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Transparency in the extractive industries sector as a legal tool for strengthening good governance: The EU's approach

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DISCUSSION PAPER
NO.01/2021

TRANSPARENCY IN THE EXTRACTIVE INDUSTRIES SECTOR AS A LEGAL TOOL FOR STRENGTHENING GOOD GOVERNANCE

The EU's Approach

Nilyufar Abdulatova

Nowadays, humanity encounters many problems connected to the use of natural resources. International actors have established diverse global initiatives and regional and national legal reforms linked to the issue. Thus, this study provides a comparison of selected provisions regarding information disclosure orders of the EITI Standard 2019 and the EU Directives. The paper presents a descriptive comparison of two prominent legal mechanisms enhancing good governance in the extractive industries sector: The Extractive Industries Transparency Initiative (hereafter the EITI) and the EU Directives. Moreover, the study briefly discusses the meaning of the good governance concept and the significance of the principles of transparency as a tool to strengthen fiscal and non-fiscal accountability in the extractive industries sector. The author argues that developing resource-rich countries should join the EITI and support the initiative by implementing legal mechanisms promoting good governance in the natural resources sector. The findings of the study are summarised in the conclusion.

KEYWORDS

The EU Directives, the Extractive Industries Transparency Initiative, the EITI Standard 2019, sustainable development, good governance, transparency, natural resources sector

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1 Introduction

The intensity of subsoil use, environmental disasters, corrupt governments¹, and shortage of appropriate legal frameworks have invoked the world community to maintain good governance over natural resources for many decades.² These problems pose a threat to future generations, especially in resource-rich developing countries. It is a well-known fact that countries with natural resources always have a significant potential to be corrupted by the political elite or multinational corporations.³ A literature review of the previous relative studies shows that, exactly, the scarcity of eminently suitable normative foundations promoting the fiscal and non-fiscal transparency in the extractive industries of resource-rich countries can lead them to disasters, such as the “*resource curse*”⁴ or “*oil curse*”⁵. Defining this phenomenon, we can assert that the ‘resource curse’ has its roots in the 1960’s crisis in the Netherlands, when the country discovered natural gas in the North Sea⁶ and was named a “*Dutch Disease*”.⁷ The resource curse (also known as the “*paradox of plenty*”⁸) arises when resource-rich countries fail to profit from their natural resource capital.⁹ Governments, international organisations and non-governmental organisations started upgrading the situation by launching unique programs and initiatives to enhance good governance over natural resources. Thus, legal measures towards strengthening good governance have been implemented on national and international levels: the Conflict Minerals Trade Act provisions of the Dodd-Frank Act bill¹⁰, the Kimberley Process¹¹, the WTO legal framework (Article XX of GATT)¹²,

¹ Rotberg, Robert I., ed. *Corruption, Global Security, and World Order*. Brookings Institution Press 2009, p. 497 et seq.

² Gupta, Aarti, and Michael Mason. *Transparency in Global Environmental Governance: Critical Perspectives*. Cambridge: The MIT Press 2014, p. 133 et seq.

³ Cust, James, *The role of governance and international norms in managing natural resources*. WIDER Working Paper 2017, p. 2 et seq.

⁴ Frankel, Jeffrey. *The Natural Resource Curse: A Survey of Diagnoses and Some Prescriptions*. Faculty Research Working Paper Series, Harvard Kennedy School and NBER 2012, p. 4 et seq.

⁵ Peck, Sarah and Chayes, Sarah, *The Oil Curse: A Remedial Role for the Oil Industry*. Carnegie Endowment for International Peace, 2015 <https://carnegieendowment.org/2015/09/30/oil-curse-remedial-role-for-oil-industry-pub-61445>

⁶ Mittelman, Melissa, *The Resource Curse*. Bloomberg Quick Take 2017 <https://www.bloomberg.com/quicktake/resource-curse>

⁷ Ibid.

⁸ *The Resource Curse: The Political and Economic Challenges of Natural Resource Wealth*. Natural Resource Governance Institute Reader, 2015

⁹ Ibid.

¹⁰ Hendrix, Cullen S., Noland, Marcus, *Confronting the Curse: The Economics and Geopolitics of Natural Resources Governance*. Peterson Institute for International Economics 2014, p. 92 et seq

¹¹ Meessen, Karl M., *Kimberley as a Means of Promoting Good Governance: The Role of Business*. In: Bungenberg M., Hobe S. (eds) *Permanent Sovereignty over Natural Resources*. Springer 2015, pp. 173 et seq.

¹² Schefer, Nadakavukaren K., *All that Glitters: Conflict Diamonds, Dirty Gold and the WTO Legal Framework on Trade and Human Rights*. In: Bungenberg M., Krajewski M., Tams C., Terhechte J., Ziegler A. (eds) *European Yearbook of International Economic Law* 2018, pp. 96-106

the EITI¹³ and the EU Directives¹⁴ on more robust good governance in the extractive industries sector.

