

# THE KEY TO KIMBERLEY

# INTERNAL DIAMOND CONTROLS

## SEVEN CASE STUDIES

## INTRODUCTION

HUGE EFFORTS HAVE BEEN MADE BY ALMOST FOUR DOZEN GOVERNMENTS AND THEIR DIAMOND INDUSTRIES TO COMPLY WITH THE KIMBERLEY PROCESS CERTIFICATION SCHEME (KPCS) FOR ROUGH DIAMONDS. AUTHORITIES HAVE BEEN ESTABLISHED, CERTIFICATES PRINTED AND STATISTICS GATHERED. WHERE THE MOVEMENT OF DIAMONDS IS CONCERNED, MOST OF THE EMPHASIS HAS SO FAR BEEN PLACED ON INTERNATIONAL TRANSFERS BETWEEN COUNTRIES: TAMPER-PROOF CONTAINERS, FORGERY-RESISTANT CERTIFICATES, AND THE COMPILATION OF DATA REGARDING SHIPMENTS.

But the KP certificate is more than a physical description of what is in a parcel when it leaves one country and arrives in another. It *certifies* that the diamonds in each parcel are conflict-free. In order for a government to do this, it is required to “establish a system of internal controls designed to eliminate the presence of conflict diamonds from shipments of rough diamonds imported into and exported from its territory.”<sup>1</sup>

Beyond this simple wording, however, the KPCS has little to say on this critical issue, leaving each participating country to devise its own system of internal controls. These have been referred to in some countries as “chains of warranty”, or “chains of custody”. The World Diamond Council has issued a guide on how such chains might be handled by private sector companies, but their recommendations are voluntary, they are supplementary to the regulations of each participating country, and their writ has a limited reach, especially in diamond producing countries.

The KPCS is only as good as its ability to keep conflict diamonds out of the system. It is therefore extremely important that the certificates be more than a system of registered letters between countries. They must be guarantees that the goods contained in shipments are clean. It is essential, therefore, that producing countries maintain systems that allow them to track diamonds back from the point of export to the place where they were mined, to ensure that no additional goods have been added to the chain.

Trading countries must be able to track diamonds back from the point of re-export to the point of import, in order to be confident that nothing has been added to the chain. Establishing and verifying an auditable trail is therefore the key to a successful certification system – the “key to Kimberley”.

## THE STUDY

THIS STUDY OF KPCS-RELATED INTERNAL DIAMOND CONTROLS IS A JOINT PUBLICATION OF PARTNERSHIP AFRICA CANADA AND GLOBAL WITNESS. IT DESCRIBES “BEST PRACTICES” IN SEVERAL COUNTRIES. IT REVEALS SERIOUS WEAKNESSES AS WELL, WHICH - IF THEY ARE NOT CORRECTED - WILL COMPROMISE THE EFFECTIVENESS OF THE OVERALL KIMBERLEY PROCESS DIAMOND CERTIFICATION SYSTEM.

THE TWO ORGANIZATIONS WOULD LIKE TO THANK THE MANY DIAMOND AUTHORITIES AND PRIVATE SECTOR FIRMS IN ANGOLA, CANADA, BELGIUM, THE DEMOCRATIC REPUBLIC OF THE CONGO, GHANA, THE UNITED KINGDOM AND THE UNITED STATES FOR THEIR ASSISTANCE WITH THE RESEARCH, AND FOR COMMENTS ON EARLY DRAFTS.



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# SUMMARY

THIS STUDY EXAMINES INTERNAL CONTROLS IN SEVEN COUNTRIES: TWO OF THEM ARE MAINLY PRODUCERS OF ALLUVIAL DIAMONDS (THE DEMOCRATIC REPUBLIC OF CONGO AND GHANA); ONE HAS MIXED ALLUVIAL AND KIMBERLITE PRODUCTION (ANGOLA); ONE PRODUCES ONLY FROM KIMBERLITE MINES BUT IS ALSO AN IMPORTER (CANADA); AND THREE ARE TRADING COUNTRIES (BELGIUM, THE UNITED STATES AND BRITAIN).

In each case, the country in question has established elaborate systems, although these are implemented with varying degrees of effort. The most elaborate system is that of Belgium. Although still not fully operational, the Belgian diamond controls, supplemented by new anti-money laundering laws, could be a model for other trading countries, particularly as they have not imposed a huge burden on the industry. The American system is based largely on industry self-regulation, and offers another interesting model, although this report concludes that greater government oversight is required in order to provide confidence in the system's effectiveness. It is essentially a registered letter system, with little verification, so far, as to what is contained in the letters.

There are specific cases of “best practice” that deserve support and study, for possible emulation elsewhere. In the Democratic Republic of the Congo (DRC), the *Service d'Assistance et d'Encadrement du Small Scale Mining (SAESSCAM)* is an autonomous government body that aims to organise and assist the artisanal mining sector, creating cooperatives and providing training and small loans to artisanal miners. One of the main objectives is to track the flow of diamonds and to ensure that artisanal production is funnelled into the formal sector. In Ghana, registered exporters buy diamonds in what may be West Africa's first diamond bourse, in Accra. Payments are made on their behalf by a government agency, drawing on foreign exchange the firms have imported in advance. The system is transparent, competitive, and it avoids many of the problems associated with informal purchasing.

The most problematic area for internal controls, however, is found in countries where alluvial diamonds are produced by artisanal miners. Angola and the DRC are major artisanal alluvial producers and Ghana is a minor producer, but the problems are the same. In each country there is a good system for recording and formalizing the diamond trade prior to export. And systems for licensing dealers and recording transfers have been articulated back

through the system. But the trail runs cold one or two transactions upstream. There are, in fact, no effective controls in these countries that would prevent conflict diamonds, smuggled diamonds, or any other extraneous diamonds from entering the system.

The lack of controls in countries with artisanal alluvial diamonds is an old problem. The geographic and geological nature of alluvial diamonds, and their value in relation to the poverty of the countries where they are found, make this one of the most serious problems facing the effective implementation of the KPCS. This problem is what made Angola, Sierra Leone and the DRC vulnerable to conflict diamonds in the first place. It will retain its potential for destabilization in these countries, and in the diamond industry at large, until it is solved.

This report covers only seven of the 40-plus participants in the Kimberley Process. Where internal controls are concerned, there are undoubtedly good and bad practices in other countries. It is hoped that these studies will be helpful to governments in examining the effectiveness of their internal controls, and to review teams visiting not just these seven, but all KP participants — as examples of what *can* be done, and as pointers in making further recommendations for improvement.

Each case study in this report concludes with recommendations, although the larger issue of internal controls is one that the Kimberley Process Certification System must grapple with at a broader level. One part of a long-term solution is to treat the problems in countries with artisanal alluvial diamonds as a development rather than a regulatory issue: one with economics rather than police action as the solution. This is discussed in greater detail in a companion study, produced concurrently with this one by Partnership Africa Canada and Global Witness: *Rich Man, Poor Man — Development Diamonds and Poverty Diamonds: The Potential for Change in the Artisanal Alluvial Diamond Fields of Africa*.

## GENERAL RECOMMENDATIONS

The governments of all countries where diamonds are produced artisanally (DRC, Angola, Sierra Leone, Guinea, Ghana, Liberia and others) should:

1. Agree on a standard export tax on rough diamonds (three per cent is the most common levy) in order to stem cross-border smuggling for tax evasion purposes;
2. Consider establishing a centralized diamond bourse as Ghana has done, in order to ensure the security of diamonds and individuals, and to make monitoring more effective;



3. Require all cash to be imported through the formal banking system;
4. Require payments to diamond sellers to be made through the banking system, as in Ghana, not in cash;
5. Strengthen the training and funding of government monitoring bodies;
6. Consider the appointment of international inspection and audit firms to complement and help enforce local internal control regulations;
7. Consider establishing a reward system, as in Sierra Leone, for information leading to the confiscation of illicit goods;
8. Hold regular regional and international meetings to share information and experience;
9. Strengthen the enforcement of laws and increase the capacity of government bodies overseeing and implementing laws and regulations.

The governments of all countries that import and trade diamonds should:

1. Ensure that random independent government inspections are made of diamond trading, importing and manufacturing companies to ensure their compliance with Kimberley Process standards;
2. Require companies to develop management systems that ensure the effective operation of any self-regulation systems, and ensure that company audits are also checked on a random basis for accuracy and completeness;
3. Introduce a legally binding protocol, as in Belgium, to support systems of self-regulation.

## GHANA

### OVERVIEW

DIAMONDS DO NOT MAKE A SIGNIFICANT CONTRIBUTION TO THE GHANAIAN ECONOMY, AND GHANA HAS BEEN SPARED THE RAVAGES OF DIAMOND-FUELLED CONFLICT. BUT GHANA'S PROXIMITY TO COUNTRIES SUCH AS SIERRA LEONE AND LIBERIA HAS NOT PROTECTED IT FROM THE EFFECTS OF THESE CONFLICTS, PARTICULARLY IN TERMS OF REFUGEE DISPLACEMENT.

In 2003, Ghana produced approximately 927,000 carats, with an export value of US \$21.75 million. As with all other alluvial diamond producers there are significant problems in attempting to control the actual mine sites and the smuggling of diamonds. But Ghana's diamonds are of a relatively low quality, roughly \$20-\$25 a carat. This ensures that the more unsavoury elements of the diamond trade stay away due to the high volume of goods needed to make a valuable parcel. This also makes it relatively difficult to smuggle in and launder high quality gem goods.

