



First Floor  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

26 September 2008

Submitted electronically

Dear Sir / Madam

**Exposure Draft of an Improved Conceptual Framework for Financial Reporting**

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

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.

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 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 arising from Chapter 1 of the Exposure Draft**

- 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 boards' conclusion.

In our experience transnational corporations (TNCs) do not behave as if they are extensions of their shareholders. This is particularly true with regard to their engagement in the developing and emerging economies of the world where few people have direct relationship with TNCs as shareholders and where the behaviour of those companies suggests that they are independent entities acting in their own right. As such we think that the boards are correct in presuming business entities reporting in accordance with its standards to be entities in their own right standing independent of their owners, and without sole responsibility to them.

We do, as we note below, question whether the board has drawn the right conclusions that flow from this decision, and whether it has in consequence of this decision correctly identified the principal users of financial information, what their needs might be and whether it has as a result paid insufficient regard to the importance of the stewardship concept, which we think remains of considerable significance despite recognising the importance of the entity perspective.

**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 note that the objectives of the IASC Foundation are, according to its constitution 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;
- (c) in fulfilling the objectives associated with (a) and (b), *to take account of, as appropriate, the special needs of ....emerging economies*; and
- (d) ....”

We have edited as appropriate those items not relevant to our submission and have italicised those elements we think important to our argument.



We do not believe that the boards have fulfilled the requirement of the IASC Foundation in suggesting, as the Exposure Draft does, that their duty is to (Para OB3):

...assist in the efficient functioning of economies and the efficient allocation of resources in capital markets by developing high quality financial reporting standards.

We suggest that the boards have, in reaching their conclusion, paid insufficient interest to the public interest and the special needs of emerging economies although it is clear that they have duty to do both.

In addition, and as importantly, the boards have failed to give equal weight to the needs of those participating in the world's capital markets and other users of financial data. This is despite it being very clear from the form of words used the IASC Foundation Constitution that there can be no justification for considering one such group to be superior to the other. That constitution gives clear indication that equal weight has to be given to both by use of the conjoined transition phrase 'and' instead of the many available alternatives that might have implied a ranking of claim, including, for example, use of the phrase 'as well as' when referring to other users.

Accordingly 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, failing to fulfil the mandate given to it to promote global accounting standards in the public interest. We comment below on those in whose interest we think the Board should also be acting.

**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.**

As noted above, we do not think that the boards have correctly identified the principal users of financial statements prepared using the standards that they promote. Our observations that follow are based on this premise.

We stress that we accept that the providers of capital to a company do both have special interests in its financial reporting and do have particular needs for information that may not be of interest to other users of financial statements but which are of sufficient significance to justify their provision nonetheless. We accept that these needs are sufficient to justify the existing reporting model promoted by the boards.



It is, however, our opinion that not all of the information needs of providers of capital to a corporation are met by the existing models of disclosure promoted by the boards and that additional disclosures of the types noted in this submission would meet the information needs of providers of capital in this regard as well as meeting the needs of those other users of the financial statements of TNCs (such as ourselves) in making economic decisions. We stress that in making this comment we are restricting our observations to financial data, and not to that additional, and supplementary information of a non-financial nature which it has now become customary for many TNCs to supply.

As such we are of the opinion that the Board is, by restricting its consideration of the needs of users to their decisions undertaken in their sole capacity as providers of capital, denying them the information they need to make economic decisions across the full spectrum of their economic decision making. If that is the case then we are of the opinion that their decisions taken as providers of capital will not be optimal. If that is the case then boards will not be facilitating the optimal allocation of resources within efficient capital markets. Nor will they be requiring supply of that information needed by other users of financial information included in the financial statements of TNCs.

In that case we do not think the boards' approach broad enough to meet the needs of the suppliers of capital or other users.

## **Questions arising from Chapter 2 of the Exposure Draft**

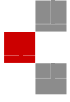
### **1. Do you agree that:**

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

Yes. But please note our comments made below which suggest that the choice of primary user the boards have made will, in our opinion, restrict the usefulness of this understanding because the financial data that the boards propose to supply will not be relevant for all users and will, due to incompleteness fail to be a faithful representation of the economic events to which they relate.

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

Yes. However, as with the previous question please note our comments made below which suggest that the choice of primary user the boards have made will, in our opinion, restrict the usefulness of this understanding because the financial data that the boards propose to supply will not enjoy these characteristics for many users.



