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Submission to the SEC – Conflict Mineral Audit Viability

An audit process to provide complete transparency around minerals being purchased by US firms is absolutely achievable. Such a process is critical in advancing the US Government's human rights agenda for the Democratic Republic of Congo both explicitly and through associated activities, and also supports the US Government's intentions for counter-terrorism and anti-money laundering.

Each audit and audit process will have unique challenges that must be overcome. To provide complete transparency for an individual buyer requires assurance of the complete supply chain from mine face to manufacturing process. Audit may be conducted from either end of the supply chain, but true transparency can only come from a process that starts at the mine face and certifies minerals as they flow backwards. Mine face audit requires strong relationships, keen understanding of the quantities that should be being produced and sensitivity to spikes in production, and where appropriate more discreet methods of inquiry.

Mine-to-buyer supply chain certification is possible; it requires a combination of skill sets and capabilities, including staff experienced in operating in medium to high risk environments forward auditing the mines, forensic accountants, minerals and mining experts and others. To argue that audit is not possible, or is onerous, demonstrates a lack of expertise in achieving this type of integrated task.

The capabilities to deliver the audit process are not free. However, they are subject to economies of scale; a mandatory regime will be a lot more cost-effective across the affected industries than a voluntary one. The cost of audit is small compared to many profit margins affected by those costs, as reflected by the share prices of consumer electronics firms today.

There will be compromises, particularly early in the process; these do not affect the moral imperative of the law. For instance, a smelting operation outside the United States may be buying from multiple sources and selling to buyers in various countries. We must accept that the smelter is not held to the same standards as the US buyers, but as long as the smelter is buying enough certified material to meet US demand, an important first step has been made.

It is illustrative that this firm has been attempting to work with the various representative industry bodies and organizations asserting to provide the 'industry mandated' audit course, in order to ensure that we address the concerns of all stakeholders. However, none of the industry bodies will engage with us or provide details, suggesting that open audit is so against their interests that they are against even entertaining the idea of an independent, certified audit capability, other than 'smelter certification'.

Smelter certification creates significant risk to the letter and intent of the law. Smelters outside the US, the focus of industry certification efforts, have no incentive to actually certify the materials. They are not subject to US law or US sanctions, and the buyers, it seems, want the appearance of compliance rather than veracity.

A prevailing counter-argument is that conflict minerals are too difficult to identify. This is fair, when the problem is viewed through a specific, chemical approach. Taken more broadly, being able to incentivize mines to be compliant and monitored creates an ever increasing network of certified mines, which must be monitored to ensure that all the product they provide comes from that source.

Challenges to successfully implementing an audit regime are myriad, not least the requirement for the will by US Government departments to take the formal action to compel and facilitate compliance. Countries that host smelting operations and equipment construction operations must be similarly encouraged to support the program, or at least to facilitate through visas and, preferably, safe conduct for auditors. There are regimes that are not minded to do so.

There are certainly economic arguments against any form of auditing regime; that the electronics companies are being forced to bear the burden and finance reform, that with 30% of tantalum coming from affected areas it is impossible to maintain prices while boycotting these minerals, and that audits are too expensive.

The International Conference of the Great Lakes Region (ICGLR) conference to be convened in Congo on November 12, 2010 intends to endorse a five part Minerals Tracking and Certification System that is still being developed at the time of writing. This system uses the Kimberly Process as inspiration; for this system to succeed international enforcement by government and agencies such as the SEC will be critical. The electronics companies are being expected to play their parts, because if the critical element of finance for conflict minerals were not a contributory factor, there would be one less factor driving the violence and human rights violations; the companies being required to audit derive their profits from these sources, and so it is appropriate that they take responsibility for all stakeholders in their value chain, as many corporate governance mandates state.

At present the audit regime is based on accountability, and should drive a far more accurate picture of the flows of minerals, cash and influence around these minerals. This creates the opportunity, the platform, to begin to deliver solutions to the area that are informed by the information created through auditing, and it is with that information that longer term solutions can be delivered.

Ironically, there are other economic theories supporting an audit regime. Such a regime is likely to create jobs within the audit regime, particularly for American companies maintaining a predominantly American workforce. There is a significant chance that market pressures will, over time, push buyers to prefer minerals smelted in the United States, increasing the requirement for labor at existing and potentially new smelting facilities.

Auditing in support of HR 4713 is both viable and necessary under both the intent and letter of the law. The successful delivery of this auditing will not only contribute to addressing the most pressing human rights disasters of this century, but will contribute to a myriad of other government department imperatives such as hunting war criminals, combating terrorism and preventing money laundering.

There is a moral responsibility for US companies to take responsibility for the implications of their actions, and this requirement is beginning to take shape among both the electorate and political elite.

The SEC has the opportunity to drive the creation of a set of standards that will not only improve conditions and create government efficiencies, but that will lead to greater stability for capital markets, removing current uncertainties about the effects of the mandated audits, given that anything other than strict imposition early will create doubt about when such an imposition will take place.

Audit is viable. I strongly recommend that the Securities and Exchange Commission embrace the legal and moral imperative of Section 1502 of HR4713 and begin strict enforcement at the earliest possible opportunity.