Following the rebel takeover of diamond mines in northern Côte d'Ivoire in November 2002, some Abidjan diamond exporters moved to Ghana. Interviews carried out for this report with former Abidjan dealers indicated a concern that diamonds could now be entering Ghana from Côte d'Ivoire. This is made possible by the fact that diamonds from Côte d'Ivoire are similar in quality and value to diamonds from Ghana, although there are some distinct identification features.

### LEGISLATIVE FRAMEWORK

The Kimberley Process was implemented on 27 October 2003 through the Six Hundred and Fifty Second Act of Parliament and received by Presidential Assent on 24 October 2003. The legislative framework for mining in Ghana is laid down in the Minerals and Mining Law.<sup>2</sup> Within this framework, the State is the owner of all minerals occurring in their natural state within Ghana's land and sea territory. All minerals in Ghana are vested in the President on behalf of, and in trust for, the people of Ghana. Thus, regardless of who owns the land upon or under which minerals are situated, the exercise of any mineral right requires, by law, a license to be granted by the Minister for Mines.<sup>3</sup> The Law also spells out in broad terms the rights and obligations of a holder of a mineral right and the terms and conditions upon which each mineral right grant should be made. A mineral right granted is not transferable or tradable in any form except with the prior written consent of the sector Minister.

### THE PRECIOUS MINERALS MARKETING COMPANY

In 1989 the government established a parastatal organization, the Precious Minerals Marketing Company Ltd. (PMMC), to purchase minerals from small producers in an effort to stem diamond smuggling. Estimates suggested that as much as 70 percent of

Ghana's diamonds were being smuggled out of the country in the mid-1980s. In its first sixteen months of operation, the PMMC bought 382,423 carats of diamonds and sold 230,000 carats of diamonds worth US \$8 million.

The PMMC has gone through several marketing strategies. Diamonds were initially shipped to a PMMC office in Antwerp for sale, with the assistance of a consultant. This proved expensive and unprofitable. During the next stage, six buyers were invited to Ghana every quarter for tender sales, but this soon stopped due to the low prices being offered. Today there is an open market system in which registered buyers from India, Belgium, South Africa, the Far East and Israel operate from offices in Ghana, offering competitive prices. Licensed diamond traders are allowed to sell to whomever they like. In effect, this is West Africa's first diamond bourse and is a model that deserves study for possible use in other African diamond producing countries.

In order to become a registered buyer/exporter, the PMMC first ensures a company's financial credibility. Dun & Bradstreet (D&B) reports are required prior to the commencement of operations. All resident buyers must transfer US dollars through the Central Bank in advance for the purchase of diamonds. The sellers are paid immediately after sale at a bank in the Diamond House. Diamonds purchased by registered buyers are kept under lock in the custody of the PMMC, pending export. The diamonds are subject to inspection and valuation by the PMMC prior to export.

### ARTISANAL DIAMOND MINING, "GALAMSEY" AND THE BELGIAN MARKET

Currently there is only one large scale industrial mining facility. Based at Akwatia, it is operated by Ghana Consolidated Diamonds Ltd.

Artisanal diamond and gold mining in Ghana is widespread and is typified by a get-rich-quick mentality and a transient youth population. It is also:

- Largely poverty driven;
- Labour intensive; and
- It detracts from farming

In the 1960s local diamond miners sold diamonds to illegal diamond buyers, mainly from Nigeria, who smuggled them out to

neighbouring countries for sale. In 1963 the Diamond Marketing Board was established and rough diamond purchases and sales were to be channelled through the mainstream economy. In 1972 the Diamond Marketing Board became the Diamond Marketing Corporation and its role increased to the marketing of diamonds by both small scale artisanal miners and mechanised mining companies. This was followed by the creation of the PMMC.

As in many artisanal mining areas there is a considerable problem with illicit diamond mining – locally known as 'galamsey'. The main Ghanaian diamond mining town, Akwatia, has an informal diamond market appropriately known as the 'Belgian Market'. During a visit for this report, diamonds were readily available for sale, and an array of low quality diamonds was presented. No paperwork is necessary for the buying and selling of diamonds at this market. Diamonds are only for sale on Thursdays and Sundays.

### THE OFFICIAL BUYING AND SELLING PROCESS

The PMMC issues buying licences to Ghanaian nationals, the only people legally allowed to buy rough diamonds in the diamond mining regions. According to the PMMC there are approximately 1000 buyers registered, however approximately 200 are active.

As of February 2004 there were eight licensed diamond buyer/exporters all based in Diamond House in Accra. Each pays \$1500 a month for their export licence and they are assigned a target of \$150,000 a month. In order to purchase rough diamonds officially, one must fill out a Rough Diamond Purchase Voucher in triplicate. The voucher includes the registration number of the seller, his name, the number of carats purchased and the value. These records are open to inspection.

Diamond exporters place the money used to buy the diamonds into an account of the PMMC, which then pays the diamond sellers. It is therefore difficult to buy diamonds in cash, unless money is smuggled into the country. This system, unique to Ghana, is simple and transparent, and makes for good control of the cash flowing into the country for the purchase of diamonds. This is a "best practice" that could be emulated elsewhere.

Ghana Consolidated Diamonds Ltd currently sell their diamonds in Accra via tender. As of February the tender was averaging about 16,000 carats a month.

## THE EXPORT PROCESS

By law all diamonds are marketed through the PMMC. The PMMC has several duties in this regard, including valuations on export, and collecting a two per cent export tax. The PMMC covers all areas of the implementation of the Kimberley Process, including issuance of the Kimberley Process certificate. Exports take place every Tuesday, Thursday and Friday.

## CONCLUSION

Ghana has a small alluvial diamond mining industry. The PMMC is fully implementing the Kimberley Process, however there are insufficient resources to monitor and control illicit diamond mining and buying.

Additional points:

- Ghana's system for licensing buyer/exporters and for managing cash transactions could be a model for other countries where this aspect of the diamond trade has been problematic;
- There is the possibility of some smuggling of diamonds from Côte d'Ivoire into Ghana; these are *de facto* conflict diamonds, given the cessation of all official diamond exports from Côte d'Ivoire;
- There is some smuggling of diamonds out of Ghana, representing a loss of tax revenue;
- There is little control over the alluvial mining areas;
- Chains of custody are not being implemented from the artisanal mining areas to the point of export;
- It would be difficult and costly to place effective controls on the alluvial diamond mining areas. Economic solutions to illicit behaviour (i.e. better prices for diggers in the formal system) are likely to be more effective.

All weaknesses in implementation of controls pose a threat to the integrity of the Kimberley Process, and the factors outlined above suggest that a close watch should be kept on the volume and quality of Ghana's diamond exports and the system should be strengthened to ensure that it works effectively. Any significant increase in volume or per carat value could be an indication of more serious problems.

# ANGOLA

ANGOLA WAS THE FIRST COUNTRY TO IMPLEMENT A FULL CERTIFICATE OF ORIGIN FOR DIAMOND EXPORTS – FOLLOWING UNITED NATIONS SANCTIONS ON UNITA'S DIAMOND TRADING IN 1998 AND THE LAUNCHING OF INVESTIGATIONS IN 1999. THE FIRST UN REPORT ON SANCTIONS VIOLATIONS CONCLUDED THAT LACK OF MEANINGFUL CONTROLS WITHIN ANGOLA COULD FACILITATE UNITA'S TRADING OF ILLICIT DIAMONDS. THE GOVERNMENT INTRODUCED A FULL CERTIFICATE OF ORIGIN, SIMILAR TO TODAY'S KIMBERLEY PROCESS CERTIFICATES, AND IMPLEMENTED A MORE CONTROLLABLE SINGLE CHANNEL MARKETING SYSTEM AT THE BEGINNING OF 2000. THE OBJECT OF THESE CONTROLS WAS THAT THE EXCLUSION OF CONFLICT DIAMONDS SHOULD BE VERIFIABLE, REPLACING THE PREVIOUS "WIDE-OPEN SYSTEM".

The country became a test case for diamond control initiatives in government-controlled areas. These initiatives, never fully implemented, were monitored for their effectiveness by the UN, which ultimately concluded that "existing controls fall far short of those envisaged for diamond purchases",<sup>4</sup> although the UNITA command did not trade diamonds through ASCorp and had its own well established sales system.

It is estimated that there have been between 270,000 and 400,000 illicit miners in Angola during the last 12 years, at least 80 per cent of them Congolese by nationality. Many of these were brought in to mine for UNITA in the first instance. Numbers increased following the end of the war in 2002, and in December 2003, the FAA (*Forças Armadas Angolanas*), working with the national Police and Migration Services, was ordered to expel illegal aliens on the basis of threats to national security and territorial integrity.