- (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 must be pervasive constraints on the production of financial information. We would however stress that neither is, in our opinion, a constraint with regard to the production or supply of the country by country information that we request, below. We offer these reasons:

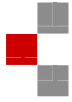
- (i) This information is material to the understanding of financial statements by both suppliers of capital and other users of those statements. Its omission would, therefore, breach the fundamental and enhancing qualitative characteristics noted in the previous answers. Any breach of those characteristics must be material, and accordingly there is a cost over-ride in this case.
- (ii) As a matter of fact all users of financial statements are, ultimately, human beings. This means that they are all, eventually, physically located in a place. The place in which a person is located is always going to be material to that user. If that is the case then when issues of geography are taken into consideration the only acceptable definition of materiality is the place itself. As such information must be supplied on all locations in which an entity trades.
- (iii) As has been noted by some companies, given due notice of the need to prepare the information to which we refer below the cost of its preparation would be modest and its impact on timing low. This was, for example, noted by one major multinational corporation at the round table hearing on country by country reporting within IFRS 6 staged by the IASB in London on 15 September 2008. In that case the credibility gain from providing financial statements prepared on an entity basis incorporating the information we request below would, in our opinion, be small in proportion to the 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 note our comments on the following questions.

- (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 two questions but believe it appropriate to answer them together.

We do believe that information that is complete, free from material error and neutral is necessary as the basis for economic decision making. We regret that we do not think that this is likely to be provided if the approach to the conceptual framework noted in the exposure draft is adopted.

This is because we believe that the principal users of financial information have been incorrectly identified by the boards and information that they need to ensure these characteristics are met would, if the exposure draft is adopted in its current form, not be made available for their use. We note that information and who those other users might be below.

Our concern here is to note that the decision not to supply this information is, in our opinion, incorrect because that decision does not portray the necessary characteristic of neutrality that the boards consider a fundamental qualitative constituent of appropriate financial reporting. As a result the information that it is proposed be supplied is, in our opinion, incomplete and likely as a result to contain material error in that economic decisions based on that information will have to be made on the basis of insufficient data to ensure an objective conclusion on the part of the user.

In that case the information to be supplied by the boards cannot, in our opinion, be considered a faithful representation of the economic phenomenon that financial statements prepared in accordance with standards promulgated by the boards should seek to describe.

As a result whilst we agree with the boards' definitions we do not think they have been correctly used in the proposed conceptual framework and as such it is inappropriate for use in its current form.

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

Yes.

**Additional observations**

Having answered the questions the boards' have posed we address the deficiencies to which we have alluded in the exposure draft as follows:

**1. Those additional users of financial information that we believe should be considered to have distinct, separate and appropriate needs for information that cannot be met solely by the supply of information designed for the benefit of the providers of capital are:**

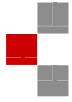
**a. Governments**

We are concerned to note that governments are not noted as suppliers of capital to business entities in the exposure draft, although it is clear that they are significant creditors of such enterprises and as such suppliers of capital both with regard to taxation and other matters.

Additionally, governments have particular needs for information from those entities that are likely to be report using the standards promoted by the boards and this will be particularly true in developing and emerging economies to whom it is noted in the IASC Foundation Constitution that the IASB owes a special duty of care. We have particular concern with regard to those TNCs engaged in the extracted industries that operate in these economies. This is because:

- Those entities tend to be few in number but highly material in individual economic impact when working in developing and emerging economies;
- Most developing and emerging economies have difficulty in collecting reliable economic data upon economic activity within their domains and as such the reports of material private sector entities will be vital to them in the conduct of their management of their economies;
- Many governments in developing and emerging economies are seeking to break their dependence upon aid by establishing sustainable taxation revenues to meet the needs of their populations. This can only be achieved if they have reliable information on the income streams of those entities that trade within their domains on the basis of which they can form economically appropriate decisions.

It is unlikely that the information that the governments of developing and emerging countries will be able to secure this information from existing sources because:



- To do so might breach tax confidentiality;
- Existing data will be based on the reporting of legal entities and will not as a consequence be geographically constrained to their domain; nor will it be consolidated to show the full impact of the trading entity net of intra-group transactions within the domain when prepared on a sub-consolidated entity basis.

