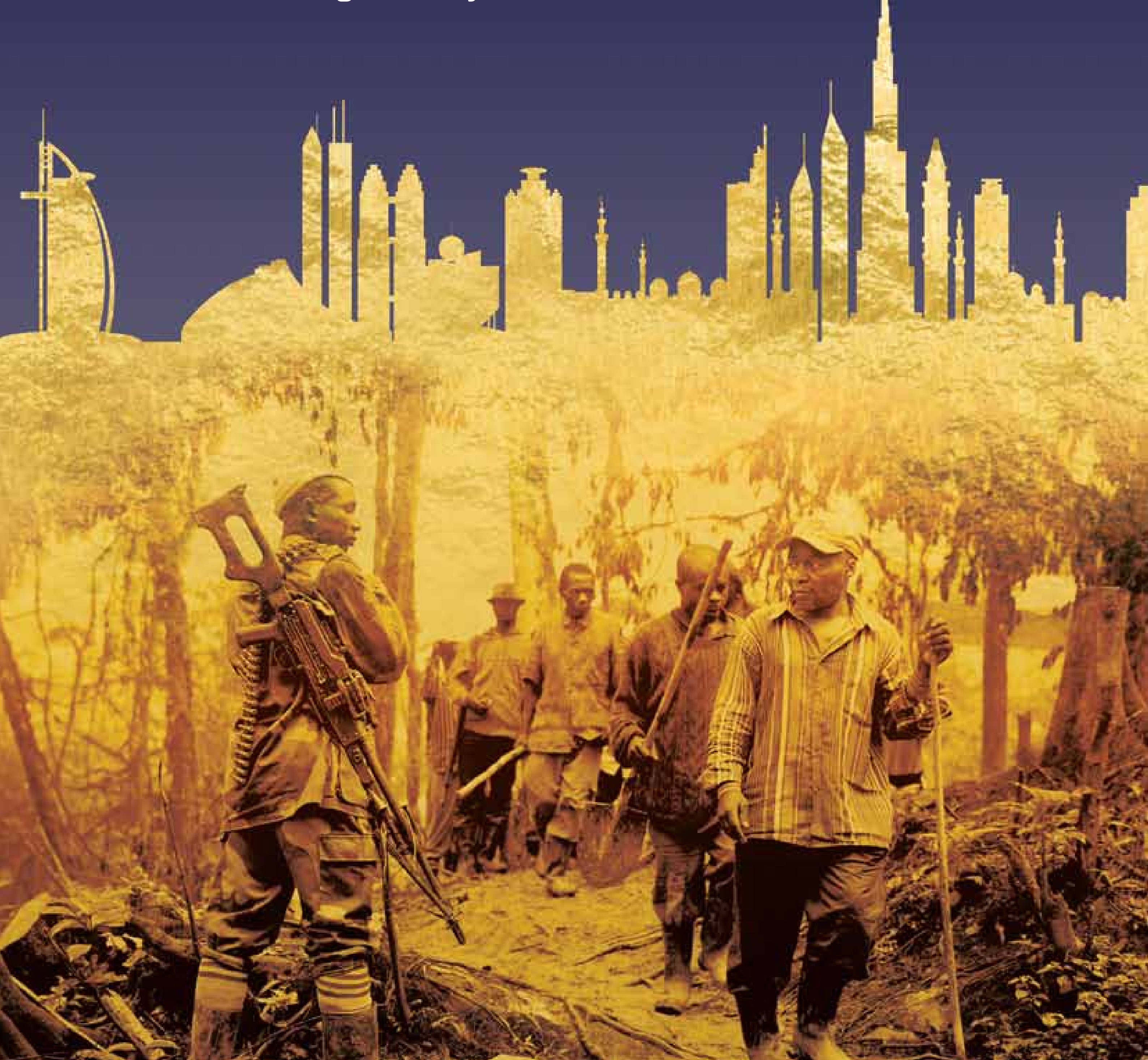
February 2014

global witness

CITY OF GOLD

Why Dubai's first conflict gold audit never saw the light of day



CONTENTS

INTRODUCTION 2

WHAT IS CONFLICT GOLD AND HOW CAN IT BE STOPPED? 4

MAJOR COMPLIANCE FAILURES BY KALOTI 5

THE DMCC: REGULATING TRADE OR PROMOTING BUSINESS? 8

ERNST & YOUNG'S ROLE 10

CONCLUSION 12

RECOMMENDATIONS 13

ENDNOTES 14

Front cover photo: A soldier from the Congolese Rebel Army FPC watches artisanal miners on their way to work at the Musia Gold Mine.
Credit: Panos/James Oatway

INTRODUCTION

The global accountancy firm Ernst & Young turned a blind eye when the Dubai metals regulator changed its guidelines during the course of an audit at the Middle East's largest gold refinery, according to a former Ernst & Young partner, with the result that a report of serious failures at the refinery went unpublished.

The unreported audit findings pointed to an increased risk of money laundering and of dirty gold from the Democratic Republic of Congo and other conflict zones entering the refiner's supply chain during 2012.

The matter has come to light thanks to Amjad Rihan, the partner at Ernst & Young Dubai who was in charge of the audit of Kaloti Jewellery International.[1] Our analysis is largely based on detailed documentation shown to Global Witness by Mr Rihan.

The documents suggest that the regulator, the Dubai Multi Commodities Centre (DMCC) altered its audit guidelines after becoming aware of the negative findings in Ernst & Young's report. The changes enabled Kaloti to keep the results confidential.

According to Mr Rihan, the Ernst & Young Global Executive body was aware that critical audit findings were sidelined following the DMCC's changes to the guidelines. Mr Rihan maintains that the firm turned a blind eye, despite his repeated requests that the findings be reported to relevant stakeholders, with the effect that damaging results were swept under the carpet.

Following Ernst & Young's failure to disassociate the firm from the DMCC's actions, and its decision to agree a new audit engagement with Kaloti, Mr Rihan refused to sign the audit report and stepped away from the project.