## ASCORP AND SODIAM

In 1975, the Portuguese colonial diamond company, Diamang, was largely nationalized and in 1986 was replaced by the present state diamond company, Endiama. The 1994 diamond law gave Endiama "the sole rights of prospecting, research, exploration,

reconnaissance, treatment and marketing of diamonds within the entire national territory, or to any joint venture in which it participates.” At the end of 1999, Endiama transferred its marketing rights to a newly created 99 per cent Endiama subsidiary, *Sociedade de Comercialização de Diamantes (SODIAM)*, as a vehicle to represent majority state interests in ASCorp (an acronym for Angola Selling Organisation).<sup>5</sup> The ASCorp single channel was

Artisanal diamonds are now also channeled through SODIAM, which has opened buying offices in Luanda. It plans to open additional buying offices in the provinces in the near future, and says it aims to double diamond purchases from the artisanal sector to \$20 million a month.<sup>6</sup> The US diamond company, Lazare Kaplan International, has signed an agreement with SODIAM to support operations.<sup>7</sup>

## THERE IS, AT PRESENT, NO ASSURANCE THAT ANGOLA’S INTERNAL CONTROLS PREVENT DIAMONDS FROM LEAVING OR ENTERING THE COUNTRY ILLEGALLY.

conceived as the most effective means of regulating and controlling the industry from mine to point of export, providing a system that would tighten up Angola’s certificate of origin system, and ensure the exclusion of UNITA diamonds from internal trading systems.

When ASCorp’s contract ended in July 2004, control of exports has now passed to SODIAM, which will be the principal player in this aspect of Kimberley Process controls. The Minister of Mines has stated that the change to SODIAM — as the sole body responsible for diamonds sales — is part of a move to stop clandestine prospecting, in line with Kimberley Process requirements. SODIAM is now the official exporting authority and it prepares the Kimberley Process Certificates for each box of diamonds. Boxes are sealed once the price is agreed and the Kimberley Process Certificate attached. The designated signatories are the Vice Ministry of Trade and the Vice Minister of Geology and Mines. There are no official diamond imports into Angola.

Diamonds from the eight official Angolan mining operations presently producing are sent directly from the mines to SODIAM, where sales negotiations take place between the companies’ valuers, SODIAM and Diamond Counsellor International, the official valuator. Since these diamonds are, or should be sent in run-of-mine parcels, any anomalies in the parcel will be visible.

SODIAM then exports the diamonds to their final destination. Although ASCorp’s contact has ended, the same companies continue to buy from Angola. Seventy five per cent of the total production is exported to Leviev companies in Israel. The rest is exported mainly to the EU and Dubai, where SODIAM has a marketing arrangement with a subsidiary of Omega Diamonds.

### CONTROL MECHANISMS FOR MINERS AND BUYERS.

At present there is no system for determining the origin of diamonds from the artisanal sector beyond records of purchases kept by buying offices. This remains an incomplete paper-based system. The generic culture of this type of diamond buying has historically been that no questions are asked, with the objective of ensuring supplies of rough diamonds at the lowest possible prices.

Since the size of the artisanal sector is now being reduced by action against illicit miners and the forced expulsion of illegal immigrants, there will be less scope for such buying operations in future. If the government is successful in reducing numbers of miners to the proposed level of 10,000, which is improbable, the sector will not be able to support many internal buyers. Despite the expulsion of many illegal miners, it is estimated that there are still approximately 200,000 active in Angola. SODIAM has stated that approximately \$2 million worth of diamonds are being smuggled out of Angola every month at present.

Proposed control mechanisms for the remaining artisanal miners have yet to be put in place. One will require small miners to dig only on the fringes of industrial mines, which will control the miners. But diamond deposits exist in areas where no mining companies currently operate and it is not clear how such deposits will be protected.

Although it is intended that all miners will be registered, it is not yet evident what internal controls and licenses are planned for the buying structures in order to establish a chain of warranties from mines to the buying office.





As an essential part of the previous chain of control, ASCorp licensed ‘*colaboradores*’ (sub-buyers) who were security checked and approved by Angolan authorities, including Endiama, to ensure they had no UNITA linkages. Credentials were issued for a period of three months and had to be renewed quarterly. *Colaboradores* also signed a contract with ASCorp for a fixed quota of diamonds and were allowed to operate only in the geographical area defined by the license. Possession of diamonds without credentials was also made illegal.

ASCorp found that the optimum number of licensed *colaboradores* was 250 but by mid 2004, some 3,000 illicit West African middlemen had been arrested and deported. These middlemen bought from the diggers and sold to buying offices, or they smuggled goods out of the country. The size of these groups suggests that the level of smuggling from the illicit sector into neighbouring countries such as the Democratic Republic of the Congo and the Republic of Congo has been high. New border posts are expected to aid in reducing smuggling and the movement of illegal miners.

A computer-based control system for registering middlemen in government controlled areas, initiated in 2000, was never fully implemented, and the license for the system expired in May 2003. While this was in part due to the end of the war and the lifting of sanctions, it is clear that control *systems* could not work in the presence of an increasing number of foreign illegal miners, and were abandoned in favour of a more draconian solution to this problem. With the end of conflict in Angola, the problem is now to control smuggling into neighbouring countries and world markets, as well as providing the required internal controls within Angola. Reverse flows of diamonds from the DRC were seen when the trading of diamonds for dollars was banned in the Congo, and continuing conflict there could lead again to smuggling into Angola.

## THE CSD

Part of the responsibility for this lies with a new body responsible for implementing controls on the ground. Gazetted in December 2003, the *Corpo Especial de Fiscalização e Segurança de Diamantes* (CSD) has a role which encompasses diamond security at every level of the system. Its remit is to:

- Follow up the activities of companies involved in the prospecting, exploitation, buying and trading of diamonds, as well as the gathering of information;

- Propose and put in place measures to detect groups and individuals involved in the illegal mining and trafficking of diamonds. The CSD will train and set up an anti-smuggling unit;
- Oversee the movements of money related to diamond trading and oversee the physical security of diamonds being moved or sorted;
- Recommend juridical and administrative measures which contribute to the stability of the sector;
- Produce global analyses on the development of the market, as well as conditions on the ground in the mining regions;
- Conduct studies on national and international markets and provide advice related to the trading of the Angolan diamonds.

This very broad mandate ranges far beyond questions of smuggling and Kimberley Process compliance, and gives the CSD a crucial role in diamond policy making. The CSD reports to the SINFO, Angola’s co-ordinating intelligence organ, rather than to the diamond authorities.<sup>8</sup>

A further element to the restructuring of the CSD has been suggested: resurrecting the security system that operated in Angola in the 1980s and which worked relatively well, but under much less difficult conditions. Under this system, 50 pairs of inspectors, one Angolan and one international, worked together to monitor and oversee buying offices and buyers, gathering information on artisanal mining and smuggling.

## CONCLUSIONS

There is, at present, no assurance that Angola’s internal controls prevent diamonds from leaving or entering the country illegally. New controls and stronger internal chains of warranty are being developed, but they have yet to prove themselves capable of dealing with the intractable issues of illicit mining and trading, including the involvement of FAA officers. The transition from one diamond control system to another needs to be ended as quickly as possible. Issues of weak governance of the industry are problematic and have been also been highlighted by the IMF and others.

The policy during the war years was to legalize small miners, to license buyers, and to bring order into the diamond regions slowly, using non-military methods. This was only partially completed and may never have been fully possible, given the large

numbers of illegal miners and buyers. The more dramatic methods now being used, if successful, may help Angola to meet Kimberley Process standards. These come at a human cost, however, and it remains an open question as to how the new systems will work to control illegal mining and create a more secure, just and credible artisanal mining and trading environment in the process.

## RECOMMENDATIONS

The Government of Angola should:

1. Consider reintroducing the security tracking system (or similar) implemented by ASCorp in 2002 and 2003;
2. Consider the appointment of international inspection and audit firms to complement and help enforce local internal control regulations;
3. Conclude the transition from past regulations to the new system as rapidly as possible;
4. Immediately end the violence associated with the expulsion of foreign diamond workers and seek ways to ensure their orderly and safe repatriation.

# THE DEMOCRATIC REPUBLIC OF THE CONGO

## BACKGROUND

DIAMONDS FROM THE DEMOCRATIC REPUBLIC OF THE CONGO HAVE NEVER BEEN SUBJECT TO UN SECURITY COUNCIL RESOLUTIONS CLASSIFYING THEM AS 'CONFLICT DIAMONDS', HOWEVER THE ROLE OF NATURAL RESOURCES, INCLUDING DIAMONDS, IN FUELLING THE DEVASTATING CONFLICT IN THE DRC HAS BEEN WELL-DOCUMENTED.<sup>9</sup> THE DRC IS CURRENTLY HOLDING ONTO A FRAGILE PEACE AFTER FIVE YEARS OF WAR, WHICH ENDED IN 2003. THE EAST OF THE COUNTRY IS STILL FAR FROM PEACEFUL, AND TWO RECENT COUP ATTEMPTS DEMONSTRATE THE FRAGILITY OF THE CURRENT TRANSITIONAL PROCESS.

The DRC is one of the world's biggest producers of diamonds by volume, and deposits can be found in every province, in a country three times the size of France. The vastness of the country, its

9000 km border with nine countries, its huge artisanal mining community, its established smuggling networks and its reliance on the informal economy, all make its diamond industry extremely difficult to control. An example of this can be found in the expulsion of neighbouring Republic of Congo (not a diamondiferous country) from the Kimberley Process in July 2004. This had an immediate and positive effect on official exports from the DRC, which increased markedly that same month.

