

Digging for justice

A group of non-governmental agencies is calling for an extractives industries IFRS that will reflect the economic needs of the developing world. **Richard Murphy**

The campaigning organisation Global Witness has recently published a report calling for an International Financial Reporting Standard (IFRS) for the upstream (ie exploration and production) extractive industries. In doing so it has been joined by a range of development and civil society agencies including Save the Children, Catholic Aid for Overseas Development, CARE International UK, Publish What You Pay, Transparency International UK and the Open Society Institute.

The coordinated action of these agencies in calling for an IFRS, motivated by concern for what they see to be a key issue in the development agenda, almost certainly marks a first in accounting history. No one knows of another occasion when it has been made so clear that accountancy could make such a direct contribution on that issue. In fact they believe the benefits that could result from the standard they request could extend much further than that.

Global Witness is not alone in wanting an IFRS for the upstream extractives industry. The International Accounting Standards Committee, the International Accounting Standards Board's predecessor body, reviewed the need for such a standard in 2000.

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Botswana: Mining for gem diamonds

Most respondents at the time believed an IFRS was needed. Since then, the large accountancy firms involved in this sector published reports in favour of such a move and IFRS 6, *Exploration for and Evaluation of Mineral Resources*, published by the IASB in December 2004, makes clear it is but a stepping stone on the way to such a standard.

In the light of this near universal view, what Global Witness does is suggest what such a standard might cover if the interests of the stakeholders that the agencies involved seek to represent were taken into account. Those stakeholders are almost universally in developing countries and have

specific interest in the impact of the upstream extractive industries on their location or country.

They might range from individuals, through supplier organisations to governments. What all the agencies involved believe is that the voice of these stakeholders will not be heard in this debate unless they represent their interests.

In the opinion of those agencies these stakeholders need country-by-country reporting on three key issues: commercial performance; taxes and other benefits paid to governments; and reserves.

New and unique approaches

The approaches taken are unique,

and in some cases new. For example, with regard to commercial performance the report calls for disclosure of the following information:

- turnover in total;
- third party turnover;
- production costs;
- development costs;
- interest paid;
- profit before tax;
- tax;
- the total p&l account charge in respect of taxes and other benefit streams due to central and local governments and their agents as a result of the extraction of resources;
- the actual payments for tax and other benefit streams as a result of

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the extraction of resources as reported in the cashflow;

- the liabilities owing for tax and other benefit streams as a result of the extraction of resources at the end of each period;
- deferred taxation liabilities for the country at the start and close of the period and movements during the period, with explanatory notes;
- production volumes by key products and by key properties;
- reserves data by key products and by key properties;
- capital expenditure incurred;
- gross and net assets employed;
- the number of employees engaged and their gross remuneration;
- the names of subsidiaries working within the territory;
- the key properties within the territory and for each a summary of the contract regime in use and details of any partners and joint venturers;
- comparative data where appropriate in each case.

This might appear a substantial list, but the upstream extractives industries normally completely dominate the economic wellbeing of any country in which they are located, in many being by far the largest source of foreign revenue earnings.

This is also why the extractives industries are, in those countries, almost always the largest contributors to the state in terms of taxes paid. In fact for many extractives companies, tax paid is the largest economic footprint they have on those countries, for while their earnings are substantial in relation to the economy as a whole, their employment contribution, for example, is not.

Endemic corruption

This fact, plus the fact that corruption has been endemic in this sector, creates a high requirement for disclosure of data to ensure governments are, and can be on a recurring basis, accountable for the revenues they receive.

As a result the report calls for disclosure of each benefit stream

separately, so that taxes, production entitlements, royalties and so on would all need separate disclosure. This reflects the practice of the extractive industries transparency initiative (EITI), which was created in response to a campaign by Global Witness and others. It would be insufficient that these items be reported in combination. This is because it is vital that each level of government and each state agency or state-owned company be held accountable for the funds paid to it.

In comparison, the report takes a simple line on reserves, while acknowledging this is the area on which much of the work on developing the bulk of the IFRS for the extractives industries will be focused.

The mainstream financial community places much significance on reserves data, and the complexities of reporting it. Global Witness suspects that most stakeholders it seeks to represent do not. They do not have the financial literacy to use the reserves data which the majority of the financial community want. For that reason the report calls for simple measures to be supplied in addition to these complex ones. These measures concentrate on the physical usage of reserves and it is suggested that the following be disclosed:

- what reserves there are at the end of the period;
- where they are;
- what reserves it was believed could be accessed at the start of the period;
- how many reserves have been discovered in the period;
- what volume of reserves have been used in the period;
- what volume has been lost or was deemed inaccessible in the period;
- what has been paid for the use of reserves;
- what the value of reserves is at current market price.

This data could be supplied as a reconciliation table for the period.

In recognising the need for this relatively simple approach the report makes an additional point, which is the reason why Global

Witness believes that this is an issue for an IFRS and not for corporate social responsibility (CSR) reporting. They recognise that there is a difference between the two. Both the EITI and CSR are about reporting and accountability. Mainstream financial reporting is primarily about decision making. As such, to suggest that something should be covered by an IFRS is to suggest it has use in the decision-making process some or all users want to undertake about a company based on its financial statements.

Critical management data

What Global Witness and its partners make clear in offering their report is that they believe the data they request is not only vital to stakeholders in developing countries. It would also, they believe, make available critical information for managers within the extractives industries (who will realise the need for accountability at this level) and for analysts, independent investors and specialist groups such as socially responsible investment funds, who sometimes need reasons for not engaging, as well as for engaging with companies.

While some brokers might be able to secure the information they need by direct request to the companies with which they are engaged, most people cannot. For them, information on where a company faces political or resource risk is essential for the accurate assessment of the value of a company, especially as in this sector decision making needs to be taken over the long term but risk can frequently arise in the very short term. The information requested does, therefore, meet that need as well.

In combination Global Witness and its partners have made a case for an IFRS for the extractive industries that provides data that could be supplied in no other way, but which provides decision-useful information for the stakeholders they represent and the more conventional shareholder/investor community. They are keen that others share their opinion on that call.

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More information

Copies of the report *Extracting Transparency: The Need for an International Financial Reporting Standard for the Extractive Industries* (September 2005) are available from www.publishwhatyoupay.org/ifrs. A questionnaire to provide response to the report can be completed at <http://www.surveymonkey.com/s.asp?u=985451374796>.

The Global Witness website is at <http://www.globalwitness.org/>