National Mining Association White Paper on SEC Implementation of Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Extractive Resource Issuer Disclosure of Payments to Governments)

This white paper outlines key issues the National Mining Association ("NMA") believes should be addressed by the Securities and Exchange Commission ("SEC") in developing its proposed rules to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). As you know, Section 1504 requires extractive resource issuers to disclose, in an annual report, payments above a "de minimis" threshold that they have made to governments in furtherance of the commercial development of minerals, oil, and gas. The issues discussed in this white paper are based on analysis of Section 1504 by members of the NMA, and on discussion of Section 1504 with SEC staff responsible for developing the proposed rules at a meeting held on October 15, 2010, attended by representatives of the NMA.

This white paper is authorized by the NMA and incorporates views expressed by its members, although it does not necessarily reflect the precise views of each member on all covered topics. Depending on the content of the proposed rule, the NMA may wish to submit further comments on the rules as proposed, suggest that the SEC periodically study the burden imposed by the rule once it becomes effective, or propose congressional oversight hearings. Further, this white paper is limited to the issues raised by Section 1504. The NMA, or any of its members, may submit comments separately on other sections of the Act.

As discussed herein, the NMA believes it is critical that the rules implementing Section 1504 (1) align the scope of disclosure as close as is practicable with the Extractive Industries Transparency Initiative ("EITI") to which Section 1504 is explicitly tied, (2) adhere to the legislative intent by allowing for Section 1504 disclosures to be furnished in an annual report, and (3) use the discretion of the SEC to adopt other reasonable interpretations of statutory terms that minimize burdens on extractive resource issuers, and thereby avoid putting them at a competitive disadvantage. With these purposes in mind, this white paper will address the issues in the following three areas: (1) what should be disclosed and by whom; (2) how the disclosure should be made (form and timing); and (3) what should not be required to be disclosed.

I. The "What" and "Who" of the Section 1504 Disclosure

The NMA generally supports the objectives of the EITI, which fosters transparency by encouraging companies to make voluntary disclosures of payments made to governments. Given that Section 1504 is a unilateral mandate, and given its stated purpose, it is critical that the SEC implementing regulations are aligned with the EITI. The Act recognizes this, in requiring the SEC rules to define what "payments" must be disclosed "consistent with the guidelines of" the EITI. Among other things, this suggests the need for the SEC to define "payments" as closely as is practicable with the EITI definition.[1]

A fundamental goal of the EITI is to develop accountings of "government take" from the extractive sector that are credible, by reconciling reports of payments made by companies with reports of payments received by governments.[2] These reconciliations will only be accurate and credible if the SEC rule calls for disclosure of the same payment stream as is covered by the EITI, allowing for an "apples-to-apples" comparison. If the SEC rule requires companies to disclose more than EITI requires of countries, then this rule would create the damaging misimpression that countries are underreporting payments received. This could have negative consequences for the entire initiative as well as create problems for companies operating in those countries.

To promote alignment with EITI, the SEC should do the following in the implementing regulations:

- <u>Define "state enterprise" consistently with the EITI</u>. Under the Act, the scope of payments to be disclosed includes payments to foreign state enterprises[3]. Under the EITI, countries report payments received by *their* state enterprises, which are engaged in "upstream activities".[4] To ensure consistency with the EITI, the SEC rule should define a "state enterprise" for purposes of Section 1504 as (a) majority-owned (greater than 50% interest) by the state[5] and (b) engaged in "upstream" activity.

  - *Adopt the EITI definition of "upstream".* In defining "upstream" activity, the SEC should adopt the EITI definition,[6] which includes the following activities commonly used by companies in reporting to investors, regulators, and others: (1) prospecting; (2) acquisition of mineral rights; (3) exploration; (4) appraisal or evaluation; (5) development and construction; (6) production; (7) closure and decommissioning. The Act allows for this alignment with the EITI by defining "commercial development of oil, natural gas, or minerals" to include "exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity, as determined by the" SEC.[7] This definition, although at first blush different from EITI's categories, is in fact generally consistent:

    - The first component of the Act's definition of "commercial development" – "exploration" – is equivalent to the third component of the EITI definition.

