Question 12: Do respondents agree that disclosures should be reported on a cash-paid basis?

38. We think that reporting on a cash-paid basis may cause confusion, though superficially seeming to give clearer alignment with the tax transparency objectives of the legislation. This is in part due to the fact that tax payments to the local tax authority often lag behind the generation of economic benefit, so the payments reported in any one year are unlikely to relate to the reported revenue in that year, making an effective tax rate calculation on the cash paid basis devoid of meaning.
39. It is likely that banks will make use of narrative disclosure to explain anomalies, especially when cash tax paid looks high or low. They will also be likely to disclose accounting tax payable or receivable relevant to that year's earnings and potentially other contributions such as levies so users are able to see a full picture.

Question 13: Do respondents agree that using the existing method for corporation tax attribution ensures minimal additional compliance burdens with respect to disclosure by UK branches of third country institutions?

40. Yes.

Question 14: Do respondents agree with the above definition of public subsidies?

41. We agree that public subsidies should exclude money received from central banks. We suggest that HMT provide further clarity around policy measures such as Funding for Lending and Help to Buy, which we do not believe should be included within the requirements.

Question 15: Can respondents outline how the new reporting requirements will differ from what they are currently required to report and what, if any, additional information is required.

42. Additional information is required regarding submission of information contained within parts d, e and f of the requirements to the European Commission. It is not currently set out how the information should be transmitted so certainty and clarity are needed in this area.

43. Comparatives are not required by the CRD IV text. We agree with this approach, particularly in the first year of implementation. However, it is more usual for comparatives to be provided for reported financial information.

44. Additionally the guidance should clarify that this information is only required to be submitted by UK GSIs by 1 July 2014 and not all GSIs.

E philippa.kelly@icaew.com

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