

GAO'S THIRD REPORT ON CONFLICT MINERALS
"COMPANIES FACE CONTINUING CHALLENGES...":
AN ANALYSIS



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GAO’s Third Report on Conflict Minerals

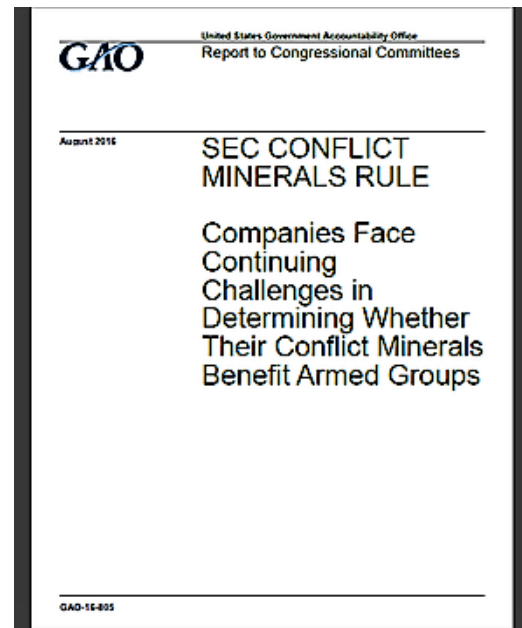
1.0 INTRODUCTION

Douglas Hileman Consulting LLC (DHC) provides this tip sheet on the Government Accountability Office’s (GAO) third annual report pursuant to Section 1052 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The report is titled “SEC Conflict Minerals Rule: Companies Face Continuing Challenges in Determining Whether Their Conflict Minerals Benefit Armed Groups¹” (2016 GAO Report).

The 2016 GAO Report summarizes companies’ SEC submittals for the 2014 reporting period; by GAO’s press time, the 2015 submittals were in, and several organizations have published their summaries of the newest (and third) batch of submittals. The GAO Report highlights continuing challenges in the conflict minerals supply chain, and takes the Department of Commerce to task for not fulfilling some statutory mandates regarding due diligence and the Independent Private Sector Audit (IPSA).

DHC believes the GAO report includes two sections that are misleading or unsupported. This document summarizes the GAO Report, and provides DHC’s perspective on these two issues.

DHC is simultaneously publishing “Commerce Deserves a Break,” with valid reasons that the Department of Commerce should be behind! See www.DFCMAudit.com or www.douglashileman.com.



¹ Available at <http://www.gao.gov/products/GAO-16-805>



2.0 HIGHLIGHTS OF GAO-16-685

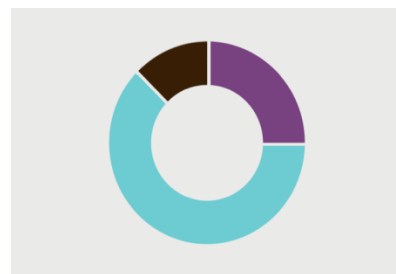
The Government Accountability Office (GAO) released their annual report on conflict minerals on August 25, 2016. This is the GAO’s third annual report, fulfilling a mandate in Section 1052 of the Dodd-Frank statute. The 2016 GAO Report had main three focus areas:

- 1) Company filings [for the 2014 reporting period]
- 2) Uncertainties about Source, Due Diligence, and Efforts to Reduce Risks
- 3) Status of Department of Commerce on output the statute requires of them.

The report provides background on the rule, GAO’s mission, uses of conflict minerals, and a summary of key provisions of the SEC Conflict Minerals Rule. GAO provided objectives, scope and methodology, and stated that the report was done using the performance audit standards.

2.1 Company Filings

Due to timing of the GAO Report release, there is nothing new for professionals who have been following the SEC conflict minerals submittals. The 2016 GAO Report includes data on submittals for the 2014 reporting period. A total of 1,283 companies submitted filings, with an estimated 86% being domestic companies. Compared to 2013 (Year One), company filings indicated greater knowledge of their supply chain. An estimated 80% of the filers went beyond the Reasonable Country of Origin Inquiry (RCOI) and conducted due diligence (DD).



The GAO’s methodology involved sampling, and extrapolating results of the sample back to the total of 1,283 companies that submitted filings. GAO estimated that 3 percent chose to label their products as “DRC Conflict Free.” DHC notes that this would mean approximately 36 companies would have submitted an Independent Private Sector Audit (IPSA). In fact, only six companies did so for the 2014 reporting period. While the GAO methodology was clearly described, is consistent with general audit practice, and seems logical (given resource constraints), the size of this discrepancy is a good reminder of the limitations of any audit.

Companies reported that they planned to (or did) take actions such as encouraging supply chain to shift to those who are conflict-free.



2.2 Uncertainty About Source And...

Due diligence at processing facilities (smelters or refiners, or “SORs”) continues to be difficult due to suitable traceability mechanisms. Challenges include forging chain-of-custody tags, and commingling of certified and non-certified ores. This creates challenges for the remainder of the value chain. Industry groups continue to work with the OECD to improve certainty and traceability of conflict minerals.