The refiner was being reviewed against supply chain due diligence guidance developed by the DMCC, based on standards set by the Organisation for Economic Cooperation and Development (OECD) and the United Nations to prevent gold revenues from funding conflict and human rights violations in Congo and elsewhere. In 2012, the DMCC made it a condition of membership for Dubai Good Delivery refiners to do due diligence on their activities and suppliers. The audit carried out by Ernst & Young was part of a first round of reviews commissioned by Dubai-based refiners to assess their implementation of the DMCC guidance.

The leaked audit report prepared by Mr Rihan's team reveals that the refiner:

- Failed to report suspicious cash transactions worth in total over US$ 5.2 billion in 2012;
- Knowingly accepted up to four tonnes of gold coated with silver exported from Morocco by suppliers who had used falsified paperwork; and
- Lacked adequate supply chain information on several tonnes of high-risk gold from Sudan.

The implications of compliance failures in Dubai's gold market are serious. Dubai is home to over 20 percent of the world's physical gold trade – worth close to US$ 70 billion in 2012.[2] The United Nations and Global Witness have repeatedly exposed the emirate as a key destination for gold that funds abusive warring parties in eastern Congo. The Dubai regulator has a particular responsibility to ensure that its member companies are

THREE REPORTS ARE GENERATED AS PART OF THE AUDIT PROCESS

1. Ernst & Young prepares a confidential **management report** for the client and regulator, including a detailed account of the refiner's implementation of due diligence.
2. The refiner writes a public-facing **compliance report**, which should in theory mirror the findings in the management report.
3. After reviewing the compliance report, Ernst & Young issues a public-facing **assurance report**, in which they either agree or disagree with the refiner's report and which includes a final overall compliance rating.

doing business responsibly. Kaloti alone refines 45 percent of the gold processed in Dubai.[3]

A compliance report published by Kaloti in November 2013, based on a follow-up review also carried out by Ernst & Young under the DMCC's revised guidelines, indicates that the refiner had taken steps to address the failures identified in its 2012 operations. However, the report makes little reference to the gravity of the initial non-compliance.

The apparent cover-up by the DMCC calls into question Dubai's commitment to ethical commodity trading and suggests a conflict of interest in the DMCC's dual role as government regulator and trade promotion body. Ernst & Young's willingness to toe the line was critical to the DMCC ultimately securing clean audit results for a key Dubai refiner. The decisions made by the global leadership in this case, which appear to contradict the firm's own ethical standards and undermine its credibility as an objective third party, warrant further scrutiny.

Although the actions of the DMCC and Ernst & Young were lawful, any suppression of reports of serious non-compliance hampers efforts to clean up a trade that fuels brutal conflicts and human rights abuses around the world. Public disclosure is a key incentive to improving business practice. Nondisclosure of the type of failures found by the initial audit could mislead those buying gold, including banks, manufacturers and high street jewellers, and could even expose US-based customers to sanctions under a new law designed to curb the trade in conflict gold.

Global Witness wrote separately to Kaloti Jewellery International, the DMCC and Ernst & Young to seek comment on the events described in this report. Their responses are summarised below.

- Kaloti denied any allegation of non-compliance in its gold business and emphasised that it had never been found by Ernst & Young to be sourcing from conflict zones, although the same letter acknowledged non-compliance in the initial stages of a 'long multi-staged audit process'. Kaloti said that all disclosure was done in accordance with DMCC requirements and industry best practice, and that the company adhered to all audit requirements.

- The DMCC rejected any suggestion of a cover-up or improper action. The DMCC denied that its actions risked misleading purchasers of gold or other stakeholders, or in any way undermined efforts to enhance effective regulation of the gold trade or to suppress adverse audit findings. The DMCC said that all of its processes are consistent with international best practice, and that revisions of its guidelines were efforts to conform to international standards.

- Ernst & Young denied turning a blind eye to the suppression of audit results and said that the findings of non-compliance were fully reported to the client and to the DMCC, whose regulatory standards it independently applied at all times. The firm refuted any claim that Ernst & Young Dubai acted in a manner not compliant with the Ernst & Young Code of Conduct.

2013: TIMELINE OF EVENTS RELATING TO DUBAI GOLD AUDITS

WHAT IS CONFLICT GOLD AND HOW CAN IT BE STOPPED?

In eastern Democratic Republic of Congo (DRC), foreign and Congolese armed groups and members of the Congolese army have made millions of dollars through illegal control of the minerals trade in a conflict that has lasted for almost fifteen years. In recent years, gold has played a more prominent role in fuelling conflict in eastern DRC. This is largely due to a steady reduction in other major sources of revenue for armed groups – tin, tungsten and tantalum – following reforms spurred by the US Dodd Frank Act's conflict minerals provision.

A recent mapping of tin, tantalum, tungsten and gold mining areas in eastern DRC shows that armed actors illegally tax the trade in more than half the sites.[4] Because gold mines are numerous and often remote, and gold is easy to conceal and smuggle, DRC's gold sector has been largely unaffected by reforms.

Global Witness investigations in November 2013 showed that Dubai is the main destination for Congolese gold laundered through Burundi. Over 70% of the gold exported from Burundi comes from the southern part of eastern DRC, where the majority of gold-mining areas are controlled by notoriously abusive rebels.[6] Gold that funds armed groups in the northern part of eastern DRC transits via Uganda, and much of this makes its way to Dubai as well.[7]

INDUSTRY CROSS-RECOGNITION

The outcome of Dubai conflict gold audits may have far-reaching implications. US-listed companies required to comply with the Dodd Frank legislation are seeking out responsible trading partners and rely on industry certification schemes like the Responsible Jewellery Council (RJC) to support their due diligence efforts. In October 2013, the RJC signed a cross-recognition agreement with the DMCC. This means that RJC members – including companies like Tiffany & Co, Cartier, Signet and JC Penney – can automatically market gold sourced from DMCC accredited refiners as conflict-free.[5] The Electronics Industry Citizenship Coalition (EICC), an industry association that initiated an auditing programme for smelters and refiners, is also discussing cross-recognition with the DMCC.

