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Conflict minerals
Evolving compliance challenges

September 2014

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Why it matters

Demands for supply chain transparency evolve

Another step in the movement around supply chain transparency was added when the Securities and Exchange Commission (SEC) issued its final rule in Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Final Rule").

The first conflict minerals filing deadline has now passed and it has become increasingly clear to registrants and the marketplace how challenging it is for registrants to gain visibility and transparency into the conflict minerals supply chain. This reality was reinforced in the recently released report from the U.S. Department of Commerce that noted certain limitations and challenges in compiling a list of all known conflict mineral processing facilities worldwide[1]. An article written by the Wall Street Journal's Emily Chasan also highlighted the fact that the U.S. Department of Commerce's report further demonstrated the challenges faced by companies in identifying the source of the conflict minerals in their prodcuts[2]. The majority of companies that filed a Form SD in Year 1 indicated that they were unable to determine the origin of the conflict minerals in their supply chain. Additionally, less than 25% of Year 1 filers published a list of the smelters or refiners used in their conflict minerals supply chain, as required by the Final Rule[3]. This lack of transparency appeared to be a disappointment to those who were expecting to gain meaningful insights about the due diligence programs put in place by the registrant by reading their Conflict Minerals Report (CMR). While the immediate marketplace reactions to the Year 1 filings included some criticism, the media attention was less critical than expected by many registrants. Many, however, anticipate that the non-governmental organizations (NGOs) focused on this topic will likely continue to contribute to the public debate with greater scrutiny of registrants' conflict minerals compliance programs and disclosures. It is also expected that the SEC will look to provide their observations around Year 1 filings and possibly publish additional guidance for registrants. Both could serve to influence how companies advance their conflict minerals compliance programs.

As the marketplace attention around conflict minerals continues to evolve, so will expectations for greater transparency around registrants' broader supply chain risk management practices. Registrants may be well served by developing more comprehensive and integrated approaches to supply chain compliance activities and disclosure practices in a manner that permits flexibility in adapting to changing and evolving regulations and disclosure requirements. Registrants should consider how to integrate their conflict minerals compliance program with other supply chain compliance activities (e.g., Foreign Corrupt Practices Act (FCPA), Regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), Restriction of Hazardous Substances (RoHS), etc.) to leverage potential efficiencies and proactively get in front of new regulations.

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[1] Report available at: **http://www.ita.doc.gov/td/forestprod/DOC-ConflictMineralReport.pdf**

[2] Emily Chasan, Wall Street Journal - Online; 09/05/2014

[3] **Deloitte Heads Up:** ***Navigating next steps after the year 1 Form SD and conflict minerals reporting cycle***

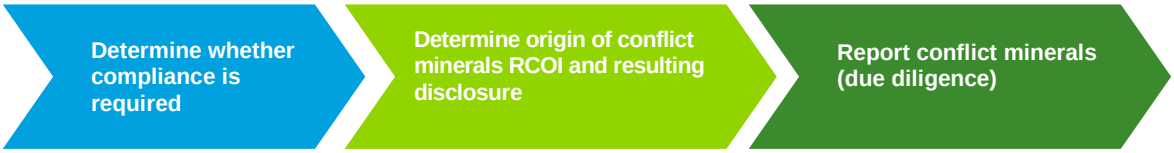
With legal action against the SEC regarding the constitutionality of certain disclosures under the Final Rule still partially unresolved, more than 1,300 registrants submitted their first conflict minerals filing in early June. The SEC estimated that approximately 6,000 registrants would be affected by the Final Rule; however, a significantly lower number filed a Form SD indicating whether conflict minerals (tin, tantalum, tungsten, or gold — commonly referred to as 3TG) necessary to the functionality or production of their products manufactured or contracted to be manufactured may have originated in the Democratic Republic of Congo (DRC) or an adjoining country.

Although the ultimate resolution of the legal action is uncertain as of September 2014, and may be several months away, Deloitte believes that it is unlikely that the Final Rule will be completely overturned. Rather, a recent Appellate Court decision in another First Amendment case (American Meat v. U.S. Department of Agriculture) may indicate the Final Rule is here to stay.

What is required?

