Conflict Minerals: Time to Develop a Compliance Strategy

The long wait for direction on the conflict minerals provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act is finally over. It's time for companies to develop a strategy for compliance. On Aug. 22, the U.S. Securities and Exchange Commission completed its deliberations over Dodd-Frank Section 1502 and voted to adopt the provision and issued a 357-page set of rules for compliance.

These rules mean companies will need to disclose whether their manufacturing process or products utilize so-called "conflict minerals" from the Democratic Republic of Congo (DRC) and adjoining countries. Congress included this provision in Dodd-Frank because of concerns that the exploitation of these minerals by armed groups is helping to finance conflict in the DRC region and is contributing to a humanitarian crisis.

Congress believes that these reporting requirements will provide transparency for investors and, through that transparency, help curb the violence.

> **Though the timing is right and the upfront costs could be significant, this could prove to be an investment that yields even greater savings over the long term.**

Minerals covered under the provision are commonly referred to as "3TG," for tin, tantalum, tungsten and gold. These minerals are used in a wide range of industries including electronics and communications, aerospace and automotive, jewelry, health care devices and diversified industrial manufacturing.

The DRC holds a substantial supply of tantalum and large deposits of gold and tin, which means a large number of companies will undoubtedly be affected by this provision. The SEC estimates it may affect about 6,000 companies in the United States and abroad. Private companies may also be affected if they are part of the supply chains of the companies affected by the reporting requirements.

Three Steps to Follow

Under Section 1502, Dodd-Frank mandates three steps:

1. SEC-registered companies must determine if they have any exposure to 3TG.

2. Companies must determine, on a reasonable basis, if the 3TG minerals they use originated in the DRC or an adjoining country. If the metals did not originate in the DRC nations or are considered scrap or recycled, companies must report how they determined this in a new specialized disclosure Form SD.

3. If the 3TG minerals do come from the DRC region — or if the source is unknown — companies must trace the supply chain for the source and furnish an independently audited report on those due-diligence efforts.

The compliance deadlines are already within sight. Under the rules, companies will need to compile data for calendar year 2013 (irrespective of their fiscal year) and make their first filing by May 31, 2014. The SEC's requirement to "file" this report potentially creates for companies a higher standard for compliance. The practical impact is that a company could be held liable for "false or misleading statements" under Section 18 of the Exchange Act.

Without question, compliance will be costly. The SEC estimates it will cost affected companies a total of $3-$4 billion in the first year and at least $200 million each year afterward. All that said, this new compliance requirement — done correctly — could offer beneficial insights for companies as they gain more visibility into their supply chain. Some are already using this information to rationalize their supply chain operations and exert better risk controls over suppliers.

Though the timing is tight and the upfront compliance costs could be significant, this could prove to be an investment that yields even greater savings over the long term.

Building a Framework for Compliance

For companies that are already developing a conflict minerals compliance framework, the process is being led by C-level executives, with the board of directors and CEO driving strategy. But though each company's compliance framework may be organized differently, the ultimate responsibility for reporting information to the SEC sits primarily with the chief financial officer, as conflict minerals reports (subject to audit) would be furnished as an exhibit to a company's public filings with the SEC.

Building a Section 1502 reporting structure below the CFO and chief operation officer is likely to be demanding, involving work from at least four corporate departments:

Once a company has its internal compliance framework built, it needs to determine the sources of the minerals in its supply chain. This can be a daunting task.

supply chain and procurement, legal counsel, finance and internal audit. Meanwhile, the audit committee will want to be involved in the same way as with any financial statement to the SEC, given there is an external audit requirement for the conflict minerals filing.

And given the intent of the law, some companies are also including their office for sustainability or corporate social responsibility (CSR).

Mapping the Supply Chain

Once a company has its internal compliance framework built, it needs to determine the sources of the minerals in its supply chain. This can be a daunting task, as exemplified by an aerospace company that is already engaged in the process. As one executive put it, a typical commercial airplane has more than five million parts, and airplane companies are usually just the final assemblers of the aircrafts.

Yet, the company has commercial relationships with its tier-one suppliers, and those suppliers may have a dozen or more tiers of suppliers, each tier made up of a web of usually confidential commercial agreements.

Like the organization in this example, a number of companies have already gotten a jump on the Dodd-Frank requirement and have at least started to set up a compliance framework. By KPMG's count, 77 companies have published a conflict minerals statement online and 63 organizations included conflict minerals information in their SEC filings for 2011. Others have set goals.

For instance, semiconductor maker Intel Corp. says it wants to make the first microprocessor validated as "conflict free" by the end of 2013.

In some cases, companies have been spurred to comply by state rules. California and Maryland have already adopted conflict minerals provisions, and Massachusetts and Rhode Island are considering legislation. Internationally, Australia has released due diligence guidelines, and there are three proposed laws under consideration in the European Union.

For companies that have not yet considered this issue, it's time to get started. When starting the process, keep in mind that this does not have to be simply a compliance exercise. It could result in a supply chain operation that's more transparent for the company's investors and better for its bottom line.

Jim Low is a partner at KPMG LLP, the U.S. audit, tax and advisory firm, and leader of KPMG's Financial Services Regulatory Center of Excellence (www.kpmg.com/us).

FEI Member Larry Salva Appointed to FASB's EITF; FEI Member George Beckwith Appointed to FAF's PCC

On Sept. 10, the Financial Accounting Standards Board (FASB) announced the appointment of three new members to the Emerging Issues Task Force (EITF). EITF assists FASB in improving financial reporting through the timely identification, discussion and resolution of financial accounting issues.

Larry Salva, Comcast Corp.

Among the new members is FEI member **Larry J. Salva,** senior vice president, chief accounting officer and controller of Comcast Corp. He will begin his term on the EITF on Nov. 1, 2012. Salva serves on FEI's Committee on Corporate Reporting (CCR) and has served as the committee's chair.

The other members appointed to the EITF are Terri Z. Campbell, CFA, a managing director with Liberty Mutual Group Asset Management Inc., and Jackson Day, the Americas director of accounting standards setting for Ernst & Young LLP.

George Beckwith, National Gypsum Co.

Then, on Sept. 19, the Board of Trustees of the Financial Accounting Foundation (FAF) appointed the chair and members of the Private Company Council (PCC). The PCC is a new body that will work with FASB to determine whether and when to modify U.S. generally accepted accounting principles (U.S. GAAP) for private companies.

George Beckwith, vice president and chief financial officer of National Gypsum Co. and chairman of FEI's Committee on Private Company Standards, was named as a member of the council, along with chair Billy M. Atkinson, who served as chairman of the National Association of State Boards of Accountancy (NASBA) until 2010.

Others comprising the committee are Steven Brown, vice president of US Bank; Jeffery Bryan, partner, Professional Standards Group of Dixon Hughes Goodman LLP; Mark Ellis, CFO, PetCareRx Inc.; Thomas Groskopf, director and owner, Barnes, Denning & Co. Ltd; Neville Grusd, president, Merchant Financial Corp.; Carleton Olmason, managing principal, GMB Mezzanine Capital; Diane Rubin, partner, Novogradac & Co. LLC; and Lawrence Weinstock, vice president – Finance, Mana Products Inc.