tax justice network

FAO: Technical Director
International Accounting Standards Board
First Floor
30 Cannon Street
London, EC4M 6XH
United Kingdom

26th September 2008

Dear Sir / Madam

Exposure Draft of an Improved Conceptual Framework for Financial Reporting – comments from the Tax Justice Network

We write to submit comment on the above exposure draft issued by the International Accounting Standards Board (IASB) in May 2008.

The Tax Justice Network is a global coalition of researchers, economists, financial and legal specialists, NGOs, faith groups, and others, with a shared interest in promoting financial transparency, good governance and accountability, and in combating harmful tax practices.

We believe that the exposure draft you have issued will have significant impact upon the availability of information we need to conduct our work. That involves, amongst other things, monitoring corporate governance, the trade of multinational corporations (MNCs), the impact of those companies on international trade (especially with regard to developing and emerging economies) and our assessment of the taxation liabilities of those companies together with related issues in such fields as the monitoring of corruption. As a consequence your exposure draft, if enacted will have impact upon our work, all of which is aimed at the relief of poverty. It is this last concern that motivates our submission of comment to you on this occasion.

We note that you raise a number of general questions on which you seek comment as well as specific issues relating to the drafts of chapters 1 and 2 of the Improved Conceptual Framework. We do, for reasons that will become

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apparent primarily address issues in chapter 1 of that revised Framework when making our comments.

In making our submission we address the issues on which you request comment, and then provide a broader justification for our concerns.

Questions relating to Chapter 1

1. **The boards decided that an entity's financial reporting should be prepared from the perspective of the entity (entity perspective) rather than the perspective of its owners or a particular class of owners (proprietary perspective). Do you agree with the boards' conclusion and the basis for it? If not, why?**

We agree with the board's conclusion with regard to MNCs. The shares in these companies are owned by persons who cannot be identified by the MNC, who may have a fleeting association with it and who have no intention of ever engaging with it by exercising their proprietorial rights. In consequence we are of the opinion that MNCs are freestanding entities quite separate from their owners or providers of capital and as such think it appropriate that they be required to account on this basis.

2. **The boards decided to identify present and potential capital providers as the primary user group for general purpose financial reporting. Do you agree with the boards' conclusion and the basis for it? If not, why?**

We do not agree with the board's conclusion on this matter. We have a wide range of reasons for forming this opinion and draw attention to them in turn as follows.

a. **We suggest that the IASB has not fulfilled its public interest remit as laid down in the IASC Foundation Constitution in reaching this conclusion.**

The IASC Foundation Constitution says that "*The objectives of the IASC Foundation are:*

> ***(a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;***
> ***(b) to promote the use and rigorous application of those standards;***

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(c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and
(d) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions."[1]

We note that in the Exposure Draft the IASB says that its duty is (Para OB3):

The boards' mandate is to assist in the efficient functioning of economies and the efficient allocation of resources in capital markets by developing high quality financial reporting standards.

We do not think that the statement in paragraph OB3, which is that on which the boards appears to have reached their conclusions, can be reconciled with the requirements of the IASC Foundation Constitution, which is the superior document that must prevail if any dispute is to arise on this issue since the IASC is the governing body of the IASB.

We submit that if the IASB's conclusion that the accounts of MNC's must be prepared on an entity basis (with which we concur) is correct then it follows that:

- **i. The interests of all users of financial statements must be given equal weighting when considering the IASC and IASB obligation to create global accounting standards in the public interest. We suggest that to confuse the public interest with the interests of present and potential capital providers is a category error.**
- **ii. If, as the IASC constitution makes clear, there is no order of priority between the needs of users of the world's capital markets and other users then each must be given at least equal weighting in determining the needs of users of financial statements, and consequently in determining the information that those statements should supply, and as such the identification of one group as having priority in reporting to the exclusion of all others is contrary to the constitutional requirement of the IASC;**
- **iii. By assuming that the world capital markets (which are primarily, and by value almost entirely located in the developed economies of the world, and where by definition the vast majority of capital traded is owned by those resident in the developed economies of the world) as its primary focus of concern the IASB has ignored its obligation to consider the special needs of the emerging economies of the world and**

[1] http://www.iasb.org/NR/rdonlyres/1904AEEE-3554-49C6-BD96-A4611A6964BE/0/IASCFoundationConstitution2.pdf accessed 3-9-08

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as such is acting in contravention of the requirements of the IASC Foundation Constitution.