Corruption is a major concern at all levels in the DRC. However, serious and positive efforts at change are being made by the Centre of Evaluation, Expertise and Certification (CEEC), the body set up to implement Kimberley Process standards and regulations. The international community has also made some attempts at addressing the problem, but much remains to be done.

## DIAMONDS IN THE DRC

The diamond industry in DRC is made up of two industrial companies mining kimberlite pipes – the parastatal MIBA, formed in the 1960s, and Sengamines, set up in 1999. There is a small number of semi-industrial operations, predominantly in Tshikapa, in Kasai Occidental. Many of the difficulties in controlling the industry are related to artisanal mining, a largely informal and unregulated activity which is notoriously hard to control. In the DRC, the number of artisanal diamond miners is estimated at 700,000.

## LEGISLATION

The Kimberley Process Certification Scheme is implemented according to Ministerial Decree Number 193, dated 31<sup>st</sup> May 2003, 'In Respect of the Implementation of Kimberley Process in DRC'. The mining sector is regulated by the Mining Code, specifically Law No. 007/2002 of July 11 2002 relating to the Mining Code, and the accompanying regulations contained in Decree No. 038/2003 of 26 March 2003 relating to the Mining Regulations, drafted with the assistance of the World Bank.

## FLOW OF DIAMONDS FROM MINE TO EXPORT

According to official estimates, 80 per cent of DRC diamonds by value, and 70 per cent by volume come from alluvial deposits that are mined artisanally. Artisanal miners, known as 'creuseurs',





sell diamonds on to middlemen, known as ‘traffiquants’ or ‘négo-ciants’, who then sell to the licensed exporters or ‘comptoirs’. Artisanal miners may work independently, in a collective, or they may be supported by middlemen. Middlemen may then sell on to other middlemen, who will finally sell a larger parcel on to ‘comptoirs’. Nationwide it is estimated that diamonds, mined by up to 700,000 diggers, are sold on to approximately 100,000 middlemen, finally reaching 12 licensed *comptoirs* which export the diamonds. Approximately 80 per cent of the diamonds are sent to Antwerp.

## CADASTRE MINIER AND THE CEEC

According to the 2002 Mining Code, the *Cadastre Minier* – an autonomous government body associated with the Ministry of Mines – is responsible for processing applications for mining titles. Both MIBA and Sengamines are currently in discussions with the government regarding compliance with the Code. All other operations, however, including semi industrial and artisanal, must apply to the *Cadastre Minier* for concession areas. After proof of their financial capacity, and submission of an application form, individuals or companies are allotted their concession area. In many cases, however, areas are being mined that have not been officially sanctioned.

The Centre of Evaluation, Expertise and Certification (CEEC) was established in 2001 as a public service, but since March 2003 has functioned as an autonomous government body, charged by Presidential Decree with implementing the Kimberley Process. The Ministry of Mines and the Ministry of Portfolio have formal oversight. Rather than having oversight of the whole process from mine to export, the CEEC supervises the work of *comptoirs* and the export process, ensuring that all parcels exported comply with the Kimberley Process.

## COMPTOIRS

The 12 licensed *comptoirs* have offices in the main diamond trading centres, although they are not yet fully established in Kisangani, where goods are still smuggled out to neighbouring countries. All of the *comptoirs*, with the exception of one Congolese operation, have parent companies in Brussels, and are Lebanese, Israeli, or Belgian-run.

Each *comptoir* must be licensed, at an annual fee of \$250,000, and the Ministry of Mines sets monthly performance targets for them, which in July 2004 was \$5 million. The mining code and regulations stipulate that the maximum number of buyers allowed on one export licence is ten, but additional buyers can be added to the licence for an extra cost. This law was written to allow for a few extra buyers, but one *comptoir* interviewed for this report had almost 50 buyers. The higher the number of buyers on one licence, the harder it is for the CEEC to provide effective oversight.

One official from the CEEC and one from the Ministry of Mines are present in each *comptoir* buying office during its opening hours, keeping records of all purchases. This takes place in Kinshasa and in the five provincial diamond trading centres where the CEEC has offices. As a security measure, officials are rotated to ensure that they do not stay in one *comptoir* for any length of time. When a deal is made in a *comptoir*, a ‘*bon d’achat*’ is signed, of which there are five copies. The buyer keeps one, the seller keeps one, and the CEEC takes the remaining copies for its records.<sup>10</sup>

While the CEEC is present in the *comptoir* and keeps its own records, the Mining Code requires the *comptoir* to submit its own reports. *Comptoirs* have different levels of organisation regarding their paperwork, however. One *comptoir* visited for this report keeps daily records for every buyer it employs. These records were full and complete, and could be checked easily, while other *comptoirs* had cupboards full of disorganized papers.

After they are purchased, the goods are sealed in an official CEEC envelope and kept in the *comptoir* safe. When the *comptoir* wants to send a shipment to Kinshasa, the goods are reweighed, packed in a large envelope and shipped. The *comptoir* is responsible for its own security, but transportation has not been a problem.

The CEEC in Kinshasa weighs the goods again on arrival, and any serious discrepancies are investigated. This process is again witnessed by officials from the customs office, the OCC – the quality control office under the Ministry of Commerce and Portfolio – and a Ministry of Mines representative. These individuals are not diamond experts, but they provide some checks on the work of the CEEC. These officials are also rotated to increase security. The CEEC then sorts and values the goods, before they are reweighed by the OCC, customs and Ministry of Mines officials.

Before packing and sealing the goods into a bag with a wax seal, photographs are taken, which can then be sent along with the Kimberley Certificate, and any other information, to the country of import. After photographing, the goods are held in the CEEC safe. When the taxes are paid, the Kimberley Process Certificate is issued. Security companies such as Brinks transport the shipment to the airport, where customs officials make the final checks.

In addition, a ministerial order<sup>11</sup> requires that the origins of the funds be stated, and that all exports must be exported to the single destination indicated at the start of operations. Any changes must be justified. This control may help prevent money-laundering.

CEEC representatives are also present at the industrial operation, Sengamines, when shipments are being prepared. Alongside them is an official from the Ministry of Mines, the customs office (OFIDA), and OCC, a ministerial office dealing with quality control. After weighing, sorting and packing at the mine, the Sengamines production is sent to the CEEC Kinshasa where the same process is followed as with exports from the *comptoirs*. All official MIBA production also goes through the CEEC in Kinshasa prior to export, and is subject to the same oversight. Statistics from the two industrial mines are submitted monthly to the CEEC.

## INDEPENDENT COUNTER-VALUATION

Independent counter-valuation adds a further control prior to export. In May 2003 a new independent valuator, WWWSIDC, was appointed. That year, official diamond exports reached \$642 million, a 62.5 per cent increase in the value of exports over the previous year. This was due in part to higher levels of valuation – which addressed years of apparent under-valuation. In June 2004, the Minister of Mines halted the work of WWWSIDC, despite the fact that the valuator's contract is with the CEEC, a parastatal that reports to the Presidency. The result has been a loss of independent oversight as well as a loss of millions of dollars in foreign exchange, as demonstrated by a stagnant average price per carat during what is a strong market for rough diamonds.

## MINISTRY OF MINES

According to Article 117 (Title IV, Chapter 2) of the Mining Code all *négociants* must be licensed. *Négociant* cards cost \$500 and are renewable annually. Unlike *comptoirs*, the Ministry of Mines has supervision responsibilities for *négociants*. CEEC statistics state

that there are 100,000 *négociants*, ranging from small village operations using matchsticks to weigh diamonds, to *négociants* in major towns buying on a large scale. The number of *négociants*, as well as their established links with the informal sector, mean that oversight is difficult. Currently only a small fraction of *négociants*, and none interviewed for this report, had licences.

Title 10, Chapter 2, Article 250 of the mining regulations of April 2003 states that *négociants* are obliged to keep a daily register with information on the date, place, and name of the buyer or seller. The quantity of diamonds, their quality and the price paid should also be recorded. Every six months *négociants* are obliged to provide a report to the governor of their province, and the provincial Department of Mines. This is not being implemented. The provincial departments of mines do not have the capacity or funds to provide effective oversight of this kind of system. In Mbuji Mayi, Department of Mines officials claim that they regularly visit the offices of *négociants* based in town, but lack of transport makes it impossible to visit many others. One *négociant* interviewed for this report admitted that he ought to compile reports but that it was tiresome and nobody asked for them.

## CREUSEURS

The 2002 Mining Code provides relatively detailed regulation over artisanal mining. This has been welcomed as an attempt to bring this informal and notoriously unregulated activity into the formal sector. According to the code, artisanal mining is to be undertaken “within limits of a determined geographical area.” Further, “in the artisanal mining areas, only the holders of artisanal miners’ cards which are valid for the area concerned are authorized to extract . . . diamonds.” These cards or licenses cost \$25 annually.

The Ministry of Mines is responsible for the supervision of artisanal mining, but officials admit that it is extremely difficult to provide effective oversight over such a vast industry. Of the estimated 700,000 artisanal diamond miners, only a tiny fraction has been licensed. Of a possible 500,000 artisanal miners in Kasai Orientale, Department of Mines officials in Mbuji Mayi thought that perhaps 2000-3000 had licences.

