



cutting through complexity

Conflict minerals and beyond

Part four: Lessons for an
integrated compliance program

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Introduction



Companies that are required to file with the US Securities and Exchange Commission (SEC) have had to contend with a new, official disclosure requirement that covers the consumption of tantalum, tungsten, tin, and gold (“conflict minerals” or 3TG). This report considers the lessons learned thus far and how they can be applied to a holistic compliance program covering a wide range of regulations, not just those relating to conflict minerals. It also examines the way in which companies have complied with the regulations in the first reporting period.

The conflict minerals reporting requirement, under Section 1502 of the Dodd-Frank Act (the “Act”), has caused companies to examine their supply chains in a way they have never done before. Section 1502 requires companies to determine whether their products contain any 3TG and, if so, whether the minerals come from the Democratic Republic of the Congo (DRC), or surrounding countries, where armed militia are financed by the trade in 3TG. Under Section 1502, over 1,300 companies have filed with the SEC their first conflict minerals disclosure.

The process of conflict minerals reporting has yielded some surprises. After closely examining their supply chains, a number of companies found that their suppliers had been buying gold refined by the North Korean central bank,¹ potentially breaching US regulations unrelated to Section 1502. This raises the possibility that companies may find that they run afoul of other government regulations in the

Key lessons

- Strong processes enhance supply chain transparency.
- Risk-based compliance deepens insights into the supply chain.
- Conflict minerals reporting should be integrated with overall compliance.
- An integrated review of filings helps improve reporting accuracy.
- Rigorous conflict minerals reporting enhances a company’s reputation.

¹ The Wall Street Journal, “North Korea Gold Taints U.S. Firms”, June 4, 2014

process of complying with Section 1502. Organizations could become exposed to a range of risks, including reputational, operational, legal and others, if they do not know who their business partners are, how they operate, how they source their materials, how they manufacture, and so on. It is more important than ever that companies buying products understand their source in order to manage associated risks.

The view of KPMG is that complying with Section 1502 is not only required by law but also a matter of good business governance. By determining a company's exposure to conflict minerals, executives will, of necessity, deepen their understanding of their supply chain. This may enable them to enhance the management of their business risks, particularly those risks lurking unseen in the supply chain, several stages removed from the company itself. The reporting process may also enable a company to assess the risks holistically, by connecting disparate threats that, when added together, may harm its operations and its corporate reputation. No company wants to be associated, however indirectly, with a pariah state or a militia that abuses human rights. Protecting the brand is good for business.

It is a testament to the complexity and uncertainty of the process that the SEC quoted² an estimate of a university group and a manufacturing industry association that approximately 4,500 companies were affected by the requirements of Section 1502 to annually evaluate the use of conflict minerals, more than three times the number that actually submitted the Form SD (Special Disclosure) and the Conflict Minerals Report (CMR) in June 2014. In the preceding months, companies and their representatives contested in court the legality of Section 1502. This led to a partial stay of the conflict minerals reporting requirement, pending further court proceedings. A lot of companies dragged their feet about setting up a compliance process. Many hoped the conflict minerals reporting requirement would be relaxed or removed entirely.

Despite the legal uncertainty surrounding Section 1502, it looks as if the regulations are not going away; if anything, the disclosure requirements by the SEC in the company's CMR may be raised higher in the future. This may cause more companies to file a conflict minerals

report by the next deadline of June 1, 2015 and, for those that filed in 2014, to provide more information about whether there are conflict minerals in their supply chain.

Conflict minerals reporting is one step in the march toward supply chain transparency and sustainability. It will require significant and expanded effort, regardless of conflict minerals, to meet the growing demand from stakeholders for increased transparency. Companies need systems, processes, and contracts that enable them to understand what is in their products and where they come from. Regulators in the US and elsewhere (for example the UK Timber Act and Blood Diamonds) are continually looking for the means to require companies to expand disclosures about their supply chains (see Appendix page 20). These disclosures may include not only materials sourcing but also human rights issues.

NGOs are interested in a broader approach than conflict minerals and can be expected to continue their efforts to persuade companies to enhance transparency. Companies understand the importance of having "clean" products and are looking for ways to differentiate them from the competition, in answer to the rising expectations of customers. In the end, the consumer market will drive companies to increase the transparency of the supply chain.

This final report from KPMG in a four-part series argues that the process of dealing with conflict minerals regulations should be integrated into an organization's overarching program of compliance with other major regulations covering such things as trade sanctions, anti-bribery & corruption and anti-money laundering, and provides some lessons learned for the future. From the beginning of the series of reports, we have suggested that compliance with conflict minerals regulations is not just a routine exercise, but a matter of developing and adhering to a broader strategy of brand protection and compliance that should lead to performance improvements. KPMG's first report, published in September 2012,³ focuses on developing a compliance strategy. The second report, published in November 2012,⁴ examines the business benefits of a transparent minerals supply chain. The third report, published in June 2013,⁵ covers supply-chain optimization.

