Douglas Hileman Consulting, LLC
Van Nuys, CA 91405-4235
www.douglashileman.com
www.DFCMAudit.com
www.DFCMTraining.com

Conflict Minerals: What's Ahead for Your Company?
Answers in Plain Sight – Part Four: Summary
By Douglas Hileman, CRMA, CPEA

The Securities and Exchange Commission (SEC) rule for Section 1502 of the Dodd-Frank Wall Street Consumer Reform & Protection Act ("Dodd-Frank Conflict Minerals" or DFCM) took effect for calendar year 2013. The SEC rule provided for two transition years, recognizing that it would take issuers some time to gather information on the origin of tin, tantalum, tungsten and gold (3TG) in their supply chain. Companies subject to DFCM submitted their filings for Year One on or before June 2, 2014.

Companies are realizing that Year Two is more than half over. The SEC filings are an annual process, as are many of the business processes that support it. Many DFCM practitioners know it will differ from Year One – but how?

Several firms have done research on the SEC filings, or sub-groups of them. These surveys are like looking in the rear view mirror; they don't tell you what's ahead.

Douglas Hileman Consulting LLC (DHC) recently conducted industry research of companies with similar parameters to find out. DHC customized research to consider where a company is in the overall supply chain, and included companies that make parts or components ("**Component companies**"), their customers ("**Customer companies**" - who typically make products for sale), and companies up the supply chain from the first group ("**Suppliers**"). The research included review and assessment of SEC filings – including forward-looking statements included in the SEC filings, and other public disclosures. These disclosures should provide clues as to what lies ahead – including for your company.

This white paper – the last in a four-part series –provides overall thoughts on the research, and suggestions for companies as they prepare for Year Two of DFCM.

SEC Filings

Of all the companies in the three categories selected for research, approximately two-thirds submitted filings to the SEC. Approximately 90% of these filed a Form SD and a Conflict Minerals Report (CMR). Those not filing with SEC were non-U.S. companies or private companies.

Description of Due Diligence: Almost all companies described the design of their due diligence framework as being consistent with the OECD Due Diligence Guidelines.[1] Many expressly described the steps taken in alignment with the five steps in the OECD Guidelines. The Suppliers included less information on due diligence step than Component or Customer companies. One Supplier described their risk-based approach, including disclosing that they had omitted over 1,000 of their suppliers (constituting less than 20% of their applicable spend) from their initial due diligence effort.

DHC notes that Suppliers generate the very information that all other companies depend upon, yet their descriptions in SEC filings were the least developed. The Supplier that is reaching out to up to 1,000 suppliers for the first time in 2014 may learn of minerals sourced from Covered Countries that were not reported in Year One. This will be a surprise to the Supplier; it could also surprise the Component companies and Customer companies down their value chain. DHC suggests that companies that use the OECD framework describe the steps they took in their SEC filings (or in other public disclosures, if they are not subject to SEC) that demonstrates this to readers.

Smelter Information: In general, the closer the company was to consumer-facing products, the more information the company provided on smelters. There were many variations as to the type of information, such as all smelters provided by suppliers, only smelters in Covered Countries, or smelters on the CFS list. The disclosures made by companies in the Component category varied much more than for Customers or Supplier company categories. The Suppliers disclosed relatively little information.

DHC notes that the group of companies (Suppliers) that provided the least information in SEC filings is the very group that provides information to all the other groups. DHC notes that the Suppliers provide this information via the Conflict Minerals Reporting Template (CMRT), a tool developed by and for industry. The CMRT is not included in SEC filings, nor is it industry practice to make it publicly available. There does not seem to be a trend regarding including smelter lists in SEC filings. DHC suggests that companies take an approach that is consistent with their culture on all SEC and other public filings.

Industry Involvements: Customer companies described the strongest relationship and use of industry associations, followed by Component companies, with the Supplier companies a distant third. The groups mentioned most often by all company groups were the Electronic Industry Citizenship Coalition and/or the Conflict Free Sourcing Initiative[2].

DHC notes that the CFSI depends upon revenues from memberships to support the Conflict Free Smelter Program. At August 2014, company membership is $5,000 per year – or $3,000 per year for members of

[1] OECD (2013), OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas, Second Edition, OECD Publishing. http://dx.doi.org/10.1787/9789264182050-en
[2] See www.eicc.info and www.conflictfreesourcing.org

CFSI partner associations (including EICC). This provides free access to Reasonable Country of Origin (RCOI) data, networking and participation opportunities with other industry specialists, and the opportunity to shape industry response to conflict minerals reporting requirements. DHC notes that Industry associations are a mechanism to pool resources, learn from others, and identify emerging issues in a cost-effective way. DHC encourages meaningful (including financial) support, especially if a company is relying on the CMRT for compliance filings.