The object of related actions and legal changes is to increase accountability in the extractive industries through the transparency mechanisms of fiscal and non-fiscal reporting. These statutory reforms lie in creating capable instruments to share the information on revenues coming from the extractive industries with the public and to provide democratising impulses in the governance framework leading to the sustainable development of developing states.¹⁵ This paper aims to show the significance of transparency growth in the extractive industries by covering two prominent legal models on strengthening good governance over the natural resources sector. The study is based on a descriptive comparison of specific provisions of both legal mechanisms and a literature review method of the EITI Standard 2019¹⁶ and the EU Directives¹⁷.

1.1 Why does the author concentrate precisely on these two legal regimes?

Firstly, the EITI's vision and EU's way of encouraging good governance in the extractive industries are interconnected, since the EU is one of the biggest supporters of the EITI's policy. Secondly, the importance of EU legal reforms are aggravated by the fact that most of Europe's energy companies (BHP, Shell, BP, Total,

¹³ The Extractive Industries Transparency Initiative (EITI) is the global standard to promote the open and accountable management of oil, gas and mineral resources. The EITI Standard requires the disclosure of information along the extractive industry value chain from the point of extraction, to how revenues make their way through the government, and how they benefit the public. In each of the 53 implementing countries, the EITI is supported by a coalition of government, companies and civil society. See in <https://eiti.org/who-we-are> accessed 20 March 2020

¹⁴ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC; 2. Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

¹⁵ Gupta, Aarti, and Michael Mason. *Transparency in Global Environmental Governance: Critical Perspectives*. Cambridge: The MIT Press 2014, p. 133 et seq.

¹⁶ The EITI Standard defines the requirements applicable to member countries implementing the EITI.

¹⁷ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC; 2. Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

Rio Tinto, Eni, Statoil)¹⁸ are working worldwide, especially in developing regions with a rich heritage of natural resources. Therefore, the legal instruments established by the EU to enhance transparency in the extractive industries can be considered a direct contribution of the EU to international sustainable development.

1.2 The structure of the paper

The paper consists of an introduction (1), two main chapters (2, 3) and conclusion (4). Part (2) of the study contains an overview of the content of good governance in the extractive industries and its fundamental principles. Additionally, the author discusses the significance of good governance in the natural resources sector in the framework of current sustainable development goals. The next chapter (3) covers the EU's approach in comparison with the EITI one. The EU energy acquis¹⁹ is the second component to be investigated and compared in this discussion paper since the EU is the biggest supporter of promoting good governance in the extractive industries and makes a considerable contribution to the development of related legal mechanisms. The selected provisions of the EU's legal foundations and EITI requirements on fiscal and non-fiscal transparency are compared in this part. Further, the outputs of the study are summarised in the conclusion.

2 Good Governance in the Extractive Industries Sector for Sustainable Development

2.1 A link between good governance and sustainable development

Promoting good governance in the extractive industries through the transparency of financial and non-financial information of certain types of businesses has a clear linkage with sustainable development goals²⁰, especially in resource-rich developing countries. In 2012 the UN had indicated and maintained the significance of the sustainable development of appropriate management in the natural resources sector in its Resolution²¹. The Resolution states that there is a need to encourage the integrated and sustainable management of natural resources.²² As a result, 17

¹⁸ Barnier, Michel, The EU transparency and accounting directives. *The Journal of World Energy Law & Business* 2014, pp. 16-19

¹⁹ Van Vooren, Bart and Wessel, Ramses A., *EU External Relations Law: Text, Cases and Materials*. Cambridge University Press 2014, p. 438 et seq.

²⁰ Report on Extractive Industries for Sustainable Development, United Nations Development program 2014 file:///C:/Users/User/Downloads/Extractive-Industries-Brochure.pdf

²¹ G.A. Res. A/RES/66/288, UNGA 66th Sess., at 27 July 2012

²² *Ibid.* (4)

Sustainable Development Goals²³ (hereafter SDGs) were adopted by the UN in 2015. The relativity of the SDGs to good governance in the extractive industries is covered in the SDG17, which underlines the emergency of strengthening domestic resource mobilisation, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.²⁴ Goal 17 highlights the responsibilities of undertakings to pay their fair share of taxes and encourage transparency in the flow of mining revenues between the private sector and states.²⁵

Whereas, the EU supports good governance by implementing legal mechanisms for transparency, covering not only the companies operating in the extractive industries sector but logging productions as well²⁶. Furthermore, the European Non-Financial Reporting Directive (hereafter Directive 2014/95/EU) amended the Accounting Directive, which imposes obligations to report non-financial statements on Corporate Social Responsibility: endorsing society's interests and a route to sustainable and inclusive recovery.²⁷ Moreover, the preamble to the Directive 2014/95/EU suggests that undertakings are obliged to report on their use of renewable versus non-renewable energy.²⁸