The Final Rule requires certain registrants to follow a three-step process for evaluating conflict minerals contained in their products and to file a Form SD by June 2, 2014, for the 2013 calendar year, and annually by May 31 thereafter, describing their process for conducting a reasonable country of origin inquiry (RCOI). In certain circumstances, the registrant is required to include a CMR describing its due diligence measures and, for certain of those situations, to have an independent private sector audit (IPSA) performed in accordance with generally accepted government auditing standards (GAGAS).

The SEC's three-step approach (abbreviated summary):



The registrant must comply with the Final Rule if:

- It files reports with SEC under the Exchange Act
- Conflict minerals are "necessary to the functionality or production" of a product manufactured or contracted to be manufactured by the registrant
  - Only applies when a conflict mineral is contained in the final product
  - Also applies to foreign private issuers

If the Final Rule applies, the registrant must perform a RCOI to determine whether conflict minerals originated in the DRC or an adjoining country.

If conflict minerals did not originate from DRC, or are from scrap or recycled sources:

- The registrant files Form SD and discloses conclusion and a brief description of its inquiry and due diligence process

If unable to determine conflict minerals origination or if conflict minerals originated from DRC countries:

- Conduct supply chain due diligence in accordance with a nationally or internationally recognized due diligence framework:
  - *Organisation for Economic Cooperation and Development's (OECD) Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (OECD Framework)*[4]
- File Form SD and, in certain circumstances, a CMR as an exhibit:
  - *Currently, registrants are not required to describe their products as "DRC conflict free," having "not been found to be 'DRC conflict free,'" or "DRC conflict undeterminable." Pending further action, an IPSA will not be required unless a registrant voluntarily elects to describe a product as "DRC conflict free" in its CMR*[5].

[4] Currently, the only nationally or internationally recognized framework available

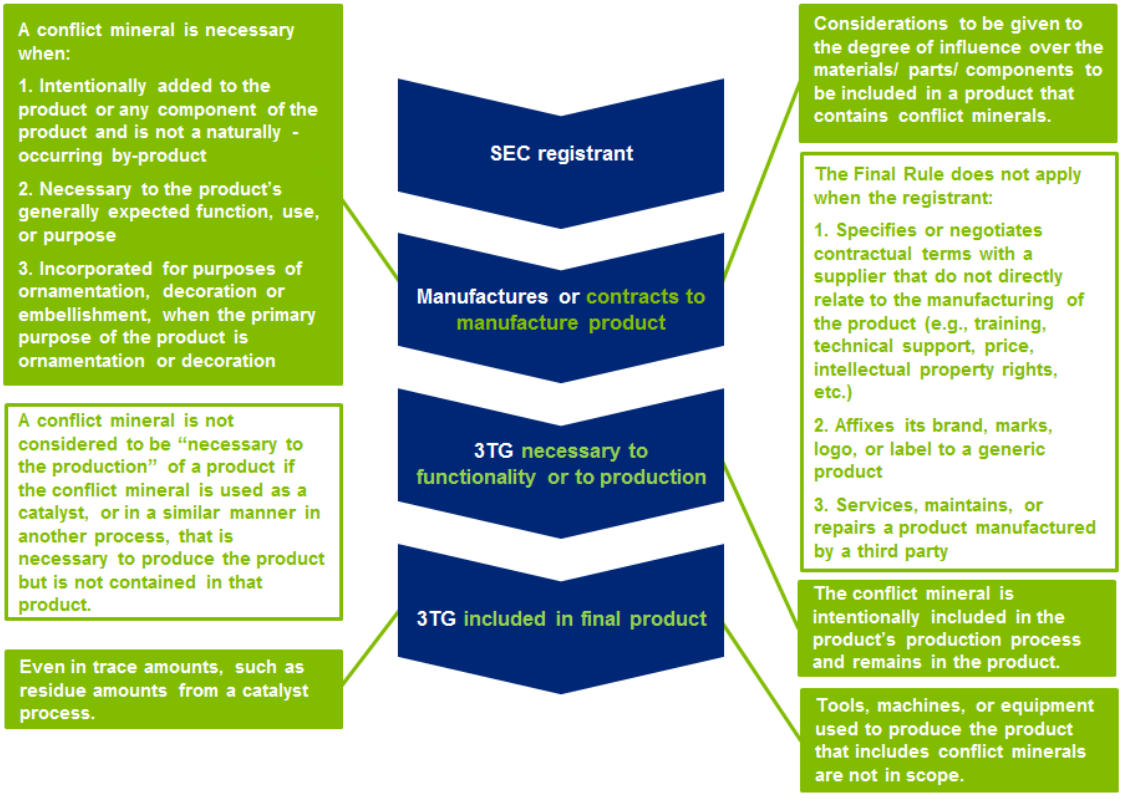
[5] **SEC Statement on the Effect of the Recent Court of Appeals Decision on the Conflict Minerals Rule**

