KPMG
cutting through complexity

Conflict minerals and beyond

Part one: developing a global compliance strategy

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Introduction

Within the "Miscellaneous Provisions" of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank" or the "Act") are regulations for companies that use or extract minerals. These are contained in sections relating to Conflict Minerals (Section 1502), Mine Safety Disclosures (Section 1503), and Payments to Governments by Resource Extraction Issuers (Section 1504). A purpose of the law is to improve industry transparency and provide investors and citizens with new tools to hold companies and governments accountable for socially responsible behavior.

This KPMG report is the first in a four-part series that covers Section 1502 of the Act, which requires all US and foreign companies reporting to the Securities and Exchange Commission (SEC) to disclose annually whether certain minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by the company originated in the Democratic Republic of the Congo (DRC). DRC and its neighbors have seen years of brutal civil strife, some of it financed by mineral extraction. SEC-reporting companies will need to determine if they manufacture or contract to manufacture products that contain conflict minerals that are necessary to the functionality or production of the product (page 4 and 5). The minerals in question are gold, as well as columbite-tantalite, cassiterite, wolframite and their derivatives: tin, tungsten and tantalum. The Act calls for companies to describe the measures taken, and in certain circumstances "to exercise due diligence on the source and chain of custody of such minerals", including an independent audit of the measures. They must describe the products manufactured that are "DRC Conflict Free", "Not DRC Conflict Free" or "DRC Conflict Free Undeterminable" (conflict free products are defined in the Act as those that do not finance or benefit armed groups in the DRC or adjoining countries).

Dodd-Frank was signed into law on July 21, 2010 and the SEC published on August 22, 2012, the final regulations governing the way companies comply with Section 1502. Under these rules, certain SEC reporting companies will have to file a specialized disclosure report on conflict minerals by May 31, 2014 (for the 2013 calendar year) and annually by May 31 thereafter. In the meantime, other jurisdictions around the world have issued or are in process of debating their own rules and guidance for companies with regard to conflict minerals. These include the Australian government, the EU parliament, the states of California and Maryland, two US cities and eight American universities.

In an effort to inform our readers of the significance of these measures, KPMG has published two reports on conflict minerals.[1] Given the importance of the issues, however, KPMG's series of papers on conflict minerals will aim to take a global view of the topic. Although Dodd-Frank is a US law, it affects thousands of companies around the world. Similarly, measures in other jurisdictions will affect the way US companies operate. The Organisation for Economic Co-operation and Development (OECD) has its own global program to provide companies with guidance on how to manage responsible supply chains of conflict minerals.

This report will focus on developing a compliance strategy. Future reports will cover: the management of the minerals supply chain; reporting and disclosure; and optimizing implementation of the compliance strategy.

Government regulations are focusing more and more on supply chains – not just in the area of conflict minerals, but also labor rights, worker safety, environmental effects, and so on. KPMG member firms believe that compliance with these regulations is not just a box-ticking exercise, but a matter of strategy beyond compliance. By taking a broad view of the impact of these regulations on the entire enterprise and developing a strategy of

1 Conflict Minerals Provision of Dodd-Frank: Immediate implications and long-term opportunities for companies; Conflict minerals … Does compliance really matter?

compliance, companies are likely to reap long-term benefits in the form of supply chains that are more efficient, less risky and more transparent.

Section 1502 is an important piece of this puzzle. The conflict minerals provision directly affects a significant number of all publicly traded companies in the US as well as a high proportion of the 1,000 foreign companies registered with the SEC and when all the companies in these firms' supply chains are included, the number grows by several thousand. Automobiles, for example, contain significant amounts of tin, tungsten and tantalum. JAPIA, the Japanese auto parts association, says that the Japanese automotive industry has 300,000 to 400,000 companies in its supply chain. Apart from the sheer number of companies, there is the issue of competitiveness. Companies that do *not* develop a rigorous conflict-minerals compliance strategy may end up at a competitive *dis*advantage.

A number of companies acted ahead of the SEC's rules and have set up a framework of compliance. These include semiconductor maker Intel which has set the goal of making the first microprocessor validated as conflict free by the end of 2013.[2] Some aerospace companies have held a series of symposia for their suppliers to educate them about conflict minerals. Apple's annual Supplier Responsibility Progress Report[3] provides details on the company's steps to require that its suppliers only use conflict-free minerals. A survey of KPMG partners and directors conducted in May 2012 by KPMG's Americas' Financial Services Regulatory Center of Excellence(COE) shows that 45% of 94 KPMG firms' partners and directors say their client companies have started work on complying with Section 1502, even before the SEC voted to adopt rules.