When it comes to the EITI's contribution towards meeting sustainable development goals, this initiative recognises the need for good governance to ensure transparent management of resource revenues through its principles and targets.²⁹ One of the EITI's objectives is to support sustainable development by advancing effective, accountable and transparent decision-making institutions and legal/ fiscal frameworks with a purpose to make information on the collection, allocation and distribution of the revenues coming from the extractive industries available to local communities at all levels.³⁰ Here, the paper brings us to the moment when the *key tool* to enforce sustainability in the extractive industries sector must be defined and discussed. This is the "*good governance*" concept.

²³ United Nations Sustainable Development Goals

<https://www.un.org/sustainabledevelopment/sustainable-development-goals>

²⁴ White Paper (Report), Mapping Mining to the Sustainable Development Goals: An Atlas, Columbia Center on Sustainable Investment (CCSI) 2016, pp. 66-68

²⁵ Ibid.

²⁶ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC; 2. Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

²⁷ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ. 15.11.2014, p.2, recital (3)

²⁸ Holmes, Ingrid and Maule, Sam. A SUSTAINABLE FINANCE PLAN FOR THE EUROPEAN UNION. Report. E3G, 2016, pp. 28-34.

²⁹ Report on How the EITI Contributes Towards Meeting the Sustainable Development Goals, EITI 2016 <https://eiti.org/document/how-eiti-contributes-towards-meeting-sustainable-development-goals>

³⁰ Ibid., Target 16.6

2.2 What is good governance?

The concept of “*good governance*” is becoming more popular these days among international scholars, who contribute to related literature by evaluating this definition. Some scholars define the term “*good governance*” as public sector management with democracy and respect for human rights.³¹ Others discuss the quality of good governance of resource-rich countries as a reliable tool to attract international investors; currently, most investors and international financial institutions are increasingly basing their aid and loans on the conditions of the good governance of the hosting country.³² Essential elements of effective good governance, such as the rule of law principle³³, public sector management³⁴ and mechanisms to control corruption³⁵, demonstrate the “*complexity*”³⁶ of the concept. For example, the OECD understands the concept of good governance as successful management of government in a manner that is substantially free of abuse and corruption, and with due regard for the rule of law.³⁷

In its turn, the World Bank focuses on a broader explanation of good governance, by stating that it is an emergency tool to lead a country to economic and social prosperity and development,³⁸ and illustrates the good governance concept by reciting three different features:

1. the stable³⁹ political situation;⁴⁰
2. the appropriate legal mechanisms to save the country’s resources;⁴¹ and
3. the capacity of governments to produce and implement policies.⁴²

Moreover, the fundamental principles of good governance must be taken into detailed consideration to achieve these three features of the concept.

³¹ Neumayer, Eric. The pattern of aid giving: the impact of good governance on development assistance. Routledge studies in development economics. Routledge, London, UK 2003, pp. 8-13

³² Report on *What is Good Governance?* United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) <https://www.unescap.org/sites/default/files/good-governance.pdf>

³³ Ibid.

³⁴ Ibid.

³⁵ Ibid.

³⁶ Report, DAC Orientation on Participatory Development and Good Governance, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OCDE) 1993
<http://www.oecd.org/officialdocuments>

³⁷ Glossary of statistical terms of ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) <https://stats.oecd.org/glossary/detail.asp?ID=7237>

³⁸ Report on Good Governance: An Overview, International Fund for Agricultural Development, INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT (IFAD) 1999
https://www.ipa.government.bg/sites/default/files/pregled-dobro_upravljenje.pdf

³⁹ Peck, Sarah and Chayes, Sarah, The Oil Curse: A Remedial Role for the Oil Industry. Carnegie Endowment for International Peace, 2015 <https://carnegieendowment.org/2015/09/30/oil-curse-remedial-role-for-oil-industry-pub-61445>

⁴⁰ Ibid

⁴¹ Ibid

⁴² Ibid.

