Location, location

Campaigner Richard Murphy proposes a radical new International Accounting Standard that would require reporting turnover and tax by location

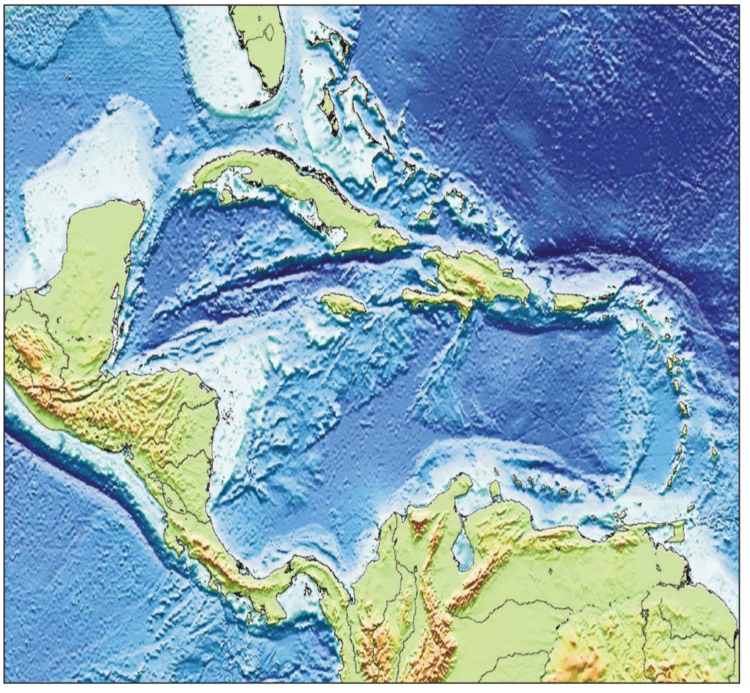
The accountancy world continues to be rocked by scandal, from Enron to Parmalat. While no one would wish to say fraud and malpractice are endemic in modern business what is clear is that when it occurs, modern accounts appear unable to indicate its presence. The time has come for a fundamental review of how multinational enterprises (MNEs) report to ensure this risk is reduced.

There are several reasons why the risk does seem limited to MNEs: they are the largest companies; they have the greatest chance of misstating their records because of the opportunities that differences in currencies, legislation, auditing, accounting standards and tax administration provide; and they are likely to be quoted and the range of stakeholders is therefore larger than usual and the impact greater.

Society cannot afford fraud in such operations, as the potential cost of the Parmalat failure to the Italian government has shown.

Trade and tax havens

MNEs dominate world trade. The UK government believes over 60% of all world trade is inter-group by MNEs. That means it is made up of sales from one company in a group to another company in the same group under common ownership or control. Many estimates also suggest that 50% of all world trade passes through tax havens. Much of this is of course MNE inter-group trade. And it is this coincidence that provides one of the strongest clues as to where the problem in current corporate reporting for MNEs lies: the simple fact is that none of this inter group trade is reflected



anywhere in the published accounts of these companies.

It may be very hard for a lay person to see how MNEs' published accounts could be true and fair, as their auditors say they are, when the 60% or more of world trade they undertake on an inter-group basis is not reflected in them. But this is precisely what accounting standards require. Take for example IAS 27, *Consolidated and Separate Financial Statements*, which will apply to all EU MNEs and those of over 30 other countries from 2005. This says that the parent company of an MNE is required to present consolidated accounts. That means its accounts must be presented as if it was a single company. What this means is:

- all inter-group sales and purchases are eliminated from the published profit and loss account included in the accounts;
- all money owed to and from inter-group companies is eliminated from the balance sheet included in the accounts.

It cannot be denied that preparing accounts in this way is important. Such accounts should continue to be prepared. They show shareholders what transactions their MNE has undertaken with third parties, and it is only those transactions that can add value to the group. But it is also the case that these accounts are no longer enough. There are two reasons:

- it is clear that inter-group transactions can seriously detract from the value of a company, as Enron and Parmalat have shown;
- there are many more stakeholders than shareholders. They need other information.