Top benefits of compliance

- Know the supply chain
- Assess risks holistically
- Protect the brand

² Section 1502 final rule, release 34-67716, p.249, SEC

³ Conflict minerals and beyond. Part one: Developing a global compliance strategy

⁴ Conflict minerals and beyond. Part two: A more transparent supply chain

⁵ Conflict minerals and beyond. Part three: Optimizing the supply chain



Reporting lessons from an automotive supplier

Project description

KPMG in the US has been advising a large US automotive assembler, with over 500 tier-one suppliers, on its conflict minerals reporting program. The program began by appointing a project team consisting of company personnel from internal audit, legal, procurement and representatives from the company's three business units, with the aim of establishing a strong management oversight of the project. The team did not include IT to begin with, but KPMG learned that IT needed to be involved from the early stages of the program in terms of data processing and analysis.

The KPMG team spent six weeks near the start interviewing individuals throughout the company to develop a map of the conflict minerals reporting process. The process was divided into four phases: (a) developing the overall strategy, including setting up the stakeholder team; (b) conducting the reasonable country of origin inquiry (RCOI) using the EICC-GeSI questionnaire; (c) institutionalizing the process, including the development of a standard operating procedure; (d) the preparation of Form SD and, if needed, the Conflict Minerals Report.

Challenges

The company currently has three data centers (it is in the middle of a new ERP implementation), making it very difficult to harmonize the information, such as when one supplier is in each of the three databases. The same supplier might show up in the databases under several different names, making it difficult to send only one questionnaire. Once duplicates have been excluded, it is sometimes hard to find the right person to send the survey to.

Tier-one suppliers are pushing back when they are asked by the company to buy parts from a particular vendor. The company is being told: why not go to tier-two and -three suppliers itself since it has that relationship? But the company is making it clear that it is contacting only the tier-one suppliers and offering whatever support they need to obtain the relevant information from their suppliers.

Lessons

Every step in the process takes longer than expected. The company has very strong ties to its suppliers, but even so, it is having difficulties obtaining crucial

information because the suppliers are taking a long time to supply the data. Internally, it is important that the IT department is committed to the project, given the amount of data that needs to be analyzed. IT organizations tend to be overworked, so they need to feel as if they have an important stake in the project if it is to proceed smoothly.

It is also important to have a small group of suppliers to provide feedback on items such as the questionnaire and the process for gathering information. The company has an advisory council of ten suppliers that sell a wide range of components and materials containing 3TG, and the council has played a crucial role in managing the conflict minerals program.

The project team has found that the process goes a lot more smoothly if the project team can show there is a business value to the rest of the company. The conflict minerals reporting program works best when it is used to help drive a change that the entire organization needs, such as a streamlining of the vendor management system, an improvement dear to the heart of the procurement department.

Analysis of filings



To help companies meet the requirements of Section 1502, KPMG analyzed the 2014 filings of 232 companies, both US and foreign, registered with the SEC. This analysis, available upon request, allows companies to compare themselves with their cohort. Of the 232 companies selected, 197 filed both Form SD and a CMR; 17 filed only Form SD; 18 did not file.

In the product status disclosure, no less than 67 percent of the companies included a description other than “DRC conflict free”; “DRC conflict undeterminable”; or “Not found to be DRC conflict free”. In response to the stay by the SEC, many companies elected not to declare a status. Discussions with companies indicated that many were also unsure about the validity of data received through the Reasonable Country of Origin Inquiry (RCOI) and subsequent due diligence. Additional reasons for not declaring a status included: companies either know or have reason to believe that the conflict minerals included in the products did not originate from the covered countries; the minerals came from recycled or scrap sources; or they were not able to determine the origin of the products due to the complexity of their supply chain.

Among the companies that filed a CMR, 89 percent said that, for their due diligence framework, they had followed the OECD guidance⁶ (the sole internationally recognized program). And 51 percent aligned their due diligence with the entire five-step framework outlined by the OECD. Other international initiatives were also highly influential. Some 93 percent of the companies said in their filings that they were working with the Conflict-Free Sourcing Initiative (CFSI),⁷ founded by members of the Electronic Industry Citizenship Coalition and the Global e-Sustainability Initiative (EICC-GeSI).

