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Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

Accounting

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Endorsement of IFRS 8 *Operating Segments* Analysis of potential Impacts (API)

Public consultation: Please send back responses by no later than 29 June 2007.

The European Commission is seeking further input regarding the endorsement of IFRS 8 *Operating Segments* before finalising a report on the potential impact of endorsement for submission to the European Parliament in September 2007.

We seek input from a broad range of constituents (incl. preparers, users, auditors, standard setters, academics) to the **Questionnaire (see ANNEX)**.

The issue – Adoption of IFRS 8 *Operating Segments* for use in the EU

IFRS 8 *Operating Segments* (IFRS 8) has been published in its final version by the International Accounting Standards Board (IASB) on 30 November 2006. IFRS 8 is a disclosure standard replacing IAS 14 *Segment Reporting* (IAS 14), which is the standard currently endorsed for use in the EU. IFRS 8 introduces the "management-approach", which means that the defining of segments as well as the preparation of information used for segment reporting is based on information prepared for internal management decisions. IFRS 8 has no implication on reported profit or loss; it is a pure disclosure standard. In other words, it has no impact on the way income, expenses, assets, liabilities or equity are recognised, measured or presented in financial statements. However, segment information is a highly relevant source for users of financial statements to get a better understanding of the overall performance of a company.

Background of Segment Reporting

In 1997 there was an international discussion about the future direction of segment reporting. The revision of the segment reporting requirements in the US resulted in the introduction of the management approach for identification of segments as well as measurement principles and the revised standard SFAS 131 *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131). The predecessor of the IASB, the International Accounting Standards Committee (IASC), and the US Financial Accounting Standards Board (FASB) at that time could not agree on a common way forward. As an outcome, the US Standard SFAS

131 and the IASC standard IAS 14 differed in their basic approach. It was clear that at a certain point in time the debate had to be re-opened with the aim to converge the standards based on experience gained so far. Segment Reporting therefore when the elements of the "roadmap" have been agreed was identified as one specific area for convergence.

Main changes from IAS 14

The key change introduced by IFRS 8 is the move to the management approach for identifying segments and for the measurement of segment information. The main changes are:

- IFRS 8 requires identification of operating segments on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker. IAS 14 requires identification of two sets of segments, one based on related products and services (primary segments) and the other based on geographical areas (secondary segments).
- IFRS 8 requires the amount reported for each operating segment item to be the measure reported to the chief operating decision maker for the purposes of allocating resources to the segments and assessing its performance. IAS 14 requires segment information to be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group.
- In contrast to IAS 14, IFRS 8 does not define segment revenue, segment expense, segment result, segment assets and segment liabilities, but requires an explanation of how segment profit or loss, segment assets and segment liabilities are measured for each reportable segment.
- In addition IFRS 8 introduces some additional disclosure requirements (also for interim reports) compared to IAS 14.

The context of this Questionnaire

After having received positive advice from the European Financial Reporting Advisory Group (EFRAG), Member States in the 2 February 2007 Accounting Regulatory Committee (ARC) meeting supported unanimously the Commission proposal to adopt IFRS 8 in the EU. In discussions with the Committee on Economic and Monetary Affairs (ECON) of the European Parliament (EP) it became evident that there were sufficient concerns which would lead the EP to the conclusion not to support endorsement of IFRS 8. The Commission agreed therefore that IFRS 8 will not be endorsed before 30 September 2007. Further, the Commission agreed that in the meantime it will continue to consult interested parties and will carry out an analysis of potential impacts of adopting IFRS 8. The Questionnaire annexed to this paper is part of the analysis. Responses and additional input received will be analysed and used for the final assessment.

Questionnaire

Please submit your response, which should be as precise and short as possible, to the European Commission, DG Internal Market and Services, Mr. Piotr Madziar, Head of Accounting Unit F3, B-1049 Brussels and/or to the following e-mail addresses:

Piotr.Madziar@ec.europa.eu and Reinhard.Biebel@ec.europa.eu

by no later than **29 June 2007**.

Please provide the following details together with your response:

- The name of your organisation

**The Tax Justice Network International Secretariat
38 Stanley Avenue
Chesham
Bucks HP5 2JG
United Kingdom**

- Short description of the general activity of your organisation

The Tax Justice Network campaigns for national and international tax justice, with a particular emphasis upon creating effective taxation systems in developing countries so that they can end their dependency upon aid finance.