There is therefore an unknown number of people working in a completely unregulated environment. Despite attempts to allow mining only in certain zones, diamonds are mined artisanally along roads, in fields and forests in a manner that is extremely hard to regulate. Miners move frequently from one area to another, and



they do not keep records of who they sell to. An initiative within the Ministry of Mines aims to address some of these shortcomings, and bring artisanal mining into line with the formal sector.

In March 2003, the *Service d'Assistance et d'Encadrement du Small Scale Mining* (SAESSCAM) was established by presidential decree, following a pilot project set up in 1999 in Tshikapa. It is an autonomous government body that aims to organise and assist the artisanal and small-scale mining sector, creating cooperatives and providing training, equipment, and small loans to artisanal miners. One of the main objectives is to track the flow of diamonds, as well as other minerals, from the mine to the point of sale. The intention is to ensure that artisanal production is funnelled into the formal sector, cutting down on smuggling and illicit sales. SAESSCAM currently operates in Tshikapa, working with two cooperatives and some semi-industrial operations, but it remains to be seen how this potentially good idea can be implemented effectively nationwide, considering the vast area and the numbers of people involved.

## RECOMMENDATIONS

The government of the DRC should:

1. Immediately reinstate the independent diamond valuator;
2. Ensure that the roles of the Ministry of Mines, the CEEC, and the *Cadastre Minier* are clearly established and demarcated to ensure that each is working most effectively on internal controls;
3. Require all diamond *comptoirs* to complete daily electronic buying records – these should include the amount and value of diamonds bought and details on each seller;
4. Ensure that the correct diamond taxes are levied and that the proceeds are distributed according to law in a transparent and effective manner;
5. End the practice of allowing additional buyers on a buying licence; the government should either increase the cost of the licence and/or the number of buyers. Regardless, it should enforce the law;

ON PAPER, THE DRC HAS A RELATIVELY COMPLETE SET OF CONTROLS...  
IN PRACTICE, THERE IS LITTLE KNOWLEDGE OF WHERE THE DIAMONDS ORIGINATE,  
OR EVEN WHETHER THEY WERE MINED IN THE DRC

## CONCLUSION

On paper, the DRC has a relatively complete set of controls, which theoretically allow it to check the chain of custody back through the system from each *comptoir*, through the *négociants*, to the individual who mined the diamonds in question. The system works relatively well from the purchase of diamonds at the *comptoir* level through to the export, with reasonably stringent checks and controls in place.

In practice, however, given the lack of control over the *négociant*/middleman link of the chain, and the almost complete absence of information about diggers, there is little knowledge of where the diamonds entering the chain at the *comptoir* level originate, or even, potentially, whether they were mined in the DRC, other than through physical identification of the stones.

Although strong efforts are being made to improve the system, a lack of capacity and funds makes control over *négociants* and diggers very hard to implement.

6. Ensure that all diamond miners and traders are licensed as required under the 2002 Mining Code;
7. Consider the appointment of international inspection and audit firms to complement and help enforce local internal control regulations;
8. Ensure that SAESSCAM is fully supported, and that positive outcomes are replicated in other areas;
9. Attempt to find ways for Congolese middlemen and diamond miners to gain access to formal sources of credit so they can enter the formal economy;
10. Carry out public information programmes on the radio to highlight changes in the Mining Code;
11. Ensure that the Ministry of Mines in diamond areas has the transport required to carry out its role effectively.

# EUROPEAN UNION

INTERNAL CONTROLS WITHIN THE EUROPEAN UNION FALL UNDER COUNCIL REGULATION 2368/2002 OF 20 DECEMBER 2002. THE REGULATION IS BINDING IN ITS ENTIRETY AND IS DIRECTLY APPLICABLE IN ALL MEMBER STATES. AN EC MANAGEMENT COMMITTEE, COMPRISING ALL MEMBER STATES, ASSISTS THE COMMISSION AND SERVES AS A FORUM FOR ENSURING CONSISTENCY AND COMPATIBILITY AMONG MEMBER STATES.

Primary responsibility for internal controls and for the issuance of a Kimberley Certificate for the export of rough diamonds lies with “Community Authorities”. At present, there are only three Community authorities, Antwerp, London and Idar-Oberstein in Germany (the latter as of August 2004). In Antwerp, the Community Authority is the Federal Public Service Economy; in Britain it is the Government Diamond Office, a part of the Foreign and Commonwealth Office, and in Germany it is the Hauptzollamt-Koblenz.

The Community authority may issue a Community (EC) certificate to an exporter that has “provided conclusive evidence that the rough diamonds for which the certificate is being requested were lawfully imported” in accordance with the EC regulation dealing with KPCS requirements.

The EC authority lists organizations “representing traders in rough diamonds which have established a system of warranties and industry self-regulation for the purposes of implementing the KP certification scheme”. Applications from members of these organizations for certificates may be “fast tracked”. Five organizations — four diamond bourses in Antwerp and the London Diamond Bourse and Club — applied for this authority, which was granted for the former in April and the latter in July 2003.<sup>12</sup> In their applications, each of these organizations were required to provide conclusive evidence that they will require their members to enact a series of procedures regarding invoices and the maintenance of records, and that each member will have its records certified for KPCS compliance by an independent auditor.

Exporters that are members of these five bourses can “fast track” their access to a KP export certificate and can submit, as conclusive evidence of lawful import into the Community, a signed declaration to that effect. This “fast tracking” system requires,

*inter alia*, that each company using it must “instruct an independent auditor to certify that [its] records have been created and maintained accurately and either that it has identified no transactions which failed to comply with the [KPCS] undertakings... or that any transaction which failed to comply... has been duly reported to the appropriate Community authority.”<sup>13</sup>

This system of industry self-regulation is backed by different procedures in each of the three existing EC authorities.

## BELGIUM

REGARDLESS OF THE PROCEDURES DESCRIBED BELOW, ALL ROUGH DIAMONDS ENTERING AND LEAVING BELGIUM MUST BE INSPECTED BY DIAMOND EXPERTS WHO ARE SWORN IN BY THE FEDERAL PUBLIC SERVICE ECONOMY (FORMERLY KNOWN AS THE MINISTRY OF ECONOMIC AFFAIRS). THESE INSPECTIONS ARE CENTRALIZED IN THE DIAMOND OFFICE, AND ARE PERFORMED UNDER THE SUPERVISION OF THE FEDERAL PUBLIC SERVICE ECONOMY. BELGIAN CUSTOMS OFFICERS ARE ALSO PRESENT IN THE DIAMOND OFFICE TO DEAL WITH CUSTOMS FORMALITIES. EACH DIAMOND PARCEL IS OPENED, AND ALTHOUGH THE INSPECTION IS CURSORY, IT IS ENOUGH TO SPOT ANY SERIOUS ANOMALIES IN THE CERTIFICATE DECLARATION.

### CODE OF CONDUCT

A detailed Code of Conduct has been developed by the four Belgian diamond bourses, with specific reference to the KPCS and in support of the EC Regulation. The Code of Conduct (completed at the end of 2002) spells out the roles and responsibilities of the Bourses and their members in respect of the KPCS. It provides for the establishment of an Arbitration Commission, a Code Board and a Code Appeals Board. It also contains detailed provisions for the investigation, suspension and sanctioning of members. Its provisions cover the audit requirement spelled out in the EC Regulation.

Each member of a bourse must sign the Code. Traditionally, members of a bourse are individuals, not companies. The rules



of the bourses have been changed in order to hold both companies and individuals accountable. One individual might own five companies, for example. In the case of a problem with one of the companies, the individual and all of the other companies may be held accountable.

Most Belgian diamond exporters are members of one of the four bourses. Membership in a bourse, however, is not compulsory, and companies may operate outside this system if they wish. In such cases, they are directly accountable to the Federal Public Service Economy (i.e. the Community authority), and must provide conclusive evidence of the source of the diamonds they wish to export at the time of each export (see also below). Only seven Belgian companies are currently not members of a bourse. Approximately 688 others are covered under the Code.<sup>14</sup>

## WHEN FULLY IMPLEMENTED, BELGIAN CONTROLS SHOULD PROVIDE AN EXCELLENT MODEL THAT COULD BE CONSIDERED BY OTHER PARTICIPANTS IN THE KIMBERLEY PROCESS.

### MONITORING PROTOCOL

During the first half of 2004, the diamond bourses, the HRD and the Federal Public Service Economy negotiated a “protocol” which gives legal authority and greater specificity to the Code of Conduct. It details the obligations of the four diamond bourses in respect of their members with regard to KPCS reporting. It also states that bourses will oblige their members to commission an independent inspector to certify that all of a company’s transactions meet the conditions in Article 17.2a of the EC Regulation. This is the regulation that describes the chain of warranties and the details required on invoices for each sale of rough diamonds. The protocol defines an independent inspector as “an auditor, accountant or bookkeeper working for a third party and legally recognized to exercise their profession.”<sup>15</sup> The Protocol became a legally binding instrument on Sept. 7, 2004, and the Federal Public Service Economy requested all members of the four bourses to submit their independent audit reports for 2003 by the end of the month. In future, companies will have until the end of March to submit reports for the previous calendar year. The Federal Public Service Economy intends to carry out spot checks of companies once the reports have been submitted.