It is my suggestion that we need

Further information

A full copy of the proposed standard is available at www.taxjustice.net/e/articles

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1: Proposed IAS for multinational enterprises

My proposed new IAS would require all multinational enterprises to report:

1. The name of the state in which it is located.
2. The names of the states in which each of its subsidiaries, branches or related companies is located.
3. In respect of each subsidiary, branch or related company it should disclose:
- its name
- its principal trading activity
- the means by which it is related, and the proportion of the entity controlled by the MNE.

4. The MNE should also be required to report in respect of itself and each subsidiary, branch or related company:
- its turnover as reported in its own financial statements
- its turnover with third parties
- its turnover with related parties
- its purchases from related parties
- its labour costs and number of employees
- the value of natural resources included in turnover at sale price
- its profit before tax
- its corporate taxes due in cash for the period as well as any deferred tax movement, identified separately.

to tackle both these issues by the creation of a new International Accounting Standard to be adopted Europe-wide and by the US Financial Accounting Standards Board at the same time. This would require all MNEs to report the information set out in Box 1.

Radical proposal

This is a radical proposal and is detailed in full in the proposal I have published with the Association for Accountancy and Business Affairs, an organisation that campaigns for enhanced accountability within business and the accounting profession, whether related to accounts, auditing or taxation. It is also a remarkably simple one. All the information required to publish this data is already held by all the MNEs that will be affected, except perhaps for that on labour and raw material costs. The reason why they have this data already is that they have to know it to take it out of the consolidated accounts they publish now. So, while this proposal is radical it will impose very little cost at all on these companies. And since I suggest that the data be published on the internet only, shareholders will not be overburdened by considerable quantities of additional data as a result of this proposal if they do not want it.

So, if all the groups that would benefit from the data (see Box 2) including the entire corporate social responsibility lobby should welcome this change, who will not? The only likely objection is from company management. But since the entire purpose of the proposal is to hold them to account, I suggest that their objections should be overruled.

Accounting for real companies

This change is about accounting for real companies subject to real economic pressures in a modern world where transparency provides the best protection against a wide range of corporate malpractice. And the proposal for an IAS requiring companies to report their turnover, tax paid and other key information for each territory in which they operate is a key step towards achieving that transparency. As such I hope it will be welcomed by standards-setters, accountancy institutes and other interested parties everywhere.

2: Who will want this data and why?

1. Shareholders. They want to know the degree of risk inherent in the companies in which they invest. Substantial artificial transactions taking place inside group companies seem to be a clear indicator of risk. This is because they:
- increase the risk of undetected malpractice
- suggest aggressive tax avoidance might be taking place, which has a risk of future cost when detected and a current serious distortion of the valuation for many companies
- suggest a short-term approach to profit that is derived from financial engineering rather than underlying core value.

None of these traits is attractive to shareholders, and the chance of each being exposed is substantially increased under the rules I propose.
2. Creditors and suppliers. This group includes banks, trade suppliers and employees. All of these suppliers of credit to a company are risk averse. They wish to know that the asset backing of the company they are supplying is secure. Knowing whether the company is seeking to hide profits offshore clearly helps them appraise the risk they are taking in supplying any particular part of a group because cash held offshore may not be available to them.
3. Employees. They will want to know where in the world and on what terms labour is being employed both to ensure fair treatment and to appraise the risk of their work being transferred between states.
4. Environmentalists. They will know more about where natural resources are being sourced.
5. Government agencies. They will know more about what happens within their territories and will be able to regulate trade better as a result.
6. Taxation authorities. The new rules will also assist an effective crack down on tax avoidance through the use of offshore financial centres and increase the tax yields of countries in which real economic activity takes place. This is because group subsidiaries in tax haven territories which trade almost entirely with other group companies and which are designed solely to launder profits out of the tax system will be easy to spot if this data is disclosed.

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