



SEC Proposes Rules for Extractive Industry Payments

The SEC proposed rules that would require resource extraction issuers to disclose certain payments made to the U.S. federal government or foreign governments for the commercial development of oil, natural gas, or minerals.¹

Key Facts

- The proposed rules would apply to resource extraction issuers that are required to file annual reports on Forms 10-K, 20-F, or 40-F.
- Disclosure would be required for a payment, or series of payments, made to a government or governments of \$100,000 or more during the fiscal year. The disclosure must include details about the type and total amount of payments made to each government, and for each project, including the related type of natural resource.
- Resource extraction issuers would be able to ask the SEC for an exemption from disclosure requirements when disclosure is prohibited by local law.

Key Impacts

Resource extraction issuers would be required to:

- Publicly disclose the information annually as an exhibit to Form SD using the XBRL format;² and
- File Form SD no later than 150 days after their fiscal year-end.

A report prepared for foreign regulatory purposes or for the U.S. Extractive Industries Transparency Initiative (USEITI) would be allowed in place of Form SD if the report satisfies requirements that are substantially similar to those in the proposed rules.

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¹ SEC Release No. 34-76620, Disclosure of Payments by Resource Extraction Issuers, December 11, 2015, available at www.sec.gov.

² XBRL stands for Xtensible Business Reporting Language, which is an interactive data reporting standard required by the SEC.

Background

The Dodd-Frank Act directed the SEC to issue rules requiring resource extraction issuers to disclose certain payments made to governments for the commercial development of oil, natural gas, or minerals.³ In response, the SEC adopted Rule 13q-1 in August 2012, but it was subsequently overturned in July 2013 by the U.S. District Court for the District of Columbia.⁴ The SEC's newly proposed rules address the issues identified by the court ruling. The SEC plans to vote in June 2016 to adopt the proposed rules using the proposed expedited schedule.

Key Changes from 2012 Rules

Payments by a Subsidiary or an Entity under Common Control

- Defines the terms *subsidiary* and *control* based on accounting principles instead of using the definitions in Rule 12b-w

Scope of Project

- Defines the term *project*

Exemption from Compliance

- Although the proposed rules do not include an automatic exemption when the required disclosure is prohibited by the host country's law, resource extraction issuers can apply for an exemption on a case-by-case basis

Alternative Reporting

- In certain instances, resource extraction issuers could be permitted to attach a report that complies with the rules of a foreign jurisdiction or that meets the USEITI reporting requirements

Disclosure

- Additional disclosure would be required for the resource that is subject to commercial development and for the subnational geographic location of the project

Key Provisions of the Proposed Rules

The proposed rules apply to SEC issuers that engage in the commercial development of oil, natural gas, or minerals, and that are required to file an annual report with the SEC. The term commercial development includes exploration, extraction, processing, export, and acquisition of a license for these activities.

³ Dodd-Frank Wall Street Reform and Consumer Protection Act.

⁴ KPMG's Defining Issues No. 12-42, SEC Issues Final Rule for Extractive Industry Payments, available at www.kpmg-institutes.com.

Excluded Activities

The proposed rules would not extend to activities that are ancillary or preparatory to commercial development. For example, the proposed rules would not consider a manufacturer of products (e.g., drill bit) used to commercially develop oil, natural gas, or minerals to be engaged in commercial development of the resource. Transportation, marketing, refining, and smelting activities also are excluded from the definition of commercial development. The SEC issued Q&As in May 2013 to provide guidance to assist companies in determining whether they fall within the scope of the proposed rules.⁵

Payments Included in the Disclosure

Payments made by a subsidiary or entity under the control of the issuer would fall under the scope of the proposed rules. Control would be determined by the consolidation principles that the issuer used in its audited financial statements that are included within the annual report filed with the SEC. Resource extraction issuers would have control of another entity when they consolidate that entity or proportionately consolidate an interest in the entity using financial reporting accounting principles.

Payments to Governments

The proposed rules apply to payments for the commercial development of oil, natural gas, and minerals to a foreign national government, a department, agency, or instrumentality of a foreign government, or a company that is at least majority-owned by a foreign government. A foreign government also includes foreign subnational governments, such as the government of a state, province, county, district, municipality, or territory under a foreign national government.