    - The next three components of the Act's definition – "extraction, processing, and export" – encompass the "production" phase in the EITI definition (although the term "export" by itself can encompass a variety of situations, when used in this context we believe it should be interpreted to align with the EITI – focusing on the exporting of raw materials, such as ore, for processing, which is an integral part of mineral production).

    - The "other significant actions related" component of the Act's definition encompasses the first, second, fourth, fifth, and seventh components of the EITI definition.

- <u>Clarify that certain payments do not "further" commercial development of minerals</u>. In determining what types of payments meet the "furtherance" test, we believe the SEC should exclude (a) payments that relate to "downstream" operations (i.e., that do not meet the EITI definition of "upstream" cited above)[8] such as refining activities[9], (b) payments that provide only "indirect economic benefits" such as construction of local infrastructure (like schools, roads, hospitals, and the like) that are not primarily used for extractive activities, local purchasing or employment, and other forms of community development[10], and (c) payments made on behalf of third parties such as vendors, consultants, or employees (withholding taxes are one type of example).

- <u>Adopt a clear standard for "control", defining the reporting entity as the issuer those entities whose results are fully consolidated</u>. The Act requires a covered issuer to disclose payments by entities it "controls", a term the Act does not define. The rule should adopt a definition of "control" that is clear and easy to apply, and consistent with a practical ability of the issuer to access the types of financial information to be disclosed. We believe that entities whose results are "fully consolidated" by the issuer under relevant accounting standards often also are legally controlled by the issuer. For other entities whose results the issuer effectively reports on a *pro rata* basis using other methods (e.g., the equity method), the issuer often lacks sufficient influence to compel the disclosure of the type of granular information required by Section 1504. Thus we believe the disclosure requirement should only apply to entities whose results are fully consolidated. If the SEC were to consider not using "full consolidation" as the relevant indicia of control, then we would suggest considering the following alternative criteria:

    - *The issuer holds, directly or indirectly, a "voting interest greater than 50%"*. *See* Exchange Act, 15 U.S.C. § 78m(b)(6) (recognizing that an owner of 50% or less of an interest in a subsidiary may lack the ability to control the entity's accumulation and dissemination of accounting data).

    - *The issuer holds a 50% interest and is designated as "operator".* A majority equity test would not resolve how to handle 50%-50% joint ventures. We believe an "operator" test would be the most practical and appropriate method for such ventures. This test could establish a rebuttable presumption that a party designated as "operator" would have the greatest level of control over the venture (making it the reporting entity for purposes of Section 1504). In addition, because most projects will have an operator, this would reduce an incentive to "structure around" this test to avoid reporting obligations under Section 1504.

    - *Issuer holds less than 50% interest, is the largest single holder of voting shares, and is designated as "operator"*. The majority equity test also would not resolve how to handle cases where there are multiple owners, none of whom have a majority of the equity (greater than 50%). In those cases, there should be a rebuttable presumption that the venture is controlled by the party with the largest single interest who also is designated as "operator".

- <u>Permit issuers to report payments on a *pro rata* basis, in proportion with their ownership of controlled entities</u>. The rule should address the amount of payments attributed to the issuer when the issuer "controls" a venture for purposes of the rule, but holds less than a 100% interest. Even if the issuer fully consolidates the results of an entity, when other parties hold an ownership interest in that entity, it would not be fair to attribute *all* of the government payments to the issuer. Thus issuers should be allowed disclose the *pro rata* share of a controlled venture's reportable payments, as well as any payments it makes directly. This approach would still be meaningful to users of the report, as the issuer's interest in the venture still can be used calculate the estimated payments for the remainder of the venture.

- <u>Allow issuers to report payments on a "net" basis</u>. For some categories of payments, such as taxes, governments may make payments to the reporting entity (e.g., tax refunds) that offset other payments made by that entity. Thus, to ensure the disclosure is meaningful and incorporates all relevant information, the rule should allow companies to report their "net" payments over the course of the reporting period.

