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Let's talk: governance

First-year conflict mineral reporting
reveals insights and surprises



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First-year conflict mineral reporting reveals insights and surprises

More than 1,300 companies made their first conflict minerals filings in early June pursuant to a new Securities and Exchange Commission (SEC) rule.¹ These filings include (1) a Specialized Disclosure Report (Form SD) for companies that determined conflict minerals (tin, tungsten, tantalum or gold – commonly referred to as 3TG) are a necessary component in their supply chains and (2) a Conflict Minerals Report (CMR) exhibit for a subset of those companies that had reason to believe the 3TG in their products may have originated in the Democratic Republic of the Congo (DRC) or an adjoining country (covered countries; see below for a description of the rule). The number of filings is significantly lower than the earlier estimates of around 6,000 impacted companies and 4,500 that would be required to file a CMR provided by commenters to the SEC.²

A review of disclosures in the Form SD filings and CMR exhibits provides insight into the impact of this new SEC rule.

Most filers in this initial year were unable to determine the origin of 3TG in their products and filed a CMR stating the need for further due diligence. Many of these companies have complex supply chains and reported difficulties in tracing the origin of the 3TG in their products given insufficient supplier responses to their inquiries. Many companies reported that suppliers did not respond to questionnaires or did not provide complete or adequate responses. For this reason, many of the CMR reports did not include the type of detail that may have been expected.

Data for this report is based on EY's Center for Board Matters corporate governance database and EY's review of the filings. The review includes filings through 6 June.³

The conflict mineral rule

In August of 2012, the SEC issued a final rule on conflict minerals disclosure as required under Section 1502 of the Dodd-Frank Act. The rule requires all reporting companies (including foreign issuers) to file a Form SD if they determine conflict minerals – tin, tantalum, tungsten and gold (3TG) – are “necessary to the functionality or production” of their products manufactured or contracted to be manufactured. These companies must conduct a reasonable country of origin inquiry (RCOI) to determine if any of the 3TG materials originate in the covered countries. A company must also file a CMR if it knows or has reason to believe the conflict minerals may have originated in the covered countries, and are not from recycled or scrap sources. Congress imposed this requirement to trace the source of conflict minerals to put pressure on supply chains to reduce a source of funding for armed groups in the DRC, due to concerns that they are subjecting workers and indigenous people to human rights abuses and financing regional conflicts.⁴

The rule was challenged by several business groups, but in 2013, the District Court for the District of Columbia granted summary judgment in favor of the SEC. Also, in April 2014, the US Court of Appeals for the District of Columbia Circuit rejected the majority of the plaintiffs' claims on appeal. However, the Court determined that the requirement to describe products as “not DRC conflict free” unconstitutionally impacts free speech. As a result, the SEC issued guidance indicating that for now companies are not required to describe their products as “not found to be ‘DRC conflict free,’” “DRC conflict undeterminable” or “DRC conflict free,” although they may voluntarily elect to do so.⁵

Companies are required to file annually by 31 May for the prior calendar year, regardless of the timing of their fiscal year-end.

Key findings across all SEC reporting companies

- ▶ 1,315 companies filed a Form SD; of these, 77% of these filed an associated CMR.
- ▶ 85% of those filing a Form SD were companies headquartered in North America, followed by companies headquartered in Europe (10%), Asia-Pacific (3%) and other areas of the globe (2%).
- ▶ Only 4 companies obtained an independent private sector audit (IPSA) of their CMR including the due diligence framework used and activities undertaken. The vast majority indicated their reports were not subjected to an IPSA as the rule provides a two-year transition period for those firms whose 3TG status is uncertain.⁶

S&P 500 companies: conflict minerals disclosures

EY reviewed the Form SD filings for the 213 S&P 500 companies that identified the use of 3TG in their supply chain. More than 85% of these (184 companies) filed an associated CMR.

S&P 500 Form SD and CMR exhibits



An executive officer must sign off on the Form SD. Company representatives selected varied significantly:

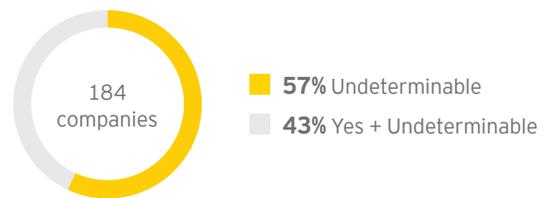


Conflict minerals report disclosures

Key findings from a review of the 184 S&P 500 companies filing a CMR exhibit show:

Most companies were not yet able to determine the origin of the conflict minerals in their products. More than 40% identified that at least some portion of their sourcing originates in the covered countries but indicated additional due diligence was necessary for some portion of their product components and suppliers.