- Country where your organisation is located

The Tax Justice Network International Secretariat is based in the UK but affiliated national campaigns are to be found in most European countries, the USA and Canada. The Tax Justice Network for Africa is based in Nairobi, Kenya and is rapidly developing links throughout that continent.

- Contact details incl. e-mail address

Correspondence with regard to this submission should be sent to:

**Richard Murphy FCA
IFRS Project Director
The Tax Justice Network International Secretariat
The Old Orchard
Bexwell Road
Downham Market
Norfolk PE38 9LJ
UK**

+44 (0) 1366 383 500

+44 (0) 777 552 1797

richard.murphy@taxresearch.org.uk

In case we would need further details on the submitted information we would take the liberty to contact the relevant respondent.

Please feel free to do so

Question 1:

Please indicate whether you submitted comments to IASB and/or EFRAG during their consultations.

We submitted comment to the IASB.

Question 2:

a) Do you think information prepared under the management approach on which IFRS 8 is based is more relevant, reliable, comparable, understandable and useful than information prepared under IAS 14?

b) Do you think that information prepared under the management approach improves the true and fair representation of business activities?

c) Are you of the opinion that segment information based on the management approach provides greater accuracy for measuring individual segments and ultimately results in greater forecast precision than segment information based on IAS 14?

a) **The information prepared under the management approach on which IFRS 8 is based is less relevant, reliable, comparable, understandable and useful than information prepared under IAS 14 because:**

1. The management approach reduces comparability because the corporate governance and internal reporting structure of the reporting entity changes the information supplied to third party users of financial statements. This gives rise to the following problems:

- a. **Management chooses the reporting segments it requires for internal management purposes. These purposes may not coincide with the needs of shareholders and stakeholders for information on the economic impact of separable businesses within the reporting entity or with regard to the geographic location of the reporting entity's operations;**
- b. **As governance structures change so will information reported. This reduces comparability over time within one entity.**
- c. **Similar entities with different management structures will report differing information on segments which might, however, be similar in their economic impact on the entity as a whole. This substantially reduces comparability between entities;**
- d. **To reduce disclosure entities might deliberately reduce the number of segments reporting internally. This would result in less reliable reporting to users of financial statements as well as creating a false**

incentive to bad management which financial reporting standards should not do.

The first consequence is that substantial comparability is lost as a result of adopting this approach. The second is that this standard is now about disclosure of corporate governance and internal reporting regimes. It no longer relates to the provision of segment data relating to the activities of the entity. As such it fails to supply that relevant information which is its supposed purpose. As such it is not fit for purpose. In that case this standard should not be adopted by the EU.

- 2. The information provided by IFRS 8 will not be reliable because:**
 - a. The accounting policies applicable to its production need not be the same as those used for the remainder of the financial reporting of the entity. It will not as a result be possible for an auditor to declare the IFRS 8 disclosures to be ‘true and fair’: an entity cannot report truthfully and fairly using two different standards of reporting in one set of financial statements. As such one must, by definition be wrong or be unaudited, Since IFRS 8 is a disclosure requirement it will, by default, be the data disclosed on segments that will be neither audited or true and fair and as such it will, by definition, be unreliable;**
 - b. The disclosure required by IFRS 8 need not be complete. Only 75% of segment data need be disclosed. No reconciliation of that incomplete data need be made to the reporting provided elsewhere in the financial statements. As such a basic reconciliation control mechanism that assures reliability and completeness of information in an accounting environment has been abandoned in IFRS 8. It is inevitable as a result that the information provided will either be less reliable, or will be viewed as such by the user. Unreliable information is of no use to the user of it. In that case IFRS 8 will effectively represent the end of meaningful reporting of segment data;**
 - c. Without prescribed definitions of segment revenue, segment expense, segment result, segment assets and segment liabilities the data supplied will have uncertain meaning and accordingly is unlikely to be relevant to a user who wishes for reasonable certainty in the data provided in a set of financial statements.**

- 3. The information provided by IFRS 8 will not be relevant because:**
 - a. The geographic disclosure within IFRS 8 is too limited to be relevant, requiring discrimination only between the state of incorporation and all other locations. This is an arbitrary split having little commercial or other relevance and therefore almost meaningless to the user of the financial statements. Those users of financial statements who wish for geographic data need it to assess:**
 - i. Political risk;**
 - ii. Geophysical risk;**
 - iii. Taxation risk;**
 - iv. Reputational risk;**

- v. Governance risk;
- vi. Economic risk in differing national markets;
- vii. Issues relating to local performance;
- viii. Corporate social responsibility.