II. The "How" of the Section 1504 Disclosure

As discussed in this section, it is critical that the SEC rule allow extractive resource issuers to furnish at their election Section 1504 disclosures in annual reports separate from the annual reports filed on Form 10-K (or the equivalent for foreign issuers), after an appropriate transition period to prepare for implementation, at a point of their choosing in the fiscal year after the reporting period, and in a format of their choosing that allows for searching using electronic tags. These forms of flexibility will allow extractive resource issuers to better manage and minimize the significant burden created by Section 1504.

- Requiring Section 1504 disclosure in the filed annual report would be contrary to the legislative history of the Act, impractical, confusing, unnecessarily burdensome, and inconsistent with the purposes of Section 1504. The Act made a conscious choice only to require disclosure in "an annual report", and does not require the payments disclosure to be included in the filed annual report or the audited financials within that report. The legislative history shows that the phrase "an annual report" is significant. Congress substituted this phrase for the phrase "the annual report" found in earlier proposals,[11] evincing a clear intent not to require that issuers make Section 1504 disclosure in "the" annual report on Form 10-K (or its equivalent for foreign issuers). Consistent with this language, we strongly urge the SEC to minimize the burden of compliance with Section 1504 by allowing companies to "furnish" the disclosures in annual reports, such as proxy statements or sustainability reports, provided separately from "filings" on Form 10-K (or the equivalent for foreign issuers), and not to require that the report be audited. In addition to adhering to the text of the statute, a rule that adopts this approach would make sense for several reasons:

    - *Timing considerations.* If the SEC were to require the Section 1504 disclosures to be included in the registrant's filed annual report, which is normally prepared in January and February and approved by its board of directors in the mid-February timeframe (for domestic issuers whose fiscal year is on a calendar basis), this would create unrealistic (and unnecessary) time pressures. Extractive issuers would have to invest considerable time and resources to gather and organize Section 1504 payment data at the same time as preparing the other information investors clearly need in annual reports on Form 10-K (or the equivalent form for foreign issuers). In addition, as noted in Part III below, we believe the threshold for "de minimis" payments should be linked to total expenses for the issuer for the fiscal year. For these and other reasons, filed annual reports likely would be delayed if they were required to include Section 1504 disclosures. Indeed, given the tight deadlines for filing Form 10-K (particularly for large accelerated filers), late filing also could occur. For investors, any potential delay in the release of companies' annual reports and financial statements is a significant issue. Imposing such delays would be wholly unnecessary, given that Section 1504 disclosure requirements arise from a completely different type of policy concern than those underlying regular SEC filing requirements. Thus, the Act's provision for alternative delivery methods makes sense from both a policy and a practical perspective.

    - *Section 1504 disclosures will be on a cash and local currency basis, which are incompatible with filed annual reports.* Requiring that

Section 1504 disclosure be included in filings on Form 10-K (or the equivalent for foreign issuers) would drive up the cost and burden of implementing the company's disclosure controls and procedures. Section 13(q)(2)(D)(ii)(II) of the Act requires disclosures be broken out by local currency used to make the payments. Inclusion of such information in a filing on Form 10-K (or its equivalent) could lead to a need to reconcile the multiple currencies in which these payments are made to the reporting currency in the financial statements. Differences due to foreign exchange (spot vs. average vs. closing prices) also may need to be explained and reconciled to related financial disclosures due to the differences between reporting under the Act (cash basis) and under financial reporting standards (accrual basis). It is not necessary to create such complexity and burden, because the Act does not require that Section 1504 disclosures be made in the filed annual report.