As such we are of the opinion that the IASB is by suggesting that present and potential capital providers be considered the primary user group for general purpose financial reporting acting contrary to the requirement that it act in accordance with the public interest in promoting global accounting standards.

b. The board has ignored the real interests of all other users of financial statements in suggesting that the primary user group of financial statements prepared on the entity basis are present and potential providers of capital.

In the Exposure Draft the IASB refers to equity shareholders, loan capital providers, employees, suppliers, customers and other groups (OB6) as users of financial reports. Regulators are mentioned (BC1.39). Governments and their agencies and members of the public are also mentioned (OB8).

This results in a list of potential users of financial statements whose needs are recognised by the IASB that is very similar to a list drawn up by the United Nations Conference on Trade and Development who in their 2008 report "Guidance on Corporate Responsibility Indicators in Annual Reports"[2] recognised the following groups of stakeholders:

- **Investors and financial institutions;**
- **Business partners;**
- **Consumers;**
- **Employees;**
- **Surrounding community;**
- **Civil society organizations; and**
- **Governments and their institutions.**

The overlap with the IASB list in the exposure draft is almost exact despite the fact that it is assumed different audiences are being addressed.

It is also interesting to note that this coincidence is not a function of timing. A document entitled "The Corporate Report" published by the UK's Accounting Standards Steering Committee in 1975 and which might be considered a precursor of the current exposure draft listed those with interest in financial reporting as:

[2] http://www.unctad.org/en/docs/iteteb20076_en.pdf accessed 15-8-08

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- **The equity investor group (shareholders)**
- **The loan creditor group (banks and bondholders)**
- **The analyst-adviser group who advise the above groups**
- **Employees**
- **The business contact group**
- **The government**
- **The public.**

The close similarity between this list and those noted above is obvious. It is clear as a consequence that it is relatively easy to identify those groups with interest in financial reporting and that this list has not changed over a considerable period of time.

In that case it must be assumed that when the IASC accepted a mandate to serve the public interest those interest groups that it was meant to serve or those that could be identified as having interest in its work are those groups noted above. We would argue that in that case it is inappropriate to argue, as the Exposure Draft does that (OB8):

> ***Other users who have specialised needs, such as suppliers, customers and employees (when not acting as capital providers), as well as governments and their agencies and members of the public, may also find useful the information that meets the needs of capital providers; however, financial reporting is not primarily directed to these other groups because capital providers have more direct and immediate needs.***

We do not dispute that providers of capital do have specialised needs when considering the data they expect to be supplied in financial reports. We wholeheartedly support the provision of that information even if it has limited use to other users of financial statements. But in our opinion it does not follow that a body that is tasked with acting in the public interest should, when proposing a move from the proprietary to the entity basis of accounting, suppose that the special needs of capital providers, who comprise just one of seven or eight interest groups who use that data, should be paramount.

Nor is it possible to presume that if, as is stated at OB4 *general purpose financial reporting is directed to the needs of a wide range of users rather than only to the needs of a single group* then (OB4) *information needed to satisfy the specialised needs of some users may be beyond the scope of general purpose financial reporting* when it is also said that (BC1.21) *including in financial reports some information that is primarily directed to equity investors, present or potential (information that some view as more consistent with the proprietary perspective), is appropriate.* There is clear bias shown as a result towards the special needs of some users of financial statements without adequate explanation

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being given for ignoring the special needs of others. We consider this unacceptable.