Metrics: Most companies provided few performance metrics for their conflict minerals programs. The metrics they reported varied widely, including number of products, number of commodities defined from purchasing activities as being in scope, number of smelters in the supply chain, and response rate from suppliers. Metrics often provided context. For example, a company may disclose a large number of products, so as to provide context for a low percentage of suppliers contacted. On the other hand, some metrics appeared to be included to show how far the program had come – such as one company's disclosure of a 99% response rate from suppliers. Only one company in the research portfolio used non-SEC reporting channels ("white paper" posted on their website the same day as their SEC filings) to disclose a substantial array of metrics that were not included in the SEC filings.

DHC notes that, absent the requirement in the SEC rule to report metrics (and there are none), it is reasonable to go easy on metrics in the SEC filings. Metrics to provide context for public consumers of information can be provided via disclosures on websites, white papers, or other means. Companies should disclose metrics if this aligns with their business strategy, and if there are robust systems and controls to ensure the accuracy of the metrics. There are likely additional metrics that help with internal management reporting. Companies can elect to share some of these selectively outside the company – for example, with customers or business partners.

Forward-Looking Statements & Other Disclosure Mechanisms

The forward-looking statements in the SEC filings of Customer companies tended to be more specific and actionable than those provided by Component companies. Supplier companies provided relatively few forward-looking statements, and most of those were modest.

Forward-looking statements almost always included some type of increased outreach or communications with companies in the supply chain. At least one company was relatively specific in stating they could require their suppliers to prepare and conform to an action plan. At least one company included a forward-looking statement that implied an offer to help their suppliers.

Company websites offer a source of conflict minerals information for companies not subject to SEC reporting requirements. This information may not be as comprehensive as SEC submittals.

DHC Analysis and Suggestions

This research was different. DHC and researchers noted several striking differences between their understanding of SEC conflict minerals filings and other disclosures from this research effort, as compared to what has been published elsewhere. This was due to the design of the research effort – namely, grouping companies according to their place in the supply chain; focus on forward-looking statements; and adding non-SEC disclosures and information sources to the scope.

Component companies may be caught in a "squeeze play." Customer companies are raising the bar higher and faster than the Component companies (their suppliers), who are, in turn, raising the bar higher and faster than their suppliers (the Suppliers). DHC suggests this could lead to dramatically different expectations for Year Two, and that many companies could be disappointed in the information they receive in their CMRTs.

Customer company expectations are likely to expand beyond receiving CMRTs from their supply chain. Companies may not be prepared to respond to specific requests, prepare action plans, report on action plans, or make changes in their own supply chains. Customer requests may include criteria for triggering their escalation procedures, which could include loss of business. DHC suggests that companies log and respond to customer requests diligently. Track the types of inquiries received, and compare the issues to how your program is evolving. Track the commitments you make, and prepare timely responses.

Year Three Is Coming! The SEC rule includes two transition years. DHC notes that Year One was more of a "start-up year" – leaving only one year for "transition." Year Two DFCM programs cannot represent an incremental improvement over Year One; they should be a substantial leap towards requirements and expectations for Year Three.

What Now?: DHC suggests that companies subject to DFCM undertake several work streams, including:

- conduct similar research of their key customers, peers, and suppliers,
- assess your ability to fulfill forward-looking statements in customers' filings,
- identify gaps in your conflict minerals improvement plans,
- adjust Year Two conflict minerals program accordingly, and
- begin planning for Year Three.

Acknowledgements

Ms. Jingchun ("Jessie") Liu, Mr. Eric Thomassian, and Mr. Pat Treebumrung assisted in conducting primary research. DHC gratefully acknowledges their time, effort, and contributions.

About Douglas Hileman

Douglas Hileman, CRMA, CPEA has over 35 years of experience in compliance, governance, risk management, auditing, and external reporting. His experience includes nine years in industry, six years at a Big 4 accounting firm, 15 years in environmental and management consulting, and over six years as president of his own firm. While at PricewaterhouseCoopers, he supported dozens of procedures for financial audits, as well as numerous engagements through internal audit and risk management. He led an audit for a company to comply with terms of a consent agreement with the SEC – the first (and, to date, the only) one of its kind. He submitted comments on the draft SEC rule for conflict minerals. He has published and presented numerous thought leadership pieces on DFCM, focusing on company practices to achieve timely, effective, and efficient compliance with the rule and the numerous other requirements related to the issue. He has supported clients in developing and improving conflict minerals programs, and benchmarking conflict minerals programs among industry participants. DHC conducted one of the four Independent Private Sector Audits (IPSAs) known to be filed with the SEC for Year One. He is a member of the Institute of Internal Auditors (IIA), including as a board member of the Los Angeles chapter, and a member of a global committee. He is a Certified Risk Management Assurance professional, a Certified Professional Environmental Auditor, and a Professional Engineer.

See www.douglashileman.com for more on Mr. Hileman and his firm's services. See sister sites www.DFCMAudit.com and www.DFCMTraining.com for more information on conflict minerals.