Conflict Minerals: A Clearer Path On the Horizon

Companies working to meet the mandates of the conflict minerals provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act could have a clearer path toward compliance. Further guidance from the regulators and audit guidelines from the American Institute of Certified Public Accountants (AICPA) may soon be on the way.

Many companies have faced the quandary of cutting through the complexity of the voluminous regulations around conducting their due diligence on tracing the roots of the "conflict minerals" outlined in Dodd-Frank. Meanwhile, in certain circumstances they would need to trace the source of those minerals in a manner that is auditable, furthering the challenges for companies trying to do the right thing.

The U.S. Securities and Exchange Commission (SEC) voted last August to adopt Dodd-Frank Section 1502, issuing a 357-page set of rules for compliance on conflict minerals. Those rules state that companies need to disclose whether products they manufacture contain certain minerals mined in the Democratic Republic of Congo (DRC) and adjoining countries that hold a substantial supply of mineral deposits and, therefore, could affect a large number of companies.

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

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

The SEC estimates the provision may affect about 6,000 companies in the United States and abroad, as well as many private companies that 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 for companies to follow:

1. SEC-registered companies must determine if they have any exposure to 3TG.
2. 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 they 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. However, if a company's due diligence does not confirm a source for the first two reporting periods, it may use an "undeterminable" conclusion and may not require an audit.

> **Despite a lack of clarity on the rules for conflict minerals, the industry response continues to be significant.**

SEC Compliance and IPSA Audit Guidance Needed

Compliance deadlines already are in sight, as the first filing must occur by May 31, 2014 for calendar year 2013. There is a need for additional information within the complex compliance document, which has left many companies eager for news that the SEC will release updated rules that provide additional clarity.

Though there has been no formal announcement, there is speculation that the SEC is taking action to provide further guidance for implementing the rules. Some hope that the guidance will include definitions for uncertain terms such as "contract to manufacture," "necessary to the production" and "necessary to the functionality."

Despite offering what seemed to be some leniency in the final rules allowing companies to use the classification of "undeterminable" for up to two years, those that have been working toward understanding their supply chain are not able to make this claim and will need to file a conflict minerals report (CMR), and thereby undergo an audit.

With this in mind, companies are keen to understand the audit requirements in order to complete the CMR. In the meantime, the AICPA has convened a task force to provide practitioners with guidance relating to the Independent Private Sector Audit (IPSA), which is required to be performed in accordance with the Government Auditing Standards, also known as "Yellow Book," and can consist of either an examination attestation engagement or a performance audit.

A Global Concern

The issue of conflict minerals is not limited to the U.S. government, but also affects local governments around the world. California, Pittsburgh, Australia and the European Union Parliament all have passed bills and resolutions around conflict minerals. The method of addressing these issues varies across governmental bodies; however the issue itself is gaining traction globally.

Most recently, measures and activities in the EU have progressed significantly, with the latest memo from the EU stating that it is pushing toward regulation, and that it may not be limited to the Central Africa region or to 3TG. A memo to the European Civil Society and Industry from Judith Sargentini, member of the European Parliament (Greens/European Free Alliance Group), mentioned that there would be a draft legislative proposal published before the year's end. In addition, the Dutch government has launched a Conflict-Free Tin Initiative.

Companies will be wise to get a broad transparency program in place as the theme of legislation is progressing beyond four metals.

Compliance Response Significant

Despite a lack of clarity on the rules, the industry response to addressing conflict minerals continues to be significant. Company efforts range from certifying that their supply chains are conflict free and conducting surveys on their suppliers to educating and informing their suppliers and developing their own conflict minerals policies. A KPMG count shows at least 92 companies have published a conflict minerals statement online and 197 organizations included conflict minerals information in their SEC filings for 2012.

For those companies struggling with the complexity of the regulations, here are some helpful takeaways:

- Centralized projects can help reduce variances in approach by subsidiaries.
- Develop clear ongoing communication with suppliers and provide training to assist in their understanding of required responses to improve response rates and quality.
- Procurement categories are a good place to begin scoping, but they often do not complete 3TG identification.
- Proper product due diligence requires internal information systems to contain accurate and searchable bills of material information. Therefore, the support and involvement of the chief information officer is vital, and data and analytic capabilities can offer assistance to ensuring all areas of the supply chain are reviewed.
- Up-front product due diligence is critical in reducing the number of suppliers to be surveyed to maintain manageable survey process.

There are steps companies can take to begin the reporting process, and additional guidance will be welcome by those organizations affected. Careful planning remains key. Organizations are using this compliance requirement as an opportunity to better understand their supply chain.

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.