Dodd-Frank Conflict Minerals
SEC FAQ Batch 2: What's New for IPSAs?
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The Securities and Exchange Commission (SEC) published a series of FAQs for the Dodd-Frank Conflict Minerals (DFCM) rule on April 7, 2014. Several questions dealt with the Independent Private Sector Audits (IPSAs). Douglas Hileman Consulting LLC (DHC) summarizes each FAQ, with the author's thoughts on how each affects IPSAs.

FAQ 13 confirmed that non-CPAs can do IPSAs. SEC stated in the final rule that "unless the GAO makes some formal pronouncement, it appears that any auditor of the Conflict Minerals Report will need to conduct the audit using the standards set forth in GAGAS…" (p. 215). The final rule also referenced the attestation standards and performance standards of GAGAS, which are used by CPAs and non-CPAs, respectively (p. 214-215). FAQ 13 confirms what most in the regulated community had interpreted. Non-CPAs are, indeed, permitted to do IPSAs.

FAQ 14 clarified that an issuer is not required to obtain an IPSA if any of the issuer's products are "DRC conflict undeterminable" during the reporting period [two years for larger (most) issuers]. The question was raised in the context of a filer that determines that at least one of its products may be described as "DRC conflict undeterminable." The question could imply that the filer had also determined that at least one of its products had also been determined to be "DRC conflict free." DHC notes that the rule does not specify how a company must (or can) make its declaration(s) during the transition period. During the transition period, a company could reach different conclusions for different products or product lines, with some being "DRC conflict undeterminable" and some being "DRC conflict free." If the issuer has product lines with different determinations, "if any of an issuer's products are 'DRC conflict undeterminable' during this period, the issuer is not required to obtain an IPSA…" [emphasis retained from the original]. In this scenario, the issuer would file as "DRC Conflict Undeterminable" as the entire entity. This does not prevent a filer from making different declarations for different products or business segments. See FAQ 15 for this scenario.

FAQ 15 confirms that an IPSA is required if an issuer describes any of its products as "DRC Conflict free." This is the opposite end of the spectrum of the scenario implied in FAQ 14. If a company is mostly "DRC Conflict Undeterminable," can the majority of the declaration outweigh even a single declaration of "DRC Conflict Free"? The answer is no.

Neither FAQ 14 nor 15 addressed whether a filer is required to describe any of its products as "DRC Conflict free" if they find them to be so. DHC suggests this could have been published as "FAQ 14-1/2." FAQ 14 implies that a company has flexibility as to how it describes its products in the Conflict Minerals Report (CMR). This can be by product, product line, line of business, subsidiary – any level the issuer chooses. An issuer may describe products as "DRC Conflict Free" provided there is sufficient basis to do so. An issuer may elect to do so for many reasons: as a differentiator to customers; to show diligence to shareholders or NGOs; or to maintain position as a corporate leader. An issuer may also choose criteria for reporting conflict free status such that products that are DRC Conflict Free and DRC Conflict Undeterminable are in the same group, with the result that the description of products is "DRC Conflict Undeterminable," thereby avoiding an IPSA.

FAQ 16 addressed the situation when products are composed of a number of conflict minerals from different sources. It is one of the few FAQs in this batch that did not mention the IPSA.

FAQ 17 confirms that the scope of the IPSA does not include the completeness or reasonableness of the issuer's due diligence. This is consistent with the final rule; Objectives 1 and 2 are independent of each other. SEC noted in the August 22, 2012 final rule that commenters had recommended that the final rule clearly state the objective of the audit (p. 210). SEC also acknowledged that "the final rule does not require an audit of the entire Conflict Minerals Report" and that "the objective we are adopting differs significantly from the objectives of other audits required by our rules." (p. 217 and 218, respectively). The SEC also noted they considered "concerns about the costs that could arise from a requirement to audit the conclusion about the conflict minerals' status and take other approaches." (p. 218). DHC suggests that these comments indicate that SEC was deliberate in specifying the IPSA Objectives – both in what they are, and what they are not. IPSA auditors should not be tempted to expand the objectives or scope of the IPSA. Users of the IPSA Audit should be aware of the objectives, and what the IPSA does not do.

FAQ 18 said that the Reasonable Country of Origin Inquiry is not subject to the IPSA. DHC agrees, and notes that this was not stated or implied in the final rule. However, some issuers may have commingled the RCOI with the due diligence. DHC has provided a separate blog and download on this issue, available at www.DFCMAudit.com.

FAQ 19 confirmed that recycled or scrap sources require disclosures on the Form SD, and not in the Conflict Minerals Report. Since the IPSA focuses only on the CMR, the disclosures related to recycled or scrap sources will not be subject to the IPSA.

FAQ 20 clarified that the issuer's description of the due diligence measure it performed for the "period covered by the report" can occur before or after the reporting period. It also clarified that due diligence need not occur consistently throughout the year. Both parts of FAQ were driven by Objective 2 of the IPSA, which requires the IPSA Auditor to "express an opinion or conclusions as to whether the issuer's description of the due diligence measures it performed, as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook." DHC addressed the concept of cut-off dates in a series of downloads available at www.DFCMAudit.com.

FAQ 21 clarifies that the issuer is not required to include a full description of the design of its due diligence in the Conflict Minerals Report. The SEC notes, however, that the due diligence measures undertaken must be described in the CMR, and that these are the subject of IPSA Objective #2. The two IPSA objectives are, theoretically, independent of each other. Although it is not an IPSA objective to match the two, DHC suggests it is a question that is sure to arise. Non Governmental Organizations (NGOs), analysts, shareholders, customers and competitors will inevitably undertake their own exercises to match the two. If the description of the design of the due diligence and the steps undertaken to conduct the due diligence do not align, this could raise confusion or distrust on the part of the reader. DHC suggests that issuers describe the due diligence measures undertaken to enable readers to perform their own analysis.