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Conflict minerals The automotive perspective

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The current automotive environment

Consumer preferences are changing the mobility landscape and affording consumers more choices than ever before in meeting their transportation needs. For automotive registrants, these shifting consumer demands result in a number of complex questions that may ultimately impact their products and how they engage their customers. As automobiles are now essentially computers on wheels, innovations in connectivity, mobile phones, apps, and smart card technology are invading the automotive industry. Moreover, automotive consumers will increasingly expect customer experiences that go beyond the sales or service transaction and leverage technology to integrate with their connected lifestyles – both inside and outside of the automobile. The overwhelming majority of this technology is uniquely affected by conflict minerals.

Automotive registrants face unique supply chain risks resulting from a complex and constantly evolving operating environment. Typical supply chain management trends, macro environment factors, and industry-specific drivers have changed the profile and potential severity of risks faced by automotive supply chain operations. Among these new trends are social and environmental expectations from non-governmental organizations (NGOs) and more informed Gen Y consumers utilizing social media to influence immediate impacts on potential customers. While original equipment manufacturers (OEMs) are increasingly focusing on alignment of supply chain compliance processes to drive increased transparency across the value chain, and compliance with regulatory and other stakeholder requirements, the need for a coordinated compliance program has never been higher.



The conflict minerals environment and the automotive impact

The current state of conflict minerals

Another step in the movement around supply chain transparency was added when the Securities and Exchange Commission (SEC) issued its final rule on Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Final Rule”). As the marketplace attention around conflict minerals continues to evolve, so will expectations for greater transparency around registrants’ broader supply chain practices. Registrants will be well-served by developing more comprehensive and integrated approaches to supply chain compliance and risk management activities and disclosure practices in a manner that permits flexibility in adapting to changing and evolving regulations, disclosure requirements and stakeholder expectations. Registrants should consider how to integrate their conflict minerals compliance program with other supply chain compliance activities (e.g., Foreign Corrupt Practices Act, Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), Restriction of Hazardous Substances (RoHS), etc.) to leverage potential efficiencies and proactively get in front of emerging trends.

Many automotive registrants are now asking how to translate the Year 1 filing results and lessons learned into next steps they can take to improve their conflict minerals compliance activities and reporting process going forward. Year 1 filings revealed tremendous diversity in approaches to preparing the Form SD and the Conflict Minerals Report (CMR), from the organization of content, to the depth of data analysis and disclosure, to commitments regarding

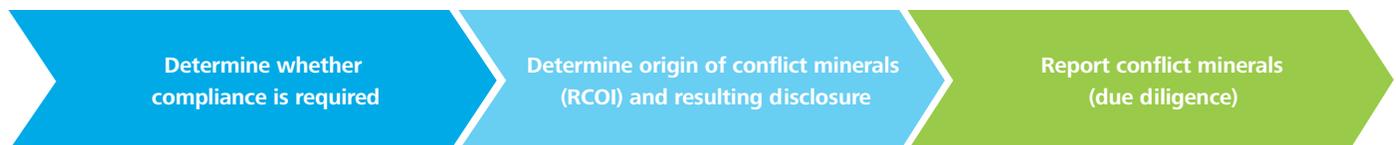
continuous improvement, to name a few.

Conflict minerals and automotive registrants

The Final Rule requires automotive registrants to follow a three-step process for evaluating conflict minerals (tin, tantalum, tungsten, or gold – commonly referred to as 3TG) contained in their products and to file a Form SD and/or a CMR annually by May 31. Conflict minerals represents a significant undertaking for many automotive registrants, particularly considering the size and complexity of many of the automotive organizations. An automotive registrant with decentralized operations and billions purchased from thousands of suppliers faced the dilemma of where to begin the reasonable country of origin inquiry (RCOI) process... should the starting point be the parts purchased from suppliers or the suppliers themselves?

International Material Data System (IMDS)

IMDS represented the starting place for many automotive registrants. Although conflict minerals information is not currently tracked in IMDS, it does contain records for the materials used to manufacture automobiles, giving automotive registrants a leg up in determining what parts purchased may contain 3TG. Conflict minerals-specific information in IMDS would likely improve the efficiency of many automotive registrants’ conflict minerals compliance programs.