- *Applying financial statement audit requirements to Section 1504 disclosures is not called for in the legislation, and is not necessary to carry out its purpose.* Allowing for disclosure outside the context of the filed annual report would avoid substantial recurring costs associated with auditing the financial data in annual reports filed on Form 10-K (or its equivalent for non-U.S. issuers), which companies would incur on top of the cost of establishing new tracking and reporting systems to prepare Section 1504 disclosures. Irrespective of audit costs, compliance costs to establish tracking and reporting systems would include (1) the updating of local accounting ledgers to capture the appropriate levels of information by country at the local, regional and international levels on a cash vs. accrual basis: (2) the training of local accountants to record data consistent with reporting requirements and company policy; (3) the establishment of policies to more clearly define and describe the required components; (4) conducting internal audits to ensure that policies are applied appropriately and consistently; (5) establishing and testing of controls on a periodic basis to ensure compliance; and (6) the negotiation of agreements with joint venture partners and majority stakeholders to permit such information to be collected, analyzed and disclosed. The auditors would then either be required to audit this information and review the disclosures made or, at a minimum, to review the process and information to ensure completeness, existence and reasonableness of the information reported. Audit costs would apply not only to the periodic reports, but also for filings in connection with public offerings that incorporate such reports by reference. Therefore, we strongly urge the SEC to leave issuers free to determine the level of auditing or verification for Section 1504 disclosures rather than mandating auditing by requiring Section 1504 disclosures to be integrated into financial statements filed with annual reports.[12]

- *Requiring extractive resource issuers to include Section 1504 disclosures in the filed annual report would impose other unnecessary burdens.* Allowing for disclosure outside the filed annual report also would avoid any question of whether issuers would need to incur the cost of linking Section 1504 disclosures to Sarbanes-Oxley Act certifications and the internal controls over financial reporting (ICFR) framework. Such a linkage is wholly unnecessary, given that Section 1504 was adopted in connection with the EITI, and not for the purpose of clarifying existing financial reporting obligations. Imposing these costs also would be unfair for an SEC rule focusing on participants in only one industry (extractive), and then only on those participants who are issuers. *See* Section 23(a)(2) of the Exchange Act (prohibiting SEC rules that impose an unnecessary burden on competition of companies that must file Exchange Act reports).[13] To the extent any similar securities disclosure provisions have been adopted in other countries (such as on the LSE AIM in the United Kingdom and the Hong Kong Securities Exchange), those are incorporated into listing requirements rather than periodic disclosure requirements. The Section 1504 requirement of periodic disclosure therefore already exceeds the level of disclosure required in any other market. Requiring inclusion of the Section 1504 disclosure in the filed annual report would only further exacerbate this imbalance across securities markets.

- *Filed annual reports serve to provide investors with material information, while payments to governments are rarely material to the average investor.* The SEC rule should recognize that payments a company makes to a given government will rarely be "material" from the perspective of most investors who are analyzing the consolidated financials of the issuer as a whole. The EITI, which Section 1504 is designed to foster, is not an initiative designed to protect investors; rather, it is designed to promote revenue accountability in host countries. As a result, Section 1504 is not focused on providing information that is material to the investment decision of the average investor, but primarily to allow the public at large to track certain receipts by governments. Comments on similar disclosure requirements considered by the International Accounting Standards Board ("IASB") do not show a consensus among investors that such disclosures are material. This fact further supports allowing disclosure outside of filed annual reports. In addition, the SEC rule should take care to avoid any implication that inclusion of a payment stream in the Section 1504 disclosure makes that stream "material" (the mere fact that a payment stream is above the "de minimis" threshold, discussed in Part III below, should not mean the payment stream is automatically material from a financial reporting perspective).

- <u>Liability standards</u>. In those rare instances where a given payment stream were material to an investor in the context of the financials of the company as a whole, then the anti-fraud regulations adopted by the SEC under Section 10(b) of the Exchange Act could be invoked by the SEC if there were a material misstatement or omission. Thus, there is no need for the SEC to apply other liability rules that attach to SEC filings, or to provide for incorporation of Section 1504 disclosures into SEC filings. There is also no basis in the Act for promoting a private right of action under Section 1504, and the SEC should take care not to promote such a right.