Among industries, our discussions with companies seems to indicate that electronics and automobiles may be the most advanced in their conflict minerals compliance efforts. Fifty to fifty-four percent of the companies surveyed in these two industries disclosed their status as “other”; a relatively low number. Among the electronics companies, 91 percent have a conflict minerals policy and all those that have communicated their conflict minerals

policy to their suppliers have included the policy in their supplier contracts. Sixty-eight percent of electronics companies in the survey provided training materials to their suppliers to encourage the accurate collection of data.

The SEC provided little guidance on the disclosure requirements for the CMR, but NGOs such as Enough and the Responsible Sourcing Network published⁸ their expectations for the reports. These consisted of seven points:

- Does the company have a conflict minerals compliance and governance policy?
- Has the company communicated the policy to its suppliers?
- Does the company follow the OECD framework?
- Is the company’s due diligence in line with the OECD five-step guidance?
- In its effort to comply with Section 1502, does the company work with the EICC-GeSI or the CFSI?
- Has the company disclosed the list of identified/conflict-free smelters in its supply chain?
- Does the company describe any training or support provided to its suppliers to encourage the collection of data?

The KPMG survey of 232 companies found that of those that filed a CMR, only eight percent met all the NGOs’ criteria. Patricia Jurewicz, Director of the Responsible Sourcing Network, is not discouraged by the weak response from the majority of companies to the requirements of Section 1502. “We have to remember that this is first time that companies are mandated to report on a Human Rights abuse in their supply chain,” she says. “The wider supply-chain community is not accustomed to providing the information, so it will take a while to build up the communications, the trust, and the systems to collect the data.” Clearly, many companies have a lot of work to do to improve the level of transparency in their supply chain.

⁶ <http://www.oecd.org/investment/mne/GuidanceEdition2.pdf>

⁷ <http://www.conflictreesourcing.org/conflict-minerals-reporting-template/>

⁸ <http://www.sourcingnetwork.org/expectations-shortlist/>

Reporting lessons from a global semiconductor company

Project description

KPMG in the US has been working with a global semiconductor company to perform a readiness assessment with regard to the company's conflict minerals reporting process and then to review the implementation of KPMG's recommendations. The company is a member of the Conflict-Free Sourcing Initiative that developed the conflict-free smelter program as well as many tools designed to assist companies with their conflict minerals programs. The semiconductor company has developed strong processes and controls in order to comply with the SEC regulations and OECD Guidance. These include a standard operating procedure, training materials and publicly available documents concerning the company's conflict minerals policy. All of the work is overseen by an established steering committee composed of representatives of a number of departments, including corporate responsibility, procurement and logistics, environment, health & safety, internal audit, manufacturing and corporate counsel. The steering committee reports to the Chief Financial Officer and the audit committee.

As of the end of the company's reporting period, it had surveyed its suppliers to determine the source of minerals necessary for production or functionality. This process had reduced the number of covered suppliers to less than 500 identified as using tungsten,

titanium, tin and gold. Each supplier survey provided more information to improve sourcing transparency, thereby enabling the company to focus its due diligence efforts.

Challenges

As with many issuers, the company has approached conflict-minerals reporting with a strong compliance focus, but many would argue that the conflict minerals requirements are not just a straightforward compliance exercise. Not only is the supply chain a critical source of competitive advantage, it is also a potential strategic risk. A break in the supply chain can be enormously disruptive to a business. By contrast, an efficient, strong supply chain can provide companies a competitive advantage. A successful program therefore requires an understanding of the way in which conflict-minerals compliance might affect the business, both in terms of supply chain risk and opportunity. For example, if a supplier of a crucial component is found to be non DRC conflict-free, the question arises as to how the company manages the associated risks, including customers' reactions.

As with many compliance efforts, the resources required to meet the May 31, 2014 deadline were initially underestimated. Few of those involved have been assigned full-time to the program. This can put pressure not only on the conflict minerals program, but also on

business operations, due to diverging responsibilities. Another challenge was the lack of documentation around the initial determination that the company was covered under the SEC regulations. Documenting the early discussions and a walk-through of the SEC steps is an important component of the process.

Lessons

If a company regards conflict-minerals reporting solely as a compliance issue, they will be missing an opportunity to make their supply chain more resilient, transparent and more efficient. Companies may gain a competitive advantage by developing a compliance strategy, consisting of an organizational framework, a process of mapping the supply chain and auditing the result. Greater transparency leads to better management of the business.

A robust tool to track and manage supplier surveys is also important. Don't underestimate the level of effort required to meet the requirements for compliance under section 1502, particularly in the first two years. Indeed, many companies are underestimating the time and resources required to complete the reporting process in the time available. A commitment to provide enough resources in the first two years, and/or supplementing the resource requirements with qualified external resources, is likely to improve the quality of the process and the auditability of the final result.