### ADDITIONAL MEASURES

Belgian police and customs authorities have greater powers than the bourses and the protocol, and can go beyond these measures if they have a concern, or if they are requested to do so by the Federal Public Service Economy.

New anti money-laundering (AML) laws have been enacted requiring banks to verify the identity of clients when there are transactions of more than €10,000, and restricting cash transactions to amounts of less than €15,000.<sup>16</sup> These make the large cash transactions, which have been common to the diamond industry, a thing of the past, and they add an additional element of transparency to the KPCS.

In addition, a Royal Decree of 30 April 2004 requires new and more rigorous licensing of diamond dealers, both self-employed

individuals, and companies trading and cutting diamonds. The decree requires each dealer and company to specify its diamond stocks at the end of the year, along with all purchases and imports and all sales and exports. The law covers cutting firms as well as rough traders, and declarations must cover purchase price, carat weight before and after cutting, and the loss of carat weight in the cutting process.

### NON BELGIAN COMPANIES

Companies and individuals in other EC member states may import and export their rough diamonds only through a designated EC authority. At present, only Antwerp, London and Idar-Oberstein are recognized for this purpose. (When Poland, Hungary and the Czech Republic joined the EC in May 2004, their independent authority to import and export rough diamonds expired.)

Individuals and companies in other countries may belong to a Belgian diamond bourse, in which case they are obliged to comply with the Code of Conduct and the Protocol. The Protocol, however, is unlikely to carry the legal weight outside Belgium that it does inside the country.

Non-Belgian individuals and companies that are *not* members of a bourse may export their diamonds through the Diamond Office and must, on the occasion of each export, provide “conclusive evidence” that the diamonds in question meet KPCS requirements. They must also provide evidence that they have fulfilled all required formalities in their own country. The Belgian Federal Public Service Economy can contact the authorities in other EC member states to verify these details.

The Belgian government, however, says that it cannot require the audits that are required of Belgian companies.

## CONCLUSIONS

The system of industry self-regulation and the provisions for Belgian companies falling outside the system are detailed and rigorous. When fully implemented, they should provide the KPCS with confidence that the Chains of Warranty system and internal controls in Belgium are adequate. They provide an excellent model that could be considered by other participants in the Kimberley Process.

At the time of writing, the provisions had not been fully instituted. The first test will come with the results of the audits for 2003 and the way in which these audits deal with stock control. The government, the bourses and the HRD are not expecting any surprises. The most likely problem will be ensuring that all 688 firms and their auditors understand what is required, and ironing out what are likely to be a variety of difficulties and misunderstandings, with a view to a smoother application for calendar year 2004.

The routing of diamond exports from other EC countries through Belgium is more problematic. The rigorous reporting requirements for Belgian companies do not extend to those in other EC member states. These countries must follow the EC Regulation in respect of the KPCS, but the responsibility, upon export, to accept conclusive evidence of lawful import is delegated to the “Community Authority”, which is – in effect – the Antwerp Diamond Office and the Belgian Federal Public Service Economy. Because their actual authority to validate evidence is restricted to Belgium (plus whatever enquiries they can make of authorities in the exporter’s home country), two things occur. The first is a gap in the rigorous chain of warranties that applies to companies and individuals operating in Belgium. The second is the creation of a non-level playing field, something that justifiably concerns Belgian companies.

## RECOMMENDATION

In its role as a Community Authority, Belgium (and all other Community Authorities) should require the same levels of detail, transparency and verification of non-Belgian firms as it does of its own. If this is not forthcoming, it should refuse to issue KP certificates on their behalf. The EC should support and make this position clear to all EU member states.

# UNITED KINGDOM

THE BRITISH ROUGH DIAMOND BUSINESS IS SKEWED BY THE PRESENCE OF ONE VERY LARGE COMPANY, DE BEERS. ALTHOUGH THE LONDON DIAMOND BOURSE AND CLUB (LDBC) HAS 350+ MEMBERS, THERE ARE FEWER THAN A DOZEN ROUGH DEALERS, MOST WITH A FOCUS ON INDUSTRIAL DIAMONDS.

## CODE OF CONDUCT

The London Diamond Bourse and Club has modeled its Code of Conduct for members on the Belgian Code. Like the Belgian Code, it covers the auditing requirement contained in the EC Regulation. Although there have been discussions about annual audits of books by third-party auditors, there is so far no formal arrangement for this to take place on a regular basis. Interviews with London diamantaires yielded mixed reactions to the idea. Some said it would be “impossible”, while others suggested that some sort of random sampling of records could be done to provide greater assurance that the chains of warranty are being observed.

## OTHER MEASURES

The Government Diamond Office, which is part of the Foreign and Commonwealth Office, is responsible for the issuance of KP certificates and exports (Customs deals with imports). The Diamond Office has visited several of the exporters and has conducted spot checks on stocks, stock registers and invoices, using independent diamond valuers. Unlike the Belgian Diamond Office, which inspects all parcels before shipment, Britain uses a “risk analysis” approach. It builds up a profile on diamond and courier companies, using information from police and intelligence services, as well as information provided informally from the diamond industry itself.



Unlike Belgium, Britain requires diamantaires to pay VAT. This necessitates the maintenance of books on VAT collected and paid, along with the submission of accounts and payments. These books must tally with other financial records and are more likely to be inspected than other books of account. In addition, companies trading within the EC are required to submit “Intra EC Trade Statistics” which detail shipments to other EC countries by value and by consignee. These documents provide a paper trail that could be used for random sample KPCS checks.

As in Belgium, there are new British anti money-laundering laws which limit cash transactions to amounts of less than £10,000. This has changed the way many diamond companies do business.

### NON BRITISH COMPANIES

On occasion, the British Diamond Office has issued certificates for companies in other EC member states, notably Ireland, but also companies in France and Sweden. Acting on behalf of companies in other countries presents problems for both the companies and the British Diamond Office. The latter wants assurance that when it signs a KP certificate, the goods are what they purport to be. This has required either trips by British valuers to Ireland, or the shipment of goods through London. Both methods are costly and time consuming, but they are a necessary corollary to the EC approach to KPCS management.

### CONCLUSIONS RE UK

The small community of British rough diamond traders and the rigour applied to the KPCS by the Government Diamond Office

suggest that British internal controls are being well applied. The auditing provision, however, remains weak. Each member of the Bourse is to supply the Bourse with details of how it conforms with EC Regulation 17(2)a and that it has instructed independent auditors to “act accordingly”. The Bourse undertakes to facilitate the provision of relevant documentation from companies nominated at random by the GDO. This is considerably less clear and less rigorous than the provisions contained in the Belgian *protocol*. Direct spot checks of companies and company records by the GDO, however, add a feature that has so far not taken place in Belgium. Agreement on a stronger audit protocol in Britain would provide the KPCS with full confidence that the chains of warranty system and internal controls in Britain meet or exceed KPCS standards. As in Belgium, they would provide an excellent model that could be considered by other participants in the Kimberley Process.

### RECOMMENDATIONS

Audit provisions should be strengthened; the example of Belgium shows one possible way for Britain to do this.

As in the case of Belgium (and all other Community Authorities) Britain should require the same levels of detail, transparency and verification of non-British firms as it does of its own. If this is not forthcoming, it should refuse to issue KP certificates on their behalf. The EC should support and make this position clear to all EU member states.

## DE BEERS

IN ORDER TO ENSURE COMPLIANCE WITH THE EC REGULATION ON EXTERNAL AUDITS, DE BEERS INSTRUCTED ITS AUDITORS, ERNST AND YOUNG, TO CONDUCT A SYSTEMS ANALYSIS OF ITS CONTROL SYSTEMS FROM MINE TO FINAL SALES. MORE RECENTLY, IT CHANGED AUDITORS, AND ASKED THE NEW FIRM, DELOITTE TOUCHE, TO CONDUCT A STOCK AUDIT OF ITS LONDON OPERATIONS. THE AUDITOR HAS PRESENTED A DETAILED REPORT ON THE DIAMOND TRADING COMPANY’S COMPLIANCE WITH THE KPCS.

WHILE DE BEERS IS OBVIOUSLY NOT A TYPICAL DIAMOND COMPANY, THE AUDIT APPROACH – A RECONCILIATION OF OPENING STOCKS ON JANUARY 1 WITH CLOSING STOCKS ON DECEMBER 31 BY CARAT WEIGHT, AS WELL AS A REVIEW OF ALL SALES INVOICES FOR FULL KPCS COMPLIANCE – COULD BE CARRIED OUT IN A SIMILAR WAY BY OTHER AUDIT FIRMS ON MUCH SMALLER OPERATIONS. THE LETTER SUBMITTED BY THE AUDITOR PROVIDES PUBLIC ASSURANCE THAT KPCS-RELATED CONTROLS WITHIN THE COMPANY ARE BEING WELL MANAGED. AND THE DETAIL PROVIDED MEANS THAT A FURTHER INSPECTION OF THE COMPANY’S BOOKS CAN BE DONE WITHOUT GREAT DIFFICULTY BY THE COMMUNITY AUTHORITY IF REQUIRED.