Nobody will know the full cost until companies begin reporting on conflict minerals in their supply chains. Full compliance may take years. SEC staff estimated that the total start-up cost for companies to comply would be between $3 billion to $4 billion, with annual costs ranging between $206 million to $609 million. A study by Tulane University[4] estimated the cost of setting up a compliance program for issuers and their first-tier suppliers to be $7.9 billion for year one. The aerospace industry, for example, estimates the cost for its manufacturers will range from $100 million to $2 billion, depending on the complexity of the final regulations issued by the SEC.

"Compliance with Section 1502 will give companies an opportunity in law to control their supply chain. They have never had that before," says Jim Low, Partner and Lead of KPMG's Americas' Financial Services Regulatory Center of Excellence. "They will be forced to map out their supply chain which will allow for them to learn a lot about themselves. The upfront cost will be big, but the savings could be immeasurable in the next 5–10 years."

2 http://www.businessinsider.com/intel-plans-conflict-free-tantalum-microprocessors-2012-6
3 http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2012_Progress_Report.pdf p11
4 A critical analysis of the SEC and NAM economic impact models and the proposal of a third model in view of the implementation of Section 1502 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, October 2011.

Following the rules

On a 3-2 vote, the SEC approved the final rule governing Section 1502 on August 22, 2012. The rule applies to certain SEC-reporting companies that use tantalum, tin, gold or tungsten if the minerals are "necessary to the functionality or production" of a product manufactured, or contracted to be manufactured, by the company. A company is considered to be "contracting to manufacture" a product if it has some influence over the manufacturing of that product. A company will not be deemed to have influence over the manufacturing (based on a company's specific facts and circumstances) if it merely:

- Affixes its brand to a generic product manufactured by a third party.
- Services a product manufactured by a third party.
- Specifies contractual terms with a manufacturer that do not directly relate to the manufacturing of the product.

Under the final rule, a company meeting the criteria above and using any of the four minerals is required to conduct a "reasonable country of origin" inquiry in good faith to determine whether any of its minerals originated in the covered countries or are from scrap or recycled sources (the scrap and recycled sources was a significant change from the proposed rule). The inquiry must determine whether:

- The company can state with reasonable certainty that the minerals did not originate in the covered countries or are from scrap or recycled sources.
- The company has no reason to believe that the minerals may have originated in the covered countries or may not be from scrap or recycled sources.

If either of these statements is true, then the company must disclose its determination, provide a brief description of the inquiry it undertook, and the results of the inquiry. All of this must be disclosed on a new specialized form to be filed with the SEC called Form SD. The company must also make this disclosure available on its website.

If the inquiry, however, determines both of the following to be true:

- The company knows, or has reason to believe, that the minerals may have originated in the covered countries.
- The company knows, or has reason to believe, that the minerals may not be from scrap or recycled sources.

then the company must undertake due diligence on the source and chain of custody of its conflict minerals and file a Conflict Minerals Report as an exhibit to the Form SD. The company must also make publicly available the Conflict Minerals Report on its website. The due diligence measures must conform to a nationally or internationally recognized due diligence framework, such as the due diligence guidance approved by the Organisation for Economic Co-operation and Development (OECD). Upon conclusion of a company's due diligence efforts, it must determine the following classification for the affected minerals:

DRC Conflict Free – If a company determines that its products are "DRC conflict free" (i.e., the minerals may originate from the covered countries but did not help finance armed groups) then the company must undertake the following audit and certification requirements:

- Obtain an independent private sector audit of its Conflict Minerals Report.
- Certify that it obtained such an audit.
- Include the audit report as part of the Conflict Minerals Report.
- Identify the auditor.

Not Been Found to Be "DRC Conflict Free" – If a company's products have not been found to be "DRC conflict free," then the company, in addition

to the audit and certification requirements, must describe the following in its Conflict Minerals Report:

- The products manufactured, or contracted to be manufactured, that have not been found to be "DRC conflict free."
- The facilities used to process the conflict minerals in those products.
- The country of origin of the conflict minerals in those products.
- Its efforts to determine the mine or location of origin with as much specificity as possible.

DRC Conflict Undeterminable – For a two-year period (or four-year period for smaller reporting companies), if the company is unable to determine whether the minerals in its products originated in the covered countries or financed armed groups there or came from scrap or recycled sources, then those products are considered "DRC conflict undeterminable." In this case, the company must describe the following in its Conflict Minerals Report:

- Its products manufactured, or contracted to be manufactured, that are "DRC conflict undeterminable."
- The facilities used to process the conflict minerals in those products, if known.
- The country of origin of the conflict minerals in those products, if known.
- Its efforts to determine the mine or location of origin with as much specificity as possible.
- The steps it has taken or will take, since the end of the period covered in its most recent Conflict Minerals Report, to mitigate the risk that its conflict minerals benefit armed groups, including any steps to improve due diligence.