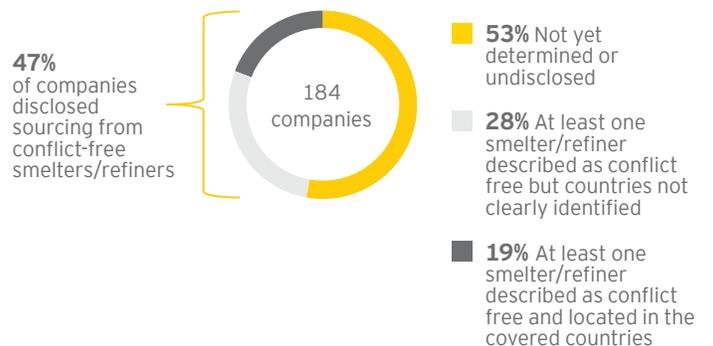
Sourcing from covered countries



Most companies did not have sufficient information to fully trace the source of 3TG materials. About half were able to identify some portion of smelters as conflict-free and only 27% provided a list of smelters and refiners.

Additionally, nearly 20% noted that one or more smelters in covered countries are conflict-free.⁷

Conflict-free smelters and refiners



Most companies disclosed the use of third-party due diligence tools in their review process, including:

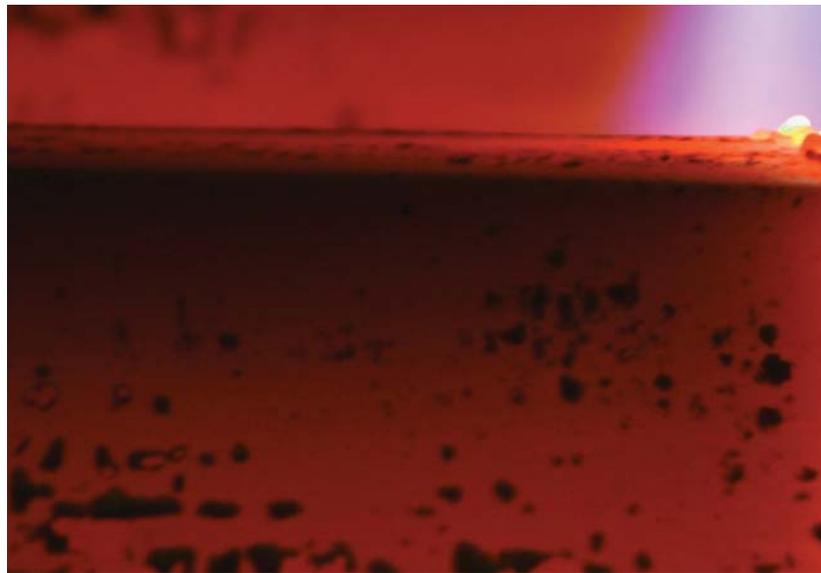
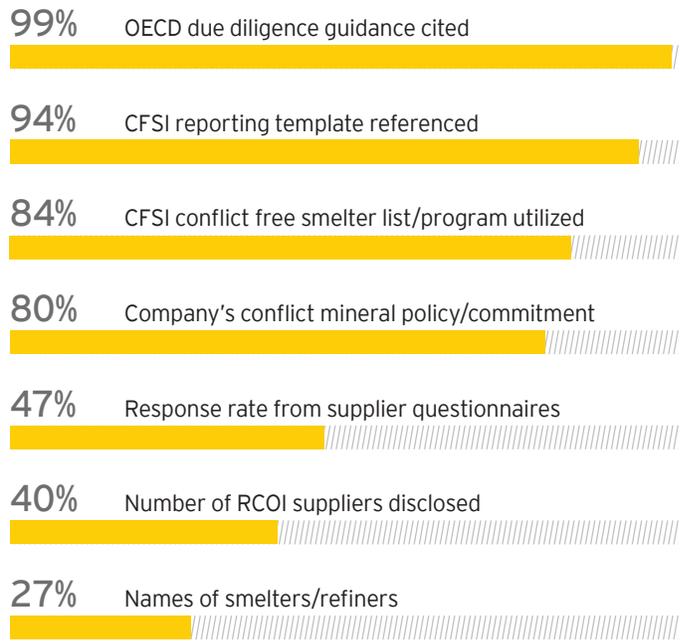
- ▶ Organization for Economic Co-Operation and Development (OECD) Due Diligence Guidelines for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: This due diligence framework is widely cited and currently the only government-backed multi-stakeholder initiative aimed at developing transparent mineral supply chains and corporate-supplier engagement practices in the mineral resources sector. Many companies created a formal policy position or commitment statement on conflict minerals in connection with OECD guidance related to the development of strong company management systems.
- ▶ Conflict-free Sourcing initiative (CFSI)⁹ reporting template: This is a supply chain survey tool that is designed to identify the smelters and refiners that process the necessary conflict minerals contained in a company's products. The reporting template includes questions on a supplier's responsible sourcing policies, its practices for engaging with upstream suppliers and the smelters/refiners from which conflict minerals are sourced.
- ▶ CFSI Conflict-Free Smelter Program: The most commonly cited independent third-party audit program which provides certification regarding the conflict free status of smelter and refining facilities. Some companies included in their CMR exhibits the identification of smelters used.