The data supplied does not allow this analysis to take place and as such IFRS 8 should not be adopted as it is not fit for purpose.

- b. Users of financial statements want segment data that relates to the key identifiable commercial segments within the entity which can be separately identified by third parties irrespective of the internal reporting system on those structures. IFRS 8 does not either require or allow this and as such does not provide relevant information for segment analysis. In addition key data such as mandatory disclosure of profit and loss information, finance costs and tax paid are not required; nor is cash flow information for a segment whilst balance sheet disclosure is too limited to be useful and this is a retrograde step from IAS 14. Accordingly the information supplied by IFRS 8 is not relevant to the user.
4. The information that IFRS 8 is intended to supply will not be useful. For the reasons noted it will provide no positive benefits to the user because it will be incomplete and inconsistent with other reporting. More worryingly though, these qualities of incompleteness and inconsistency provide substantial opportunity for abuse by allowing management to portray a result quite different from that in the audited financial statements. The result will be:
- a. Reduced confidence in the audited financial reports;
 - b. Confusion as to what data might represent a true and fair view;
 - c. Increased costs of capital as a result of the increased in perceived risk that will result from this.

In summary, we are of the opinion that IFRS 8 is unfit for its intended purpose, is a retrograde step when compared with IAS 14, will not provide the user of financial statements with relevant, reliable, comparable, understandable and useful information and opens opportunity for misleading (or worse, fraudulent) reporting of information by management. As such it should not be adopted.

- b) We do not think that information prepared under the management approach improves the true and fair representation of business activities for the reason noted above. It is neither true or fair, nor does the required disclosure relate to the business activities of the entity but is instead comment upon its internal reporting structures. This may be interesting, but is not the declared purpose of IFRS 8.
- c) We do not think that segment information based on the management approach provides greater accuracy for measuring individual segments and ultimately results in greater forecast precision than segment information based on IAS 14. We would go further: we believe it impossible that segment information based on the management approach could provide greater accuracy for measuring individual segments or ultimately result in greater forecast precision than segment information based on IAS 14.

Question 3:

a) Do you assess that cost for preparation of information is lower under IFRS 8 than under IAS 14?

b) Do you think that the cost/benefit balance of replacing IAS 14 by IFRS 8 is positive (e.g. lower cost outweighing the potentially lower quality of information provided or potentially higher quality of information provided outweighing higher cost)?

a) **We expect that the cost of preparation of information is lower under IFRS 8 than under IAS 14. The preparation of incomplete, unauditable data on the basis of non-disclosed accounting policies is always lower than the cost of producing complete, relevant, reliable and auditable information.**

b) **The cost / benefit analysis of replacing IAS 14 with IFRS 8 has to be negative. IFRS 8 will provide data that is not comparable, relevant, reliable or useful. As such it will not be used. Worse though, it could mislead. In consequence we would suggest that the value of the data supplied will be negligible, nil, or might be of negative worth. This last possibility is significant with regard to risk of fraud and misrepresentation. This might increase the cost of capital in some companies. As such there is significant risk of a negative cost / benefit analysis.**

Question 4:

Do you consider that the principles on which IFRS 8 is based, in particular the fact that information for segment reports should be prepared through the eyes of the "chief operating decision maker", would pose problems on established EU practices, e.g. in the area of corporate governance?