Determining when compliance is required

Many registrants encountered challenges in the first year of conflict minerals compliance; one of the first included determining whether compliance was required. The Final Rule included a number of areas where significant judgment was required, including scoping definitions for the terms “product”, “contract to manufacture”, and “necessary to the functionality or production”.

The **SEC's Frequently Asked Questions** around conflict minerals provided some clarity around the considerations registrants were to evaluate when assessing whether they were subject to the Final Rule. Additionally, many industry organizations such as the Automotive Industry Action Group (AIAG), American Apparel and Footwear Association (AAFA), the National Retail Federation (NRF), Retail Industry Leaders Association (RILA), and the Aerospace Industry Association (AIA) took steps to assist their member companies through promoting collaboration among the industry, and in some cases suggesting interpretations to ambiguous areas of judgment. Engaging with peer companies and external legal counsel to seek input on interpretations, and then documenting the conclusions reached, emerged as leading practices. Additionally, such measures set the foundation for a consistent application of certain definitions in the years ahead.

A registrant is subject to compliance with the Final Rule if the following conditions are met:



Year 1 challenges and emerging trends

Challenges of the conflict minerals supply chain

Among the challenges encountered in the first year of conflict minerals compliance, for many registrants this was the first time they were required to identify a complete population of suppliers at an enterprise level (across all business units, impacted subsidiaries, etc.) that provided 3TG inputs to the registrant's products. Registrants were then required to investigate the impacted suppliers with the objective to achieve transparency into the multiple tiers of their products' supply chain. As a result of undertaking the process, certain leading practices emerged in light of the multiple challenges:

Challenges	Leading practices
Many registrants were unsure of where to even begin.	The starting point for many registrants included: • Creating a cross-functional team • Developing a policy on the use of conflict minerals • Establishing a process guided by the OECD Framework • Participating in industry working groups • Engaging a third-party consultant
Many registrants experienced challenges evaluating the surveys they received from suppliers, while suppliers were challenged with responding to the surveys given the obligation to obtain necessary information from their suppliers. Once registrants began receiving survey responses from suppliers, data quality was notably a challenge, including: • Incomplete survey responses • Inconclusive responses (e.g. supplier did not have the information to determine the origin of the conflict minerals in the products they supplied)	The **Conflict Minerals Reporting Template (CMRT)** provided a standard reporting template for registrants to use when gathering necessary information from suppliers. The CMRT also served as the consistent format for suppliers when responding to multiple customer inquiries. Additionally, the CMRT included a list of standard smelter or refiner (SORs) names to help suppliers report actual SORs. Another leading practice included providing supplier training on conflict minerals compliance and disclosure requirements, including instruction on how to complete the CMRT and communicating expectations of suppliers.
For supplier responses received, registrants were tasked with determining the accuracy and reliability of the responses.	Participation in industry working groups were beneficial for many registrants seeking to put a conflict minerals compliance program in place that was consistent with their peers and contemplated leading industry practices. Additionally, a defined escalation process with specific follow-on steps to further investigate supplier responses and the identified SORs was a leading practice.
Data management proved to be an issue for many registrants, considering the volume of suppliers and products.	Certain registrants used a conflict minerals technology solution to send supplier surveys, track and gather responses, and then ultimately summarize data for reporting purposes. Many conflict minerals technology solutions helped to organize the volumes of data from suppliers.