For those products that are "DRC conflict undeterminable," the company is not required to obtain an independent private sector audit of the Conflict Minerals Report regarding the conflict minerals in those products. However upon expiration of the 2 or 4 year period, if the Company is not able to determine the source of the minerals, it would be deemed *Not Been Found to Be "DRC Conflict Free"* and would be subject to the audit provisions.

Recycled or Scrap Due Diligence – There are special rules governing the due diligence and Conflict Minerals Report for minerals from recycled or scrap sources. If a company's conflict minerals are derived from recycled or scrap sources rather than from mined sources, the company's products containing such minerals are considered "DRC conflict free."

If a company cannot reasonably conclude after its inquiry that its gold is from recycled or scrap sources, then it is required to undertake due diligence in accordance with the OECD Due Diligence Guidance, and get an audit of its Conflict Minerals Report. Currently, gold is the only conflict mineral with a nationally or internationally recognized due diligence framework for determining whether it is recycled or scrap, which is part of the OECD Due Diligence Guidance.

For the other three minerals, if a company cannot reasonably conclude after its inquiry that its minerals are from recycled or scrap sources, until a due diligence framework is developed, the company is required to describe the due diligence measures it exercised in determining that its conflict minerals are from recycled or scrap sources in its Conflict Minerals Report. Such a company is not required to obtain an independent private sector audit regarding such conflict minerals.

Building a framework for compliance

If companies are to comply with Section 1502 of the Act, they will need to get their own house in order as well as set up a robust external process to obtain information from their suppliers. This section focuses on the internal framework for compliance.

Companies reporting to the SEC should, without delay, set up a structure to manage compliance. Almost all such firms will never have had to analyze their supply chain in the way they will be expected to do under the conflict minerals provision. They will have to reorganize themselves to ensure the process is smooth and efficient. Departments that hardly talk to one another will have to collaborate. [see page 6 for collaboration sidebar]

These kinds of changes are rarely painless and never quick. Most executives believe that it will take at least two years to implement compliance fully, starting from the moment the rules are published. Bob Shepler, Director[5], Government Relations, Government & Regulatory Affairs, at Lockheed Martin, a US defense contractor, reckons it will likely take a few years, and some think the transition will last even longer.

Corporate changes that are far-reaching, complex and difficult usually require strong support from the C-suite as a first step. Compliance with Section 1502 is no different. "The changes should be led by C-level executives, because the process is likely to extend throughout the company. So you need a big initiative," says Koichi Iguchi, Partner in Business Performance Advisory at KPMG in Japan. Adds Jim Low: "The entire C-suite will be involved in year one, because compliance with Section 1502 is so novel and it could affect business models. The board and the CEO will drive strategy."

The SEC will require companies to provide the public disclosure on a new form filed with the commission, called Form SD. This filing requirement is likely to add a certain degree of liability for companies' statements concerning the source of their materials. At the behest of the CEO and the board, the CFO therefore should be the one to formulate a strategic plan for compliance.

Non-issuers will not have to report on conflict minerals to the SEC, but will be called upon by the issuers to provide information to them. For non-issuers, the process should be the responsibility of the Chief Operating Officer, since supply chains normally fall within their purview.

Certain issuers' conflict minerals reports (an exhibit to Form SD) may require an independent private sector audit; in those situations the external auditors should be brought into the process near the beginning and not at the end. The clearer the governance structure of compliance the better, for this will determine the audit trail and will enable the external auditors to know where to find the information needed to sign off on the measures taken to exercise due diligence over the supply chain.

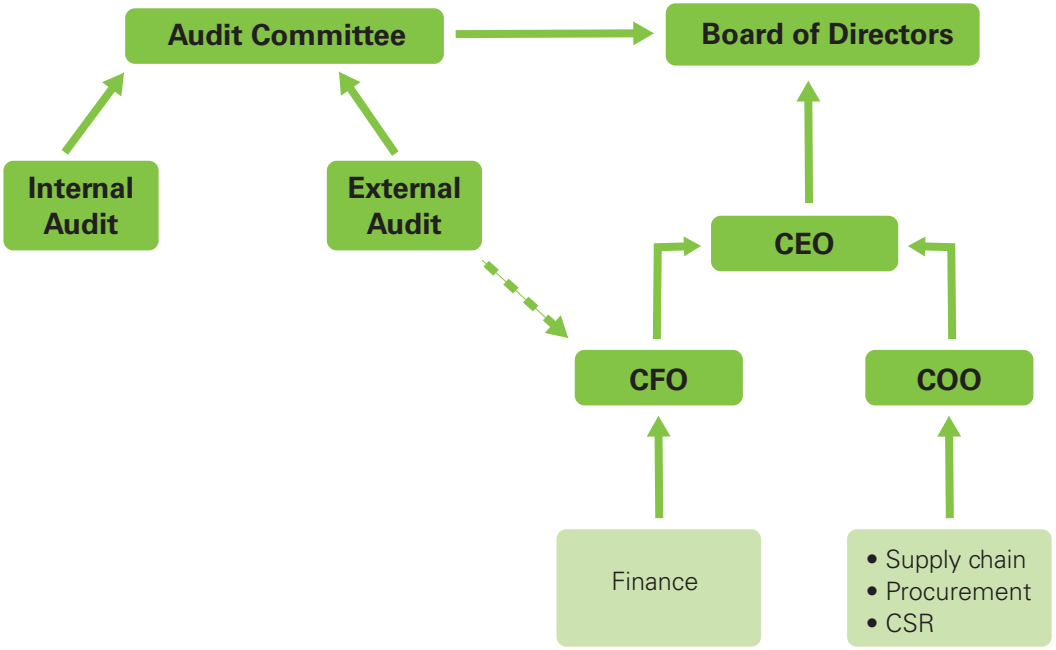
Building a Section 1502 reporting structure below the CFO and COO is likely to be demanding. At least four corporate departments will be required to work together: supply chain/procurement, legal counsel, finance and internal audit (and CSR, if it exists in the company). The audit committee will be expected to be involved in the same way as it