Disclosures indicate that tracing the sourcing of conflict minerals was challenging for these large companies. About half of the S&P 500 companies filing a CMR disclosed a supplier response rate and only 40% identified the actual number of RCOI suppliers surveyed. The average number of suppliers surveyed was about 2,500, but ranged from 5 to almost 40,000. Fewer than one-third disclosed both the number of suppliers and the response rate.

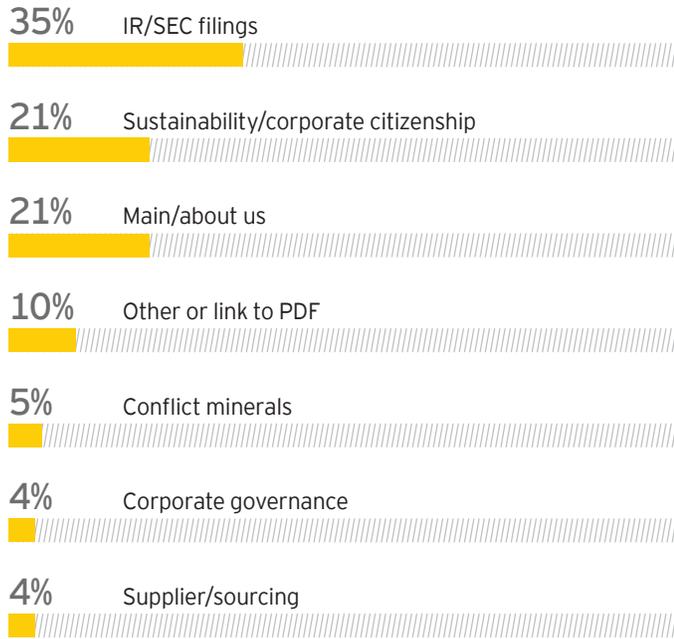
Of those companies disclosing a supplier survey response rate, over three-fourths indicated a rate higher than 50%. This may suggest that a 50% or greater threshold was seen as desirable prior to choosing to include this information.

Companies filing a CMR are also required to post the report on their company website. While the location varied significantly, the most common area for these reports (35%) was the general investor relations page.

