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The Honorable Mary L. Shapiro, Chairman
Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549

Via electronic filing

Re: File No. S7-40-10, Proposed Regulation on Conflict Minerals Disclosures - Section 1502(b) of the Dodd-Frank Wall Street Reform Act

Dear Chairman Shapiro and Secretary Murphy:

The ELM CONSULTING GROUP INTERNATIONAL LLC ("ELM") is an international environmental, heath, safety and sustainability ("EHSS") management consulting firm specializing in the development and implementation of related audit programs. In August 2010, **ELM was selected by a US-based electronics industry association to review, test and implement their third party conflict minerals supply chain traceability audit program**. We are thoroughly familiar with the audit-related aspects of SEC's proposed conflict minerals regulation and our comments are based on that experience.

ELM is submitting comments on two overall themes:

- Auditor standards. We comment on the requirement for the Conflict Minerals Report to be a "*certified independent private sector audit conducted in accordance with the standards established by the Comptroller General of the United States*", and the related preamble discussion (75 Fed. Reg. 80958 – 80959), including footnote 101.

- Definition/scope of scrap and recycled materials. We comment on risks to both issuers and auditors stemming from the current proposal, and offer a solution to SEC that already exists within the federal government.

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Auditor Standards

From our reading of the proposal preamble, Footnote 101 (75 Fed. Reg. 80958) is most instructive on the issue of auditor standards. The footnote states, in part:

> *We note that, under the Conflict Minerals Provision, the Comptroller General establishes the appropriate standards for the independent private sector audit. Staff of the GAO has informed our staff that they preliminarily believe no new standards need to be promulgated, but rather auditing standards that are part of the Government Auditing Standards, such as the standards for Attestation Engagements or the standards for Performance Audits will be applicable. See GAO–07–731G.*[1]

We support the position communicated to the Commission by GAO staff that "no new standards need to be promulgated" and recommend that SEC directly incorporate or reference GAO-07-731G. We feel this is paramount given our experiences explained below.

Various industry associations are developing programs to assist their members in complying with the law; one of these includes total management of an audit program to produce Conflict Minerals Reports[2]. Industry associations by definition consist of companies that have varying business relationships with each other – i.e., competitors, customers and suppliers. As such, auditors supporting this program face a range of potential impairments to independence as set forth in relevant independence standards[3]. Indeed, our research failed to find a precedent in any other legally required audit being fulfilled by an association on behalf of the audited entity.

Under the association program, audits are executed in two ways:

- Direct engagement of an auditor by the association. Where the association contracts directly with an auditor, the auditor has no contractual relationship with the audited entity. Basic contract mechanisms including liability limitations or indemnifications do not exist between the auditor and audited entity, creating significant potential risk for the auditor. Additionally, the audited entity is not allowed by the association to review, comment on or otherwise participate in the report development.

- Direct engagement of an auditor by the audited entity. The association may direct an auditor to contract directly with the audited entity where either (a) the audited entity is not a member of the association, or (b) a member has a confidential business relationship

[1] SEC's preamble language does not refer to other accounting standards; therefore our comments are limited to GAO-07-731G.
[2] The stated use of these audits is to fulfill the Conflict Minerals Report under the law and implementing regulations.
[3] Our experience with this audit program shows the potential for impairments to auditor independence through scenarios such as those stated in Section 3.10 of GAO-07-731G.

> with the audited entity. Where either of these occurs, the association directs/manages the audit process as if the association has engaged the auditor. The auditor is then placed in a position of serving multiple masters with influence over the audit scope, process, information, reporting and payment. Further, contract mechanisms including liability limitations or indemnifications do not exist between the association and auditor for these engagements, creating significant potential risk for the auditor. Additionally, the audited entity is not allowed by the association to review, comment on or otherwise participate in the report development, placing the auditor at odds with its contractual obligations to the auditor.

Congress and SEC made it clear that an audit of the highest possible quality and standards is the cornerstone of the law's goal. Section 13(p)(1)(B) of the Securities Exchange Act of 1934 (as added by Section 1502(b) of the Dodd-Frank Act) states that "*Such a certified audit shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals."* For SEC to promulgate a regulatory framework that does not reinforce this would be inconsistent with Congressional intent.

Given the lack of both (a) a specific audit/due diligence standard prescribed by the Commission[4] and (b) any precedence of legally required audits being met through industry association programs, the Commission must incorporate the audit standards of GAO-07-731G into the rule to ensure independent third party conflict minerals audits are consistent with the Congressional mandate.

Added benefits of this include:

- Clarifying requirements for auditor signatures on attestations and audits (Question #42 of the proposed rule).

- Establishing a definitive standard of care for the audit process, audit qualifications, etc., which will likely reduce potential liability of conforming auditors (Questions #42 and #43 of the proposed rule).

- Clarifying that the audit reports developed under this standard are not qualitatively different from other experts' reports under SEC rules (Question #44 of the proposed rule).