Over the comprehensive appraisal of development literature and collecting data, the author has identified a list of fundamental principles of good governance, which have been discussed by the practitioners, scholars and international organisations. The following principles of good governance have been recognised as essential:⁴³

- participation of civil society;
- the rule of law; and
- accountability and *transparency*.⁴⁴

2.3 Why is transparency a crucial principle to ensure good governance in the extractive industries?

The principle of transparency in the extractive industries sector means that decisions are taken, and their enforcement is done in a manner that follows the rules and regulations within the existing legal framework. Legal mechanisms based on the principle of transparency must provide and enhance freely available financial (consolidated financial statements)⁴⁵ and non-financial (relating to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters)⁴⁶ information in easily understandable forms⁴⁷ and ensure that it is directly accessible to the public. Furthermore, transparency is considered to be a “*core democratic value to build a dialogue between the discloser and interested parties*”.⁴⁸

International scholars often cite transparency in the extractive industries sector as a tool to keep undertakings accountable in the framework of legal mechanisms because accountability cannot be enforced and observed without a principle of transparency being applied.⁴⁹

⁴³ Report on What is Good Governance? United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) <https://www.unescap.org/sites/default/files/good-governance.pdf>

⁴⁴ Report on What is Good Governance? United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) <https://www.unescap.org/sites/default/files/good-governance.pdf>

⁴⁵ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013

⁴⁶ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013

⁴⁷ Report on What is Good Governance? United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) <https://www.unescap.org/sites/default/files/good-governance.pdf>

⁴⁸ *Mudacumura*, Gedeon M. Accountability and Transparency: Cornerstones of Development and Democratic Governance. In: G.M. Mudacumura and G. Morçöl (eds.), *Challenges to Democratic Governance in Developing Countries*, Public Administration, Governance and Globalization, Springer International Publishing Switzerland, 2014, pp. 43-44

⁴⁹ Report on What is Good Governance? United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) <https://www.unescap.org/sites/default/files/good-governance.pdf>

The application of transparency should be brought to the action through legal mechanisms regarding:

- the decision-making to extract;⁵⁰
- licensing procedures;⁵¹
- launching competent and non-corrupt institutions with clear mandates in the regulation and monitoring of operations;⁵² and
- transparent revenue management.⁵³

Consequently, the quality of local governance based on the abovementioned principles became newly relevant to millions of people around the world in the early twenty-first century.⁵⁴ This transparency means a lot for resource developers (investors) as well since the existence of legal mechanisms controlling the industry in potential hosting states can be defined as a tool to reduce human rights violations and corruption⁵⁵. Moreover, the quality of good governance in the extractive industries is the essential requirement to achieve sustainable development, which is on the main goals of “*modern humanity*”.⁵⁶ The economic welfare of resource-rich countries and a robust legal mechanism promoting good governance are interrelated components of a well-ordered international community.⁵⁷

As an outcome from the discussion, it can be stated that there is no good governance without transparency; consequently, there is no sustainable development without good governance. Therefore, resource developers and the governments of resource-rich countries must consider establishing and implementing legal mechanisms to promote transparency in the extractive industries sector. Since the EU calls on the undertakings operating in the extractive industries to follow the transparency mechanisms, the EITI enhances this principle among the governments of resource-rich countries by proposing membership in the EITI.

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² Ibid.

⁵³ Ibid.

⁵⁴ Grindle, Merilee S. *Going Local: Decentralization, Democratization, and the Promise of Good Governance*. Course Book ed., Princeton: Princeton University Press, 2009, p. 164 et seq.

⁵⁵ Kolstad, Ivar and A. Wiig. “Is Transparency the Key to Reducing Corruption in Resource-Rich Countries?” *World Development* 37/2009, pp. 521 - 532

⁵⁶ United Nations Sustainable Development Goals
<https://www.un.org/sustainabledevelopment/sustainable-development-goals>

⁵⁷ Herdegen, Matthias. *Principles of International Economic Law*. Oxford University Press, 2d Edition 2016, pp. 159-163

3 EU's approach

From the very beginning, the EU moved towards economic development and social prosperity, and this was reflected in its core functional treaties.

The Treaty on European Union (hereafter TEU) states:

“The Union shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment”.⁵⁸

In the commentaries to the TEU, the concept of ‘sustainable development’ has been identified as “*intergenerational equity*”⁵⁹, i.e. responsibility for future generations.⁶⁰ The Treaty on the Functioning of European Union (hereafter TFEU), in its turn, reaffirms a need for an inclusive legal framework to enhance sustainability, especially in environmental and energy areas, since they are related not only to the economic aspect but also with social well-being and climate change issues. Article 191 says that the EU contributes to achieving the “*preserving, protecting and improving the quality of the environment; protecting human health; prudent and rational utilization of natural resources and promoting measures at an international level to deal with regional or worldwide environmental problems, and in particular combating climate change*”.⁶¹

Moreover, Art. 194 states that the EU’s energy policy aims “*to ensure the security of energy supply in the EU and to promote energy efficiency⁶² and energy saving and the development of new and renewable forms of energy*”.⁶³ As has been mentioned earlier in this paper, most of the European energy companies operate in resource-rich countries outside of the EU, and this fact shows that the EU should call undertakings listed⁶⁴ in the EU to comply with EU’s *acquis* on sustainable development. This, in turn, gives rise to a thought that there is always a big challenge to achieve sustainable development without strengthening of good governance in the energy sector. To comply with the principle of transparency of good governance in the extractive industries, the EU developed new legal requirements to trace related information on