We do expect that this is the case. Our reasons are as follows:

a) **There is no concept of a ‘chief operating decision maker’ in European corporate governance principles. That is because the responsibility for managing a company in European law falls to a unitary board of directors, and that responsibility cannot be devolved even if one or some of the directors carry executive responsibility in addition to their duty as board members. As such to incorporate this logic in financial reporting creates a precedent not reflected either in law, corporate governance thinking or corporate practice. Firms such as PricewaterhouseCoopers have recognised this in their published commentaries on IFRS 8.**

b) **The fact that the ‘chief operating decision maker’ may be a person or a group of persons does under IFRS 8 add confusion, meaning that in effect it recognises the duty of either a chief operating officer or alternatively an operating board as distinct and separate from the Board of Directors as a whole. In either case this is a precedent that does not fit with the legal unitary responsibility of the board both for the company as a whole and the financial statements it publishes.**

c) **The division of responsibility that the use of the term ‘chief operating decision maker’ creates is worrying:**

- i. **Firstly, it suggests that the management of the company have an interest in the operation that is distinct and different from that of the shareholders or other stakeholders.**
- ii. **Second, it allows management to report on a basis different from that used elsewhere in the financial statements. This is bound to encourage poorer corporate governance by increasing the risk of unbalanced reconciliations between the differing statements through which transactions that suit the purpose of management but not the company as a whole might pass.**
- iii. **Thirdly, by creating the idea that there is a form of reporting which is unrelated to taxation obligations and other duties to society reporting structures may be created which are, in the eyes of management the best indicator of performance in the organisation but which only relate to its concerns and do not relate to the obligations the organisation has to third parties such as shareholders, governments, regulators, employees, tax authorities and the like. This is unacceptable within a structure which should also promote corporate responsibility as part of good corporate governance.**
- iv. **Fourthly, these management statements may well be unaudited. This is because, as has already been noted, it is not possible for an auditor to state that two sets of financial statements based on differing accounting policies can both be true and fair, but IFRS 8 requires this. The concept of ‘dual reporting’ is therefore introduced to IFRS by IFRS 8, which undermines the whole credibility of the reporting process and allows management to put forward the view that their version of results, incomplete as it might be is a better indication of performance in the period. This undermines the credibility of governance surrounding the whole reporting process, and will create the impression that one set of accounts belongs to the auditors, another to the company.**
- v. **Finally, the requirement that reporting only reflect the data presented to the chief operating decision maker creates the perverse but almost inevitable instinct in organisations that dislike disclosure to reduce or eliminate segment data supplied to that person, so restricting data to be disclosed. The disastrous consequence of not reporting appropriate segment data has been indicated by experience with Cable & Wireless, for example.**

Question 5:

Do you agree with the argument that IFRS 8 requires smaller listed companies to report a segment by segment analysis of their business including commercial sensitive information with the effect that competitiveness of smaller listed companies in the EU will be harmed? Please provide reasons for your view and indicate how far that constitutes a change compared to the requirements of IAS 14.

No, we do not agree with this sentiment at all, for the following reasons:

- a) **Our primary concern is with geographic reporting. We believe that every entity of whatever size should be required to report geographically on a country-by-country basis, with each country and protectorate (without exception) in which they trade being considered material for this purpose so that no exclusions take place. This is a level playing field. This information is not, of course, required by IAS 14, which does however require mandatory segment data on a geographic**

basis without reducing that to the country-by-country level. Our reasons for wishing for an extension to IAS 14 are noted in section 8, below. Further comments on geography and IAS 14 are in section 6, below.

- b)* We do not agree that supplying segment data can harm smaller companies. Some companies only operate in one country. As such their reports provide a complete view of their trading activity, which may also relate to one activity. To argue that non-disclosure of segment data to protect commercially sensitive information would be equivalent to arguing that a company with one segment in one country should not be required to file financial statements. This latter situation is, of course, very common in the SME sector and especially amongst medium sized and non quoted large companies and any exclusion from disclosure by smaller quoted companies would simply put those entities at a competitive advantage when compared with their unquoted competitors. That cannot be reasonable, or an expectation that should be had of IFRS. We support disclosure of segment data for all commercially identifiable and distinct activities of an entity, whatever its size, and think IAS 14 achieved this objective better than IFRS 8 does.

Question 6:

a) Do you believe that the lack of mandatory requirements for full segment information on a geographical basis in IFRS 8 gives sufficient reason for a non-endorsement decision?

b) Do you believe that other mandatory requirements for segment information are missing in IFRS 8 (compared to IAS 14)? If yes, which ones?

