

## **Conflict Minerals: What's Ahead for Your Company?**

### **Answers in Plain Sight – Part Two: Customers**

**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 beginning to focus attention on their DFCM programs for Year Two. Many DFCM practitioners know it will differ from Year One. Companies are beginning to see requests from customers. Customer requirements are not enforceable by a regulatory agency, yet they represent another “compliance” requirement if companies want to continue as suppliers. Customer expectations in Year Two are changing – but to what?

Some of the answers are in plain view. 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 (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.

This white paper – part two of four – looks at disclosures from Customers of component companies (“Customers”).

### **SEC Filings of Customer Companies**

A little more than half of the Customer companies selected for research filed a Form SD and a Conflict Minerals Report (CMR). The remainder were non-U.S. companies or private companies. Customer company disclosures differed on matters in SEC filings including:

- **Describing Determinations:** None of the customer companies used the term “DRC Conflict Undeterminable;” most described the same conclusion, but without using those exact words. One included statements specifying that described their products in more detail, including the number of products (some in the thousands), and how they identified which products were in scope for DFCM.



- **Source of 3TG:** Most customer companies indicated that at least some of the 3TG in their supply chain originated (or was said to have originated) in Covered Countries<sup>1</sup>. One Customer did not provide this info, but did submit a CMR. One Customer company commissioned their own third party audit for smelters not already on the Conflict Free Smelter (CFS) list, and reported the audit conclusion found no evidence that these smelters procured minerals from sources that funded armed groups.
- **Industry Involvements:** Almost all Customer companies mentioned industry associations – usually the Electronic Industry Citizenship Coalition<sup>2</sup> and/or the Conflict Free Sourcing Initiative. Some mentioned the Responsible Jewelry Council, and/or the London Bullion Market Association. One customer company made no reference to industry association involvement.
- **Metrics:** Customer companies include few performance metrics in their SEC submittals. The metrics they did include varied widely, including number of products, number of commodities defined from purchasing activities as being in scope, number of smelters identified in the supply chain, and response rate from suppliers.

#### **Forward-Looking Statements: Customer Companies**

The vast majority of Customer companies in the research effort provided forward-looking statements in their CMRs. Common themes included:

- Continued, and increased engagement with suppliers
- Support of suppliers to procure 3TG from conflict-free smelters (CFSs)
- Greater response from suppliers
- Getting better information from suppliers

There were some forward-looking statements made by only one Customer company<sup>3</sup> included in the research:

- Develop and implement acceptance criteria for supplier declarations
- Support suppliers using smelters not on the CFS list in finding alternative sources for 3TG
- Benchmark industry practices, and adopt leading practices
- Implement and monitor action plans for suppliers to meet [the customer's] expectations
- Expressly avoid restrictions on sourcing from legitimate mines in Covered Countries

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<sup>1</sup> Covered Countries include the Democratic Republic of Congo (DRC) and all adjoining countries.

<sup>2</sup> See [www.eicc.info](http://www.eicc.info)

<sup>3</sup> Each statement was made by only one company that was included in the research; the statements listed are from a cross-section of companies included in the research.



### **Other Disclosure Mechanisms: Customer Companies**

The Customer companies had considerable information on conflict minerals on their websites. In general, the information appeared to be written for public consumption, using language that is “reader-friendly,” contrasted to legal-sounding language necessary for SEC filings.

A common theme of content on Customer company websites was the companies’ commitment to reducing/ eliminating conflict minerals from their supply chains, and looking to their suppliers to make it happen. The [summarized] points below were on one (and only one) of the Customer companies’ websites – and no two were on the same company’s website:

- We desire to source responsibly from Covered Countries, and avoid contributing to conflict metals.
- We prohibit the use of conflict minerals in any form, and require suppliers to do the same.
- We strive to be conflict free in our products and within our supply base.
- Any possible connection between our products and the funding of armed conflict is unacceptable.

One of the Customers provided a date associated with being conflict free – by the end of 2015.

### **DHC Analysis and Suggestions**

DHC noted that all of the Customer companies took advantage of late-breaking court decisions that stayed the requirement to use any particular phrase to describe their products, relative to conflict-free status.

The Customers also signaled in SEC filings and on their websites that they are pursuing elimination of 3TG sourced from conflict areas– and they are looking to their suppliers to get them there. Many of the forward-looking statements used verbs that were stronger (require, monitor, act, escalate) than Component companies used to describe efforts in similar areas (encourage, support).

One of the Customer companies had several statements indicating the intention of being industry leaders – through benchmarking, adopting leading practices, and supporting legitimate sourcing from Covered Countries.

In general, Customer companies had more content on their websites (e.g., other than SEC filings) than the Component companies. The reader-friendly language is for public consumption, suggesting that the customers anticipate that NGOs, analysts and other stakeholders will read it. The content on websites included forward-looking statements.



DHC notes that the SEC rule does not require issuers to include forward-looking statements in their SEC filings (Form SD or CMR); the SEC rule certainly does not require companies to report on progress against forward-looking statements. There is even less requirement for companies to publish forward-looking statements on websites. Even so, most Customer companies elected to do so. It is common practice for companies to set goals in reporting of non-financial information (environmental performance, social and economic parameters) and to report on progress towards achieving those goals in subsequent years. The Customer companies approach for conflict minerals resembles that approach, suggesting that the Component companies can expect more engagement, involvement, and active monitoring from their customers in Year Two.

The SEC rule provides for two transition years, and expects public issuers to make conflict free determinations in Year Three. The rule is silent on when in Year Three (or any year) these determinations would apply. Given the evolving state of supply chain systems and controls for 3TG, and the fact that the SEC filings are annual, DHC believes that year-end 2015 is a reasonable date as a goal for all products to be DRC Conflict Free. Court decisions and other developments may determine whether companies will be required to use specific terms in SEC filings. Customers' forward-looking statements in SEC filings and on their websites seem to indicate that conflict free determinations – whatever language will be used to describe them – will be expected.

Analysis of SEC filings and other disclosures among the Customer companies confirms that “the [customer] pack is moving.” The pack is moving quickly, and expects its suppliers to be in lock step. In many cases, the customers are raising the bar faster than peer companies have disclosed they are moving.

DHC suggests that companies subject to DFCM:

- conduct similar research of their customer companies, identifying expectations from their suppliers
- compare customer expectations to improvements anticipated in your own conflict minerals program, including stated program improvements for Year Two,
- identify gaps in your conflict minerals improvement plans, and
- adjust Year Two conflict minerals program accordingly.



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## **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](http://www.douglashileman.com) for more on Mr. Hileman and his firm’s services. See sister sites [www.DFCMAudit.com](http://www.DFCMAudit.com) and [www.DFCMTraining.com](http://www.DFCMTraining.com) for more information on conflict minerals.