⁵⁸ TEU, Art. 3

⁵⁹ Blanke, Hermann-Josef, Mangiameli, Stelio (Eds.), *The Treaty on European Union (TEU): A Commentary*. Springer-Verlag 2013, p. 172

⁶⁰ *Ibid.*

⁶¹ TFEU, Art. 191 (1)

⁶² *Ibid.*

⁶³ *Ibid.*

⁶⁴ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013, Art. 46 (1)

certain types of businesses listed in the EU.⁶⁵ In 2013, the EU came to a result with the Directive⁶⁶ on disclosure of financial information, which has been amended with the Directive⁶⁷ on disclosure of non-financial information by certain types of undertakings and groups. The implementation of modified legal mechanisms on disclosure of financial and non-financial information of energy companies operating shows the EU's support towards the improvement of good governance in the extractive industries sector.

3.1 How does it work?

After adoption of the Directive 2013/34/EU, all member states of the EU had an obligation to implement legal and administrative regulations necessary for the compliance with the Directive within a specified period. According to the EU approach, “*large undertakings and public-interest entities which are active in the extractive industry or logging of primary forests*”⁶⁸ should report on material payments made to governments in the hosting states on an annual basis. By undertakings, the EU means companies “*listed in the EU with any activity involving the exploration, prospection, discovery, development and extraction of minerals, oil, natural gas and logging in the EU or third country.*”⁶⁹ These particular types of undertakings are obliged to report on financial and non-financial information (discussed in detail below) to the governments on a “*country-by-country*”⁷⁰ method. Directive 2013/34/EU has defined “*government*” as any national, regional or local authority of a Member State or a third country.⁷¹ Once again, the author wants to maintain that the EU legal framework on financial and non-financial disclosure of revenues coming from the extractive industries and logging is a comprehensive instrument to convert EITI's volunteer regime to mandatory for countries, that still do not join the EITI.

⁶⁵ EITI, ‘European Commission proposes disclosure requirements, to strengthen the EITI’ (2011) See on <https://eti.org/news> accessed 28 July 2020

⁶⁶ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013

⁶⁷ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

⁶⁸ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013, recitals (44)

⁶⁹ Ibid., Art. 41 (1,2,3)

⁷⁰ Barnier, Michel, The EU transparency and accounting directives. The Journal of World Energy Law & Business 2014, pp. 16-19

⁷¹ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013, Art. 46 (3)

Why mandatory? This approach simulates a willingness of resource-rich countries to be engaged in the process of good governance improvement and implement the national legal framework on transparency in the extractive industries. Various reasons are deliberated throughout the paper, from supporting green economies and combating corruption to the attraction of foreign investors.⁷² The connection between two prominent legal foundations can be observed from the key provision of the EU Directive 2103/34/EU.

Firstly, it states that the information should contain types of payments comparable to those disclosed by an undertaking participating in the Extractive Industries Transparency Initiative (EITI).⁷³ This statement of Directive 2013/34/EU demonstrates the “*complementarity*” of two transparency regimes. Secondly, it asserts that the reporting under the EU Directives should push resource-rich countries to implement the EITI principles and criteria and account to their citizens for payments such governments receive from undertakings active in the extractive industry or loggers of primary forests operating within their jurisdiction.⁷⁴

The EITI, in its turn, boosts good governance in the extractive industries around the world through its Standard 2019, consisting of seven essential requirements, which must be followed by the country wishing to join the EITI. Under Requirement № 2, the implementing country has to generate a particular legal instrument within the national legislation to deliver transparency and accountability in the extractive industries sector. According to this requirement, a state (EITI member) must disclose a list of related information to the multi-stakeholder group, which includes government agencies, companies active in the extractive industries and civil society.⁷⁵

The member country should report the following:

- “disclose a description of the legal framework and fiscal regime governing the extractive industries;”⁷⁶
- “disclose all information related to all contracts and license awards and transfers taking place during the accounting period covered by the most recent EITI disclosures;”⁷⁷

⁷² Malden, Alexander. A safer bet? Evaluating the effects of the Extractive Industries Transparency Initiative on mineral investment climate attractiveness. *The Extractive Industries and Society*. 4/2017, pp. 788-794

⁷³ Ibid.

⁷⁴ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013, recitals (45)

⁷⁵ EITI Standard 2019, Req. 1

⁷⁶ Ibid.

⁷⁷ Ibid.

