

## The new Extractive Sector Transparency Measures Act: What it means for you

October 31, 2014

### In brief

The *Extractive Sector Transparency Measures Act* (the Act) requires public disclosure of government payments made by mining and oil & gas entities engaged in the commercial development of oil, gas and minerals.

This new mandatory reporting standard for extractive companies applies to payments made to foreign and domestic governments at all levels, including Aboriginal groups. It is buried within Bill C-43, which received first reading on October 23, 2014.

### In detail

#### Other jurisdictions

The new rules are intended to be similar to those being implemented in the European Union and the United States.

In 2012, the United States had introduced Section 1504 of the *Dodd-Frank Act*, which required disclosure of payments by resource extraction issuers, but was struck down by the US District Court for the District of Columbia (in *American Petroleum Institute v. Securities and Exchange Commission* (SEC)).<sup>1</sup>

1. On July 2, 2013, the US District Court issued an opinion vacating the rule and remanding it to the SEC, concluding that the SEC needs to reconsider two aspects of the rule: 1) the requirement that all company payment reports be made public, and (continued...)

The SEC expects to issue a new proposal in the spring of 2015.

#### Who is required to report?

The reporting requirement applies to any organization (partnership, trust, company as examples) that is engaged in the commercial development (e.g. exploration, extraction or acquisition of rights) of oil, gas or minerals in Canada or elsewhere. It also applies to an entity that controls another entity that engages in these activities.

However, an entity will be required to report only if it:

A. is listed on a stock exchange in Canada, or

2) the decision not to grant any exemptions for foreign law prohibitions.

B. (I) has a place of business in Canada, does business in Canada or has assets in Canada, and

(II) based on its consolidated financial statements, for at least one of its two most recent financial years, has at least two of the following:

- i. CDN\$20 million in assets
- ii. CDN\$40 million in revenue
- iii. an average of 250 employees

The Act does not specify that the thresholds in (i) to (iii) must relate to the relevant Canadian presence. We expect they will apply to all businesses included in the entity's consolidated financial statements.

**What is meant by “oil,” “gas” and “minerals”?**

The Act defines these terms as follows:

- Oil – Crude petroleum, bitumen and oil shale
- Gas – Natural gas, including all substances, other than oil, that are produced in association with natural gas
- Minerals –All naturally occurring metallic and non-metallic minerals, including coal, salt, quarry and pit materials, and all rare and precious minerals and metals

**What must be reported?**

The reporting requirement applies to payments made:

- relating to the commercial development of oil, gas or minerals during a financial year that exceed \$100,000 (unless another amount is prescribed), and
- to any government in Canada or in a foreign state. This includes any government bodies at all levels of government, domestically and internationally (including Aboriginal entities).

Both monetary payments and payments “in kind” must be reported. The value of a payment in kind is the cost to the entity (if no cost, the fair value) of the goods or services provided.

The following categories of payment must be reported:

- taxes, other than consumption taxes and personal income taxes
- royalties
- fees, including rental fees, entry fees and regulatory charges as well as fees or other consideration

for licences, permits or concessions

- production entitlements
- bonuses, including signature, discovery and production bonuses
- dividends, other than dividends paid as ordinary shareholders
- infrastructure improvements payments

Other categories can be prescribed at the government’s discretion.

We anticipate that payments will be reported on a project-level basis, the parameters of which are likely to be based on the industry and business context.

A director or officer of the entity, or an independent auditor or accountant must attest that all information reported is true, accurate and complete. It is expected that audits will be conducted in accordance with Generally Accepted Auditing Standards (GAAS).

The draft legislation does not provide any reporting exemptions.

**The reporting process**

The Act does not include a reporting template. It is likely that a common reporting template will be developed for use in Canada, the European Union and the United States.

The legislation recognizes that the reporting obligations imposed by another jurisdiction may achieve its intended purposes. As a result, reports used in that other jurisdiction may be provided to the Minister in satisfaction of the Canadian reporting requirements.