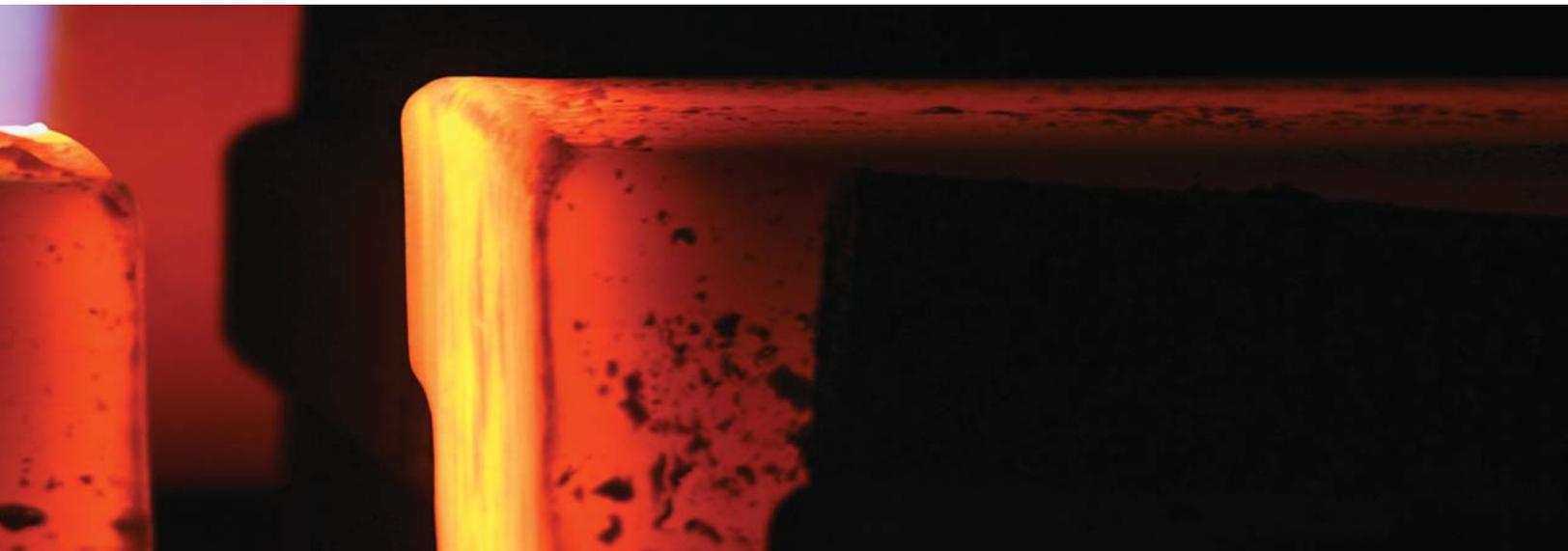
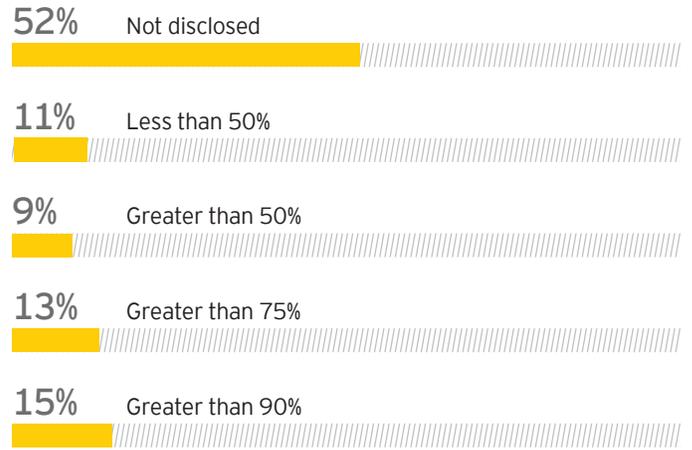
Due diligence related disclosures