Sudan's Darfur province has also recently witnessed outbreaks of conflict between rival militia over the control of artisanal gold mines. Fighting over the Jebel Amer gold mine has reportedly killed over 800 people and displaced up to 150,000 others since January 2013.[8] One report stated that Dubai is often the final destination for Darfur's gold.[9]

Ensuring that major refiners operating in Dubai are buying clean metal is an essential part of curbing the trade in dirty gold. Much of the debate around how companies can avoid trading in conflict minerals has centred on due diligence. By checking their supply chains and dealing with risks that arise – in other words, doing due diligence – companies can ensure that they are not contributing to conflict or human rights violations through their purchases.

The Dodd Frank Act, passed by the US Congress in July 2010, requires US-listed companies using minerals, including gold, from DRC and neighbouring countries to show that they have done due diligence on their supply chains.[10] Guidance developed by the UN Security Council and the Organisation for Economic Cooperation and Development (OECD), published just a few months after the US law, spells out for companies what this due diligence on mineral supply chains should consist of.[11]

The DMCC's Practical Guidance for Market Participants in the Gold and Precious Metals Industry, which Kaloti was being audited against, is based on the OECD Due Diligence Guidance.[12] Both the DMCC and OECD guidance include provisions for company management systems, risk assessment and mitigation, independent audits and public disclosure.

MAJOR COMPLIANCE FAILURES BY KALOTI

The failures outlined in the leaked Ernst & Young management report suggest that during the review period Dubai's largest gold refiner, Kaloti, did not have sufficient controls in place to ensure that conflict gold was kept out of its supply chain or to prevent suspicious transactions.[13] The audit, carried out by an Ernst & Young Dubai team and covering Kaloti's 2012 operations, was commissioned by the refiner as part of its application of the DMCC's due diligence guidance.[14] The purpose of the auditor's management report is to privately inform the refiner and the regulator of compliance risks.

Kaloti is the largest gold processor in the Middle East with the capacity to refine 450 tonnes of gold per year, reportedly set to increase to nearly 1,400 tonnes when a new factory is completed in Dubai in 2015.[15] With the expansion Kaloti will become one of the biggest gold refiners in the world.

While implementation of the DMCC's due diligence guidance is not a legal requirement, it is mandatory for refiners who want to be on the DMCC's Dubai Good Delivery List.[16] 'Good Delivery', set by individual gold exchanges, specifies the physical characteristics of gold bars and acts as a benchmark of quality for buyers. According to the Ernst & Young engagement letter, Kaloti requested to be audited against the London Bullion Market Association's (LBMA) Responsible Gold Standard, as well as the DMCC's guidance.[17] The LBMA is a London-based international trade association regulating the London Good Delivery List for gold. Kaloti is an Associate Member of the LBMA and a successful audit would represent a step towards full membership and a spot on the much sought after London Good Delivery List.[18]

SUSPICIOUS CASH TRANSACTIONS

According to the management report prepared by Ernst & Young for Kaloti, nearly 45% of the refiner's transactions in 2012 by value, worth over US$ 5.2 billion, were cash transactions.[19] Several deals were worth over US$ 3 million each.[20]

The report also indicates that 1065 cash transactions, amounting to 2.4 tonnes of gold and worth over US$ 100 million, were carried out without conducting proper due diligence on the suppliers.[21] Other cash deals involved purchasing hand-carried gold from high-risk suppliers from Sudan and buying gold coated with silver from Morocco.[22]

These types of transactions raise risks related both to money-laundering and conflict financing and should have triggered additional checks by the refiner. The management report states that the refiner did not assess risk in proportion to the increasing value of cash transactions. There is no indication in the report that Kaloti reported any of its 2012 cash transactions to the regulator in Dubai.[23]

DUBAI AND MONEY LAUNDERING

Dubai has emerged as a hub for money laundering. For example, a significant portion of the US$ 935 million looted from Afghanistan's Kabul Bank ended up in Dubai. The amount stolen from the bank amounted to approximately 6% of Afghanistan's GDP.[24] In another case, some of the money allegedly stolen by Russian officials in a major scandal that led to the death of the lawyer who had been investigating the theft is thought to be sitting in Dubai.[25] The US State Department has explicitly pointed to the gold and diamond trade as being areas in which the UAE is vulnerable to money laundering.[26]

Cash transactions can be linked to money-laundering because, unlike bank transfers, they generally require far less information about the people involved and where the money is being sent. Cash transactions above a certain value present a greater risk, which is why the DMCC's Anti Money-Laundering Policy requires member refiners to report suspicious transactions above AED 40,000 (US$ 11,000).[27] This is in line with standards set by the international

© Mohamed Nureldin Abdallah/Reuters/Corbis

Gold mine workers wait to get their raw gold weighed at a gold shop in the town of Al-Fahir in North Darfur, September 24, 2013.

Financial Action Task Force (FATF) in order to reduce the risk of money-laundering and terrorist financing.[28] The OECD Due Diligence Guidance includes the same recommendation.[29] Cash transactions can also make it easier for material that has funded conflict or human rights abuses to enter supply chains.

The management report notes that by June 2013, as the initial audit was coming to a close, the company was seeking to reduce cash transactions and informing clients to make bank transfers.[30] A follow-up management report covering the period August to October 2013, also prepared by Ernst & Young indicates that in mid-2013 Kaloti signed an agreement with a Dubai bank, in order that transfers could be made from the refiner's account into suppliers' bank accounts and direct cash payments avoided. Kaloti commissioned the follow-up review after being found non-compliant in the first audit, as required by the DMCC guidelines.[31] No evidence of money laundering was ever found, rather that the refiner needed to tighten procedure to eliminate risk.