- a)* We do believe this to be the case. We believe all multinational companies face risks at a national level which have to be understood if appropriate investment decisions are to be made. In addition we believe country-by-country reporting of commercial performance, assets employed, taxes paid and employee data would be of benefit to:

1. Shareholders;
2. Other providers of capital to a company;
3. Management of the entities concerned;
4. Employees and other directly engaged stakeholders;
5. Governments;
6. Tax authorities;
7. Regulatory agencies;
8. The local populations of countries in which the reporting entity trades;
9. Those with social concern.

Since the mandatory requirement for full segment information on a geographic basis is effectively excluded from IFRS 8 this is sufficient reason for a non-endorsement decision. What is inevitable is that once mandatory geographic reporting is lost it will be very hard to re-establish it.

As has been shown by Ole-Kristian Hope of the Rotman School of Management, University of Toronto and Wayne B. Thomas of the Michael F. Price College of Business at the University of Oklahoma in their paper entitled **Managerial Empire Building and Firm Disclosure**

(http://johnmolson.concordia.ca/news/events/pdf/paper_hope.pdf) managers when not monitored by shareholders will make self-maximizing decisions which may not be in the best interest of those shareholders. These decisions include aggressively growing the firm, which reduces profitability and destroys firm value. They used geographic earnings disclosures to examine this issue. Statement of Financial Accounting Standards No. 131 (SFAS 131), which is almost identical to IFRS 8 let them do so. Under its provisions US companies could abandon geographic disclosure of earnings and other key data. They expected that such non-disclosure potentially reduced the ability of shareholders to monitor managers' decisions related to foreign operations.

Using a sample of U.S. multinationals with substantial foreign operations, the researchers found that geographic non-disclosing firms experienced greater expansion of foreign sales, produced lower foreign profit margins and had lower firm value in the post-SFAS 131 period when compared to companies that continued to disclose geographic earnings. These differences did not exist in the pre-SFAS 131 period and did not relate to domestic operations. Compellingly, the only variable they could find that explained this was disclosure of geographic data.

In other words geographic disclosure is good for shareholders as well as stakeholders and its loss would impair corporate performance and financial returns. In addition we have argued that there are at least ten reasons for country-by-country reporting, and we attached those as an appendix to this submission.

- b) We do not have significant comment to make on this question. Our wish for extended mandatory disclosure is discussed in section 8, below.

Question 7:

Can you provide any information that has been generated by field studies, research work, internal analysis carried out in your organisation, jurisdiction?

We attach:

- a) The submission made by Publish What You Pay and others to the IASB on IFRS 8 which suggests why we believed mandatory country-by-country reporting was required in that standard. This was written by the Tax Justice network IFRS Project Director, Richard Murphy who has also written this submission. Our opinion on this issue has not changed. Slightly over half of all submissions to the IASB on IFRS 8 supported this view. Despite this the IASB:
- a. Refused to meet Publish What You Pay to discuss this issue during the consultation period despite their procedures manual saying that they were willing to do so;
 - b. Did not consider the submissions made at their July 2006 meeting at which IFRS 8 was adopted;
 - c. Only considered the submissions made at their September 2006 meeting when it was too late for any consideration to have any impact on IFRS 8;
 - d. Did when discussing the submissions made at that September 2006 meeting presume that they related to the Extractive industries alone, when that was not the case, as the attached submission makes clear;

- e. **Set up a working party to consider this matter which has met only once, has only so far consulted with the IMF and World Bank on this issue although they do not and never could represent all necessary opinion on this matter, and have not responded to any request from the Tax Justice network to meet them despite our high profile in public comment on this issue. Additionally the sub-committee have not contacted the range of experts that they requested PWYP suggest appropriate to be consulted on this matter. Accordingly the sub-group has not considered this issue with any effectiveness.**

In consequence we are of the opinion that IFRS 8 was adopted by the IASB without its own due processes being followed. Indeed, it was apparent from comment made in public session at the IASB meeting in September 2006 that members of the IASB were aware of a prior decision to adopt US standard SFAS 131 as IFRS 8 with little or no change if possible and as such all other options were to be rejected, whatever their merit. We submit that this made a mockery of the IASB consultation and governance processes and suggests that this standard was not adopted because of its suitability, but because of what the IASB considered it politically expedient to do. It would appear no consideration was therefore given to the suitability of this standard in the European context and as such it should not be endorsed.