- “maintain a publicly available register or cadaster system(s) with the following timely and comprehensive information regarding each of the licenses about companies within the agreed scope of EITI implementation;”⁷⁸ and
- “disclose any contracts and licenses that are granted, entered into or amended from 1 January 2021. Implementing countries are encouraged to publicly disclose any contacts or licenses that provide the terms attached to the exportation of oil, gas and minerals”.⁷⁹

3.2 Financial reporting: Directive 2013/34/EU

The financial accountability of resource developers and resource-rich countries dealing with revenues coming from the extractive industries sector is a very crucial component of the transparency principle. It is vital to protect revenues from being corrupted. Well-structured legal mechanisms are a beneficial tool to maintain this transparency by imposing obligations on financial reporting. So, the scope of the so-called Accounting Directive 2013/34/EU⁸⁰ covers certain types of public and private limited liability companies.⁸¹

Also, Art. 1 of the Directive states that:

- “a substantial number of partnerships and limited partnerships all the fully liable members of which are constituted either as public or as private limited liability companies, and such partnerships should, therefore, be subject to the coordination measures of this Directive.”⁸²

Besides, there is a detailed list of categories of undertakings and groups that must be considered under the scope of the Directive. The division of the undertakings depends on the balance sheet of ventures. Art. 3 of the Directive gave a full list of certain types of companies that are responsible for financial reporting and they are:

- “small undertakings with a balance sheet total: 4 000 000;
- medium-sized undertakings with a balance sheet total: 20 000 000;
- large companies with a balance sheet total: 20 000 000;
- small groups shall be groups consisting of parent and subsidiary undertakings with a balance sheet total: 4 000 000;

⁷⁸ Ibid.

⁷⁹ Ibid.

⁸⁰ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013

⁸¹ Ibid., p. 19, recital 5

⁸² Ibid.

- medium-sized groups with a balance sheet total: 20 000 000; and
- large groups with a balance sheet total: 20 000 000”.⁸³

Some exceptions to the rules have also been entailed by Directive 2013/34/EU. For instance, Art. 36 of Directive 2013/34/EU allows member states to exempt micro-undertakings from the obligation to provide annual financial statements and related reports⁸⁴, which are typical for medium-sized and large-sized enterprises.⁸⁵ The European promotion of transparency through the Directives has been shaped out of the critical financial reporting principles,⁸⁶ listed in Art. 6 of the Directive. They are the following:

- “the undertaking shall be presumed to be carrying on its business as a going concern;”
- “accounting policies and measurement bases shall be applied consistently from one financial year to the next;”
- “amounts recognised in the balance sheet and profit and loss account shall be computed on the accrual basis;”
- “the components of asset and liability items shall be valued separately;”
- “items in the profit and loss account and balance sheet shall be accounted for and presented having regard to the substance of the transaction or arrangement concerned;”
- “items recognised in the financial statements shall be measured under the principle of purchase price or production cost;” and
- “the requirements set out in this Directive regarding recognition, measurement, presentation, disclosure, and consolidation need not be complied with when the effect of complying with them is immaterial”.⁸⁷

These principles must be applied by undertakings during the preparation of annual financial statements, consolidated financial statements and related reports⁸⁸. Furthermore, Art. 4 (1) of Directive 2013/34/EU defines the core of the annual financial statement by saying that:

⁸³ Ibid., Art. 3

⁸⁴ Ibid., Art. 36

⁸⁵ Bušovová, Anna et al., Will the Czech accounting entities benefit from the Directive 2013/34/EU? *Procedia-Social and Behavioral Sciences* 220/2016, pp. 79 – 84

⁸⁶ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013, recitals (16-18) 21

⁸⁷ Ibid., Art. 6

⁸⁸ Ibid.

- “the annual financial statement shall constitute a composite whole and shall for all undertakings comprise, as a minimum, the balance sheet, the profit and loss account and the notes to the financial statements”.⁸⁹

In comparison with the EU, the EITI promotes transparency through its 12 fundamental principles.⁹⁰ These principles consider the prudent use of natural resources as a significant step leading to sustainable development,⁹¹ encourage the appropriate management of natural resources,⁹² underline the importance of transparency of governments and companies in the extractive industries and the need to enhance public financial management and accountability,⁹³ and recognise that greater transparency must be set in the context of respect for contracts and laws⁹⁴ and others.

The next step is about the quality and content of the information, which must be provided by certain types of undertakings according to the Directive. The fairness of providing information has been maintained through the special provisions saying that “all financial statements must consist of an accurate and fair view of the undertaking’s assets, liabilities, financial position and profit or loss”.⁹⁵

Besides this short mentioning of the fairness of core information, the Directive gives a list of data that must be included in the notes of all undertakings:

- “accounting policies adopted;
- information about fixed assets and instruments that are measured at revealed amounts;
- the total amount of financial commitments, guarantees or contingencies that are not included in the balance sheet;
- the number of advances and credits granted to members of the administrative, managerial and supervisory bodies;
- the amount and nature of individual items of income; and
- the average number of employees during the financial year”.⁹⁶

Furthermore, there is a request for additional financial information from all large undertakings and public interest entities⁹⁷, demanding the submission of the so-

⁸⁹ Ibid., Art.4

⁹⁰ EITI Standard 2019

⁹¹ Ibid.