RED FLAGS IGNORED

High-value cash transactions, the ore's country or mine of origin, and certain classifications of gold can constitute risk factors and should prompt refiners to increase due diligence efforts where they arise. In other words, this is about identifying and responding to circumstances where gold is more likely to have funded conflict or human rights abuses. The DMCC due diligence guidance calls on refiners to carry out an in-depth review of all risky or 'red-flag' locations and suppliers, and to conduct enhanced due diligence on such suppliers prior to engaging with them.[32]

According to the initial management report and to audit notes seen by Global Witness, the audit team found several instances in which Kaloti apparently failed to do sufficient due diligence around significant risks which arose in 2012.

- Kaloti did not carry out proper checks on several tonnes of gold from Sudanese suppliers, even though the company's own assessment system categorised the gold as high-risk.[33] According to the management report, the refiner also failed to carry out enhanced due diligence on another 2.4 tonnes of gold, supplied by over the counter 'call customers' paid with cash.[34] The follow-up audit report indicated that Kaloti had stopped accepting gold from these customers and was conducting enhanced research on high-risk suppliers, including those from Sudan.[35]

- Kaloti classified mined gold (new metal coming out of the ground) as scrap gold (recycled or scrap gold coming from jewellery or second hand electronics) in 2012.[36] Gold mined in conflict-affected areas like eastern Congo can be concealed in scrap bars in order to disguise its origin. From May 2013, mid-way through the initial audit, Kaloti began to visually segregate mined gold from scrap metal, though the audit team recommended the use of an X-ray gold tester to ensure accuracy.[37] The follow-up audit report highlighted the incorrect classification of gold in several instances by the refiner's suppliers, and noted the inadequacy of the visual segregation method.[38]

- Audit data shows that one of Kaloti's main Dubai-based suppliers in 2012 purchased gold from a company which the UN identified as linked to Congolese conflict gold. Kaloti's supplier sold the refiner around half a billion dollars' worth of gold in 2012, although the audit team only identified one transaction potentially related to Congolese supply chains.[39] According to Mr Rihan, the audit team raised concerns with Kaloti in March 2013 and recommended that enhanced due diligence be done on the supplier in question – documenting exactly where raw materials come from. The management report for the follow-up audit shows that in late 2013 Kaloti was still buying from this supplier although it also stated that the refiner had provided Know Your Customer documentation for the supplier.[40]

Global Witness subsequently obtained official Congolese gold export statistics from eastern DRC's South Kivu province for September to December 2013. The documents indicate that during this time, which overlaps with the August to September period covered by the Ernst & Young follow-up audit, Kaloti's supplier also bought gold directly from a Congolese exporter based in South Kivu, where a significant proportion of gold mines are controlled by armed groups.[41]

Global Witness research in 2013 indicated that some gold mining sites in South Kivu can even be taxed by more than one armed group at a time. In March 2013, Global Witness met with the Congolese exporter that, according to the trade statistics, sold gold to Kaloti's supplier. It was evident during the meeting that the exporter did not fully understand what due diligence consists of and, when asked about supply chain checks said to the Global Witness researcher, 'I don't get involved in that'.[42]

While there is no evidence that Kaloti bought Congolese gold that had funded conflict, the findings outlined above point to a substantial risk that such gold could enter the refiner's supply chains, unless rigorous checks are in place. This is particularly true in light of the weaknesses in Kaloti's approach to segregating scrap and mined gold identified during both audits, and underscores the importance of the refiner commissioning regular independent audits and ensuring that the results are fully transparent.

SILVER-COATED GOLD BARS

Ernst & Young's original audit found Kaloti to be in zero tolerance breach of the DMCC guidance for knowingly accepting gold coated with silver, exported by suppliers from Morocco who had used falsified documentation.[43] According to audit notes seen by Global Witness, Kaloti's management explained to the audit team that receiving silver-coated gold bars from Morocco was 'normal', due to gold export limits apparently in place in the country. The refiner reportedly accepted up to four tonnes of silver-coated gold.[44]

A zero tolerance breach is defined in the DMCC and LBMA audit guidance as 'evidence of falsification of documentation by the auditee and/or any supply chain participant, with the knowledge and acceptance of the auditee'. According to the guidance, the discovery of this type of non-compliance should trigger certain actions, including notification of the regulator – within 24 hours in the case of the LBMA.[45] Mr Rihan urged the Ernst & Young global leadership to make contact with appropriate stakeholders, including the LBMA, but the firm did not do so.

According to the follow-up management report, Kaloti did not receive any gold from Morocco during the second review period.[46]

Global Witness wrote to Kaloti to seek comment on the issues raised by the Ernst & Young audits. In its response, Kaloti stated emphatically that the company was never found by Ernst & Young to be funding human rights violations or sourcing from conflict zones, including DRC.

Kaloti declared that 'all allegations and implications relating to its non-compliance in the gold trade business are false and without any merit or substantiation' and that the company 'remains fully compliant'. The refiner also said that 'all non-compliance during the initial audit stage was related to a lack of specific Know Your Customer documentation and not to any findings of conflict gold in the supply chain'.

Kaloti said that it fully complies with all audit and regulatory requirements imposed by the DMCC.

THE DMCC: REGULATING TRADE OR PROMOTING BUSINESS?

The Dubai Multi Commodities Centre (DMCC) was established by the Government of Dubai in 2002 'to enhance commodities trade flows' and to develop Dubai into a global commodities hub. The DMCC is also regulator of the Dubai Good Delivery standard and has the role of enforcing rules, including the due diligence guidance for refiners.[47]

There appears to be a conflict in the dual role that the DMCC plays in both regulating and promoting the trade in precious metals. The desire to protect the Dubai gold industry from potential reputational damage may trump regulatory concerns, however, and could have provided a motivation for the DMCC's behaviour during the course of events covered in this report.

The DMCC strongly rejected allegations that they had acted in any way improperly or failed to properly apply responsible sourcing practices.

