21 October 2013

Our ref: ICAEW Rep 153/13

Your ref:

Mark Jackson
Business Environment
Department of Business, Innovation and Skills
1 Victoria Street
London
SW1A 0ET

Dear Mr Jackson,

EU Commission proposals to reform non-financial reporting – Calls for Evidence

ICAEW is pleased to respond to your request for comments on *EU Commission proposals to reform non-financial reporting.* The attached submission deals with the issues raised in relation to country by country reporting.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REP 153/13

ICAEW REPRESENTATION

EU Comission proposal to reform non-financial reporting

Memorandum of comment submitted in October 2013 by ICAEW, in response to the Department for Business, Innovation & Skills Call for Evidence on EU Commission proposals to reform non-financial reporting published in October 2013.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the Call for Evidence on *EU Commission proposals to reform non-financial reporting* published by the Department for Business, Innovation and Skills on 4 October 2013. This first of two submissions covers the new proposals on country by country reporting only.

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 Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

MAJOR POINTS

Tax Country by Country Reporting

5. The financial crisis has led to new demands for greater transparency in international taxation. In the search for a solution, country by country reporting has been mooted as part of the new financial infrastructure required in the wake of the crisis. Some think of it as a means to bring about 'tax justice' and better government for developing countries; some expect it to tackle tax avoidance; others expect it to improve investor relations. These are laudable objectives. Indeed, ICAEW favours robust and concerted international action to improve tax transparency.

6. We have been engaged with this debate for some time, including most recently efforts to improve accountability in resource rich emerging economies through the introduction of a requirement for major European companies in the extractive industries and certain forestry companies to provide disclosures about their payments to government on a country by country basis. We broadly welcomed the scope of the requirements included in the revised Accounting Directive, published in June 2013. Our aim during the preceding debate was to ensure that the new financial information provided would be credible, relevant and internationally consistent, that the delivery mechanism was appropriate, and that the costs and efforts involved were likely to prove proportionate to the benefits. We have applied these same tests below to the current proposal to extend the June 2013 disclosure regime to all large European companies.

ICAEW Consultation

7. ICAEW has been actively monitoring the progress of the EU legislative proposals on non-financial information, and has circulated comments on the draft legislation to interested parties. Proposals for mandatory country by country reporting of tax did not feature in the original legislation, and we have only recently had sight of the proposed amendments tabled by MEPs and by the Lithuanian Presidency. We are therefore pleased to have this opportunity to respond to BIS's informal call for evidence on the Council Presidency's proposals. We wish to

be clear however that the detailed consultation ICAEW undertakes with its members on proposals of such significance cannot be completed in the short period allowed by BIS, nor can any thorough assessment of the potential practical, legal and business impacts of the new proposals

RESPONSES TO SPECIFIC QUESTIONS

Do you think that the current proposals for CBCR are likely to be effective, and will these pose an excessive burden on companies?

Learning from experience

8. Country by county reporting is required by two recent changes to EU law. The Capital Requirements Directive (CRD IV) requires extensive reporting by European banks. A very different set of requirements applicable to large companies in the extractive and forestry sectors was introduced by the revised Accounting Directive, which became law in June 2013. The Council Presidency is now proposing that country by country reporting be extended to all large European companies through the introduction of a variant of the CRD IV regime, to be enacted by a change to the new Accounting Directive. We are aware that there is backing for this from a number of MEPs.

9. The various EU initiatives in this area do not appear to be well-coordinated. This is highly unsatisfactory, and likely to mean that the objectives of campaigners in this area will be frustrated. Adding a new set of requirements to the existing European country by country reporting regimes may indeed result in confusion rather than clarity. It is also likely to lead to significant compliance costs for business before evidence is available to assess the costs and benefits of the recently-introduced requirements for the extractive and forestry sectors on the one hand and the banking sector on the other.

10. It is of particular concern that the relevant sections of CRD IV have been used as an initial template for these new proposals. The country by country reporting aspects of the Directive, added at a late stage, were not the result of extensive consultation, and many feel that as a result the CRD IV requirements in this area suffer from a number of shortcomings.

11. We think the current approach to extending country by country reporting in Europe is fraught with risks. The objectives are laudable, but whether an effective and proportionate regime is the outcome is far from certain. We therefore suggest that the European Commission undertakes a rigorous, inclusive consultation exercise and a thorough impact assessment on country by country reporting before any further legislative requirements are proposed. The consultation should refer to evidence on how effectively existing European disclosure regimes have met their objectives, the costs and efforts involved in producing the required information, the scope of the new regime, and the impact on complexity and clutter in financial reports. It should also address:

    - relevant audit and assurance issues;
    - the need in the interests of consistent reporting and minimising costs to establish authoritative European-wide principles for the preparation of the new disclosures;
    - the relationship between the tax country by country disclosures and the numbers reported in the financial statements; and
    - the scope for harmonising the various sets of reporting requirements in this area, taking account of progress made by the Organisation for Economic Co-operation and Development (OECD), discussed below, which may usefully inform the nature of the information that may also be suitable for public disclosure.

12. We note that the Accounting Directive, which the current proposal is seeking to amend, already requires a review after three years of the regime for the extractive and forestry sectors.

Not in the financial statements

13. Whatever the decision about the scope of any new disclosure regime, we do not believe the insertion of additional country-specific disclosures into the annual financial statements or accompanying narrative reports is the best way of achieving the aim of greater tax transparency.

14. Financial statements prepared under IFRS and other reporting regimes are produced primarily to meet the information needs of existing and potential investors, lenders and other creditors in making economic decisions. Reporting to shareholders on company performance is also the basis in EU law for the preparation of financial statements. Tempting though it is to use financial statements as a vehicle for disclosures driven by other public policy imperatives, we do not believe that mandating country by country disclosures is consistent with the fundamental objective of financial reporting.

15. The new Accounting Directive permits companies in the extractive and forestry sectors to present information about payments to government outside of the annual report and accounts. This flexibility in delivery of the information is likely to prove a critical element in the success of any extended disclosure regime. If the new regime is confined to listed companies, as we suggest below, disclosure on corporate websites would usefully allow timings to be aligned with tax timetables, rather than financial reporting ones.

Scope

16. We do not support the proposed size-based criteria – which would draw in some private companies but exclude some listed companies - for determining which reporting entities fall within the scope of the proposed new regime. Concerns about the costs and benefits of requiring tax country by country reporting would apply particularly to private groups and companies, especially those centred on one jurisdiction.

17. In our view, any new requirements should apply to all companies with securities admitted to trading on an EU-regulated market, and only to such companies.

Would the proposed multilateral and EU-only approaches to tax reporting both achieve a fair balance between considerations of tax transparency and competitiveness, or do you think that one has clear advantages?

18. ICAEW favours robust and concerted international action to improve tax transparency. International cooperation will reduce concerns about business competitiveness as well as encourage more consistent disclosures. We consider that the best opportunity for achieving effective international action is the OECD's Base Erosion and Profit Shifting (BEPS) project.

19. The project is being undertaken by the 34 members of the OECD, together with the G20 countries which are not members of the OECD. Action 13 of the BEPS Action Plan calls on businesses to provide "information on their global allocation of income, economic activity and taxes paid among countries according to a common template." A recent OECD memorandum, published for consideration at an OECD meeting in November, considers how best to develop such a template to report the income that is earned in each country and the taxes that are paid. ICAEW strongly supports this initiative. If successful, it will provide a practical means of ensuring that governments have the necessary data to police the system whilst costs to business are kept to a minimum. Importantly, it recognises implicitly that the question of tax transparency needs to be dealt with principally as a tax issue, rather than as a financial reporting one.

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