

GAO Offers Bleak Assessment on Achieving Goal of Conflict Minerals Disclosure Rules

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Most companies filing reports on their use of conflict minerals remain unable to confirm their origin or whether those minerals financed or benefited armed groups, concluded a GAO report released last week. The GAO is required under Dodd-Frank to study annually the effectiveness of the SEC rule on conflict mineral disclosure in promoting peace and security in the DRC. The United Nations has indicated that armed groups continue to generate significant revenue from the control or looting of conflict minerals.

The GAO randomly sampled 100 reports from the population of 1,283 filed in 2015, met with a range of stakeholders and visited processing facilities in Asia as part of its fieldwork. 86% of companies that filed Form SDs are domestic, and almost all companies reported performing a reasonable country of origin inquiry (RCOI).

49% of companies were able to make a determination on whether or not the conflict minerals came from covered countries, a 19% increase from the prior year. Nearly all companies reported surveying their suppliers, and a little more than half received responses.

Having multiple tiers of suppliers for any mineral used posed challenges. Some companies disclosed that they received information from only about a quarter of suppliers surveyed while a few others were able to obtain data from all of them. The average supplier response rate was about 81%. More than three-quarters of companies reported using a template produced by the Conflict-Free Sourcing Initiative (CFSI) to question suppliers.

While 80% of companies reported that they exercised due diligence, with the vast majority using the OECD framework, most were ultimately unable to confirm the origin of the minerals or whether they benefit armed groups. In the second year of reporting, only six companies filed independent private sector audits (IPSA) and one filed a certification. Though not required under the SEC rules after protracted litigation, 30% of companies described their efforts as DRC conflict undeterminable.

The low level of certainty regarding the information is a result of having facilities that process conflict minerals rely on documentary evidence, which are susceptible to fraud, and multiple levels of processing operations further introduce fraud risks at any point. A UN group in 2015, for example, reported black market sales of tin supply chain tags. The minerals' processing facilities rely on paper documents from miners and exporters and there is no certification that covers the entire region. Adding to the reporting risks, processors generally use multiple intermediaries. Minerals may also be commingled prior to being processed.

Companies disclosed that their additional diligence efforts include shifting operations to new suppliers, including language in new supply contracts, and following up with suppliers that did not respond, as well as training suppliers on due diligence.

The GAO also found that the Department of Commerce (Commerce) has not submitted a report that was required in January 2013 under Dodd-Frank on assessing the accuracy of private sector audits filed by some companies. Ten filed them between 2014 and 2015. Commerce established a team in March 2016 but acknowledged that it doesn't have the skills or expertise to conduct these audits or establish best practices.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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