MOVING THE GOAL POSTS

According to documents seen by Global Witness, the DMCC amended its guidance to auditors during the period in which the audits were taking place. As a result, Kaloti's compliance report pertaining to Ernst & Young's initial audit was not published.[48]

The first set of changes to the Audit Review Protocol was issued by the DMCC at the end of June 2013, after the Ernst & Young audit team had shared their findings with the DMCC.[49] As a result of these changes:[50]

- The auditor is no longer required to give an overall compliance rating in its public-facing assurance report;
- Nonconformities which would previously have been deemed 'non-compliant low-risk' are now to be termed by the auditor as 'compliant with low-risk deviations', and refiners are instructed to report low-risk deviations as 'fully compliant' in their public-facing compliance report;
- Refiners found to be medium-risk non-compliant can now wait three years before commissioning their next audit, instead of being required to have one within 12 months; and
- The DMCC Review Committee, made up of international banks and other stakeholders, no longer takes part in determining the refiner's final rating. This removes another potential layer of scrutiny as the Committee no longer has access to the auditor's management report as a matter of course.

Individually, these amendments are unlikely to have a significant impact on any review process – and some of them are in line with the LBMA's guidance to auditors. Taken together, however, they could make the audit process less stringent and serve to reduce potential reputational risk to members.

The second and more significant change to the audit guidance was made after Ernst & Young carried out the follow-up review in late 2013. Shortly before the compliance report was published in November, a new version of the Audit Review Protocol was posted on the DMCC website. This latest version allows refiners to publish a 'consolidated' compliance report in the event of a follow-up audit.[51]

Under the earlier version of the audit guidance, both the original and the follow-up compliance reports written by Kaloti would have had to be published as separate documents. The change allows refiners to keep damaging findings confidential and risks removing a major motivation for responsible behaviour, namely public scrutiny.

The motivation for the DMCC to make these changes warrants further scrutiny. A representative of the DMCC sent an email to the Ernst & Young team asking whether the audit ratings would be more positive if the DMCC amended the review period from 2012, to first quarter 2013.[52] While the DMCC did not go through with this, in our view the approach is emblematic of the conflict between the regulator's duty to uphold standards, and its ambitions to boost trade in the emirate. At the very least, the introduction of less stringent guidelines by the DMCC midway through the first independent compliance audit of the Dubai gold sector is unfortunate timing.

The LBMA audit guidance, which like the DMCC protocol calls for a follow-up audit in cases of high-risk non-compliance, makes no reference to a consolidated report. The LBMA audit guidance also includes the requirement that high-risk non-compliant refiners should commission a follow-up audit annually until implementation improves.[53]

The DMCC said that the June 2013 changes to the review protocol were made in order to align it with the LBMA's audit guidance and other international regulatory standards, following a comparative study commissioned externally. The DMCC also said that with the application of emerging guidelines 'there would inevitably be a period of adjustment and areas requiring clarification' and that the changes made in November 2013 strengthened the protocol and 'additionally clarified the report process by introducing consolidated review reports'.

The DMCC rejected as false any suggestion that the changes made to the review protocol were intended to cover up serious non-compliance or avoid the publication of negative reports. The DMCC maintained that 'the amendments do not change the impact ratings, the review process or the findings in any way'.

A CLEAN BILL OF HEALTH

The consolidated compliance report published by Kaloti on 27 November 2013 following the DMCC's changes to the review protocol, outlines the steps taken by the refiner to meet the requirements of the DMCC guidance and refers to, but includes little detail about the original non-compliance or its scale. Kaloti makes no mention in the report of the zero tolerance breach of protocol related to the silver-coated gold.[54]

Even though Kaloti was following the DMCC's updated publication requirements in shelving the original audit findings, the fact remains that disclosure of these types of failings is very much in the public interest. Any responsible gold buyer would want to be made aware of such breaches in order to make informed business decisions.

Kaloti said that 'final findings [...] were published in accordance with the requirements of the regulator and [...] were consistent with global best practices and industry norms of compliance reporting.'

The DMCC said in a letter to Global Witness that Ernst & Young reclassified Kaloti's zero tolerance breach of protocol finding after the management report was submitted in September 2013. According to the DMCC, this was as a result of Kaloti disputing the finding, and led to the submission of another 'final' management report on 9 November 2013. The 9 November report, which Global Witness has not seen, apparently gave the refiner a high-risk non-compliant rating in the place of the zero tolerance breach. The DMCC rejected any suggestion

© Can Stock Photo Inc. / Philipus

The DMCC is headquartered in the Almas Tower, located in Dubai's Jumeirah Lakes Towers Free Trade Zone.

that they improperly influenced or interfered with the review process.'

It seems odd that a rating pertaining to findings from Kaloti's 2012 operations would be reclassified several months after the audit had apparently concluded. According to Mr Rihan, who was in touch with the audit team in late 2013, the team was not aware of the 9 November submission. It is Mr Rihan's view that reclassifying a rating and issuing a revised management report without involving the technical team that carried out the audit is highly unusual.

Ernst & Young claimed that 'at all stages of our engagement, the work (including drafting of reports) was undertaken by the EY Dubai team.'

ERNST & YOUNG'S ROLE

In theory, independent auditing is meant to promote responsible business and consumer and investor confidence by providing an objective check on a company's systems and practices. As such, it's important that the findings made by auditors – however negative – see the light of day. Although Ernst & Young was under no obligation itself to publish the results of Kaloti's initial audit, the firm's apparent acceptance of the DMCC's actions threatens the credibility of the review process. It also appears to contradict the firm's commitment to ethical business practices.

The company's own published code of conduct promises the highest ethical and professional conduct. It encourages employees to ask themselves, when faced with a difficult issue, whether they feel good about their choice and whether their decision 'is the most ethical among the possible alternatives'.[55] In this case, which saw damaging findings swept under the carpet, it might be asked whether the Ernst & Young global leadership took the strictest ethical approach.

© EY

Ernst & Young's aspirational logo and strapline.

Ernst & Young said that nothing supports the claim that Ernst & Young Dubai acted in a manner not compliant with the firm's Code of Conduct, in relation to the work done for Kaloti.