Location of CMR on company website



Supplier response rate



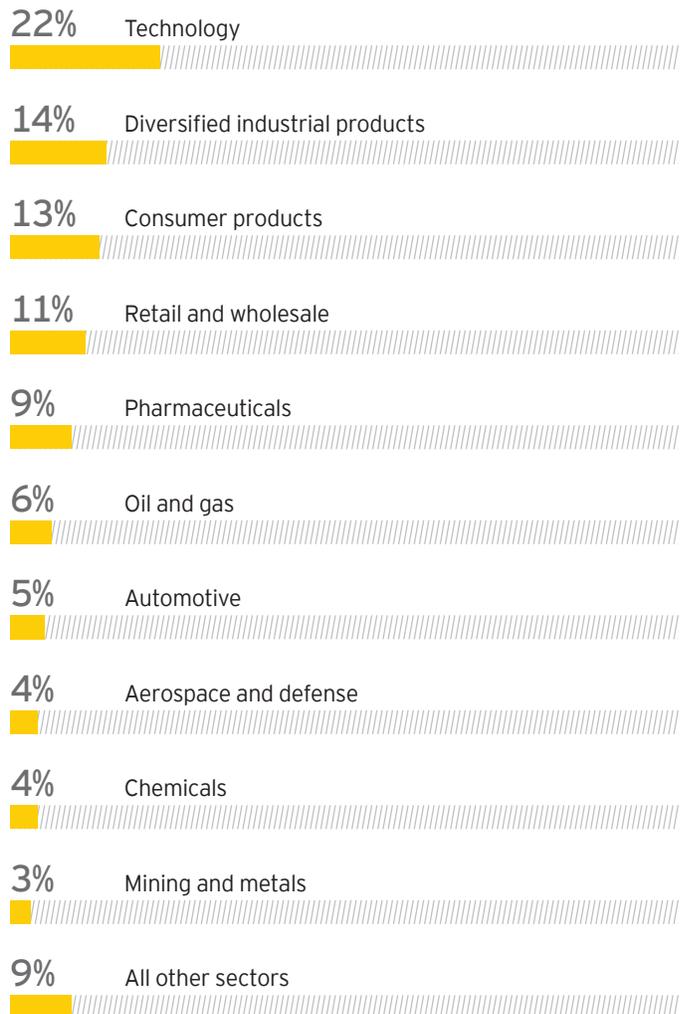


Industry trends

Around 90% of all SD filings came from companies in 10 sectors, with high concentration in the technology, diversified industrial products, consumer products, and retail and wholesale sectors. Conflict minerals were not found to be a necessary part of the supply chains for companies in only a few select sectors: airlines, asset management, biotechnology, insurance and real estate.

Top 10 sectors with SD filings

Percent of all SD filings for S&P 500 companies



Sectors	No. S&P 500 companies	SD filers (% of sector)	CMR filers (% of sector)	Sourcing from covered countries (% of CMR filers)	
				Undeterminable	Yes and Undeterminable*
Aerospace and defense	8	100%	100%	50%	50%
Airlines	3	-	-	-	-
Asset management	5	-	-	-	-
Automotive	15	67%	67%	70%	30%
Banking and capital markets	39	15%	15%	33%	67%
Biotechnology	6	-	-	-	-
Chemicals	11	73%	55%	33%	67%
Construction	3	33%	33%	100%	0%
Consumer products	49	55%	43%	71%	29%
Diversified industrial products	35	86%	71%	76%	24%
Hospitality and leisure	10	30%	10%	100%	0%
Insurance	25	-	-	-	-
Media and entertainment	21	19%	19%	75%	25%
Mining and metals	8	88%	38%	67%	33%
Oil and gas	41	29%	22%	44%	56%
Other transportation	8	13%	-	-	-
Pharmaceuticals	29	66%	59%	76%	24%
Power and utilities	34	3%	3%	0%	100%
Professional firms and services	13	31%	31%	50%	50%
Provider care	7	29%	14%	100%	0%
Real estate	21	-	-	-	-
Retail and wholesale	37	62%	57%	67%	33%
Technology	65	71%	69%	33%	67%
Telecommunications	7	14%	14%	0%	100%