5 KPMG Conflict Minerals Interview Program

would with any financial statement to the SEC and as there is a requirement for an external audit of the conflict minerals report. Some companies that have an office for sustainability or corporate social responsibility (CSR) are including this department in the process. In some Japanese firms where CSR is a new activity, compliance with Section 1502 is an opportunity for those managing CSR issues to become more involved in the core activity of supply-chain management.

In South Korea, exporters have been preparing for five years to take advantage of the March 2012 Free Trade Agreement (FTA) with the US. The process of complying with Section 1502 is expected to resemble the method by which Korean companies certify the country of origin of components for the FTA. For the latter, firms have brought together three separate functions, procurement, production and export, that had not collaborated closely before. "It is not a pleasant thing to implement, but they simply have to do it," says Mungu Park, Partner at KPMG in Korea's International Trade Consulting practice.

Governance Structure for Section 1502 (Illustrative)



Governance steps for Section1502

- Companies should create an executive steering committee
- CFO/COO formulates strategic plan for compliance
- CEO then board signs off on plan
- Compliance group executes plan
- External auditor signs off on audit

Examples of collaboration for compliance

Companies will have to collaborate internally and across industries in order to comply with the Act. In a forum organized by KPMG with leading companies in the field of conflict minerals compliance, Dow Chemicals shared its experience working across the organization to implement its strategy.

Dow has a cross-functional team responsible for implementing a trend-tracking process in order to identify, in part, supply chain issues related to conflict minerals and other substances. The purchasing and legal departments aligned with Dow have largely taken responsibility within the team for developing the first phase of outreach to suppliers of conflict minerals, and this helped build support for the overall initiative. Departments responsible for Environment Health & Safety and Sustainability Programs have also been assisting the larger team's efforts. The team aims to establish the baseline for compliance data and then will partner with corporate compliance and finance.

KPMG firms have been engaged with a number of companies to develop a compliance strategy that includes a functional group and a program leader that are involved in each step of the project, and the number of departments involved can number as high as ten depending on the activity required. The project sponsor varies among companies (e.g., compliance may drive the project, or procurement) but consistently, projects rely on collaboration between procurement, general counsel, internal audit, and IT.

Beyond collaboration at the company level, there are a number of industry-led initiatives taking place among various trade associations.

The Automotive Industry Action Group (AIAG) introduced a sponsored tool designed to survey automotive suppliers and collect responses in a database for use by the group's members. It has issued a letter to inform the industry's suppliers about Section 1502 and has suggested activities suppliers can undertake in order to assist the original equipment manufacturers in meeting the compliance requirements. Additionally, the AIAG has developed a list of frequently asked questions to assist companies as they begin to plan for compliance.

The Aerospace Industries Association has a conflict minerals working group that has helped to draft communications to suppliers and is assisting its members to achieve compliance with Section 1502.

The World Gold Council (WGC) has a steering group on Conflict Free Gold and has drafted assurance standards for conflict-free gold for WGC and its 23 members.

In support of its due diligence guidance, the OECD has implemented a pilot program for both the upstream and downstream companies. Thirty-four manufacturers are represented on the downstream pilot program.

Mapping the supply chain

Once companies have set up an internal compliance framework, then comes the hard part: finding out where the minerals in their supply chain originate. This is a daunting task that will be examined in greater depth in the next KPMG report on conflict minerals. In this report, the issues regarding the supply chain will be dealt with in summary fashion.