- <u>Timing of disclosure</u>. There are two separate timing issues raised by Section 1504: the transition period before the disclosure obligation takes effect, and the time frame for periodic furnishing of annual reports. With respect to these two issues, we believe the SEC should:

  - *Adopt a transition period that recognizes the burden imposed by Section 1504 and the SEC implementing rule*. The Act provides that the *earliest* the rule should require disclosures is for the fiscal year ending at least one year after the effective date of the rule. For most issuers, this would mean that disclosures would be made, at the earliest, for the fiscal year 2012. While disclosure in a separate annual report covering the fiscal year 2012 might be feasible, the exact transition period needed will depend, in large part, on the substance of the implementing rule. Given the need to put systems and processes in place to capture, review, and report the data subject to disclosure, it could potentially be useful for the effective date to be delayed until fiscal year 2013.

  - *Allow the Section 1504 annual report to be furnished at any point in the ensuing fiscal year*. The reporting burden associated with Section 1504 will unquestionably be significant. The top priority for the protection of investors should remain receiving financial statements and other material information in the annual report on Form 10-K (or the equivalent for foreign issuers). Thus the SEC rule should allow issuers the flexibility to determine when to furnish the Section 1504 report during the ensuing fiscal year – whether around the same time as Form 10-K, or in the following months. Given that country reports filed under EITI can be delayed several years, it would be reasonable to allow companies to furnish Section 1504 reports at any time in the ensuing fiscal year. This also would give issuers the option of checking the integrity of the data on payments covered by Section 1504 (made on a cash basis) against worldwide tax returns, which can be filed as late as the end of the ensuing fiscal year in some jurisdictions.

- <u>Issuers should retain flexibility to determine the precise format for interactive data in the disclosure.</u> The text of the Act only requires interactive data format as a means to support the creation of "electronic tags". Thus, we believe issuers should be given the flexibility to disclose the data in any format that would allow users to click through the information in a standard file type (e.g., Microsoft Word, Web-based HTML, Microsoft Excel, or .pdf) to reach data sorted by each of the electronic tags specified in the Act. The eXtensible Business Reporting Language ("XBRL") adopted by the SEC for some forms of interactive data disclosure presumably could satisfy the statutory requirement here. Given that issuers should be free to disclose the data outside the annual report on Form 10-K (or the equivalent for foreign issuers), however, issuers should not be prohibited from using other formats that allow for meaningful use of "electronic tags". This flexibility also would allow issuers to avoid some of the delays that can be associated with arranging for printers to carry out XBRL conversion of data. In addition, the rule should take care to avoid requiring that the underlying calculations and input variables be disclosed (users of the report should not be able to "reverse engineer" the report to obtain data that goes beyond the Section 1504 requirements).

III. What Should Not be Required to Be Disclosed

- <u>Adopt a definition of "de minimis" that focuses on the magnitude of payments to a country's government in relation to the expenses of the issuer (the reporting entity)</u>. The Act exempts from disclosure payments that are "de minimis." Because neither accounting standards nor the securities laws define the term "de minimis" in this context, the SEC has broad discretion to define the term. As the legislative history indicates, this discretion can be used to make the regulations less burdensome.[14] The SEC should adopt a clear, easily applied definition of "de minimis" that is appropriate for this context. We believe the SEC rule should treat the payments to the government in a country as "de minimis" if their aggregate amount in the fiscal year, across all categories, is less than a certain percentage of the gross expenses of the issuer on a consolidated basis. We suggest that the SEC adopt a 5% threshold, with reference to materiality guidelines consistent with Staff Accounting Bulletin (SAB) 99. The materiality threshold in SAB 99 is appropriate, as the definition of "payments" covered by the act is focused on benefits that are "material".[15] This threshold would align with issuers' existing internal control framework (which is based upon materiality in financial reporting), making it much easier to ensure appropriate information is collected and reported. This standard also would align company reporting with country reporting under the EITI (as EITI only requires countries to disclose payments that are "material" [16] for them). If the aggregate amount of payments to the government in a country is above this threshold, then all payments in that country otherwise meeting the definition in the Act would be reportable, even though each payment stream would not necessarily be material.