Wholly-owned subsidiaries in a corporate group that qualify as a single reporting entity can submit the group report, rather than individual

reports, to satisfy their reporting requirements.

Reports must be filed within 150 days of an entity’s financial year end and will be publicly available for five years.

We expect that entities will also post the reports on their own websites as well as a public forum like SEDAR.<sup>2</sup>

**Compliance**

Reporting entities must keep supporting records for seven years.

The legislation contemplates that the Minister will nominate a body to oversee administration and enforcement. This body can request information to confirm compliance, including a request for the results of any audit of the report.

In case of non-compliance, corrective measures can be taken, including simple rectification of the deficiencies in the report. Fines of up to a \$250,000 can be imposed if the report is, among other things, false or misleading.

Further, a director or officer who authorizes, assents, acquiesces or participates in an offence under the Act will be party to and guilty of the offence.

**Coming into force**

The reporting requirements will come into force on a day (or days) to be fixed by Order in Council.

To give some certainty regarding past and current financial years, an entity is not required to comply with the Act with respect to the financial year in progress on the day the Act comes into

2. The System for Electronic Document Analysis and Retrieval (SEDAR) is a filing system developed for the Canadian Securities Administrators.

force or for any previous financial year. Therefore, if the Act comes into force in 2014, the first financial year that it applies to will be 2015, with no need to provide historic comparatives.

For payments to Aboriginal entities, there is an additional two-year transition period after the coming into force day. Using the example above, payments to Aboriginal entities would not need to be disclosed until 2017.

### ***The takeaway***

The introduction of the legislation was much anticipated in pursuit of Canada's commitment to participate in the global fight against corruption.

As the Act works its way through the legislative process, there are several challenges entities will face in interpreting the legislation.

#### ***Including private equity and foreign entities***

The definition of an "entity" that is required to report is much broader than expected.

Including any entity with a Canadian presence that meets the threshold requirements noted above will capture foreign multinationals that have a Canadian presence, regardless of whether that presence is associated with the commercial development of oil, gas or minerals in Canada.

It will also extend to private equity firms that may own a small oil & gas or mining operation somewhere in their structure.

#### ***Concept of "control"***

The definition of an "entity" also includes an entity that "controls" another entity that is engaged in the commercial development of oil, gas or minerals.

The Act does not define the concept of "control," but does indicate that an

entity is controlled by another entity if it is controlled by the other entity, directly or indirectly, in any manner. Given the potential breadth of this test, the government will have to regulate what it means by "control" to bring much needed clarity.

#### ***Aboriginal payments***

Canada is the only country that has included within the scope of its legislation payments to Aboriginal groups.

Because the Act includes in kind payments, reporting entities will have to carefully assess what services they provide to Aboriginal communities so that they can determine what needs to be disclosed.

The EU and US legislation do not contemplate the inclusion of these payments. Therefore, a reporting entity under the Act will have to consider supplemental disclosure to meet the Canadian requirements.

#### ***Harmonizing with the EU and US***

The Act leaves many holes for the government to fill through regulation. Our view is that the holes have been intentionally left so that Canada can harmonize its rules with those of the European Union and the United States. This may also allow industry as well as Aboriginal groups to comment on the legislation before it comes into effect.

#### ***Using the data provided***

Non-governmental organizations (NGOs) have recently focused on the morality aspect of paying tax, making the argument that the corporate responsibility lens should be used in considering whether the amount of tax a company pays is "fair."

We expect that NGOs will use the new disclosure requirements to build their

argument that entities engaged in the extractive industries are not paying their fair share.

Companies need to look beyond minimalist disclosure and try to create a narrative on the wealth their business creates in a community and how that wealth is shared among employees of the company, its shareholders, the government and the community at large.

#### ***Next steps***

We expect the federal government will debate the Act over the winter, during which regulations will be developed, with the hope of a spring 2015 coming-into-force.

We will continue to monitor both the Act's progress and the availability of draft templates to provide updates on the status of the new reporting requirements.

## ***Let's talk***

For a deeper discussion of what the new reporting requirements mean for you, please contact:

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