Bob Shepler of Lockheed sums up the main challenge of compliance in this way: "We have a very complex supply chain and determining whether we have DRC-derived minerals is going to be very time and resource intensive. This level of intervention in a very expansive and complex supply chain will drive a paradigm shift in business operations and the ability of smaller companies to meet these demands." There are, for example, 5 million parts in a typical commercial airplane. Firms such as Toyota, Lockheed, and Philips are final assemblers or integrators; they have commercial and contractual relationships with their tier-one suppliers. Beneath this, however, there may be a dozen or more tiers of suppliers, each tier made up of a web of (usually confidential) commercial agreements.

Given the fact that in commodity markets, information about supply lines is a source of competitive advantage, it should come as little surprise that it will be difficult to obtain the required information from vendors. One large electronics manufacturer with significant market clout sent questionnaires to all its tier-one suppliers, yet was not able to gain the insight it required. So it engaged the vendors one by one. When this failed, it approached the problem from the opposite end of the supply chain by joining forces with other manufacturers to determine which smelters were conflict-free. Even this has been heavy going.

Some manufacturers have a flow-down clause in their supplier agreements that will apply to conflict minerals. The flow-down clause may stipulate that because the manufacturer must comply with Section 1502, vendors will have to disclose where they obtained their mineral supplies from. As Bob Shepler of Lockheed points out: "Conflict minerals are a supply chain risk which we actively manage and mitigate at the

Source: KPMG Interview program, May/June 2012.

executive level. It's straightforward to flow the information down; ensuring the information flows back up consistently is an important way to deal with the issue."

A high degree of trust between suppliers and assemblers is going to be required. How confident is Jean-Paul Meutcheho, who works in the department of Supply-Chain Sustainability at Ford Motor Company, that vendors and customers will see eye to eye on disclosing information about conflict minerals? "I am really hopeful that they will, because ignoring the issue is not the right approach. You may have to face challenges where companies are located in different jurisdictions for instance. It may take some hand holding, but this is the nature of the business and we will have to make it work."

Three directions for compliance have emerged:

Conflict-free smelter program

In theory, the optimal method for manufacturers and their suppliers to avoid conflict minerals is to buy materials only from smelters that have been certified as using raw materials that are conflict free. This would seem to offer the best way of targeting revenue that ends up in the coffers of armed groups in the DRC. According to one industry analyst: "The reality is that once the base metal[6] leaves the smelter, it is impossible to add additional ore into the supply chain and thus there is no possibility that any illicit income from the ore could go to armed groups. So if the smelters can be certified as conflict free, it doesn't matter where the metals go after that."

One such program has been set up by the Washington DC-based Electronics Industry Citizenship Coalition and the Global e-Sustainability Initiative. As of June 4, 2012, 61 smelters are going (or have gone) through the auditing process. The audit has been completed on 26 smelters and 16 have been declared to be compliant. The question that remains is whether these audits have been completed in accordance with US or international audit standards in order to allow for the auditors or SEC registrants to rely upon the results of these audits.

Closed-pipe supply line

An alternative method of securing conflict-free shipments of minerals is to verify that the source is conflict free and then set up a secure closed-pipe supply line to deliver the ore to users. AVX, a US manufacturer of electronic components, set up a closed-pipe supply line in 2011 along which to ship conflict-free tantalum ore from the DRC.[7] The first shipment of conflict-free tantalite ore went from DRC to a South African smelter already declared conflict free to be converted into powder for use in capacitors.

Risk-based supply chain

Rather than querying every supplier, the aim is to focus on vendors that may potentially buy conflict minerals. The Organisation for Economic Co-operation and Development (OECD) has been developing a risk-based model in collaboration with companies, industry associations and eleven countries in central Africa. Its initiative, called *Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*,[8] has issued a detailed report with supplements focused specifically on gold and on tin, tantalum and tungsten. "We find this [OECD initiative] to be a very worthy tool," says Jean-Paul Meutcheho of Ford. "Although Section 1502 doesn't mandate a specific due-diligence process, the OECD's is the one already in place out there. We are using the OECD guidelines as a template."

A first step of a risk-based program could be to set up a pilot project involving a single, manufactured product or a single business unit. Three Japanese electronics manufacturers, Sony, Panasonic and Toshiba, are running pilot programs. Large automotive manufacturers are due to follow suit in 2012. This is likely to involve an extensive analysis of material flows and invoices for components and so on. Production engineers as well as procurement specialists may have to be interviewed.

Once the program has developed a complete list of suppliers, the manufacturer can rate them according to the level of risk. If it is a public company in a developed market such as North America and Europe, the risk of it using conflict minerals may be low. Many of them will be reporting on conflict minerals to the SEC. Higher risk suppliers are likely to be privately owned and/or headquartered in an emerging market. These suppliers should be sent detailed questionnaires about where they buy their minerals from and their answers carefully analyzed. Even a slow response to the questionnaire may be a sign of a high-risk supplier.