- b) **We draw attention to the work of Ole-Kristian Hope and Wayne B. Thomas referred to above.**
- c) **We draw to your attention the attached copy of ‘Extracting Transparency’ written by the IFRS Project Director of the Tax Justice network which suggests the particular benefits that country-by-country reporting would provide in the Extractive Industries.**
- d) **We draw attention to the work of Raymond Baker reported in ‘Capitalism’s Achilles Heel’ (<http://www.capitalismsachillesheel.com/>) . Raymond Baker is a senior adviser to the Tax Justice Network. He has estimated world wide illegitimate ‘dirty money’ flows. He has used both a bottom-up approach (adding up dirty money’s component parts –drugs money, mispricing, etc.) and a top-down approach (approximating it as a share of global GDP.) He estimates cross-border flows of global dirty money in a range between \$1.1-1.6 trillion annually, about half of which came from developing and transitional economies, and two thirds of which is commercial dirty money e.g. arising from deliberate transfer mispricing. In April 2007, the World Bank endorsed Baker’s figure, although it has not yet published its own data. Using his lower \$500bn estimate for developing and transitional economies, Baker said:**

“Through most of the 1990s, aid was running at about \$50bn a year from all sources. It has edged up slightly in this decade. \$50bn of aid in; \$500bn of dirty money out. For every \$1 that we have been generously handing out across the top of the table, we’ve been taking back some \$10 of illicit proceeds under the table. There is no way to make this formula work, for poor or for rich.”

In the 1990s U.S. Treasury department officials told Baker that illicit inflows into the U.S. stood at around \$250 billion per year, and in a good year they

seized \$250 million of that. This equates to a failure rate of 99.9%. The volumes have increased since then, but there is no reason to think that the failure rate has improved.

“Laundered proceeds of drug trafficking, racketeering, corruption, and terrorism tag along with other forms of dirty money to which the United States and Europe lend a welcoming hand,” Baker concluded. “These are two rails on the same tracks through the international financial system.”

It is not possible to tackle any of these seriously without tackling them all.

We believe that country-by-country reporting by multi-national corporations would help stem the flow of these funds, the majority of which are, as Baker notes, commercial dirty money e.g. arising from deliberate transfer mispricing.

- e) We draw attention to two publications by the Tax Justice Network in 2006, entitled ‘Mind the Tax Gap’ ([http://www.taxjustice.net/cms/upload/pdf/Mind the Tax Gap - final - 15 Jan 2006.pdf](http://www.taxjustice.net/cms/upload/pdf/Mind_the_Tax_Gap_-_final_-_15_Jan_2006.pdf)) and ‘Do the add up’ (<http://www.richard.murphy.dial.pipex.com/Dotheyaddup.pdf>), both written by Richard Murphy. They analysed the tax reporting of the top 50 companies in the UK over a five year period (2000 – 2004) and showed:

- Significant falls in effective tax rates despite stable tax rates in the UK. These falls could not be explained by the notes to the accounts of the companies in question;
- That the accounts of the companies in question did not add up when it came to reconciling their declared tax liabilities with tax paid:
 - More than 80% of tax charges disclosed have to be restated the following year. The average restatement exceeded 10% in 2004 when, as a rule of thumb a misstatement of 5% is considered significant with regard to any figure in a set of accounts.
 - At least 62% of the accounts in question cannot be shown to add up, with the apparent difference exceeding 5% of the current tax charge. The result is that in the period surveyed £6.2 billion of current tax charges included in profit and loss accounts do not appear to have resulted in tax being paid.

We believe that country-by-country reporting of the data we request would:

- 1) Demonstrate where these differences arise;
 - 2) Expose the risk that these differences currently hide;
 - 3) Suggest the sustainability of the future cash flows of the companies in question as such reduce their costs of capital.
- f) The primary reason for adopting IFRS promoted by the IASB, the UK Accounting Standards Board, the Big 4 firms of accountants and the professional institutes of accountants is that it facilitates convergence between US GAAP and IFRS. However, in May 2007 FASB indicated that it is to review SFAS 131 on which IFRS 8 is based in the near future and that significant changes are likely as a result. http://www.fasb.org/board_handouts/05-16-

[07.pdf](#). In consequence adoption of IFRS 8 will not help convergence. IFRS 8 will most likely be non-convergent with US GAAP by the time it is implemented. This makes its current endorsement for this reason by the EC of no value at all.