In our opinion the Boards have entirely misinterpreted the consequence of their adoption of the entity concept, appropriate as that adoption is. If the entity concept is valid then the entity stands separate from all participants within it, proprietors and providers of capital included. It follows that it does therefore owe a duty to each of those participants, without selecting one group ahead of any other. This logic is inherent in the IASC Foundation Constitution. As such we believe it follows that the IASB and FASB should ensure their global accounting standards meet the needs of all those user groups, even if this requires the production of more or additional information, and even if some of that additional information will be of limited use to the providers of capital to the enterprise.

c. The board has inappropriately picked those they consider the primary user group of financial statements because they have assumed that a change from the proprietary to the entity perspective will have no impact on the way in which financial statements are used, or upon those using them.

The Boards say that present and potential providers of capital are the primary user group for financial statements because (BC1.19) ***present and potential capital providers have the most direct and immediate interest in an entity's ability to generate net cash inflows and management's ability to protect and enhance capital providers' interests.***

We agree that capital providers have had the most direct interest in financial statements to date because equity shareholders, as one significant element in that group have until recently been assumed to be the sole interest group for whom financial statements were prepared. They have therefore, unsurprisingly, shown greatest interest in those financial statements to date.

However, the interests of shareholders are now recognised as just a sub group within the broader category of those providing capital to the entity. But in that case to then argue that their previous status as primary users can now be transferred to the group of which they are now a member is, in our opinion, illogical.

To use an analogy, if financial statements had historically only ever been prepared in French then unsurprisingly those speaking French would be the main users of financial statements. If it was then realised that those speaking other languages also had interest in financial statements and that the basis of preparation should be changed to meet their needs but the information was still designed and published to only meet the needs of those reading French because

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they had to date been the only habitual users of financial statements, it would be quite clear that a serious error of judgement had occurred. It would be obvious that the consequence of the changed perception of need would not have given rise to a necessary change in behaviour to meet that need, namely publication in other languages for those who only read those other tongues. That is, however, exactly the mistake the boards are making in our opinion. They are recognising that the status of the entity has changed and that this changes its reporting obligations and those for whom financial statements are prepared and yet for all practical purposes the reporting that will take place will be the same as that undertaken in the past.

That cannot be a logical consequence of the decision the IASB has taken to base its conceptual framework on entity based reporting. Entity based reporting must reflect the obligations the IASC has accepted in its Foundation Constitution which is that reporting must be in the public interest for those who are *participants in the world's capital markets and other users mak[ing] economic decisions.*

In that case we argue that the IASB needs to assume that the users of financial statements are all those groups noted above, whose identity has been consistently noted for more than thirty years, and assume that financial statements should meet all their needs, special, specific or otherwise.

d. The boards appear to have inappropriately identified the providers of capital when identifying this user group for financial statements.

The Exposure Draft does not list government or its agencies as suppliers of capital who might have special interest in the financial statements, although they are recognised as having interest in other ways.

It is not possible to determine if this is an oversight or a deliberate omission. Whichever it is the exclusion is serious because most governments are providers of significant capital to business using the definition of capital that the boards use in the Conceptual Framework. Sometimes that capital is provided in the form of grants and subsidies but more often it is in the form of being a creditor for taxation, whether that tax is charged on sales, labour, profit or some other basis. In addition, deferred taxation is a major component of capital in many enterprises requiring its own special accounting rules; a fact that the IASB has recognised.

Further, as the recent economic climate has proven, government is very often the equity provider of last resort for many major MNC's, particularly in the financial services sector. Freddie Mac, Fannie Mae, AIG and to some degree Bear Stearns have all proven this to be the case in the USA; Northern Rock plc provides similar evidence in the UK and examples can be found in other economies. So noted has

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been the development that Martin Wolf, the senior economics correspondent of the Financial Times, has asked why companies have equity any more, government seeming to fulfil that risk bearing task in many major corporations[3]. In that case it is clear that governments should be included amongst those who are capital providers.