- <u>Exempt from the project-level disaggregation requirement those payments that are not allocable to a "project", that are commercially sensitive, or that subject to local disclosure restrictions</u>.

- *Allow aggregation at the country level of payments that are not associated with a "project" – a term that should be defined consistent with industry practice.* Section 1504 refers to disaggregation by "project". The Act does not define the term "project", however, and there is no relevant legislative history as the term was inserted into the bill late in the legislative process. Thus, the SEC has broad discretion to define the term and should do so mindful of the substantial burdens and confusion that project-level disclosure will impose if the term is defined too broadly and imprecisely. We suggest that the SEC adopt a definition of the term "project" that is consistent with mining companies' existing reporting requirements to investors. This approach would be consistent with the concepts of operating segments and reporting units under which mining companies currently provide information. Within that framework, we believe that the SEC should define the term "project" as "preparation for exploitation of, or exploitation of, mineral deposits in an identified geographic area". Consistent with the Exchange Act Industry Guide for Mining Operations,[17] this definition would exclude activities such as prospecting, surveying, and exploration, which are undertaken well before a "project" has materialized. Mining companies therefore commonly treat and describe such activities not as "projects", but in relation to "areas of interest" – which could be a country, a state or region within a country, or other jurisdiction. Accordingly, aggregate (country-level) rather than disaggregate (project-level) disclosure of payments related to such activities is appropriate.

- *Allow aggregation at the country level for payments, such as income taxes, assessed at that level.* We also believe the SEC also should allow companies to exclude certain types of payments, such as payment of income taxes, from project-level desegregation. This exclusion is needed because some payments, such as income tax payments, generally are calculated at the country level. To break such payments out by project would require some form of arbitrary allocation, which would cause confusion. In addition, allowing these disclosures to be aggregated at the country level would be consistent with EITI reporting, which occurs at the country level.

- *Allow aggregation at the country level for payments that constitute commercially sensitive information or are subject to reasonable host government confidentiality restrictions.* The provisions of the Act requiring project-level disclosure may put companies into conflict with some host government confidentiality restrictions placed on existing projects (as well as restrictions applicable to future concessions). It is critical that the regulations do not place reporting companies into such a "no-win" position, where they could incur sanctions such as fines or even the revocation of a concession. While the focus of the Act is disclosure, it could have the effect of prohibiting extractive resource issuers from lawfully conducting business in countries that maintain such confidentiality restrictions. As noted above, Section 23(a)(2) of the Exchange Act prohibits SEC rules from placing an undue burden on competition.[18] To avoid such undue burdens, the SEC rule should allow issuers to aggregate payments at the country level, if disaggregating at the project level would (1) tend to reveal confidential concession terms or other commercially sensitive information, and thereby provide an unfair advantage to competitors (who could negotiate better terms) or (2) violate a provision of a contract with the state or of local law or regulation applicable to a project (and then only if country-level disclosures will not result in a violation, either).[19] We note that the SEC has provided a similar exception from its oil and gas reserves disclosure requirements, which permit issuers to not disclose national reserves data where the disclosure would be prohibited by such country's laws.[20] Such an exception would not undermine the purposes of the Act –i.e., the goal of promoting EITI reconciliation – because countries that prohibit such project-level disclosures are not necessarily members of EITI and those that are members do not report at the project level anyway. At the same time, the payments whose project-level disaggregation is prohibited still would be included in the report (aggregated at the country-level). Issuers also could note where the exception is invoked, so that users of the report are fully informed.

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[1] *See* Exchg. Act § 13(q)(1)(C)(ii) (defining "payments" as "taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with the guidelines of the Extractive Industries Transparency Initiative [EITI] (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals."); *see also id.* § 13(q)(2)(E) (requiring the SEC rule to support U.S. participation in transparency efforts such as EITI).

[2] EITI Rules, Feb. 24, 2010, at 10 (third criteria).

[3] 15 U.S.C. § 78m(q)(1)(B).

[4] *See* EITI Revised Draft Reporting Guidelines § 6.1 (May 23, 2003).