For all these reasons we believe that:

- A focus on mandatory geographic disclosure of a form that IFRS 8 does not provide but which IAS 14 does provide (in part) is essential;
- IFRS 8 is not as acceptable a standard as IAS 14 and that the latter should be retained for the time being whilst a better approach to segment reporting is developed.

Question 8:

If you have any further comments on this consultation please provide them to us .

We believe that the mandatory disclosures required of a corporation with regard to every country and protectorate in which it operates should be:

1. The name of each territory in which the reporting entity operates;
2. The name and a description of the trade of each subsidiary operating in each territory;
3. On a consolidated basis (with such consolidation to be undertaken by territory):
 - a. Turnover in total;
 - b. Third party turnover;
 - c. Third party costs excluding those of employment;
 - d. Interest paid;
 - e. Profit before tax;
 - f. Tax charge on profits split between current and deferred tax;
 - g. Other taxes or equivalent charges due to the government of the territory in respect of local operations;
 - h. The actual payments made to the government of the country and its agencies for tax and equivalent charges in the period;
 - i. The liabilities owing locally for tax and equivalent charges at the beginning and end of each period as shown on the balance sheet at each such date;
 - j. Deferred taxation liabilities for the country at the start and close of the period;
 - k. Gross and net assets employed;
 - l. The number of employees engaged, their gross remuneration and related costs;
 - m. Comparative data where appropriate in each case.

This data would, if provided allow the user of financial statements to:

- i. Identify where the reporting entity operates, without exception;
- ii. Identify it within that territory;
- iii. Know the trade of the entity in each location in which it operates;
- iv. Reasonably appraise the financial performance of the entity in each territory in which it operates. It is stressed that data on third party and

intra-group sales and purchases is needed to appraise this properly. The reporting of only third party transactions might allow profit to be recognised with no reason for it having arisen since it is entirely plausible for a profit to arise in a location solely as a result of intra-group transactions;

- v. Assess the local employment created by the entity;
- vi. Appraise the local contribution made by an entity to the government of the host country in which it operates;
- vii. Assess the financial commitment of the entity to the territory and so appraise risk to local providers of capital, including trade creditors and employees;
- viii. Assess the dependence of the entity on areas where political, economic or physical risk exists;
- ix. Consider the group structure of the organisation and the issues that this might pose for effective corporate governance of the reporting entity;
- x. Assess the likelihood that a company is allocating its profits reasonably based upon the location of its staff, assets and third party sales;
- xi. Better appraise the tax risk inherent within the reporting entity, which was shown in the case of Vodafone in November 2005 to have a significant potential impact on corporate valuation, for example.

If IFRS 8 were adopted the prospect of this disclosure would be reduced, but development of IAS 14 provides for that possibility and as such we believe IAS 14 is a better standard for use in the EU at this time.

Appendix 1

The reasons why we think Country-by-Country (CbC) financial reporting by Multinational Companies is important are:

1. Corporate social responsibility (CSR) matters. CSR is about the relationship between a company and its host community. But this does require that the host community knows the companies there. CbC reporting provides that information.

2. Accountability matters. 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. CbC reporting names local subsidiaries.

3. Trade matters. 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 MNC accounts completely eliminate all of this trade from public view. CbC shows it all. This is vital if trade relationships are to be understood, and made fair.

4. People matter. MNC accounts include statements on the number of employees a company has and their aggregate remuneration. CbC would require this statement for every country in which an MNC operates. This would provide invaluable information on labour conditions, worldwide.

5. Tax matters. MNCs have more opportunity than any other group to plan their tax affairs. They can seek to shift their profits from state to state to find the lowest overall bill. CbC 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 don't pay. It's estimated that if this problem were tackled enough tax could be collected to pay for the Millennium Development Goals.

6. Corruption matters. 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. CbC would overcome these objections, significantly enhancing transparency in this sector, and helping cut corruption.

7. Development matters. The developing countries of the world are poor. Aid helps alleviate this problem but creates a dependency, harms the democratic accountability of developing country governments because they aren't accountable to their electorates for what they spend and aid directly contributes 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.

8. Governance matters. 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.

9. Where you are matters. 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. CbC holds a company to account for where it is.

10. Transparency matters. 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. CbC overcomes this problem. It puts all MNC activity 'on the record'.