Governments are, however, distinct from other capital providers in two respects. The first is that most are democratically accountable for their actions and as such have particular information needs to justify their actions. Secondly, they are always and by definition geographically constrained and have a limit upon their capacity to act. This necessarily means that they must be able to identify their sphere of influence and exposure to risk, a geographically based need as a capital provider that is not recognised in the Exposure Draft.

For all these reasons we believe that the boards should address this oversight in the Exposure Draft and should address the issues arising from recognition of the special status of government with regard to entity based accounting that do, inevitably, flow from doing so.

e. The boards appear to have inappropriately identified the special needs of governments who must base their calculations of taxation liabilities on financial statements prepared using the standards for which they are responsible.

In addition to the issue noted in the previous section, the boards do not note that governments are a very particular user of financial statements since those statements are frequently used as the basis for determining a corporation's liability to taxation.

Since nothing precludes the use of IASB / FASB standards for single entities these standards have direct impact upon potential taxation revenues of the states that adopt those standards for use within their domain and as such special consideration of the needs of government should feature prominently in the considerations of the boards to ensure that the agencies of government responsible for assessing taxable income can use those statements for this purpose. This is especially the case given that the IASB has adopted the entity principle that reinforces the need for the taxation of the company as a legal person in its own right.

f. The board has ignored the special needs of emerging economies in suggesting that the primary user group of financial statements

[3] http://www.ft.com/cms/s/0/3a4cb13a-7d04-11dd-8d59-000077b07658.html 8-9-08

prepared on the entity basis are present and potential providers of capital.

By definition emerging economies are found in countries with low-to-middle per capita income. Such countries are generally accepted to constitute approximately 80% of the global population, representing about 20% of the world's economies.

Three characteristics are important to note:

1) **These countries are usually identified by being in transition to industrialisation and do not usually, as a result, possess the same standards of regulation or governance to be found in developed countries;**
2) **By definition these countries are poorer than developed countries;**
3) **These countries are, therefore, likely to be subject to FDI inflows and are unlikely to have significant capital markets of their own.**

In this case these countries are likely to have more in common with the poorest countries in the world than with the developed countries of the world precisely because both groups of nations will have few participants in the world's capital markets located within them, not least because very few people in these locations will have any financial capital.

If that is the case, and given that the IASC is tasked with ensuring that the IASB develops in the public interest a single set of high quality, understandable and enforceable global accounting standards taking into account the special needs of emerging economies, then we believe that the IASB's assumption that the primary user group of financial statements prepared on the entity basis are present and potential providers of capital would appear to be wrong. A different approach is needed if the needs of emerging economies are to be met.

In particular the boards will, if they are to fulfil their obligations, need to ensure that sufficient information is disclosed in the financial statements that they promote to fill any potential regulatory defects or deficits to be found in emerging economies; to ensure those resident in emerging economies understand the impact of those investing in those economies upon the state of their well being by the provision of location specific information and by ensuring that reliable and relevant country specific information is available to assist taxation revenues to be collected by emerging economies to finance the process of transition in which they are engaged. It is not apparent that this is the case at present or that the boards have considered these issues.

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For all these reasons we consider the boards have made a serious error of judgement in identifying a single or primary user group for financial statements and would urge them to reconsider their position with regard to this issue.

3. The boards decided that the objective should be broad enough to encompass all the decisions that equity investors, lenders and other creditors make in their capacity as capital providers, including resource allocation decisions as well as decisions made to protect and enhance their investments. Do you agree with that objective and the boards' basis for it? If not, why? Please provide any alternative objective that you think the boards should consider.

For the reasons noted in response to question 2, above, we do not agree that the boards have correctly identified the principal users of financial statements prepared using the standards that they promote. Our comments in this section should be read in light of that disagreement.

It is our belief that whilst the providers of capital to a company do have both special interest in its financial reporting and particular needs for information that may not be of interest to other users that are of sufficient significance to justify their provision nonetheless, they also share a common interest with those other users of financial information who have a need for data that the boards do not, at present, appear willing to either identify or supply. In particular, we believe that segment reporting by a multinational corporation on a country-by-country basis is essential if the needs of the broad base of users, as noted above, of financial information prepared from an entity perspective are to be met.