For this reason whilst legal entity data is also of significance to governments for the purpose of imposing taxes consolidated country data is vital as well if sufficient data is to be available to ensure a developing and emerging economy government is to have the data it needs that is complete, free from material error and neutral for its use in determining national economic policy.

For this reason we believe that governments need this data which is not available at present from financial reports prepared from a proprietary perspective.

#### **b. Local trading partners**

Few developing and emerging economies require that the financial statements of local trading entities be made available for public inspection, and this remains the case even if they are the subsidiaries of TNCs. Even if they are made available this is often only possible by way of personal inspection, a near impossible task for many who live in such countries due to economic circumstances, difficulty and cost of travel and the inefficiency of many local bureaucracies.

There are however many providers of capital to companies who prepare their financial statements in accordance with the boards' standards in developing and emerging economies, whether they are local suppliers, local employees or local customers. The boards say they have concern for all these groups. Many of these may now be able to access data on a TNC through the internet, whose spread within emerging and developing economies is now becoming commonplace.

However, most such providers of capital will have difficulty in identifying the relevant financial statements they should inspect if the financial statements of those companies do not:

- (i) identify if the TNC is trading locally;
- (ii) state the names of its local subsidiaries.

There is, in consequence, an inability on the part of many suppliers of capital to identify the appropriate financial statements they need to examine if this information is not made available. As such we think it is vital that it is supplied by all TNCs when they are trading in developing and emerging economies.



This data, whilst readily accessible to and easily published by TNCs will not by itself, however, in most circumstances enable these suppliers of capital to properly appraise their position with regard to the enterprise with which they engage. That is because the published financial statements of the TNC will, almost certainly, be prepared on a global consolidated basis. The suppliers of capital to whom we refer will, however, almost certainly trade with a local subsidiary of that TNC with whom they engage using local contract law. It is highly unlikely that the group financial statements will provide these local suppliers of capital with the information they need to appraise the risk that they face when trading with that local subsidiary, whose liabilities need not be guaranteed by the group as a whole. For these providers of capital it is essential that local information, supplied at the very least on a consolidated country basis, be made available so that they can undertake the economic decisions on the effective allocation of their resources, taking risk into account, that the boards believe such providers of capital should undertake if effective capital markets are to be in operation.

If this information is not made available for these providers of capital who only engage with a TNC at a local level whilst that information that is needed by those providers of capital who engage with the group entity is made available then we suggest that the information supplied will not be neutral, which is a status that the board aspires to with regard to such data, because inherent bias will have been built into the supply of data to the providers of capital with that bias favouring those suppliers of larger amounts of capital who are more likely to be located in developed countries even though the boards do not differentiate at any point in their paper between the needs of suppliers of capital on the basis of size, and the do, for example, explicitly presume that employees, who will always be relatively immaterial in the context of the group as a whole, have specific and relevant information needs that should be met by group financial statements.

We would add that this comment reveals an essential dimension of the need to reappraise the concept of materiality when financial statements are to be prepared from an entity perspective. The proprietary perspective permits the assumption that all equity shareholders have consistent needs because each owns separate shares in the enterprise, each carrying equal rights as determined by its constitution. Materiality can, therefore, be appraised with regard to each shareholder as is if all ranked equally, one with another.

This assumption does not hold true when financial statements are to be prepared from the entity perspective, whether or not for the primary benefit of the providers of capital, because it necessarily follows from the board's assumption of the broad nature of that class that the needs of that group will differ, and their perspectives of materiality will also vary significantly. In that case materiality must be determined from the perspective of the individual potential provider of capital (or other potential



user, in our opinion) and not from that of the entity itself. If, therefore, as the boards presume, the suppliers of capital include employees the financial statements must supply those employees with that information that is material to their understanding of their economic decisions that they must undertake on the basis of the information that the financial statements should supply to them in a complete, materially correct and neutral basis to enable them to allocate their own economic resources efficiently. Nothing else will do.

As a consequence materiality with regard to the supply of information to providers of capital must be defined for all categories of those providers of capital and in the case of local traders, individual consumers and employees that data can only be relevant within the local context in which they trade. Any information aggregated at a level above that of the particular country in which they either trade or live will not meet their need and as such it is essential that data be supplied at this level to ensure that their needs are met and this in turn defines the appropriate level of disclosure that need be made if relevant and reliable information that is material to the needs of the user is to be supplied in financial statements prepared from an entity perspective.