⁹² Ibid.

⁹³ Ibid.

⁹⁴ Ibid.

⁹⁵ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013, Art. 15

⁹⁶ Ibid., Art.16

⁹⁷ Ibid, Art. 18

called report on payments to governments.⁹⁸ This report must contain information about the “*production entitlements, taxes, royalties, dividends, signature, discovery and production bonuses, license fees, rental fees, entry fees, payments for infrastructure improvements*”.⁹⁹ According to the EITI Requirement № 4, the following revenue streams should be included:¹⁰⁰

- “The host government’s production entitlement (such as profit oil);
- National state-owned company production entitlement;
- Profits taxes;
- Royalties;
- Dividends;
- Bonuses, such as signature, discovery and production bonuses; and
- License fees, rental fees, entry fees and other consideration for licenses and concessions”.¹⁰¹

Besides, the revenues disclosure should contain detailed information on “*revenue allocation*”¹⁰² as stated in Requirement № 5 of EITI Standard 2019. It declares that the implementing countries should indicate which extractive industry revenues, whether cash or in-kind, are recorded in the national budget;¹⁰³ where incomes are not recorded in the national budget, the allocation of these revenues must be explained, with links provided to relevant financial reports as applicable.¹⁰⁴

3.3 Non-financial disclosure: Directive 2014/34/EU

Above and beyond the financial statements,¹⁰⁵ the specific types of undertakings must submit the “*Corporate Social Responsibility*”¹⁰⁶ (hereafter CSR) report about the social performance of the company as non-financial data.¹⁰⁷ The EU emphasises its focus on CSR issues follows other sustainability initiatives¹⁰⁸ on the international

⁹⁸ Ibid, Art. 41

⁹⁹ Ibid.

¹⁰⁰ Ibid., Req.4

¹⁰¹ Ibid.

¹⁰² Ibid., Req.5

¹⁰³ Ibid.

¹⁰⁴ Ibid.

¹⁰⁵ Žárová, Marcela. Could New Accounting Directive Improve European Financial Reporting? *European Financial and Accounting Journal* 2013, p. 4

¹⁰⁶ Vukic, Nikolina. Corporate Social Responsibility Reporting: Differences among Selected EU Countries. *Business Systems Research Journal* 2015, p. 64

¹⁰⁷ Ibid.

¹⁰⁸ Ahern, Dierdre. Turning up the heat? EU Sustainability Goals and the Role of Reporting Under the Non-Financial Reporting Directive. *European Company and Financial Law Review* 2016/ 12(4), pp. 599-630

level.¹⁰⁹ Consequently, Directive 2013/34/EU has been amended with Directive 2014/95/EU on disclosure of non-financial and diversity information by specific large undertakings¹¹⁰ and groups¹¹¹ on an annual basis. Directive 2014/95/EU clarifies that non-financial reports should include a statement containing information relating to at least environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters.¹¹² Hence, the obligations, coming under the pressure of existing legal mechanisms on reporting non-fiscal information, push undertakings to reconsider their approach to good governance components like environmental and social matters.¹¹³ For instance, British Petroleum (BP), one the large European resource-developers, has reflected its position with regards to strengthening good governance in the extractive industries by reporting outcomes in the Sustainability Report (2019).¹¹⁴ The following statements by BP have supported the positive assessment of non-financial reporting:

“[...] the disclosure of government revenues and other relevant information can help to mitigate corruption risks in the extractive sector and support local anti-corruption efforts, especially in the framework of the EITI Standard-based approach”.¹¹⁵

EU Directive 2014/95/EU asks large undertakings that are “*public-interest entities, exceeding on their balance sheet dates the criterion of the average number of 500 employees*”¹¹⁶ and *public-interest entities which are parent undertakings of a large group exceeding on its balance sheet dates, on a consolidated basis, the criterion of the average number of 500 employees*¹¹⁷ to submit a *non-financial statement*¹¹⁸ related to:

- “a brief description of the undertaking's business model;”
- “a description of the policies pursued by the company concerning those matters, including due diligence processes implemented;”
- “the outcome of those policies;”

¹⁰⁹ Ibid.

¹¹⁰ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EC and 83/349/ECC, OJ 29/06/2013

¹¹¹ Ibid.

¹¹² Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ. 15.11.2014, 2, recital (6)

¹¹³ Ibid.

¹¹⁴ Report on Sustainability Report: Energy with Purpose, British Petroleum 2019/69.
<https://www.bp.com/>

¹¹⁵ Ibid.