We relate this need as it applies to a number of the interest groups shoes specific needs we believe musty be met by financial statements prepared on an entity basis as follows:

a. Governments

As noted above, governments are principal users of financial statements in their capacity as major suppliers of capital to business entities.

All governments are specifically geographically located and have primary interest in activities undertaken within their domain.

Their control of a specific domain confers on them their right to tax. Equally, it provides geographic constraint on that right in most cases.

For these reasons the provision of country by country data on financial performance, tax liabilities, investment and net reserves is essential to this

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specific and specialist user group, who may in many cases be unable to secure this information in any other way.

Because of the sensitivity of many of the issues referred to governments also need information to appraise the likely reliability of data on these issues of concern to them and it is only through the provision of information that differentiates third party from intra-group transactions that this necessary capacity to appraise likely reliability can be imparted for the benefit of this user group.

This might be especially true when governments act as regulators of entities within their domain and wish to be appraised of the full economic impact of an entity within their jurisdiction.

b. Employees

We believe very few employees consider their primary relationship with business entities as being in the role of suppliers of capital, although that is the only role in which the exposure draft considers their particular needs as a widely acknowledged user of financial statements.

We believe that most employees need information from financial statements to appraise the ability of a financial entity to provide them with an ongoing income stream within their immediate location.

In that case they are specifically concerned with issues relating to the local economic performance of the company for which they work and the supply of comparative economic data upon the costs of employment within the country in which they work and in other countries in which the business entity has an operation, and which might therefore provide substitute labour in place of their own.

This information is, for these reasons, heavily geographically orientated.

c. Consumers

Very few consumers will ever be providers of capital to a business entity: the example noted in the Exposure Draft of consumers making payment in advance of supply being unusual and insufficiently material in our opinion to justify their inclusion in the group of providers of capital.

However, many consumers are, in our opinion, users of financial information that might be usefully provided within the financial statements of business entities prepared on the basis of the entity perspective. In particular, as consumers they

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may wish to appraise the long-term local likelihood of continuing supply of the products they purchase, or they may wish to appraise the financial stability of the entity from which they are purchasing a product upon whose guarantee they will depend. However, since in almost every case they will not transact with the group entity that produces the published financial statements of the MNC but will instead engage directly with a local subsidiary entity of that organisation they will wish to know this data within the confines of the state in which they, in all likelihood, are both resident and in which they contract. For this reason it would appear that country-by-country reporting of financial information is of greatest significance to this particular user group, whose identity has been known for more than 30 years.

d. Suppliers

Suppliers are, in many cases, providers of capital to an entity preparing financial statements. However, just as was noted to the case with consumers in the preceding section, few suppliers trade with the parent entity of a group. As such information prepared on a group consolidated basis rarely provides them with the information they need to appraise the capacity of any local subsidiary to make payment to them for the supplies they have contracted to make.

Logically this information should be supplied by the provision of subsidiary accounting information, but in very many countries in the world, and most especially in emerging markets and even more especially in the case of information requests by small and medium-sized entities (to whom the IASB has a special responsibility under the terms of the IASC Foundation Constitution) such information is simply unavailable on any public or other record.

As such, unless multinational corporations provide information on their trading on a country by country basis most suppliers of capital to group subsidiaries will be quite unable to appraise the degree of risk they face in supplying those companies, and as such existing consolidated financial statements fail to help them in appraising their risk or to make appropriate decisions on allocating their resources efficiently.

For this reason country by country data must be supplied by multinational corporations to ensure that these providers of capital make proper decisions on the risk they wish to take when trading with entities preparing financial reports using International Financial Reporting Standards.

e. Civil society

Civil society is a generic term we use to consider both members of the public and those organisations that members of the public form to represent their interests.