Mr Rihan raised concerns several times with Ernst & Young's management in the Middle East and in Europe during the audit process, highlighting the DMCC's conflict of interest and the risk of a cover-up.[56]

As of July 2013, members of the Global Executive body had taken over responsibility for deciding how to handle the issue. One London-based member of the firm's Global Executive body told Mr Rihan in an email that he had taken the lead in the company's investigation of the matter and had involved 'our Global COO, Global Practice Protection Leader, Global Head of Risk, Head of Legal for EMEIA and external legal advisors'. Ernst & Young's leadership expressed a commitment to resolve the issue, telling Mr Rihan that 'we are taking this issue very seriously' and 'all options are under active consideration'.[57] Mr Rihan even brought the matter to the attention of the Global Chairman and CEO twice by email.[58]

The cumulative impression given by the correspondence seen by Global Witness, and the accounts of Mr Rihan, is that despite these assurances the leadership at Ernst & Young were reluctant to rock the boat and escalate concerns to relevant stakeholders (such as the LBMA) about their client's compliance risks or the actions of the DMCC.

EXCERPTS FROM ERNST & YOUNG'S GLOBAL CODE OF CONDUCT[59]

- We are robust and courageous in our challenge to clients and are not afraid to deliver unwelcome information to them.
- We support our people and will withdraw from working for any clients that put our people under undue pressure or threaten them in exercising their professional duties.
- We reject unethical or illegal business practices in all circumstances.
- We avoid working with clients and others whose standards are incompatible with our Global Code of Conduct.
- We do not hide from or ignore issues.
- We maintain and affirm our objectivity and independence, recognizing that these are critical to our professional responsibilities.
- We reject inappropriate pressure from clients or others.

By deciding to sign a new agreement to carry out a follow-up audit for Kaloti, and by not terminating the engagement with the refiner after concerns about the DMCC's conflict of interest were raised, Ernst & Young's global leadership appears to have turned a blind eye.[60]

The global leadership also concluded that Kaloti's zero tolerance breach did not need to be reported to the LBMA, according to Mr Rihan. The justification given to him for the decision appeared to be based on a technicality: that the audit firm was not yet on the LBMA's list of recommended reviewers.[61]

In a letter to Global Witness, the audit firm gave a different reason for the decision, saying that it would have been improper for Ernst & Young Dubai to report to the LBMA because Kaloti is not a member of the LBMA Good Delivery List and therefore the LBMA is not a regulator of the refiner's activities. Ernst & Young said that their external advisors supported this view.

Neither argument holds water. Kaloti is an Associate Member of the LBMA, and the Ernst & Young engagement letter for the Kaloti audit specifies that the review should cover compliance with both the LBMA and the DMCC standard.[62] The LBMA audit guidance requires auditors to communicate any zero-tolerance non-compliance to the LBMA within 24 hours. Moreover, despite Ernst & Young not being a recommended LBMA service provider, a Swiss refinery that was (and remains) an LBMA Good Delivery List member commissioned Ernst & Young to carry out an audit of its 2012 operations.[63]

Independent verification is an integral part of the due diligence process and is essential to convincing international markets that Dubai-based refiners are selling clean gold. Evidence of unreported compliance risks could damage the confidence of investors and customers and if risks are unchecked, could undermine efforts to enhance regulation of and standards in the global natural resource trade. This in turn could mean that innocent civilians continue to suffer the results of conflicts that are driven or exacerbated by unregulated minerals trade; and resource-rich countries may be denied the possibility to develop as a result of legitimate business.

Ernst & Young said that EY Dubai did not turn a blind eye to the amendment of auditing requirements or become complicit in suppressing damaging audit findings. The firm said that the required reporting was undertaken in accordance with the DMCC's amended protocol, and that the changes made by the DMCC did not affect the scope and nature of Ernst & Young's audit work.

CONCLUSION

The problem of conflict minerals has been highlighted in UN, NGO and media reports for over a decade. In eastern DRC abusive warring parties have made millions of dollars through illegal control of gold and other minerals for almost fifteen years, while civilians bear the brunt of the violence.

Gold that has funded conflict in Congo and elsewhere is traded into global markets. Efforts to tackle the problem have focused in recent years on getting companies buying and processing gold to checks their supply chains and make sure risks of contributing to abuses, even indirectly, are identified and mitigated.

With the passage of the Dodd Frank conflict minerals provision in the US and regulatory action expected in Europe, the potential for a clean and regulated trade in natural resources to help lift countries out of conflict and poverty looks greater than ever. Efforts by the G8 and G20 to increase financial transparency, including around tax and company ownership, also herald the possibility of a fairer global trading system.

Dubai is a major hub for gold trading and refining, and has been repeatedly cited as a destination for conflict gold. As such, the Dubai government and companies operating there have a critical role to play in cleaning up the harmful trade by ensuring the robust implementation of due diligence.
The matters outlined in this report raise serious questions about whether Dubai is credibly fulfilling this responsibility.

Auditors like Ernst & Young play a major public interest role in providing assurance that companies are meeting important standards. If auditors cannot be relied upon to meet the highest ethical principles, then progress in breaking the links between natural resources and conflict could be undermined.

A child mines for gold in Watsa, Ituri province, Democratic Republic of Congo, October 2004.

RECOMMENDATIONS

@ Rudy Sulgan / Corbis

Jewellery at the Gold Souk in Dubai.

- Kaloti Jewellery International should release their unpublished compliance report for the first audit carried out by Ernst & Young, covering the refiner's 2012 operations.

- The DMCC should commission an independent investigation into the allegations outlined in this report and publicly report the findings and any corrective actions in their conduct and procedures.

- The DMCC should also revise its Audit Review Protocol to require the publication of all compliance reports and to ensure that in cases of zero tolerance and high-risk non-compliance, refiners are required to commission reasonable assurance audits within 12 months of the follow-up review.