¹¹⁶ Ibid., Art. 1 (Article 19a)

¹¹⁷ Ibid., Art. 1 (Article 29a)

¹¹⁸ Ibid., Art. 1 (Article 19a)

- “the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services that are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;” and
- “non-financial key performance indicators relevant to the particular business”.¹¹⁹

The European Commission reaffirms the necessity of Directive 2014/95/EU by linking provisions of the Directive with climate – change issues.¹²⁰ So the undertakings are mandated to provide information on:

- “the climate-related risks and opportunities of a company depending on the type of its activity, its geographic location and its positioning in the transition to a low-carbon and climate-resilient economy;”¹²¹ and
- “information on the involvement of the board and management, in particular, their respective responsibilities concerning climate change to inform stakeholders on the level of the company's awareness of climate-related issues”.¹²²

Standard 2019 identifies and explains seven detailed requirements for operating resource developers and governments of current or potential members. Issues related to the principle of CSR are highlighted in Requirement № 6 of EITI Standard 2019. According to this Requirement, implementing countries are obliged to disclose information on “*social and economic spending*”¹²³.

The report should contain data related to the contribution of the extractive sector to the economy, social and environmental impact of extractive activities,¹²⁴ together with:

- “an overview of relevant “*legal provisions*” and administrative rules as well as actual practice related to environmental management and monitoring of extractive investments in the country;”¹²⁵
- “information on regular environmental monitoring procedures, administrative and sanctioning processes of governments, as well as

¹¹⁹ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ. 15/11/2014, Art. 1 (Article 19a)

¹²⁰ Communication from the European Commission, Guidelines on non-financial reporting: Supplement on reporting climate-related information 2019/C 209/01, OJ. 20/06/2019, 209/9-12

¹²¹ Communication from the European Commission, Guidelines on non-financial reporting: Supplement on reporting climate-related information 2019/C 209/01, OJ. 20/06/2019, 209/9-12

¹²² Ibid.

¹²³ Ibid., EITI Standard 2019, Req.6

¹²⁴ Ibid.

¹²⁵ Ibid.

environmental liabilities, environmental rehabilitation and remediation programs;”¹²⁶

- “the size of the extractive industries in absolute terms and as a percentage of GDP as well as an estimate of informal sector activity, including but not necessarily limited to artisanal and small-scale mining;”¹²⁷
- “employment in the extractive industries in absolute terms and as a percentage of the total employment. The information should be disaggregated by gender and, when available, further disaggregated by a company and professional level etc.”.¹²⁸

Based on the discussion, three main pillars must be considered within the framework of the non – financial statement¹²⁹ of EU Directive 2014/95/EU or social and economic spending ¹³⁰ of EITI Standard 2019, and they are social issues,¹³¹ environmental issues ¹³² and economic issues.¹³³ It is precisely these three pillars that have a strong linkage with sustainable development, which we can achieve only by enhancing good governance in the extractive industries through implementing and supporting legal mechanisms on financial and non-financial transparency of certain types of businesses.

4 Conclusion

As can be seen from the research, the reporting rules of financial and non-financial statements of undertakings operating in the extractive industries are not only a tool to keep them accountable, but there is also a secure link between good governance in the extractive industries and sustainable development on a global level. By implementing robust legal mechanisms, such as EU’s legal approach and EITI’s reporting requirements, on enhancing transparency over natural resources exploration, supply and use, whether on international or national levels, the world community makes a significant contribution to a better future for “*current and future generations*”.¹³⁴ The EU Directives act as a booster to promote good governance in

¹²⁶ Ibid.

¹²⁷ Ibid.

¹²⁸ Ibid.

¹²⁹ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ. 15/11/2014, Art. 1 (Article 19a)

¹³⁰ EITI Standard 2019, Req.6.3

¹³¹ Stjepcevic, J. and Šikšnelytė Butkienė, Indrė. Corporate social responsibility in energy sector. Transformations in Business and Economics 2017/16, pp. 21-33.

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Desai, Deval & Jarvis, Michael. Governance and Accountability in Extractive Industries: Theory and Practice at the World Bank. Journal of Energy & Natural Resources Law 2012/30, p.128

the natural resources sector by compulsory disclosure of financial and non-financial reporting of certain types of resource developers operating inside and outside the EU. Companies, familiar with transparency in the extractive industries, prefer to invest in third countries with established legal frameworks for transparent disclosure on revenues coming from the natural resources sector. Therefore, more resource-rich states are increasingly attributed to be considering the EITI's membership and implementation of related legal mechanisms on transparency in the extractive industries.

Moreover, the coexistence of two prominent models of good governance can lead to a more comprehensive way to achieve sustainable development worldwide, especially in developing countries. The world community should continue its cooperation on enhancing good governance in the natural resources sector. More research should be escalated on related issues because there is still a negative impact on economic and social well-being of people in resource-rich countries. Regional efforts, such as the EU legal approach, can lead to a better situation by promoting transparent reporting in the extractive industries sector.

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