

## Another Conflict Minerals Analysis of Year One: the Best Yet

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Since the June 2, 2014 filing deadline for Year One of Dodd-Frank Conflict Minerals, several firms have published analyses of the filings. **Davis Polk**, a prominent law firm, weighs in with “**Review of First Wave of Conflict Minerals Filings**” (“First Wave”), available at <http://www.davispolk.com/publications/>. Davis Polk’s analysis is arguably the best so far. Read on for why it’s different, what it says, and what companies can learn for Year Two – as well as additional comments offered by Douglas Hileman Consulting LLC (DHC).

### “First Wave...”: Why It’s Different

First Wave differs from earlier publications by Big 4 firms and other consultancies in two major ways:

- **The Sample:** One of the Big 4 accounting firms analyzed companies in the S&P 500 that submitted conflict minerals filings – a sample size of approximately 180. Another Big 4 firm selected five industry sectors, and picked ten in each sector – a sample size of 50. Davis Polk focused on three groups: the S&P 500, the S&P [midcap] 400, and non-U.S., SEC companies in the S&P 1200. This resulted in a sample size of 440, or approximately one-third of all SEC conflict minerals filings. This provided the obvious advantage of more thorough research from a larger sample. More importantly, this sample selection provided the opportunity to compare aspects of reporting in different groups.
- **Insights:** Other publications have provided [only] numbers and statistics. In First Wave, Davis Polk provides some insights as to what the story behind the numbers might be. The fact that 1300 companies submitted Forms SD pursuant to Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act – compared with the 5,000 to 6,000 that were expected, has been published numerous times. Davis Polk takes another step and offers some reasons as to why this might have been the case.

### What It Says

Highlights of Davis Polk’s “First Wave” include:

- **How Long?:** Conflict Minerals Reports (CMRs) averaged 5.7 pages for S&P 500 filers, and 4.8 pages for the S&P [midcap] 400.
- **Signatories:** The vast majority of signatories for S&P 400 were from Legal or Financial. In S&P 500 submittals, Operations, Quality and Purchasing functions had higher representation as signatories (27%).



- **Inquiry? Diligence? Both?:** Some companies seemed to find the difference between Reasonable Company of Origin Inquiry (RCOI) and due diligence unclear. Indeed, this has been reported many times. First Wave noted significant overlap between the two in how companies approached and described their efforts.
- **Due Diligence Framework:** Approximately half of the companies that conducted due diligence described efforts explicitly within the context of the OECD’s five-step framework.
- **Metrics:** Some companies included metrics, mostly related to supply chain outreach and responsiveness. Metrics included number or percentage of suppliers surveyed, number or percentage of responsive supplies, and number of suppliers the company engaged with for follow-up. The companies that did provide this information were not limited to those where the numbers made them look good.
- **Say It or Not?:** Only 21% of S&P 500 filers used the phrase “DRC conflict undeterminable” to label their products in CMR, but an additional 58% included statements to substantially the same effect. For the S&P [midcap] 400, the percentages were 25% and 61%, respectively. Davis Polk went on to say that other companies provided results of their supplier outreach... without any concluding statement or explicit acknowledgement of their conflict minerals determination, and noted that “as a result of the ambiguities discussed above and the range of information, presented, categorizing a company’s diligence results was an inherently subjective exercise.”
- **Smelters:** Roughly one third of companies surveyed included some information about smelters or refiners.

### What Companies Can Learn for Year Two

DHC provides insights on the Davis Polk publication, as well as suggestions for companies preparing for Year Two procedures.

- **How Long?:** Benchmarking against the length of submittals for the 2013 reporting year can be useful. However, companies may prepare submittals for Year Two that include more information, in response to stakeholder requests or publicity. Don’t look backwards when the pack is moving. Prepare a Form SD/ CMR that are as long as they need to be to fulfill reporting requirements, and to disclose what the issuer wishes to disclose using this mechanism.
- **Signatories:** First Wave offered some excellent insights as to why the type of signatory varied according to the three sample groups. DHC suggests only that companies consider where their conflict minerals programs fall in the organization, and which executive is familiar with the program and related areas. There are many reasonable, valid choices for signatory – pick what works for you.



- **Inquiry or Diligence?:** DHC suggests that the three-step approach in the SEC rule is useful for a smelter located reasonably close to the source of the ore, and that uses only certain identified mines as their only sources. DHC notes that the three steps outlined in the SEC’s conflict minerals rule do not map neatly to the five steps in the OECD framework. Many companies that are three or four tiers removed from smelters or refiners struggled with this lack of alignment. The due diligence becomes the de facto RCOI.
- **Due Diligence Framework – and IPSA:** Approximately half did not mention the OECD framework. DHC also notes that the first objective of the Independent Private Sector Audit (IPSA) is to ascertain whether the design of the Company’s due diligence framework [as set forth in the CMR] is in conformity with, in all material respects, the criteria set forth in OECD (or other internationally-recognized framework). Without stating, mapping, or otherwise making it clear that the due diligence conforms to such a framework, the IPSA auditor will have more work to do – or could issue an unfavorable opinion.
- **Metrics:** The SEC rule does not require reporting of metrics, so many issuers elected not to submit them. Most (if not all) companies have developed some type of metrics for internal management reporting. One issuer published a “white paper” - essentially their CMR with metrics included - concurrently with their SEC submittals. White papers are not subject to enforcement by SEC. This is one mechanism to provide increased transparency.
- **Say it or Not?:** 21% of the S&P 500 made no determination or description, whereas only 14% of the midcap companies surveyed withheld any type of determination or description. DHC considers logical extensions of the passage in First Wave that “categorizing a company’s diligence results was an inherently subjective exercise.” DHC thinks it unlikely that analysts, customers, NGOs, and other stakeholders will study the details of submittals to make their own conclusions. Absent conclusions, stakeholders will make their own – perhaps that the issuer doesn’t have a credible program, or they are intentionally withholding an undesired conclusion.
- **Smelters:** Smelters are the critical “inflection point” in the supply chain. The Conflict Free Sourcing Initiative ([www.conflictreesourcing.org](http://www.conflictreesourcing.org)) is one industry organization working with smelters to demonstrate conflict-free sourcing of 3TG. Whether issues include smelter lists in SEC filings, or only in the standard information templates provided to customers, DHC encourages issuers to join, support, and actively participate in industry-wide efforts as a means to improve conflict minerals programs at reasonable costs.

DHC encourages companies to download Davis Polk’s “First Wave,” and discuss it at your next conflict minerals team meeting.