[5] In defining what is a "state enterprise", other U.S. statutes focus on entities with a majority of shares held by the state. *See, e.g.,* U.S. Foreign Sovereign Immunities Act, 28 U.S.C. § 1603(b)(2). Such a definition also would ensure that enterprises controlled by individuals are not treated as state enterprises.

[6] *See* EITI Revised Draft Reporting Guidelines § 4 (citing "(1) prospecting; (2) acquisition of mineral rights; (3) exploration; (4) appraisal or evaluation; (5) development; (6)

construction (not considered to be a separate phase in the oil and gas industry); (7) production; and (8) closure or abandonment.").

[7] 15 U.S.C. § 78m(q)(1)(D), (A).

[8] *See* EITI Source Book at 28. The definitions in Section 1504 (Sections 13(q)(1)(A) (defining components of "commercial development") and 13 (q)(1)(C) (defining types of reportable payments)) are consistent with the EITI phases of upstream activity, such that the EITI definition provides sufficient guidance to the SEC in drafting the proposed rule. This consistency is important to avoid discrepancies between disclosures by companies and reports by countries, which do not include "downstream" payments.

[9] The definition of "production" in the rule should not encompass activities that are typically considered "downstream", such as certain types of refining, whether the conversion of doré bar into precious metals, or the washing of raw coal into more pure forms of coal.

[10] *See* EITI Source Book at 26.

[11] *See* Energy Security Through Transparency Act, S.1700 (Sept. 23, 2009) (§ 6 of earlier proposal, not adopted, would have required disclosure in "*the* annual report"); Cardin Amendment, S.A. 3980 (May 12, 2010) (§ 996 of amendment, later withdrawn, also would have required disclosure in "*the* annual report") (emphases added).

[12] In any event, it should be recognized that audits will not automatically produce error-free disclosures. An audit involves the selection of a sample of transactions within a population for testing. It does not guarantee that every single item in the population has been verified. Therefore, assuming an example where the accounting system shows sales revenues of US $41,825m for a given year, and cash tax payments of US $3,076m, it does not mean that every single transaction within the rest of the US$41,825 million has been checked and confirmed as not being tax payments. If there were a handful of transactions, across the companies within the group, which had been misclassified incorrectly as other operating expenses, and those transactions had not been selected for testing, the financial statements would still have received an unqualified audit opinion (clean bill of health). This also excludes payments made by entities not within a company's control (equity-accounted units).

[13] 15 U.S.C. § 78w(a)(2). Aligning the rule with the EITI, as discussed above, and adopting a reasonable definition of "de minimis" as discussed below, also are important steps toward reducing reporting burdens on companies who already voluntarily participate in the EITI.

[14] The legislative history confirms this discretion. In 2009, Senator Lugar, in describing S.1700 that formed the basis for the adopted text, said that "[i]t is expected that the SEC will follow the reporting requirements established under EITI … The legislation also gives the SEC some discretion, which should ensure ease of compliance." Cong. Rec. S9746 (Sept. 23, 2009).

[15] Exchg. Act § 13(q)(1)(C)(ii).

[16] *See* Draft Reporting Guidelines § 5.

[17] *See* Exchange Act, Industry Guide 7, Description of property by issuer engaged or to be engaged in significant mining operations, ¶ (a)(4) (distinguishing "development" and

"production" stages from "exploration" stage), available at http://www.sec.gov/about/forms/industryguides.pdf.

[18] In addition, the text of the Act indicates that Section 1504 is designed to promote "international transparency efforts" in the extractive industries. To this extent, the SEC rule implementing Section 1504 may be viewed as provision designed to promote the congressional view of the "public interest". Under Section 3(f) of the Exchange Act, any disclosure rule based on the "public interest" is required to take into account the effect on capital formation, competition, and efficiency.

[19] If country-level disclosure also would violate local law, then the SEC should require issuers to consider whether the violation could be avoided by reporting the payments without identifying the name of the country.

[20] Instruction 4 to Paragraph (a)(2) of Item 1202 of Regulation S-K.