The term federal government refers to only the U.S. federal government, not the states or other subnational governments within the United States.

Payments to third parties that subsequently are paid to governments on behalf of resource extraction issuers also are included in scope of the proposed rules.

Exemptions from Disclosure Requirements

Resource extraction issuers would be permitted to ask the SEC to exempt from disclosure requirements payments made to governments in countries where disclosure is prohibited by law. The SEC will consider providing exemptive relief on a case-by-case basis. Issuers seeking an exemption would be required to submit a written request to the SEC that describes the specific disclosure that the issuer seeks to omit from its filing, and the specific facts and circumstances that justify an exemption. The SEC would expect to see an attorney's opinion that supports the claim that a foreign law prohibits the disclosure of payment information.

Definition of a Payment

The proposed rules would require issuers to disclose each cash payment that is *not de minimis*, which is defined as a single payment or series of related payments of \$100,000 or more during the most recent fiscal year. Payments made to further the commercial development of oil, natural gas, or minerals include:

⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act Frequently Asked Questions – Disclosure of Payments by Resource Extraction Issuers, May 30, 2013, available at www.sec.gov.



The SEC said that the list of payment types would be consistent with the requirements of the European Union, Canada, and the Extractive Industries Transparency Initiative (EITI).

- Taxes (including taxes levied on corporate profits and production, but excluding taxes levied on consumption);
- Royalties;
- Fees (including license fees);
- Production entitlements;
- Bonuses (including signature, discovery, and production bonuses);
- Dividends (excluding dividends paid to a government as a common or ordinary shareholder under the same terms as other shareholders);
- Infrastructure payments (e.g., payments to build roads or railroads to gain access to resources for extraction); and
- Other material benefits that are part of the commonly recognized revenue stream for commercial development.

In-kind payments for the payment types identified in the proposed rules must be disclosed and may be reported at cost, or if cost is not determinable, at fair market value. In-kind payments include, for example, making a payment to a government in oil rather than in cash.

The proposed rules do not require the disclosure of social or community payments such as payments to build a hospital or a school.

Because it is difficult to allocate certain payments that are made for obligations at the entity level, such as corporate taxes, to the project level, the proposed rules allow resource extraction issuers to disclose those payments at the entity level.

Project Characteristics

Disclosure of payments made to governments by type and total amount per project would be required. The term *project* is defined as operational activities that are governed by a single contract, license, lease, concession, or similar legal agreement, which forms the basis for payment liabilities with a government. Resource extraction issuers would be allowed to treat multiple agreements that are both operationally and geographically connected as a single project.

The SEC proposed rules include an instruction that gives a non-exclusive list of factors to consider when determining whether agreements are operationally and geographically interconnected based on whether:

- The agreements relate to the same resource and the same or contiguous part of a field, mineral district, or other geographic area;
- They will be performed by shared key personnel or with shared equipment; and
- They are part of the same operating budget.

Form SD Disclosures

The Form SD disclosures would include detailed payment information provided in an exhibit. The information also must be provided in XBRL using electronic tags that identify the:

- Type and total amount of payments made for each project;
- Type and total amount of payments made to each government;

- Total amount of the payments, by category;
- Currency used to make the payments;
- Financial period in which the payments were made;
- Business segment of the resource extraction issuer that made the payments (consistent with the reportable segments used for the issuer's financial reporting);
- Government that received the payments, and the country in which the government is located;
- Project to which the payments relate;
- Specific resource that is being commercially developed; and
- Subnational geographic location of the project.

Resource extraction issuers would be permitted to attach a report prepared for foreign regulatory purposes or for USEITI to comply with the proposed rules if the SEC deems the information in the report to be substantially similar to the information that would be disclosed under the proposed rules.

The proposed rules would not require that these disclosures be audited.

Implementation Schedule

The proposed rules would require resource extraction issuers to annually file Form SD within 150 days of their fiscal year-end.

Resource extraction issuers generally would be required to comply with the rules starting with their fiscal year ending no earlier than one year after the effective date of the adopted rules.

Next Steps

Comments on the proposed rules are due by January 25. Reply comments, which may respond to only issues raised during this initial comment period, are due by February 16.

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