Communication with automotive suppliers

An important first step in determining whether the 3TG originated from the covered countries¹ was to initiate a supplier data collection survey with Tier 1 suppliers. Once automotive registrants began reaching out to suppliers to investigate their conflict minerals supply chain, confusion emerged in some cases due to the complexity of the supplier's organization. Complex suppliers with a global presence often had difficulty in communicating a consistent message to all divisions. Generally, North American divisions received a more consistent message around compliance with conflict minerals legislation than their European and Asian counterparts. As a result, the U.S. compliance efforts may not have been consistent with the compliance efforts at their European or Asian counterparts. Decentralized management of the supply chain also caused inconsistent responses to be sent to customers who receive the same part from more than one division of the same supplier.

Additionally, training around conflict minerals sourcing requirements and expectations did not reach all necessary internal stakeholders. Although those involved directly in supply chain management may have been aware of how to handle survey requests from customers, other departments such as sales and public policy, may not have known who within their company was responsible for responding to the survey requests. Stronger company-wide training can be performed to remedy these issues.

External communication – setting the expectations

It is important for automotive registrants to set clear expectations around conflict minerals sourcing requirements and what compliance means with their suppliers. Companies that supply multiple industries (particularly Tier 2 and further upstream suppliers) are subject to various standards set by those industries with which they must conform. An automotive supplier is often a supplier to other industries such as technology, aerospace and process & industrial products. Furthermore, even when expectations are clearly communicated to Tier 1 suppliers, a game of "telephone" ensues and the message to Tier 3 or 4 suppliers and beyond can be altered through the multiple channels of communication.

Setting expectations related to supplier surveys to gather conflict minerals data is also key. The survey data collection process presented one of the most significant challenges for most registrants within the conflict minerals compliance

process. Incomplete, inaccurate, or non-responses drove the most significant effort around supplier follow-up and verification. The lack of completeness and reliability of supplier data collected in many cases contributed to the lack of specific performance details included in the due diligence measures section of registrants' CMRs. For example, suppliers in many cases represented that as an organization they were sourcing minerals from the covered countries in the products they sold. With this response at a company level, the OEM did not have the visibility into whether the parts that the supplier provided to them contained minerals from the covered countries. Depending on the OEM, messaging on supplier responses was different. Some were allowing company level disclosures on the survey response, some were "encouraging" product level disclosures, but accepting both company level and product level disclosures, and some were rigid in their requirements.

Heading into Year 2, many OEMs recognize the need for product-level disclosures in order to provide more transparency in next year's CMR. However, with that recognition comes the challenge of obtaining product level disclosures. The tracking of part-level information from the onset as a component of the supplier's conflict minerals compliance programs is a more effective approach than OEMs coming in after the fact doing the sorting and sifting. However, many automotive suppliers may not be sophisticated enough in tracking their supply chain so as to track part-level information. As a result, OEMs should evaluate the level of support they can provide to their suppliers in order to work toward product level disclosures. The appetite to assist suppliers will largely depend on the OEM's willingness and ability to assist its suppliers weighed against the sorting and sifting that the OEM is willing to do on its own to get to product specific information. The challenge of product-level disclosures is also magnified further up the supply chain, particularly with private companies further removed upstream that may not have the resources to track part specific information. Training suppliers is a key starting point, and although a consistent industry-wide approach is likely to take time to develop, the Automotive Industry Action Group (AIAG) is tackling conflict minerals challenges such as the product-level disclosures. Involvement with the AIAG, and specifically the Conflict Minerals Working Group, will provide additional insights to increase transparency within the conflict minerals compliance program.

The road ahead

Leading practices among automotive registrants emerging in Year 1

We observed a tremendous diversity in approaches to conflict minerals compliance programs during the 2013 calendar year; however the following leading practices emerged among automotive registrants in complying with the Final Rule during the first reporting year:

- Engaging with the AIAG’s Conflict Minerals Working Group to gain access to industry convening, discussions and leading industry practices
- Establishing a conflict minerals steering committee and a cross-functional team of representatives from the various business areas affected by the requirements
- Creating a conflict minerals policy and taking measures to work with factories and suppliers, including through supplier agreements, contracts and/or purchase orders, to promote supplier collaboration and support for the retailer’s efforts to comply with the Final Rule

- Employing the industry conflict minerals technology solution to facilitate supplier surveys, track responses, and gather data for reporting¹
- Conducting training with suppliers to promote higher quality, more accurate and complete supplier responses

What to think about in Year 2

It is expected that Year 2 conflict minerals compliance activities will focus on driving improvements to Year 1 performance (e.g., increased supplier response rate, improvements to completeness and accuracy of data received, among others). The following considerations should be contemplated by automotive registrants when driving updates to their conflict minerals compliance program:

<p>Many automotive registrants faced a lack of data quality in the information received from suppliers in Year 1</p>	<p>In the upstream supply chain, there can often be a lack of resources and information particularly the farther away from Tier 1 suppliers automotive registrants get. As a result, it can be tough for suppliers to respond to their customers. Providing training to suppliers can support a collaborative environment to work towards the automotive registrant’s conflict minerals policy.</p>
<p>Engage with the AIAG’s Conflict Minerals Working Group</p>	<p>The AIAG’s Conflict Minerals Working Group worked collaboratively with its members to develop an industry approach to conflict minerals compliance, including the selection of a standard industry conflict minerals technology solution.</p>
<p>Many automotive registrants will still be subject to the Independent Private Sector Audit (IPSA) requirement</p>	<p>Prepare for the IPSA. Although the IPSA is only currently required if an automotive registrant elects to label any of its products ‘DRC conflict free’, the transition period will expire in the near term and the IPSA will be required beyond just opting to declare ‘DRC conflict free’. Automotive registrant should be mindful of the IPSA objectives and take the necessary measures to enhance the level of documentation in place to support the design of the due diligence program to conform to the OECD Framework³ and to support the due diligence measures performed as disclosed within the CMR.</p>
<p>Automotive registrants should focus on the organization of the CMR content and the potential implications for a future IPSA</p>	<p>Consider more clearly defining where the RCOI ends and due diligence begins, and the corresponding OECD Framework steps used to guide each. Additionally, automotive registrants should distinctly separate such disclosures within the CMR to clearly identify the subject matter within the CMR to be subject to the IPSA.</p>

How can Deloitte help your company in the automotive sector?

We are working with clients in various capacities supporting the development and implementation of a conflict minerals compliance program. Our breadth conflict minerals services includes the following:

- Assisting companies in assessing whether the Final Rule applies
- Assisting companies from start to finish in implementing a conflict minerals compliance program
- Providing advice and recommendations to companies as they proceed through their conflict minerals compliance program
- Performing gap analyses and IPSA readiness services for companies' conflict minerals compliance programs
- Providing advice and recommendations to companies on drafting the Form SD and CMR
- Performing the IPSA of the CMR

Our eminence in conflict minerals

To keep up with current events related to conflict minerals, we publish thought leadership that helps our clients understand conflict minerals and be aware of further developments, including the following:

- **Conflict minerals: Evolving compliance challenges:** With the first conflict minerals filing deadline now behind us, it has become increasingly clear how challenging it is for registrants to gain visibility and transparency into the conflict minerals supply chain. As the marketplace attention around conflict minerals continues to evolve, so will expectations for greater transparency around registrants' broader supply chain risk management practices. This paper addresses what is required, Year 1 challenges and emerging trends, and considerations for Year 2.
- **Heads Up: Navigating Next Steps After the Year 1 Form SD and Conflict Minerals Reporting Cycle:** This Heads Up discusses findings from our analysis of registrants' first filing under the SEC's final rule on conflict minerals and provides insights for registrants as they consider conflict minerals compliance and reporting improvements for future filings in anticipation of an independent private sector audit.



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- Over 95% of the Fortune 500 Construction & Farm Machinery Clients.
- Over 70% of the Fortune 500 Motor Vehicle & Parts Companies.
- Over 95% of the Fortune 500 Transportation & Equipment Companies.
- 90% of the Fortune 1000 Construction & Farm Machinery Clients.
- 80% of the Fortune 1000 Motor Vehicle & Parts Companies.
- Over 95% of the Fortune 1000 Transportation & Equipment.

Source: Fortune 500, May 2014 and Fortune 1000, May 2014

- **Industry insights: Consumer and Industrial Products (C&IP) Conflict Minerals Year 1 Reporting Trends:** This publication focuses on the C&IP industry which represented the majority of registrants filing a Form SD (approximately 54% of Year 1 filings). Based on Deloitte's analysis of the Year 1 filings submitted, we are sharing the insights regarding trends among the C&IP industry sectors, including the automotive sector.

This information, along with other materials, is published on our website at: http://www.deloitte.com/view/en_US/us/Services/additional-services/deloitte-sustainability/Conflict-Minerals/index.htm

Endnotes

1. The covered countries include: Angola, Burundi, Central African Republic, the Democratic Republic of the Congo (DRC), the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda, and Zambia
2. [iPoint Conflict Minerals Compliance Platform \(iPCMP\)](#)
3. [Organisation for Economic Cooperation and Development's \(OECD\) Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas](#)

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