- The Governments of United Arab Emirates and of Dubai should investigate the actions of the DMCC and any breaches of acceptable conduct, and address the conflict of interest in the DMCC's role as regulator and trade promotion body.

- The Dubai Financial Services Authority should investigate the DMCC for any breaches of Dubai's current Anti-Money Laundering regulations. Dubai Anti-Money Laundering legislation should be clarified to ensure that all precious metals dealers are required to carry out enhanced due diligence and seek adequate Know Your Customer documentation.

- Ernst & Young should commission an independent investigation into the allegations outlined in this report and publicly report the findings and any corrective actions in their conduct and procedures.

- Oversight bodies for audit and accountancy companies, such as the UK Financial Reporting Council, should examine whether Ernst & Young breached industry codes.

- The OECD should develop clear guidelines for audits carried in relation to the Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, and related standards. The guidelines should specifically include strong provisions relating to the public disclosure by companies of audit findings.

- Regulatory and industry bodies such as the DMCC, LBMA, RJC and EICC should review their audit guidance to auditors and ensure it meets the highest standards, particularly in relation to public disclosure.

- New rules should be considered for auditors to reduce the inherent conflict between safeguarding the public interest, and protecting client or commercial interests.

ENDNOTES

1 Kaloti Jewellery International DMCC (KJI) and Kaloti Jewellers Factory Ltd (the refinery) are subsidiaries of the Kaloti Group. KJI is responsible for the management of all aspects of the physical precious metals business in the UAE.

2 Please see: www.dmcc.ae/gold-overview and 'DMCC Spins New Silk Route', The New Jeweller, Issue XVIII 2013, thenewjeweller.com/tnjtv/Issues/UAE/UAE_18.pdf.

3 The Ernst & Young review team audited Dubai's three gold refineries. According to data gathered by the team, Kaloti refined 297 tonnes of gold in 2012, out of a total of 647 tonnes.

4 'Analysis of the interactive map of artisanal mining areas in Eastern DR Congo', IPIS, November 2013, www.ipisresearch.be/publications_detail.php?id=428.

5 Please see: www.responsiblejewellery.com/gold-refiner-audit-cross-recognition/; www.responsiblejewellery.com/files/News-Release-DMCC_DGD-RJC-announcement_22.10.13.pdf; and www.responsiblejewellery.com/files/S002_2012_RJC_CoC_Standard_PM.pdf.

6 Global Witness interviews with gold traders, journalists and representatives of civil society, Burundi, November 2013.

7 Final Report, UN Group of Experts on DRC, S/2011/738, 2 December 2011.

8 'Special Report: The Darfur conflict's deadly gold rush', Ulf Laessing, Reuters, 8 October 2013, www.reuters.com/article/2013/10/08/us-sudan-darfur-gold-idUSBRE99707G20131008; Sudan Briefing: the humanitarian situation in Darfur, IRIN, 15 August 2013, http://reliefweb.int/report/sudan/briefing-humanitarian-situation-darfur; 'Highlights of the noon briefing', Office of the Spokesperson of the Secretary-General, 16 January 2013, www.un.org/sg/spokesperson/highlights/?HighD=1/16/2013&d_month=1&d_year=2013.

9 'Special Report: The Darfur conflict's deadly gold rush', Ulf Laessing, Reuters, 8 October 2013, www.reuters.com/article/2013/10/08/us-sudan-darfur-gold-idUSBRE99707G20131008.

10 Dodd Frank Wall Street Reform and Consumer Protection Act, 2010, www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

11 'Due diligence guidelines for the responsible supply chain of minerals from red flag locations to mitigate the risk of providing direct or indirect support for conflict in the eastern part of the Democratic Republic of the Congo', UN Security Council, 2010, www.un.org/sc/committees/1533/pdf/due_diligence_guidelines.pdf; OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Second Edition', OECD, November 2012, www.oecd.org/daf/inv/mne/GuidanceEdition2.pdf.

12 'Practical Guidance for Market Participants in the Gold and Precious Metals Industry', Dubai Multi Commodities Centre, 2012, www.dmcc.ae/gold-responsible-sourcing-precious-metals.

13 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

14 'Clean Energy and Sustainability Services Engagement Letter – Assurance of Kaloti Jewellery International DMCC's due diligence practices for responsible sourcing of Gold in accordance with DMCC Guidelines', Ernst & Young, 26 February 2013.

15 'Business Close-Up: Kaloti Jewellery Group', MEED, 12-18 April 2013, www.kalotico.com/news/KJIMedia1.pdf; 'Kaloti begins work on world's largest gold refinery at DMCC', Lianne Gutcher, 9 December 2013, www.thenational.ae/business/industry-insights/economics/kaloti-begins-work-on-worlds-largest-gold-refinery-at-dmcc.

16 Please see: www.dmcc.ae/gold-dubai-good-delivery.

17 'Clean Energy and Sustainability Services Engagement Letter – Assurance of Kaloti Jewellery International DMCC's due diligence practices for responsible sourcing of Gold in accordance with DMCC Guidelines', Ernst & Young, 26 February 2013.

18 Please see: www.lbma.org.uk/pages/?page_id=64.

19 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

20 Transaction details are based on audit notes seen by Global Witness and the cost is calculated from the average price of gold in 2012, as set by the London Bullion Market Association, www.lbma.org.uk/pages/index.cfm?page_id=53&title=gold_fixings&show=2012&type=monthly.

21 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013 and audit notes from March 2013 seen by Global Witness.

22 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

23 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

24 Afghanistan government and Da Afghanistan Bank, Kabul Bank asset recovery, 31 March 2013, http://mof.gov.af/Content/files/AR%20Report_03_31_13_Kabul%20Bank-DAB%20fianl%20updates.pdf; and Global Witness, Inside Job: how crooks set up the largest bank in Afghanistan and then robbed it for almost $1 bn, 28 November 2012, www.globalwitness.org/library/inside-job-how-crooks-set-largest-bank-afghanistan-then-robbed-it-almost-1-billion; and Reuters, Corrupt money hides in Dubai, officials turn blind eye – Eva Joly, 13 December 2013, www.trust.org/item/20131213143038-zrhlb/?source=hptop.