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In many cases members of the public will seek information about the activity of a reporting financial entity as a member of one of the groups noted above. There are, however, occasions when they might wish to do so as a member of a civil society organisation with interest in a particular issue.

We stress that we are aware that some particular issue organisations have need for information that is not of a financial nature, may not have impact on economic decisions, and is not therefore relevant for inclusion within the audited financial statements of a reporting entity, even if it is reasonable to expect the entity to provide that information in some other form, and in some other place. We stress our comments made here have allowed for that fact.

In making our comments we are particularly concerned with regards to the economic impact of reporting entities are less around the community, especially with regard to:

- **The dependence of a community upon a particular company for the generation of well-being, such as its export trade. In some countries of the world, and in particular those in emerging economies and those where the extractive industries have particular significance, one or two companies may dominate the entire export trade of an economy;**
- **The use of natural resources. These natural resources may be within the extractive industries, as noted above, but as importantly may relate to water, agriculture, fisheries or other such products, and the concern with regard to these issues is by no means limited to the emerging economies. At a time when resource scarcity is becoming apparent decisions on all these issues will become of considerable significance to civil society within all economies throughout the world and having information available on which to make economic decisions with regard to them, and to hold both companies and governments to account on them is vital if proper debate upon the allocation of resources and resulting economic decisions are to be made. This will only be possible if information on market share, the proportion of that market share supplied from within the group itself and that from third parties, a measure of local value added and measures of profit from both within the jurisdiction where the civil society organisation is present and in comparison with others are available for appraisal.**
- **Taxation paid. Taxation is vital to very many aspects of decision-making. For many people it is a key component in their decision between rival electoral candidates in democratic elections. Such decisions have fundamental economic impact. Being able to appraise the taxation yield arising within an economy from corporation tax is one of the key measures of accountability that many citizens will wish to**

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appraise when making such decisions. For this reason information on both taxable profits and tax and other payments made to their government are vital for members of civil society when making economic decisions with regard to their own well-being and that of others when participating in the democratic process.

- This same information on taxation may also have significant impact upon a population's appraisal of risk with regard to the presence or absence of corruption within an economy and this in turn may have significantly impact on their economic decision-making. This is also true of investors, many of whom would not wish to invest in companies that engage in economic activity in countries where the risk of corruption is high. Without information on a country by country basis on taxation paid they will not have the information they need to assist them in undertaking this form of appraisal of the likelihood of corruption being present in the activities a company pursues.

We stress this is a limited review of the uses civil society might make of financial data prepared by a company on a country by country basis for the purpose of making economic decisions. What each show, and what all further examples would also demonstrate, is that without this data decision useful information is being denied to those wishing to undertake economic decisions on the basis of the financial statements prepared by reporting entities. In that case it is apparent that current data prepared by financial entities for supply to the providers of capital is both insufficient to meet the needs of those suppliers of capital and is seriously insufficient for those other uses of the financial statements to whom the boards have a duty in fulfilling their public interest mandate.

Country by country reporting

As a result of the above observations we are of the opinion that the boards have a duty to adopt country-by-country reporting requirements for all entities that prepare group consolidated financial statements on an entity basis using International Financial Reporting Standards or US GAAP.

We believe that country by country reporting would require, at a minimum, disclosure of the following information with regard to every country in which a multinational corporation has a permanent establishment for taxation purposes, or a subsidiary company:

1. The name of each country in which it operates;
2. The names of all its companies and other entities trading in each country in which it operates;

3. **What its financial performance is in every country in which it operates, including:**
    - **It sales, both third party and with other group companies;**
    - **Purchases, split in the same way;**
    - **Labour costs and employee numbers;**
    - **Financing costs split between those paid to third parties and to other group members;**
    - **Its pre-tax profit;**
4. **How much it pays in tax and other ways to the government of the country in which it is operating as a consequence (split as noted in more detail below);**
5. **Details of the cost and net book value of its physical fixed assets located in each country;**
6. **Details of its gross and net assets in total for each country in which operates.**