Suppliers that fall into the high-risk category are likely to be placed on notice by their SEC-reporting customers that they will have to show that they are not using conflict minerals. The suppliers' statements are likely to be audited, either by the customer or by an independent auditor. Many SEC-reporting companies are updating the terms and conditions of their contracts with suppliers to say that the latter must use conflict-free minerals and be prepared for an audit to prove they are conflict-free. In fact the high-risk designation could cause SEC-reporting companies to look afresh at their sourcing decisions.

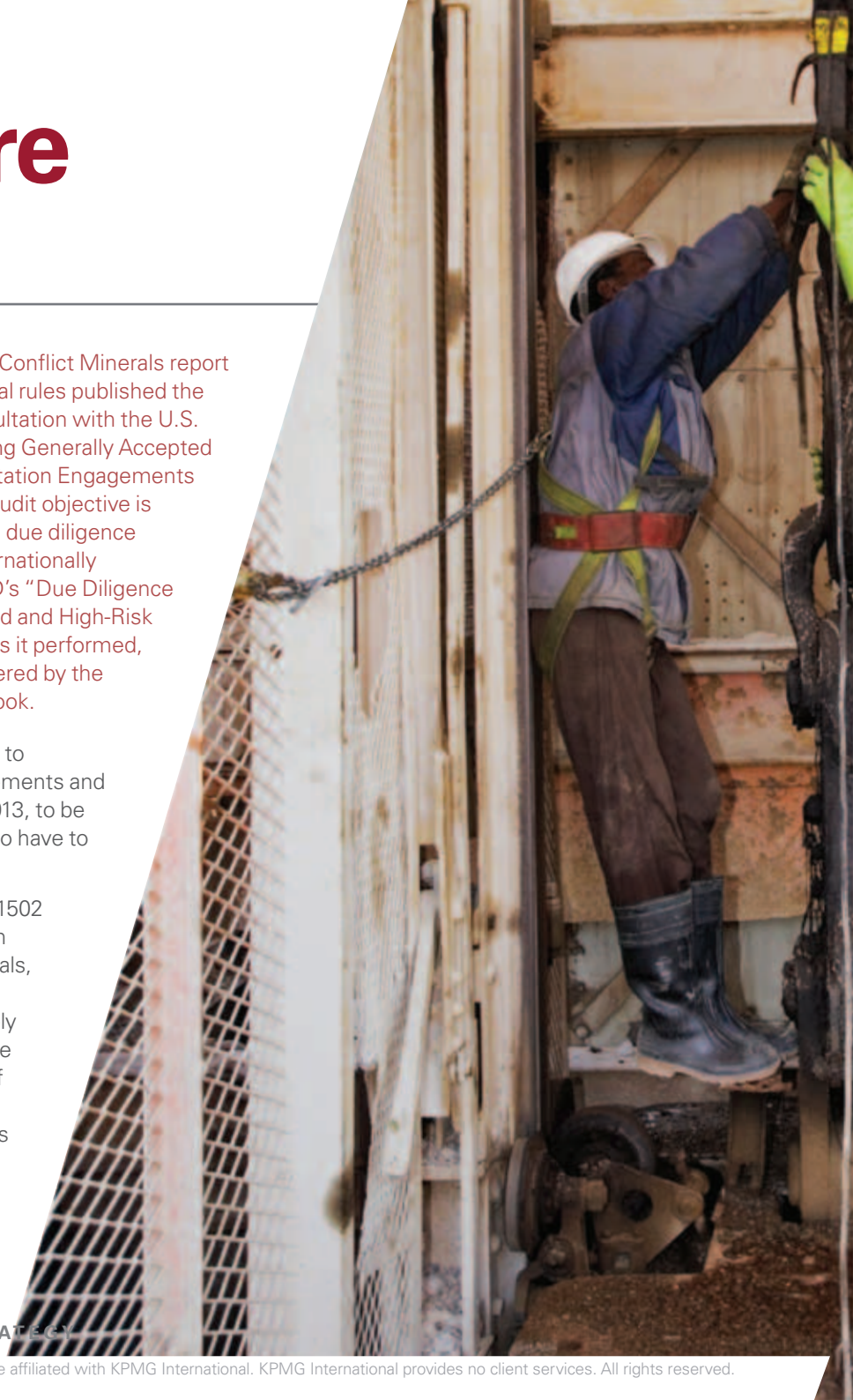
6 In the case of gold, refining can be done cheaply, so it's not possible to keep out conflict minerals in the same way from the supply chain.
7 http://www.avx.com/wsnw_PressReleaseDetail.asp?id=504&s=0
8 http://www.oecd.org/dataoecd/62/30/46740847.pdf

Audit, disclosure and beyond

Once the supply chain has been mapped, in certain circumstances the Conflict Minerals report will require an independent private sector audit. Recently with the final rules published the SEC provided clarity around that audit objective. Based on the SEC's consultation with the U.S. Government Accountability Office (GAO), the GAO determined that existing Generally Accepted Government Auditing Standards (GAGAS), such as the standards for Attestation Engagements or for Performance Audits will be applicable[9]. The final rule concludes the audit objective is to express opinion or a conclusion as to whether the design of the issuer's due diligence measures are in conformity with the criteria set forth in a nationally or internationally recognized due diligence framework used by the issuer, such as the OECD's "Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas," and whether the issuer's description of the due diligence measures it performed, as set forth in the Conflict Minerals Report, with respect to the period covered by the report, is consistent with the due diligence process that the issuer undertook.