25 Organised Crime and Corruption Reporting Project, Death of a lawyer, 31 October 2011, www.reportingproject.net/proxy/en/death-of-a-lawyer; and Reuters, Corrupt money hides in Dubai, officials turn blind eye – Eva Joly, 13 December 2013, www.trust.org/item/20131213143038-zrhlb/?source=hptop.

26 US State Department, 2013 International Narcotics Control Strategy Report, www.state.gov/j/inl/rls/nrcrpt/2013/vol2/204067.htm.

27 'Anti-Money Laundering & Combating the Financing of Terrorism Policy: G – 02' Dubai Multi Commodities Centre, September 2010, www.dmcc.ae/jltauthority/wp-content/

uploads/2011/07/G-02-AML-CFT-PP-20-September-2010.pdf, downloaded November 2013. Note that the policy no longer appears to be available on the DMCC website.

28 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations', FATF, February 2012, www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf, recommendations 22 and 23.

29 OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Second Edition', OECD, November 2012, www.oecd.org/daf/inv/mne/GuidanceEdition2.pdf, page 95.

30 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

31 'Management Report, Follow up review, Kaloti Jewellery International DMCC', Ernst & Young, 27 November 2013; 'DMCC's 'Review Protocol' on Responsible Sourcing of Precious Metals', DMCC, downloaded 6 February 2013, www.dmcc.ae/gold-responsible-sourcing-precious-metals, page 13.

32 'Practical Guidance for Market Participants in the Gold and Precious Metals Industry', Dubai Multi Commodities Centre, 2012, www.dmcc.ae/gold-responsible-sourcing-precious-metals, page 8.

33 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013, audit notes seen by Global Witness and testimony from Mr Rihan.

34 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

35 'Management Report, Follow up review, Kaloti Jewellery International DMCC', Ernst & Young, 27 November 2013.

36 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

37 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

38 'Management Report, Follow up review, Kaloti Jewellery International DMCC', Ernst & Young, 27 November 2013.

39 Audit notes seen by Global Witness; Final Report, UN Group of Experts on DRC, S/2012/843, 15 November 2012.

40 'Management Report, Follow up review, Kaloti Jewellery International DMCC', Ernst & Young, 27 November 2013.

41 Official Congolese government gold export statistics for South Kivu, September to December 2013, obtained by Global Witness.

42 Global Witness research in South Kivu, March 2013.

43 'Management Report, Al Kaloti Jewellers Factory Ltd', Ernst & Young, 29 August 2013.

44 Audit notes seen by Global Witness.

45 'DMCC's 'Review Protocol' on Responsible Sourcing of Precious Metals', DMCC, downloaded 6 February 2013, www.dmcc.ae/gold-responsible-sourcing-precious-metals, page 13; 'LBMA Responsible Gold Programme Third Party Audit Guidance', LBMA, Version 2 18/01/2013, www.lbma.org.uk/assets/LBMA_Third_Party_Audit_Guidance_v2FINAL.pdf, page 45.

46 'Management Report, Follow up review, Kaloti Jewellery International DMCC', Ernst & Young, 27 November 2013.

47 Please see www.dmcc.ae/dmcc-who-we-are and www.dmcc.ae/gold-dubai-good-delivery.

48 Email correspondence seen by Global Witness.

49 Email correspondence seen by Global Witness.

50 The following points are based on an analysis of the following versions of the DMCC's 'Review Protocol' on Responsible Sourcing of Precious Metals: 'Version 3 January 2013', 'Version 3, May 2013', 'Version 3.1, June 2013' and an undated version posted on the DMCC website in November 2013: www.dmcc.ae/jltauthority/gold/files/2012/10/DMCC-Review-Protocol.pdf.

51 DMCC's 'Review Protocol' on Responsible Sourcing of Precious Metals', DMCC, downloaded 6 February 2013, www.dmcc.ae/gold-responsible-sourcing-precious-metals, page 13.

52 Email correspondence seen by Global Witness.

53 'LBMA Responsible Gold Programme Third Party Audit Guidance', LBMA, Version 2 18/01/2013, www.lbma.org.uk/assets/LBMA_Third_Party_Audit_Guidance_v2FINAL.pdf, page 40.

54 'Management Report, Follow up review, Kaloti Jewellery International DMCC', Ernst & Young, 27 November 2013.

55 'Global Code of Conduct', Ernst & Young, www.ey.com/Publication/vwLUAssets/Ernst-Young_Global_Code_of_Conduct/$FILE/EY_Code_of_Conduct.pdf, 2013, page 13.

56 Email correspondence seen by Global Witness.

57 Email correspondence seen by Global Witness.

58 Email correspondence seen by Global Witness.

59 'Global Code of Conduct', Ernst & Young, www.ey.com/Publication/vwLUAssets/Ernst-Young_Global_Code_of_Conduct/$FILE/EY_Code_of_Conduct.pdf, 2013.

60 Documents seen by Global Witness.

61 Email correspondence seen by Global Witness.

62 'Clean Energy and Sustainability Services Engagement Letter – Assurance of Kaloti Jewellery International DMCC's due diligence practices for responsible sourcing of Gold in accordance with DMCC Guidelines', Ernst & Young, 26 February 2013.

63 Please see: www.lbma.org.uk/pages/index.cfm?page_id=147 and http://193.104.238.24/sites/default/files/Pamp_Independent%20Reasonable%20Assurance%20Report_2012_0.pdf.

Global Witness investigates and
campaigns to prevent natural resource-
related conflict, and corruption and
associated environmental and human
rights abuses.

Global Witness
6th Floor, Buchanan House
30 Holborn
London EC1N 2HS
United Kingdom
Phone +44 207 492 5820
Fax: +44 207 492 5821

mail@globalwitness.org
www.globalwitness.org

ISBN: 978-0-9926910-3-5