We would emphasise that we wish this observation to be taken into account in the discussion that materiality to which we refer above.

We would note that because every location is material to the provider of capital who contracts within that place we are of the opinion that country based data must be made available for every location in which a TNC of the types with which we are concerned trades.

### **c. Other capital providers**

Having noted the particular needs of customers, local suppliers and employees in their role as capital providers, and their consequent need for information that is material to their decision-making process, we would add that the country information that we think it essential be supplied for every location in which a TNC operates is also of significance to those providers of capital who do also obtain significant valuable and material information from the existing consolidated financial reports prepared by those enterprises, and which is made available using the existing standard issued by the boards.

In particular we believe that country based data, provided without exception for those countries in which the enterprise has an interest allows these providers of capital to appraise:

- the geopolitical risk to which the enterprise is exposed;



- the extent of intra-group trading and the nature of the internal supply chain within the group enterprise, and the risk to which this exposes it as a result of the likely structure adopted;
- the performance of the entity by location, which is critical to the capital provider in appraising the effectiveness of the entity's own decision-making process and the consequent probability of generation of future cash flows, based upon which the capital provider can determine the value of the enterprise to them, and the risks to which it exposes them in the context of their total portfolio of investments;
- the taxes, royalties, bonus fees, licence payments and other sums payable to government by the enterprise in each location in which it operates, which then lets the capital provider assess the probability that local regulation has been complied with, which is a significant factor in determining the likelihood of the enterprise maintaining its operation within the particular location in which it has invested, which in turn gives indication of likely potential for generation of future cash flows from that activity;
- the location and financing structure of the group's assets, which information is critical to understanding the location in which future cash flows might be generated, and the potential benefit arising from.

For these reasons we believe it essential that country based trading and limited balance sheet information be supplied by all TNCs. We believe that if this information is not made available the financial statements of those enterprises will be significantly incomplete and unlikely to present a true and fair view because of the omission of material information required by a provider of capital to properly appraise the potential future revenues of the enterprise, which task is an essential element of the decision-making process for which the boards presume that financial statements are made available.

#### **d. Other users**

As noted above, we do not agree that there are primary users of financial statements prepared from an entity perspective. We think there are just users.

We note that the boards refer in the exposure draft to equity shareholders, loan capital providers, employees, suppliers, customers and other groups (OB6) as users of financial reports. In addition, regulators are mentioned (BC1.39) in addition to governments and their agencies as well as members of the public (OB8). We consider this a fairly comprehensive listing of those likely to use financial statements. As we have noted above, all but regulators and members of the public who do not trade with the entity might be considered providers of capital, although as we also note the



boards do not seem to have recognised this with regard to governments, erroneously in our opinion.

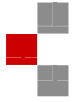
It is our opinion that to consider providers of capital to be the primary users of financial statements is also erroneous, and illogical. As noted above (in part b of this section), the current structure of financial reporting clearly does not meet the needs of many of those suppliers of capital because the data supplied is insufficiently granular and consolidated to a level that makes it immaterial for the needs of most suppliers, customers, employees and governments who supply capital to TNCs. The result is that the boards do not appear to be recognising the needs of most, by number, suppliers of capital but are, in practice, actually simply extending the group of proprietors for whom the proprietary perspective of reporting was appropriate to include the suppliers of loan capital. If that is the case then the claim made that the new conceptual framework will result in reports that meet the needs of the providers of capital as defined by the boards is wrong as the proposed outcome does not meet the needs of all members that group.

Those needs can, we suggest, only be met by assuming that the needs of all potential users should be met by financial statements prepared from the entity perspective, which we support. We would concur with the board that cost and materiality remain a pervasive constraint on this process though, and in that case have to clearly define what additional information we believe would meet the needs of those users.

We suggest that the additional information that those users needs as identified in this letter and in previous submission made to the boards are disclosure of financial data on a country by country basis.

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:

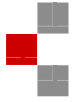
1. The tax charge on profits arising for the year split between current and deferred tax;
2. The liability for other taxes or equivalent charges due to the government of the country for which the report is being made arising in the period;
3. The actual payments made to the government of the country 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 public record. That means that what an MNC does in that 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 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 becoming 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.

### **Concluding remarks**

We confirm we would be pleased to meet with you to discuss the issues we have raised in this letter.

We provide our explicit consent for the comments included in the letter to be published.

Yours faithfully

Richard Murphy FCA  
Director