Companies will then have to prepare a Conflict Minerals Report (an exhibit to specialized disclosure form (Form SD)) in accordance with the SEC requirements and file them with the Commission to cover their activities for calendar year 2013, to be filed by May 31, 2014. The information provided to the Commission will also have to be posted on the company's website.

The GAO is charged under the Act to report on the effectiveness of Section 1502 in promoting peace and security in the DRC. But irrespective of its impact on the conflict in central Africa, companies that have to report on conflict minerals, whether as part of their Form SD disclosure or, if required, attached exhibit Conflict Minerals Report and independent private sector audit report are likely to gain operational benefits for their supply chains from the reporting and due diligence exercise. "It's essential for the topic to be embraced as a means of business improvement, rather than merely a costly compliance exercise," says Lynton Richmond, Partner, Energy Natural Resources in KPMG the UK's advisory services practice in London. Richmond is currently helping the



9 Conflict Minerals Provision of Dodd-Frank: Immediate implications and long-term opportunities for companies.

World Gold Council, an industry organization, to develop a conflict-free gold standard for its members and other gold miners.

Reporting companies will have to tread carefully in their quest for business improvements, however; if, as a result of the data gathering, they reduce the number of suppliers or use the information to play off one supplier against another, then vendors will no longer cooperate. "That will defeat the purpose of what the Act is trying to achieve and goes against the idea of cooperating with suppliers, if you use the information for something else," says Jean-Paul Meutcheho of Ford.

But there is an alternative way to view the compliance process. If companies and their myriad suppliers see that they all have something to gain from a more transparent supply chain, then it is likely to be a lot easier to comply with Section 1502 and to gain improvements in business performance. It is useful to remember that the Sarbanes-Oxley Act of 2002 was expensive to comply with, but led to long-term benefits that included increased transparency, lower borrowing costs and increases in share prices.[10]

Many companies expect that further regulation of the supply chain will follow the rules on conflict minerals, whether in the US or elsewhere. If they are right, then setting up a compliance strategy for Section 1502 will prepare companies well for other regulations that may follow. In the KPMG survey, a third of the 42 respondents – the largest percentage – who saw benefits from the conflict minerals regulations said that it would prepare their client companies for other regulations dealing with corporate social responsibility.

When companies currently conduct their due diligence, they should ensure that the process will withstand an audit under GAGAS. Corporate executives should bear in mind that conflict minerals may be the tip of the regulatory iceberg. Companies may soon have to be more transparent about their supply chains with regard to a plethora of local and national regulations, including rules governing the use of slave labor, environmental sustainability, and corrupt practices, as well as conflict minerals. It would be best if companies adopt a comprehensive approach to supply chain compliance, rather than merely complying with rules on conflict minerals. The initial cost could be high, but the long-run benefits are likely to be plentiful.

10 The Lord & Benoit Report: Do the Benefits of 404 Exceed the Cost?; Skaife/Collins/Kinney/LaFond, "Did the Sarbanes-Oxley Act of 2002 Make Firms Less Opaque? Evidence from Analyst Earnings Forecasts," 2006; Arping/Sautner, "Corporate Governance and Leverage: Evidence from a natural experiment," 2010; IIA 2005 Annual Report. KPMG's Audit Committee Roundtable Highlights, Spring 2005.

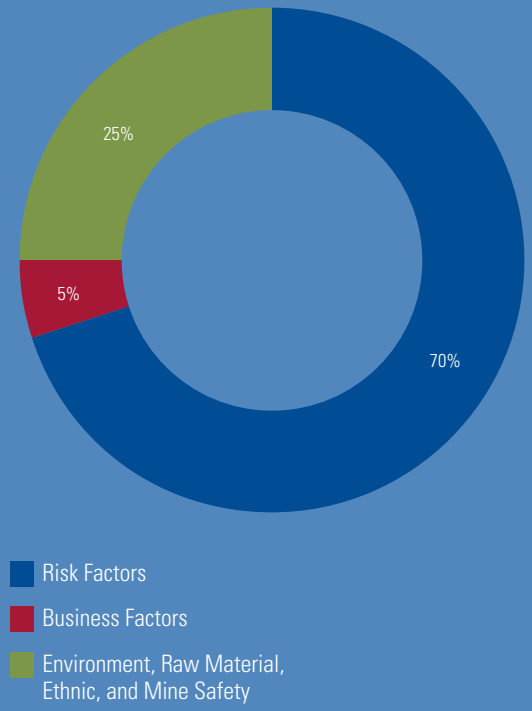
Company polices and disclosures to the SEC

Even before the final rules from the SEC, a number of companies have taken steps to implement conflict minerals policies based on the proposed rules that came out in December 2010, requiring a company to disclose in a 10-K filing and on its website its policy concerning conflict minerals.