# CANADA

WHILE CANADA HAS BECOME A MAJOR DIAMOND EXPORTER IN RECENT YEARS, ITS KPCS DIAMOND TRANSACTIONS ARE FEW IN NUMBER. IN THE FIRST EIGHT MONTHS OF 2004, IT ISSUED ONLY 120 KP CERTIFICATES, ABOUT ONE TENTH THE NUMBER ISSUED THE UNITED STATES – ITSELF A RELATIVELY SMALL PLAYER. OF THESE, 87 REPRESENTED SHIPMENTS FROM THE COUNTRY’S TWO DIAMOND MINES OR THEIR MARKETING ARMS PLUS LOWER-VALUE EXPLORATION AND LABORATORY SAMPLES. CERTIFICATES FOR DIAMONDS MINED IN CANADA ARE ISSUED IN CONJUNCTION WITH INSPECTIONS AND THE SEALING OF PARCELS, CARRIED OUT BY THE DEPARTMENT OF INDIAN AND NORTHERN AFFAIRS, CUSTOMS, AND CANADA’S INDEPENDENT VALUATOR. FULL INDEPENDENT AUDITS OF THE TWO PRODUCING COMPANIES ARE CARRIED OUT ON BEHALF OF THE GOVERNMENT OF CANADA FOR TAX PURPOSES.

Of the balance, the total value was approximately \$2.3 million in 2004. Some of these were gem or industrial diamonds being returned to the suppliers or “tops” resulting from the cutting process.

According to the KPCS-related Canadian legislation and regulations, exporters of diamonds not mined in Canada must provide the serial number of each KP certificate under which they were imported. In the case of diamonds that have been re-sold while in Canada, the exporter must still be able to relate exports to a KP import certificate. The Department of Natural Resources (NRCan) which issues KP certificates, compares the export data with the original imports to ensure that values and weights are reconcilable.

NRCan has carried out two inspection visits of small diamond companies. It has not, however, carried out any audits, and there have not been inspections of diamond re-exports to check whether the data on the KP certificate is accurate. In 2003, Canada imported \$703,820 worth of rough diamonds (HS Code 7102.31) from India, and exported almost \$200,000 to India. The per carat import value was \$162, and the export value was \$392. While this may be nothing more than the return of unwanted high-value gems or exports that are completely unrelated to imports, it could be something else. Without a modicum of inspection, the answer to questions like this is left to speculation.

The internal controls on diamonds mined in Canada are exemplary. This is possible, in part, because there are at present only two kimberlite mines operating in a remote part of the country. And the governmental controls applied to the diamonds as they move from mine to the point of export are rigorous. Where other diamonds are concerned, Canada’s diamond law gives the Minister of Natural Resources wide-ranging inspection authority. The Canadian government should make periodic random audits of Canadian diamond re-exporters, and should also carry out random inspections of goods at the point of export to ensure that they conform with shippers’ declarations on the KP certificate.

# UNITED STATES

US PARTICIPATION IN THE KPCS IS MANDATED BY THE CLEAN DIAMOND TRADE ACT OF JANUARY 2003, SIGNED INTO LAW BY EXECUTIVE ORDER 13312 OF JULY 29, 2003 AND SUPPORTED BY ROUGH DIAMOND CONTROL REGULATIONS ISSUED BY THE US TREASURY DEPARTMENT IN AUGUST 2003. ADDITIONAL REGULATIONS WERE INTRODUCED IN SEPTEMBER 2004.

The Clean Diamond Trade Act authorizes the President of the United States to “prohibit the importation into, or exportation from, the United States of any rough diamond, from whatever source, that has not been controlled through the Kimberley Process Certification Scheme.” To this end, companies and individuals (“any United States person”) are required to keep “complete information” relating to any transaction covered by the Act for at least five years, for review as required. The Act requires annual reviews of the standards, practices and procedures of any entity in the United States that issues KP certificates for the export of rough diamonds to determine whether they are in accordance with the KPCS.

The importing authority is the US Bureau of Customs and Border Protection, and the exporting authority is the Bureau of the Census which, in the US, has responsibility for trade statistics. The Act also established a Kimberley Process Implementation Coordinating Committee which includes the Treasury Department and the State Department as co-chairs, the Commerce Department, the US Trade Representative and the Department of Homeland Security. The State Department is the contact point for Kimberley Process enquiries, and acts as both coordinator within the US and interlocutor for other participating countries.



In order to ensure the legitimacy of rough diamonds being exported from any KP participant, each participating country must issue a KP certificate which asserts that the diamonds contained in the shipment are conflict-free. The US government works on the issuance of certificates with a registered non-profit body called the United States Kimberley Process Authority (USKPA).<sup>17</sup>

Licenses are issued by the USKPA to companies and freight forwarders on the basis of a legally binding contract which spells out details of the system and which requires the exporter to state that the diamonds in question are conflict free. Each export must be accompanied by an AES (automated export system) number which is entered on the KP certificate. Companies must register with the US Customs and Border Protection in order to be eligible to obtain AES numbers. The numbers are essentially a tracking device for all exports from the US. More recently, each AES number must now be accompanied by an Internal Transaction Number (ITN), required by the Transportation and Security Administration, a branch of the Department of Homeland Security. The ITN number is issued automatically with the AES number.

Each USKPA licensee must report monthly to the USKPA, which then forwards the reports to the State Department and the Census Bureau, on the use of the certificates in its possession, including the destination of each shipment, carat weight and confirmation of receipt. Each licensee must also submit an annual report. The USKPA in turn reports annually to the State Department, Customs and the Census Bureau.<sup>18</sup>

At the time of writing, there were fewer than 15 USKPA licensees in the United States, including three freight forwarders – Brinks, Ferrari Express and Malca-Amit. In the case of certificates issued by a freight forwarder, the AES and ITN applications will be made by the freight forwarder on behalf of the exporter, but liability continues to rest with the exporter.

The US KP certificate includes the following statement: “The issuer of this certificate accepts no responsibility relating to the accuracy of the data recorded by the exporter of the referenced shipment.” This is because the USKPA, which issues the certificates, does not examine the contents of parcels for export. Additionally, like most goods exported from the United States, diamonds are not subject to physical inspection by Customs, except on a random and infrequent basis. It is assumed that responsibility for checking the accuracy of data contained on a KP export certificate lies with the customs department of the importing country.

The USKPA has the authority to examine the books of licensees with regard to the use of certificates (and it does), but it is not

authorized to conduct stock or financial audits relating to rough diamonds. In other words, it does not audit the contents of transactions that are certified. Any audits of this nature are within the sole purview of government authorities.

The US Customs and Border Protection Department (which declined to be interviewed for this study), carries out random checks, and checks based on risk analysis, on all imports into the United States. Risk management concentrates on identifying and controlling events that have a potential to cause significant problems. In Customs trade terms, that means identifying imports, through statistically valid samples, that represent the greatest risk of non-compliance, and focussing resources on the imports. The key to risk management is to systematically isolate and treat risk identified through the trade compliance process. The upshot of this in the United States is that rough diamonds are rarely checked. While the Census Bureau has responsibility for exports, this is a reporting and coordinating role. The Bureau does not carry out any checks itself. Customs is authorized to check on exports, but rough diamond exports are almost never checked.

Between the point of import and the re-export of rough diamonds – the primary area of concern where “internal controls” are concerned – the terrain is less clear. The World Diamond Council (WDC) has issued an *Essential Guide to Implementing the Kimberley Process*, with provisions that have been accepted by a number of organizations, including those dealing with polished diamonds. For dealers wishing to export rough diamonds, the WDC Guide says the following:

ESSENTIALLY, YOU ARE REQUIRED TO MAINTAIN RECORDS OF WARRANTIES GIVEN AND WARRANTIES RECEIVED. IN ORDER TO RE-EXPORT, YOU MUST PROVIDE AN INVOICE COVERING THE SHIPMENT WITH THE REQUIRED INDUSTRY WARRANTY. AS A MINIMUM REQUIREMENT, IF ASKED BY A DULY AUTHORIZED GOVERNMENT AGENCY, YOU MUST BE ABLE TO DEMONSTRATE IN AN AUDITABLE MANNER THAT THE DIAMONDS CONTAINED IN THE SHIPMENT ARE COVERED BY THE NECESSARY WARRANTIES. EVERY YEAR, YOUR AUDITOR MUST BE ABLE TO VERIFY THAT YOU HAVE MAINTAINED ACCURATE AND RECONCILABLE RECORDS OF WARRANTIES RECEIVED AND WARRANTIES GIVEN.

# THE US SYSTEM, MANAGED TO A LARGE EXTENT BY THE DIAMOND INDUSTRY ITSELF, IS DIFFERENT FROM OTHERS AND HAS MANY FEATURES THAT COULD BE CONSIDERED FOR USE IN OTHER COUNTRIES. THE GOVERNMENT, HOWEVER, SHOULD PROVIDE GREATER SUPPORT TO THE SYSTEM BY TAKING A MORE PROACTIVE ROLE TO ENSURE THAT THE SYSTEM WORKS EFFECTIVELY AND THAT THERE ARE SUFFICIENT CHECKS ON INDUSTRY.

The guide spells out a general system for KPCS internal controls. Unfortunately – even if this system is widely observed – it remains voluntary, and government agencies do not use it as the basis for regulations, spot checks or verification.