[4] ELM is not commenting on this aspect of the proposed regulation as we see benefits to both establishing and not establishing a prescriptive due diligence/audit standard. However, in the absence of a prescriptive due diligence/audit standard, the Commission simply cannot also be silent or ambiguous on the applicability of auditor standards. Allowing the conflict minerals reports to be free of any applicable standards fully contravenes the plain language of Section 13(p)(1)(A)(i) of the Securities Exchange Act of 1934 (added by Section 1502(b) of the Dodd-Frank Act).

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- Providing disincentives for unqualified auditors - including those with irrelevant professional certifications - to attempt to perform these audits.

Definition of Scrap

SEC has stated the "*proposed rules would not define when a conflict mineral is recycled or scrap. Instead, any issuer seeking to use this alternative approach would provide its reasons for believing that the conflict mineral is from recycled or scrap sources in its Conflict Minerals Report, which would include due diligence on the source of the mineral*. " [75 Fed. Reg. 80963]

Without a reference point against which a site's operations are assessed, an auditor can do little more than audit against a definition that is established by the site itself in such a way to maximize its own benefit. Further, new information indicates that unscrupulous metals traders in the DRC and adjoining countries are already making plans to leverage the "scrap loophole"[5].

The proposal is problematic because the validity of the audited entity's position is not assessed until the Commission itself reviews each report and each company's reasons for believing that materials are recycled or scrap. **Assuming in the first place that this validation will occur[6], it will not happen until after the "unreviewed" audit is completed and made available to SEC, the audited entity's investors, customers, suppliers and general public, giving rise to substantial risk for the company[7] and the auditor[8] alike.** To reduce this risk, an auditor must have a reference point against which to judge "scrap" and "recycled materials" *during* the audit process. Concerns or findings by the auditor would then be reflected in the report and attestation statement.

[5] *See* http://agmetalminer.com/2011/02/24/loophole-in-conflict-minerals-law-creates-opportunity-for-scrap-dealers/
[6] There is growing concerning about the availability of funding for the Commission to fully implement the Dodd-Frank Act, and political pressure is mounting to scale back various aspects of the law's implementation. In addition, it is reasonable to expect a large number of reports will require review and validation by SEC, which will create a backlog and delays in the process.
[7] Companies are already engaging in new business opportunities based on the results of conflict mineral audits we have conducted. Should SEC determine - at a point long after an audit is completed and new contracts have been entered into - that audits or scrap determinations are not valid, a company will be placed in a position of substantial business risk. Similarly, a newly introduced Senate Bill (SB861) in California directly connects a company's eligibility to bid/propose on state contracts to SEC's review of the company's Conflict Minerals Report. *See* http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0851-0900/sb_861_bill_20110218_introduced.html
[8] Auditors would almost certainly face consequential damages claims from audited entities related to loss of revenues, which would far exceed claims related to regulatory non-compliance, fines and penalties. This also relates to our earlier points on contractual risk management mechanism.

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ELM recommends that SEC adopt in substantial part EPA's definitions of solid waste, with the related exclusions and definitions of various scrap materials (*see* 40 C.F.R Section 261.2). From our experience with EPA regulations, including a particular emphasis on the waste management regulations, we contend that EPA's definition is substantially consistent with the positions on scrap materials voiced to the Commission by many commenters on this proposal. At a time when public and Congressional pressure is mounting for governmental efficiency and consistency, leveraging EPA's long-standing, well-tested regulatory language is logical[9].

ELM appreciates the opportunity to provide input on this important proposal. It is our sincere hope that these comments from our unique and relevant perspective will be valuable to you in establishing a credible and successful audit standard for conflict minerals. We would be pleased to make ourselves available to respond to any questions or comments you may have. Feel free to contact me at 678-200-5220 (office), 678-200-3424 (cell) or email me at Lheim@elmgroup.com.

Sincerely,
THE ELM CONSULTING GROUP INTERNATIONAL LLC

Lawrence M. Heim, CPEA
Director

About THE ELM CONSULTING GROUP INTERNATIONAL LLC

ELM was founded a decade ago and now has eleven offices in the US, Mexico, Argentina, Venezuela, New Zealand, Indonesia and China (joint venture). Beyond these locations, we have a network of over 100 hand-selected affiliates in 22 other countries. A full 80% of our client base consists of Fortune 200 companies. To maintain our independence as auditors, our services are focused on environmental, heath, safety and sustainability ("EHSS") audit program development and execution and we maintain US and global auditor certifications. Our five partners have professional EHSS auditing experience ranging from 20 to 35 years.

[9] EPA has defined and refined the definition of scrap metal, by-products and other related terms over more than two decades, reflecting a substantial amount of internal analysis and industry input. At the same time, given the nature of certain reclaimable materials, SEC should allow flexibility in considering some sludges and byproducts as viable scrap/recyclable material.