To ensure that a true and fair view of taxation liabilities can be formed, which is a key consideration for many users of financial statements in civil society tax information will need to be analysed by country in more depth requiring disclosure of the following for each country in which the corporation operates:

1. **The tax charge on profits arising for the year split between current and deferred tax;**
2. **The liability for other taxes or equivalent charges due to the government of the country for which the report is being made arising in the period;**
3. **The actual payments made to the government of the country and its agencies for tax and equivalent charges in the period;**
4. **The liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;**
5. **Deferred taxation liabilities for the country at the start and close of each accounting period.**

In our opinion the disclosure of this information is vital to both providers of capital and other users of financial statements because of the significance of the following issues:

1. **Transparency. In many countries a corporation does not have to put its accounts on pubic record. That means that what an MNC does in that**

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country is not a matter of public record. That matters. What MNCs do has enormous implication for the wellbeing of the world. Country by country reporting overcomes this problem. It puts all MNC activity 'on the record'. Many investors appreciate this.

2. **Corporate social responsibility (CSR). CSR is about the relationship between a company and its host community. But this does require that the host community knows the company is there. Country by country reporting provides that information.**

3. **Accountability. A company cannot be accountable unless it can be identified. This means that the names an MNC uses locally must be on public record. Too often they are not. Country by country reporting names local subsidiaries.**

4. **Trade. 60% of world trade is intra-group trade. In other words it takes place across national boundaries but between companies under common ownership or control. Existing financial statements completely eliminate all of this trade from public view. Country by country reporting shows it all. This is vital if trade relationships are to be properly understood.**

5. **People. MNC financial statements include data on the number of employees a company has and their aggregate remuneration. Country by Country reporting would require this statement for every country in which an MNC operates. This would provide invaluable information on labour conditions.**

6. **Tax. MNCs have more opportunity than any other group in society to plan their tax affairs. They can seek to shift their profits from state to state to find the lowest overall bill. Country by country reporting discloses the profits that companies record in each country in which they operate and the taxes that they pay on them. This means they can be held accountable for what they do and do not pay. This is an issue of particular significance in emerging economies.**

7. **Corruption. The Extractive Industries are dominated by MNCs. The Extractive Industries Transparency Initiative seeks to hold those companies to account for the tax payments they make, and the**

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governments that receive those payments to account for what they do with them. Many MNCs resist disclosure of information on what they pay because of competitive pressure, contractual obligations and local political opposition. Country by Country reporting would overcome these objections, significantly enhancing transparency in this sector (and others), and help cut corruption.

8. **Development. Developing countries lack revenue to finance public goods and services. Aid helps alleviate this problem but creates a dependency, harms the democratic accountability of developing country governments because they are not accountable to their electorates for what they spend and aid can itself directly contribute to corruption. Local declaration of economic activity by MNCs with the resulting accountability for taxes paid could break this cycle and help create fully independent, accountable governments capable of raising their own taxation revenues.**

9. **Governance. Many of the major corporate scandals of recent times have involved extensive use of offshore subsidiary companies. These are becomingly increasingly common throughout the MNC world, but it is recognised that the problem of managing them creates severe governance issues for MNCs. This results in increased risk for shareholders and others who need to understand the risk inherent in an MNC's activity.**

10. **Geographic risk. Some countries are politically unstable. If a company trades there shareholders should know. Some are politically unacceptable. If an MNC trades there civil society wants to know. Some countries are subject to sanction. Trading there is illegal. Where you are matters to suppliers of capital and other users of financial statements alike. Country by country reporting holds a company to account for where it is.**

For these reasons we think the conceptual framework must embrace country-by-country reporting as an essential component in the supply of information to meet the needs of the suppliers of capital to and other users of financial statements of financial entities.

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Questions relating to Chapter 2

We have noted the questions the boards have raised. We provide our comments in the light of our comments on the questions relating to Chapter 1, above, and accordingly do not consider all dimensions of the issues raised.

