Clear cut

As EU transparency obligations become clearer, mining companies must prepare for compliance

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The European Commission building, Brussels

Photo: Sébastien Bertrand

In recent years, legislators in the European Union (EU) and US have set out their vision of creating a global standard for transparency in the extractive industries.

They hope that forcing mining and oil companies to disclose details of payments made to governments will help in the fight against corruption in resource-rich but under-developed countries.

The introduction of a global standard came a step closer in June 2013 when the EU Parliament and Council of Ministers approved the Accounting and Transparency Directives, which include requirements for EU companies to disclose payments to governments similar to those previously introduced in the US.

EU transparency requirements

The new Accounting Directive (2013/34/EU) will require companies in the extractive industries and those engaged in the logging of primary forests to disclose payments made to governments in the countries in which they operate.

EU member states must now enact relevant legislation in order to comply before July 20, 2015, with the new laws coming into force as early as January 2016.

Both the Accounting and Transparency Directives are much wider in scope than simply the reporting of payments.

The EU transparency requirements apply to entities "active in the extractive industry", engaged in "exploration, prospection, discovery, development, and extraction of minerals, oil, natural gas deposits or other materials".

They apply to entities listed on stock exchanges within the European Economic Area (EEA), including the London Stock Exchange. EEA-registered companies must also disclose if they are "large undertakings", with two or more of the following attributes:

- Gross assets of €20 million (US$52 million);
- Net turnover of €40 million (US$26 million); and,
- An average number of employees that exceeds 250.

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Companies must prepare consolidated reports if their subsidiaries are active in the extractive industry. The Transparency Directive extends these requirements to non-EU entities, where their securities are listed on an EEA stock exchange.

Companies that fall into this category must report payments to government of more than €100,000, whether made as a single transaction or series of related payments.

The following payment types must be separately disclosed:

- Production entitlements;
- Taxes levied on the income, production or profits of the company;
- Royalties;
- Dividends;
- Signature;
- Discovery and production bonuses;
- Licence; and,
- Rental and entry fees and payments for infrastructure improvements.

Payments in kind made to governments also need to be reported both in value, and, where applicable, in volume.

Only payments resulting from extractive operations should be included in the report. Taxes levied on consumption, such as value-added taxes (VAT), sales taxes or personal income taxes are excluded. Other taxes, such as payroll taxes, are not included.

Dividends generally do not need to be disclosed if paid to a government as a common or ordinary shareholder on the same terms as to other shareholders, unless they are paid in lieu of production entitlements or royalties.

The report should disclose the amount of payments by type to each government, with the term government meaning a national, regional or local authority. Payments should also be reported on a project-by-project basis, where such payments are attributable to a specific project.

The term project refers to a company's operational activities governed by a single contract, licence, lease, concession, or similar legal agreement.

Companies that comply with third country reporting requirements approved by the European Commission as equivalent to EU rules are exempt from these transparency requirements, except for the obligation to publish the report itself in the EU.

This concession is intended to relieve the administrative burden placed on international companies that are subject to double or multiple reporting frameworks.

US transparency requirements

The US requirements were enacted in the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (the Dodd-Frank Act) that was adopted by the US Securities and Exchange Commission (SEC) in August 2012. The rules were originally expected to come into force for payments from October 1, 2013.

However, the form and timing of US transparency requirements have been thrown into uncertainty following a recent ruling by the US District Court of Columbia that the Dodd-Frank Act only requires information to be disclosed publicly when it is deemed practical.

The court also concluded that the SEC's decision not to allow exemptions for certain countries where disclosure of payments is prohibited under local laws was "arbitrary and capricious".

It is not clear how the SEC will respond to the court decision. It has 60 days from July 2, 2013, to appeal. Even if the appeal is successful, commentators believe the effective date will be delayed from the October 1, 2013, deadline. However, most companies affected by the US rules are still continuing to make preparations for reporting.

Comparison of US and EU requirements

The EU requirements are broadly similar to the US transparency requirements. However, there are a number of key differences worth outlining.

Perhaps of most significance is that the US requirements only apply to listed entities in the US and not to private companies. Furthermore, the US requirements do not cover companies that are engaged in the logging of primary forests.

Other differences include the deliberate lack of a definition of how a project is defined under the US rules. The term project could apply to a range of business contexts, sectors or company sizes, according to the SEC.

Payments in relation to the processing and export of oil, gas and minerals must also be reported in the US, while these activities do not appear to fall within the EU's definition of "extractive operations".

Challenges ahead

US experience suggests miners preparing for compliance with EU rules will face significant challenges.

Most companies affected by the US requirements have encountered difficulties. The biggest problem is how to determine what payments must be disclosed.

Although the SEC published a lengthy explanatory document when it adopted the rules in August 2012, a number of questions remain as to the application of the rules in specific circumstances.

Uncertainties turn on how to ascertain which business activities fall within the scope of the rules. Are drilling contractors or carriers undertaking cross-border transportation of oil, gas or minerals included? What payments should be disclosed? Are payments relating to infrastructure improvements caught by the new regime?

Guidance has not been published for the EU rules, although the definitions do make it clear that those providing support services are not included, and therefore uncertainty is even greater.

Ultimately, the management of affected companies will need to make judgements when it comes to interpreting and applying the new rules, and be satisfied their judgements are correct.

Once mining companies have established their interpretation of the rules and exactly what payments to disclose they will need to ensure financial systems can report the information promptly and accurately.

This will involve training of relevant staff and system upgrade/adaptation to ensure relevant payment information, such as the government payee, and the name of the project to which a payment relates.

Control processes will also need to be designed and implemented to mitigate the risk of inaccurate or incomplete reporting.

Photo: Pete Souza

Barack Obama and Joe Biden on route to the White House in July 2010 to sign the Dodd-Frank Wall Street Reform and Consumer Protection Act

"Mining companies will also be releasing a large amount of new information into the public domain and will need to consider the implications"

Mining companies will also be releasing a large amount of new information into the public domain and will need to consider the implications. Some information may be commercially sensitive and companies should take into account the effect that disclosure could have on business strategy and its execution.

Governments, stakeholders, non-governmental organisations and the media are likely to scrutinise reports to evaluate the contribution to host countries and communities.

Many mining companies already provide a considerable amount of information about their contribution (including payments to governments) in voluntary sustainability reports.

However, given the granular detail of the information that will be reported and the complexity of the types of payments, there is a risk that misinterpretation could lead to damaging allegations.

In response, mining companies may choose to provide detailed commentary to explain the context, nature and amount of payments being made.

Conclusion

The obligations under new EU transparency rules are now clearer for European mining companies.

While the first instances of reporting are probably some way off, mining companies should start to prepare for compliance by seeking to understand the challenges that they are likely to face.

The challenges in relation to interpretation, reporting systems and public disclosure of information can be addressed, but not without focus, effort and cost.

Leading companies are putting together cross-functional project management teams. They are liaising with regulators, peers, and advisers on interpretation as they seek to apply the rules to their businesses.

They are identifying gaps in their reporting systems and controls and are considering the legal and commercial impact of disclosing detailed information. These companies will be best placed to meet their compliance obligations in due course. ▼

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