## ADDITIONAL MEASURES

The USA PATRIOT Act, passed by the US Congress in October 2001, contains a wide range of anti-terrorism and anti-money laundering (AML) provisions. Where commercial enterprises are concerned, the Act requires companies to “know their customer”. In the case of buyers and sellers of rough diamonds, this will require companies to assess the risks of their business being used for money laundering. They will be obliged to have a written policy for assessing risks; they will have to appoint a compliance officer, train their employees and make “reasonable enquiries” where a risk may be perceived. There must also be “independent testing” to ensure the programme is working effectively. While there is no requirement under the Act for a company to report suspicious activity (unlike banks), it could be held legally liable for any breach of the law that is detected. The final regulations have not yet been issued by the Department of Treasury.

Because much of the diamond business is financed by bank credit, it is thought that banks are likely to be more demanding than in the past in respect of record keeping where AML laws are concerned.

## CONCLUSIONS

A total of 1,517 KP certificates were issued in 2003, compared with approximately 2,000 in South Africa and almost 7,000 in Israel. There is a small number of US companies dealing in rough diamonds and fewer than 15 exporters. Where rough diamonds are concerned, the US is therefore a medium-small player.

The system, managed to a large extent by the diamond industry itself, is different from others and has many features that could be considered for use in other countries. It has made American traders in rough diamonds, especially those that import and export, aware of the need to keep records and to provide legally binding warranties as to the origins of the rough diamonds they export. This, in turn, makes them legally responsible for knowing the origin of the rough diamonds they purchase.

The government, however, should provide greater support to the system by taking a more proactive role to ensure that the system works effectively and that there are sufficient checks on industry. And there are problems with current statistics which could undermine the system’s credibility if they are not rectified.

## Statistics

Current statistical data is problematic. In 2003, according to US trade data supplied to the Kimberley Process, the US exported 5.57 million carats of unpolished diamonds, against imports of only 3.8 million carats. More surprisingly, the imports were valued at \$775 million, while the exports were valued at only \$225 million. The Census Bureau regards this as a likely timing problem, reflecting larger imports in previous years. Nevertheless, the diamond media is beginning to refer to the US as a net exporter of rough diamonds, something that is technically impossible.

Israel reported imports of 3.9 million carats in rough diamonds from the US, while the US recorded exports of only 592,000 carats. This is explained as most likely the result of confusion in the classification of rough and polished stones.<sup>19</sup> Finally, while South Africa reported exports to the US of 46,000 carats, the US recorded imports from South Africa of 601,000 carats. This may be explained by a US customs requirement that the country of *origin* be included on certificates from the EC (and everywhere else). Diamonds from the EC may therefore be coded as South African.

## An Industry-Managed System

The American KPCS system is unique in that where certificates are concerned, it is managed to a large extent by the diamond industry, with little direct hands-on involvement of the United States government. Further, while the system holds companies legally responsible for the statements they make with regard to certificates, the system is based almost exclusively on trust. The chain of warranties system laid out by the World Diamond Council is voluntary and has no basis in law. Few parcels of rough diamonds are opened by Customs on import, and almost none are inspected on export. The USKPA has no authority to verify the contents of a parcel being certified for export.

That said, there are checks on each exporter through the USKPA licensing agreement and the AES/ITN tracking system. Any parcel being exported could be inspected by government officials, and the chain of warranties plus the details of the diamond stocks and financial transactions of any company or individual in the US may be audited by the US government. This is not happening and there appear to be no plans for it.

## RECOMMENDATIONS

1. The large anomalies in the US statistical data are in serious need of attention. The major differences between US statistics and those of corresponding KP participants create a chain of confusion in the data of several countries. Guesswork as to the reasons for the anomalies can only undermine confidence in the system;
2. By insisting that imports of mixed goods (e.g. from the EC) be assigned a country of origin (e.g. South Africa) – if indeed that is the explanation for major anomalies in the US-EC/South Africa trade statistics – US Customs and Border Protection is recording data that is unreliable and confusing to the KPCS. If each KP participant were to record only the country of *provenance*, it would be a more straightforward matter to track diamonds back from trading countries to the actual country of origin;
3. Any control system is only as good as the willingness and ability of the authorities to verify that it is working as envisaged. The United States government should, through the Customs Service, make periodic random checks of imports and exports in order to demonstrate a strong commitment to the KPCS;

4. A company's income tax is based on its profits or loss. Detailed records of all transactions must be kept in case of an IRS audit. In addition, because the diamond business is so heavily financed by bank credit, banks also regularly inspect company books. Such audits and inspections should routinely be required to include a reconciliation of invoices covered by KP warranties;
5. Companies trading in rough diamonds should request their own financial auditors to tie the KPCS chain of warranties to audits of invoices; this should become part of the USKPA licensing agreements;
6. In South Africa, the government requires companies to keep a "rough register" which records the purchase of all rough diamonds from local mines or companies abroad, and the sale of all rough diamonds, either for polishing or export. A standard format like this would make the system more clear for US companies dealing in rough diamonds, and would allow for comparability and better tracking in cases where company books are audited;
7. Trade associations should play a more active role in ensuring adherence to the self-regulation, and could create a legal protocol similar to that developed in Belgium.

## NOTES

- <sup>1</sup> The KPCS document also says that participants will "as required, amend or enact appropriate laws or regulations to implement and enforce the Certification Scheme and to maintain dissuasive and proportional penalties for transgressions." An annex contains additional *voluntary* recommendations. Among them: "All artisanal and informal diamond miners should be licensed and only those persons so licensed should be allowed to mine diamonds;" and "All diamond buyers, sellers, exporters, agents and courier companies involved in carrying rough diamonds should be registered and licensed by each Participant's relevant authorities."
- <sup>2</sup> Minerals and Mining Law, 1986, PNDCL 153 (Law 153) as amended by the Minerals and Mining Amendment Act 1993, Act 475 (Act 475) and modified by the provisions of the Constitution of 1993 (the Constitution).

- <sup>3</sup> Mineral rights are legally defined to include the rights to reconnoitre, prospect for, and mine minerals. The sector Minister is also authorized to exercise, within defined limits, powers relating to the transfer, amendment, renewal, cancellation and surrender of mineral rights. The powers conferred upon the Minister must be exercised contingent upon the advice of the Minerals Commission (MINCOM), which has the authority under the Constitution to regulate and manage the utilization of mineral resources and coordinate policies in relation to minerals. Law 153 specifies the forms of mineral rights that the sector Minister is empowered to grant, the duration of the grant, the size of the concessions, and eligibility criteria for the grantee, as well as the procedure for application for mineral rights.
- <sup>4</sup> UN Security Council Report S/2002/1119, October 2002
- <sup>5</sup> ASCorp was created as a joint venture between the state vehicle, SODIAM, which has a majority 51% shareholding, and WELOX Ltd. and TAIS Ltd., each of which had a 24.5% holding. The directors were, respectively, Lev Leviev and Sylvain Goldberg and Ehud Laiado of Omega Diamonds, Antwerp.
- <sup>6</sup> Reuters: "Angola seeks to tap diamonds from small miners", 10/8/04
- <sup>7</sup> Reports from *Polished prices.com* 16/5/04 and *Antwerp Facets News Service*, 11/5/04
- <sup>8</sup> The remit of the new body is identical to that of the Diamond Inspection and Security Corps, the previous incarnation of diamond security in Angola, which included Endiama, the Ministry of Geology and Mines, the National Directorate of Criminal Investigation (DNIC) the Ministry of the Interior, the Ministry of Finance, as well as the SINFO.
- <sup>9</sup> For example, The Expert Panel on the Illegal Exploitation of Resources in Democratic Republic of Congo, operating under the authority of the UN Department of Peacekeeping Operations, reported inter *alia* on diamonds in 2001, 2002 and 2003.
- <sup>10</sup> CEEC provincial offices keep daily buying records for each *comptoir*. These records show the amount bought in carats, in US dollars, with the names of the buyer and seller. This information is collated and sent in a monthly report to CEEC Kinshasa, which therefore has full documentation on all *comptoir* operations on a monthly basis. The CEEC was, for the first time, able to produce full statistics for 2003, marking a huge improvement over the opaque past of the diamond industry in the DRC.
- <sup>11</sup> Ministerial Order no. 194/CAB.MINES-HTDRO/01/2003 of 31 May 2003
- <sup>12</sup> Council Regulation 2368/2002, 20 December 2002
- <sup>13</sup> Commission Regulation, Article 17 2a(ix)
- <sup>14</sup> This is the number of companies exporting rough diamonds, not the full membership of the four bourses. The number changes and an updated list is sent to the Ministry on a regular basis.
- <sup>15</sup> Translation of "Protocol betreffende do monitoring van het systeem van zelfregulering zoals bepaald in artikel 17 van de Verordening (EG) nr. 2368/2002 van de Raad van 20 december 2002..."
- <sup>16</sup> 12 January 2004 adjustment to Law of 11 January 1993.
- <sup>17</sup> At the time of writing, its three directors were the General Counsel of the Jewelers Vigilance Committee, the CEO of EGL-USA, an independent gemological laboratory, and the Managing Director of the Diamond Dealers Club, the New York diamond bourse. None is engaged in the buying or selling diamonds or diamond jewelry. The USKPA is funded through licensing and usage fees paid by users of the USKPA certificates.
- <sup>18</sup> Its first report, covering activities in 2003, was completed, as required, in March 2004.
- <sup>19</sup> Communication with US Census Bureau.