1. Do you agree that:

   a. relevance and faithful representation are fundamental qualitative characteristics? (See paragraphs QC2–QC15 and BC2.3–BC2.24.) If not, why?

We do consider relevance and faithful representation to be fundamental qualitative characteristics of financial statements. However, we are of the opinion that without the inclusion of country by country data of the sort noted above neither of those characteristics will be present in financial statements.

   b. comparability, verifiability, timeliness and understandability are enhancing qualitative characteristics? (See paragraphs QC17–QC35 and BC2.25–BC2.35.) If not, why?

We do agree with the boards on this issue. However, we do not believe that the boards can deliver verifiable or understandable information if they do not require country-by-country reporting within the financial statements of MNCs.

   c. materiality and cost are pervasive constraints? (See QC29–QC32 and BC2.60–2.66.) If not, why? Is the importance of the pervasive constraints relative to the qualitative characteristics appropriately represented in Chapter 2?

Materiality and cost are, of course, constraints on the production of any financial information. However, we would stress that neither is a constraint with regard to the production or supply of the country by country information that we have requested. First of all, as we have argued this information is material to the understanding of financial statements by both suppliers of capital and other users of those statements. Second, given that all users of financial statements are actually or ultimately physically located in a place, and that place is always going to be material to that user, the only acceptable definition of materiality in this regard is the place itself and therefore information must be supplied on all locations in which an entity trades. The obvious parallels are either with regard to related party transactions, where their existence is the definition of materiality for disclosure, or director's

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remuneration (admittedly in the supporting notes in many financial statements) where aggregation would make the disclosure meaningless. Lastly, with regard to cost, our research, and the evidence we have heard is that the data we are requesting be disclosed does exist, and could be made available at relatively modest cost. In terms of the credibility it would add to financial statements prepared on an entity basis by making them useful to all users this cost will be small in relation to benefit provided.

2. **The boards have identified two fundamental qualitative characteristics — relevance and faithful representation:**
    a. **Financial reporting information that has predictive value or confirmatory value is relevant.**

We agree, but see our observations with regard to the following question.

    b. **Financial reporting information that is complete, free from material error and neutral is said to be a faithful representation of an economic phenomenon.**

        (i) **Are the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?**

        (ii) **Are the components of the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?**

We note these questions and answer them together.

First, we confirm that we think completeness, freedom from material error and neutrality, which we define as being data supplied in objective form to enable others to make subjective judgement, are essential characteristics of financial statements.

We do think that the terms as we note them in the preceding paragraph are sufficiently defined to be understood. We do however draw attention to our

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emphasis on the term neutrality, which has different emphasis to that which the boards use.

What we cannot agree upon is that the boards have then in any meaningful way followed the logic of their argument when stating that the primary users of general purpose financial statements are present and potential providers of capital and that information provided to meet their needs will fulfil the information requirements of all other users of financial statements. By definition the boards' decision means that:

(i) The financial statements of reporting entities will be incomplete since the needs of some users have been ignored as a matter of choice;

(ii) The financial statements will not be objective since a subjective decision to favour one group of users over all others has been implicit in their preparation, meaning that objectivity has been lost;

(iii) The risk of material error is exacerbated if country by country reporting does not take place because available evidence suggests that in its absence the data from some countries included in consolidated financial information is never subject to audit scrutiny, resulting in an unacceptable transfer of risk to providers of capital.

For these reasons we think the boards need to fundamentally revise their approach to financial reporting to meet their own, largely appropriate, criteria for the qualitative characteristics of faithful representation of the resulting reports.

3. Are the enhancing qualitative characteristics (comparability, verifiability, timeliness and understandability) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not, why?

Yes

4. 4Are the pervasive constraints (materiality and cost) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not, why?

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Yes, but note observations above with regard to their applicability.

Concluding remarks

We thank you for this opportunity to comment and confirm we would be pleased to meet with you to discuss the issues we have raised which we think to be material. We provide our explicit consent for these comments to be published.

Yours faithfully

John Christensen

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Director

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