Challenges	Leading practices
No standard form of report for the Form SD and CMR was available	Although the **Form SD instructions** provided a skeletal framework for preparing Form SD and a CMR, the Final Rule intentionally did not prescribe a standard form of reporting. As noted in our **Heads Up** analysis of Year 1 conflict minerals filings, the following leading practices were identified: • Clearly defining and distinguishing RCOI from due diligence measures, as well as the corresponding OECD steps assigned to each • Separating the design assertion (if included), from the due diligence measures performed • Considering the attributes of suitable and available criteria[6] that are required for an auditor to perform an IPSA when developing the conflict minerals disclosures.
Certain unintended consequences resulted from disclosing SOR information; certain registrants exposed themselves to heightened scrutiny related to sourcing practices not specifically prohibited by the Final Rule.	Some registrants included the Central Bank of the Democratic People's Republic of Korea in their publicly reported SOR list and were cited for illegal sourcing from North Korea because the U.S. has sanctions against North Korea. Further, some registrants disclosed information about SORs in Uzbekistan, thereby associating the registrant with a country known for poor labor practices. The performance of additional due diligence measures to confirm the accuracy of the SOR list prior to publishing the SOR list (either on the registrant's website or within the CMR), emerged as a leading practice. Such due diligence measures included: • Determining the existence and legitimacy of the SOR name provided • Determining the timing of the smelting/refining process to understand if the SOR processed 3TG that was outside the supply chain prior to January 31, 2013[7] In addition, many suppliers reported at a company level, and therefore included SORs that may not have been part of a particular customers supply chain.

[6] See paragraph .05 of the **AICPA's Conflict Minerals Reports**, which contains FAQs on the suitability of criteria for examination attestation purposes.

[7] As stated in the Final Rule, conflict minerals are "outside the supply chain" if they have been smelted or fully refined or, if they have not been smelted or fully refined, they are outside the DRC or adjoining country.

Looking forward to year 2

There was no clear threshold of what conflict minerals compliance in Year 1 looked like. As reflected in the Year 1 filings, there was a tremendous diversity in registrants' approaches to conflict minerals compliance, as well as disclosures included in the Form SD and CMR.

Considerations for year 2

Questions that should be considered by registrants as they look to initiate or improve their conflict minerals compliance program include:

- What worked and what did not work in Year 1, if applicable?
- What lessons learned from year compliance practices can be applied to realize greater efficiency and effectiveness within the conflict minerals compliance program?
- What has changed and what is continuously changing within the conflict minerals supply chain and represents a new or ongoing risk? Does the conflict minerals compliance program contemplate such changes?
- What attention, if any, was received by NGOs or is additional attention expected to be received from NGOs in Year 2?
- How can the conflict minerals compliance program activities be integrated with other supply chain compliance activities?
- What learnings emerged through the conflict minerals compliance program that could provide insights into other areas of our supply chain?

Beyond the regulation requirement, consider the implication of the approach taken from a broader corporate brand and reputation standpoint.

As registrants look to initiate or improve their conflict minerals compliance programs, considerations should be given to the following:

Governance	• Educate the steering committee on updates to the Final Rule, planned approach, and potential investments. • Update the responsible executive and board of directors on the conflict minerals compliance requirements, changes to the compliance program, and the status in meeting these requirements. • Consider potential changes to the conflict minerals policy in light of program improvements.
People	• Educate the cross-functional team of representatives from the various areas affected by the requirements on updates to the Final Rule. • Roll-out guidance and training to other internal teams impacted.
Process	• Update or enhance the implementation of the OECD Framework including documentation of the considerations within the supplements of the OECD Framework • Analyze available product/supplier data to update in-scope products and suppliers. • Categorize or refine suppliers by risk criteria (e.g., according to volume, spend, location of supplier, among other supplier attributes.) • Develop or enhance training and communications for suppliers (communicate expectations of suppliers in helping the registrant meet obligations under the Final Rule.) • Establish or refine reporting process to meet the filing requirements and/or customer disclosure requirements. • Request and analyze supplier information and certifications received. • Follow-up on high risk suppliers based on responses received. • Establish or refine defined corrective actions. • Develop or update standard operating procedures to guide the conflict minerals compliance program.
Technology	• Leverage a system/tool, where possible, to support the conflict minerals compliance program and assist in documenting the process.

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