2.3 Commerce Has Produced Lists... but Has Not Developed Plans to Assess or Advise Audits of Conflict Minerals Filings

The third focus area was on the tasks assigned to the Department of Commerce (“Commerce”) by the statute. The statute directs Commerce to provide a list of minerals processing facilities. They did. GAO noted comments from industry members saying they found Commerce’s list helpful. GAO reviewed of some filings to confirm these conversations, and found that several companies cited the Commerce list in their filings.



The statute requires Commerce to submit an annual report starting in January 2013 that includes, among other things, its assessment of the accuracy of the IPSAs and other due diligence processes described by the conflict minerals provisions of the act that are conducted by SEC reporting companies. Commerce’s report is also to include recommendations for the processes used

to carry out such audits, including ways to improve the accuracy of the audits and establish standards of best practices. As of July 2016, Commerce had not done so.

Commerce admitted as much. Commerce concurred with GAO’s recommendation to submit a plan, with associated timeframes, outlining steps that the Department will take to meet statutory obligations.





3.0 INCORRECT OR MISLEADING STATEMENTS

3.1 Number of Companies Submitting IPSAs

The Conclusion section states that “The agency [Commerce] has, so far, not assessed or submitted a report on any IPSAs, despite acknowledging that 29 companies have filed IPSAs with their disclosures between 2014 and 2016...” This overstates the number of companies by ten. Four companies have filed IPSAs for three years; this represents *twelve IPSAs*, but only *four companies*. Two more companies submitted IPSAs for the 2014 reporting period and again for 2015. The difference between 29 IPSAs and 19 IPSAs may not seem important, but it is one of the challenges Commerce faces in fulfilling their statutory mandates. (See a companion piece at www.DFCMAudit.com and www.douglashileman.com).

3.2 Statement Attributed to IPSA Auditor

In the last sentences of “Commerce Has Not Developed Plans...”), GAO mentions that , “according to one independent private sector auditor we spoke with, because of the uncertainty about IPSA requirements and best practices, some consulting firms were misrepresenting the scope of IPSA services that are needed for compliance in order to justify excessive fees for SEC-filing companies.”

DHC was not the IPSA auditor mentioned. DHC disagrees with this statement, and GAO’s decision to include it in the GAO 2016 Report.

Any IPSA auditor providing opinions about consultants (which could include other IPSA auditors) could be regarded as having her/ his objectivity impaired. The Report did not indicate if or how GAO substantiated this comment.

The phrase “that are needed” is a value judgment. In over 35 years of auditing experience, I have led, worked on, and supported many audits – and many different types of audits. In my experience supporting financial audits (as a specialist; I am not a CPA), working with Chief Audit Executives and others in Internal Audit, and leading and supporting other compliance audits and risk assessments, I have found





that professional judgment plays a role in determining what is necessary for any audit. Indeed, the Yellow Book performance audit guidance says so (Sections 6.03, 6.04). For a new type of audit, and with a small group of audit providers, variability is to be expected. Professional judgment also plays a part in companies’ decisions on what is necessary to achieve compliance.

In addition to implying criteria (“needed”), the sentence provides a condition, cause (uncertainty about IPSA requirements...), effect (consulting firms misrepresenting), and motive. DHC finds it interesting that the cause was accepted, the effect was not substantiated, and the motive was accepted without further support.

DHC believes that it is not helpful to state or imply that there is already a single, agreed-upon set of services that are “needed for compliance.” It is also a disservice to state or imply that service providers are willfully misrepresenting scope in order to justify excessive fees. This can have a chilling effect on regulated companies considering an IPSA, so long as ongoing litigation means they are voluntary.



About Douglas Hileman



Douglas Hileman, CRMA, CPEA, P.E. has led his own firm for over seven years. He draws from over 35 years of experience in many aspects of operations, compliance, business strategy, enterprise risk management, non-financial reporting, audit readiness, and auditing. He worked at PricewaterhouseCoopers for six years, where he supported financial audits, internal audits, and other engagements involving governance, risk management, compliance. He also has nine years of experience in industry.

Douglas commented on the draft SEC Rule for conflict minerals. He has worked with clients in Advisory and Assurance roles for conflict minerals. As an advisor, he helped incorporate elements of other compliance and risk management frameworks into conflict minerals programs, anticipating inquiries from customers and senior management. His firm conducted one of the first four Independent Private Sector Audits (IPSAs), submitted for the 2013 reporting period. His firm has conducted an IPSA for each subsequent reporting period.

He is active in the Institute of Internal Auditors. He holds credentials as a Certified Risk Management Assurance professional (CRMA), Certified Professional Environmental/ Health & Safety Auditor (CPEA, Management Systems focus), Professional Engineer (chemical), and a Qualified Environmental Professional. He has submitted comments on the SEC's Concept Release on Regulation S-K, Integrated Reporting Framework (and its assurance), and numerous other standards and regulations. He has presented “Frameworks for Non-Financial Reporting” at several meetings of the Institute of Internal Auditors. His firm serves clients nationwide from Los Angeles.

See www.DFCMAudit.com for more resources on IPSAs and related aspects of conflict minerals.

See www.douglashileman.com for more resources on environmental, safety, non-financial reporting, compliance, and risk management.

Find Douglas Hileman on Linked In.