For the 2011 reporting period, KPMG research identified the following information in SEC filings:

- 63 companies have included some form of conflict minerals disclosure in their annual reports.
- 6 of these were foreign issuers (20-F filers) and 57 are US based 10-K filers.
- 43 companies listed "Dodd-Frank" in the content of their conflict minerals disclosures.

A majority of companies listed conflict minerals in the "Risk Factors" category of their annual report

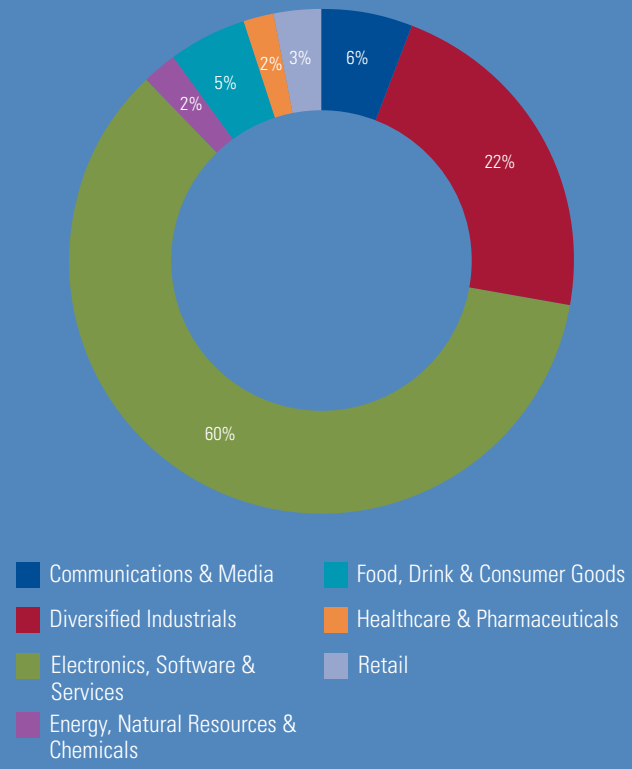


Source: Company annual reports, 10-K and 20-F, Edgar Online, March 2012.

KPMG research identified 77 publicly available statements concerning conflict minerals online. In a review of 62 of these policies that were clearly labeled as "Conflict Minerals" specific statements, we found a number of key themes represented:

- 44 companies (71%) mention being members of the Electronics Industry Citizenship Coalition.
- 35 companies (56%) include specific supplier requirements/expectations in their policy.
- 26 companies (42%) provided some background context in relation to the conflict minerals issue.
- 14 companies (23%) mention the complexity of the task of mapping out the supply chain.
- 22 companies (35%) specifically make reference to the Dodd-Frank legislation.
- 11 companies (18%) have a policy which encompasses more than just conflict minerals (for example, labor, health and safety, environmental and ethical aspects).

Companies in the Electronics industry have the highest number of disclosures



Source: Company annual reports, 10-K and 20-F, Edgar Online, March 2012.

Why KPMG?

KPMG's team of professionals in our member firms can assist in gap-analysis reviews to define the impact of proposed regulatory reform from a people, process, technology, data requirements, reporting, and analytical perspective. We assign the "right" people – those with relevant experience to understand the company's major economic, operating, and regulatory risks – and factor in the company's unique needs, dynamics, and culture.

Based on extensive experience with past due diligence and reporting requirements, KPMG has developed a simple process to help companies address the conflict minerals provision. The process involves the following key steps:

- Identify use of tin, tantalum, tungsten, and gold (3TG) conflict minerals in products manufactured or assembled
- Identify and survey suppliers of 3TG metals
- Perform a risk assessment using tools and Organisation for Economic Co-operation and Development guidelines
- Prepare disclosure statements in accordance with the SEC requirements
- Institutionalize a process that helps provide annual updates conveniently

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kpmg.com/socialmedia

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Available on the App Store

Designed by Evalueserve.

Publication name: Conflict minerals and beyond – Part one: developing a global compliance strategy

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Conflict Minerals Website

Regulatory Practice Letters

Washington Reports

Public Policy Alerts

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