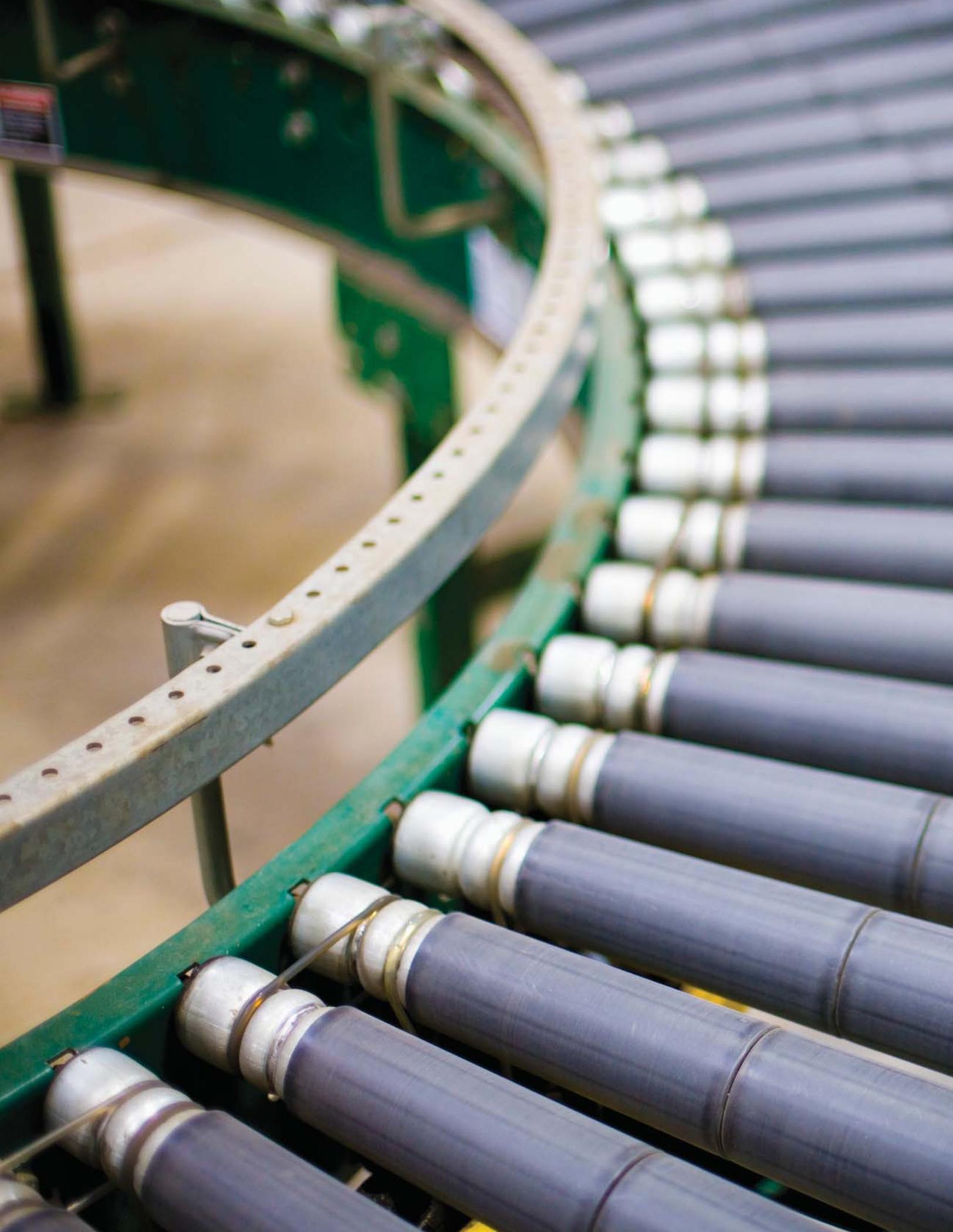
*Identified at least some portion of their sourcing originates in the covered countries but indicated additional due diligence was necessary for some portion of their product components and suppliers.

Conclusion

The number of filings for calendar year 2013 (approximately 1,300) suggests that the SEC's and business groups' initial projection of impacted companies (6,000) was overestimated and/or some potential reporters may have failed to identify the applicability of conflict mineral reporting to their operations. Initial filings also make clear that companies will need the additional time afforded under the transition period of the rule to work with their suppliers to determine the origin of the conflict minerals in their products. Many companies have complex supply chains, and a commitment from suppliers and the coordination of global organizations will be necessary for companies to assess their own systems, processes, representations and results. As companies pay increasing attention to supply chain monitoring and reporting, the information presented in this report may help serve as a guide to 3TG disclosure, facilitating an assessment of how companies compare to others in the marketplace.

Endnotes

- 1 *Conflict minerals final rule*, SEC website, <http://www.sec.gov/rules/final/2012/34-67716.pdf>
- 2 Ibid.
- 3 The filing deadline for 2014 was 2 June. In this initial reporting year, 20 companies filed after the deadline through 6 June.
- 4 For additional information, see *Conflict minerals: what you need to know about the new disclosure and reporting requirements and how Ernst & Young can help* and *To the Point: SEC moves ahead with modified conflict minerals reporting*.
- 5 See *SEC Statement on the Effect of the Recent Court of Appeals Decision on the Conflict Minerals Rule*, *SEC Issues Partial Stay of Conflict Minerals Rules*, and DC Circuit Court opinion.
- 6 Four years for smaller reporting companies.
- 7 The use of a conflict-free smelter does not directly tie to the declaration of a conflict-free product as a product may have multiple 3TG sources. As noted in the earlier discussion of the IPSA, only 4 companies identified one or more products as conflict free as a result of due diligence efforts.
- 8 <http://www.oecd.org/daf/inv/mne/GuidanceEdition2.pdf>
- 9 <http://www.conflictreesourcing.org/>



Let's continue the conversation.

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