Reporting lessons from a large US retail chain

Project description

KPMG in the US has been working with a large retail chain on a conflict minerals reporting program that consists of four steps:

- (1) develop and implement a strategy to comply with Section 1502, part of which is to decide what products are in scope and which ones are out of scope.
- (2) send questionnaires to suppliers to conduct a Reasonable Country of Origin Inquiry (RCOI).
- (3) develop a standard operating procedure that can become a regular, annual process for conflict minerals reporting.
- (4) collect and analyze the data to prepare Form SD and, if needed, produce a Conflict Minerals Report.

Deciding which products are in scope for a retailer is difficult. This depends on whether the retailer has contracted to manufacture the product; according to the final rules of the Securities and Exchange Commission, “a company is considered to be ‘contracting to manufacture’ a product if it has some actual influence over the manufacturing of that product.” A company is not deemed to have influence over the manufacturer if it merely: affixes its brand; services products made by a third party; specifies

contractual terms with a manufacturer that do not directly relate to the making of the product.

KPMG in the US advised the client that if the company merely picks items from a vendor’s catalog, then this is not deemed to be a contract to manufacture. But if the company has some influence over the design or the making of the product, then it is so deemed. With this distinction in mind, the company narrowed down the scale of the reporting process from 1,100 vendors and 21,000 products, to contacting about 200 vendors supplying 3,400 products.

Challenges

Apart from the difficulty of defining “influence,” the company faced tall hurdles to collect the data about its suppliers. This is because the information resided in several systems and some did not exist in a computer at all, but in the mental records of the company’s employees. The systems were not set up to collect the data in the format needed to comply with Section 1502, so it had to be pieced together.

When the company started the conflict minerals reporting program, it did not realize the barriers it would run into. The process of gathering the information required detective work; many of the people who had access to the information worked in different departments and had not communicated with one

another before. Extensive training was required to explain the significance of Section 1502 and the work it would entail to comply with it.

Lessons

A successful conflict minerals reporting program requires the support of high-level executives (in this case at the level of senior vice-president) to push through the establishment of a reporting structure and a compliance strategy. Without involvement at a senior level, the project would become ten times more difficult to execute effectively.

Although the process is difficult and cumbersome, at least to begin with, it can yield benefits for the company. An understanding of whether a product falls under the purview of Section 1502 can become a tool for knowledge management. The degree of “influence” over the manufacturing process requires a process to document the types of conversations the company has with its suppliers. By delving more deeply into these interactions, the company will be able to streamline the procurement process. At first sight, this may seem a stretch, but once a retailer goes down the path of compliance with Section 1502, the procurement process becomes clearer and can be codified better.

An integrated compliance program



As companies face the prospect of another round of conflict minerals reporting by June 2015, it is time to take stock of the successes and failures of the previous reporting process to see how and where things can be improved. The diagram here (see Figure 1) provides a step-by-step approach to filing the next CMR, starting with a review of filings by peer companies to compare where each company stands in relation to other filers.

One important issue concerns the more than 3,000 companies that were expected to, but did not, file a CMR or an SD in 2014. It is unclear why they did not do so and why the number of expected non-filers is so large. Since the rules require an annual evaluation, the question arises whether these companies will need to file in 2015 and in subsequent years. Also, will they be identified by the SEC as non-compliant and will competitive pressures cause these companies to file?

Whatever the non-filers decide to do, the overall message to companies is, first, that conflict minerals reporting should no longer be seen as a one-off project, but as an ongoing compliance program. Second, the reporting program needs to become part of an enterprise-wide approach, to meet not only regulatory objectives, but also business goals. "Conflict minerals reporting needs to be embedded into companies' compliance programs," says Charles Riepenhoff Jr., Managing Director and Advisory Lead for Conflict Minerals at KPMG. "By taking a risk-based approach and connecting conflict minerals reporting to other regulatory programs, a company will create a compliance culture that should drive positive performance."

If the conflict minerals program is regarded as temporary or is isolated from other compliance programs, the company risks running afoul of other regulations that, at first sight, are not connected to Section 1502. A number of companies disclosed in their June 2014 CMR filings that their suppliers used gold refined by North Korea's central bank. US sanctions law, which

Figure 1: From conflict minerals reporting project to a compliance program



Source: Conflict minerals and beyond, Part four: Lessons for an integrated compliance program, KPMG International, 2014

is administered by the Office of Foreign Assets Control (OFAC), bars the importation of materials from North Korea, whether directly or indirectly, without a license from OFAC.

By integrating a conflict minerals program with a company's other compliance programs, such as OFAC regulations or the US Foreign Corrupt Practices Act, a breach of this kind might well have been identified earlier and remedied before the CMR was filed. Uncovering these kinds of infractions in one area of compliance can actually help with compliance in another area.

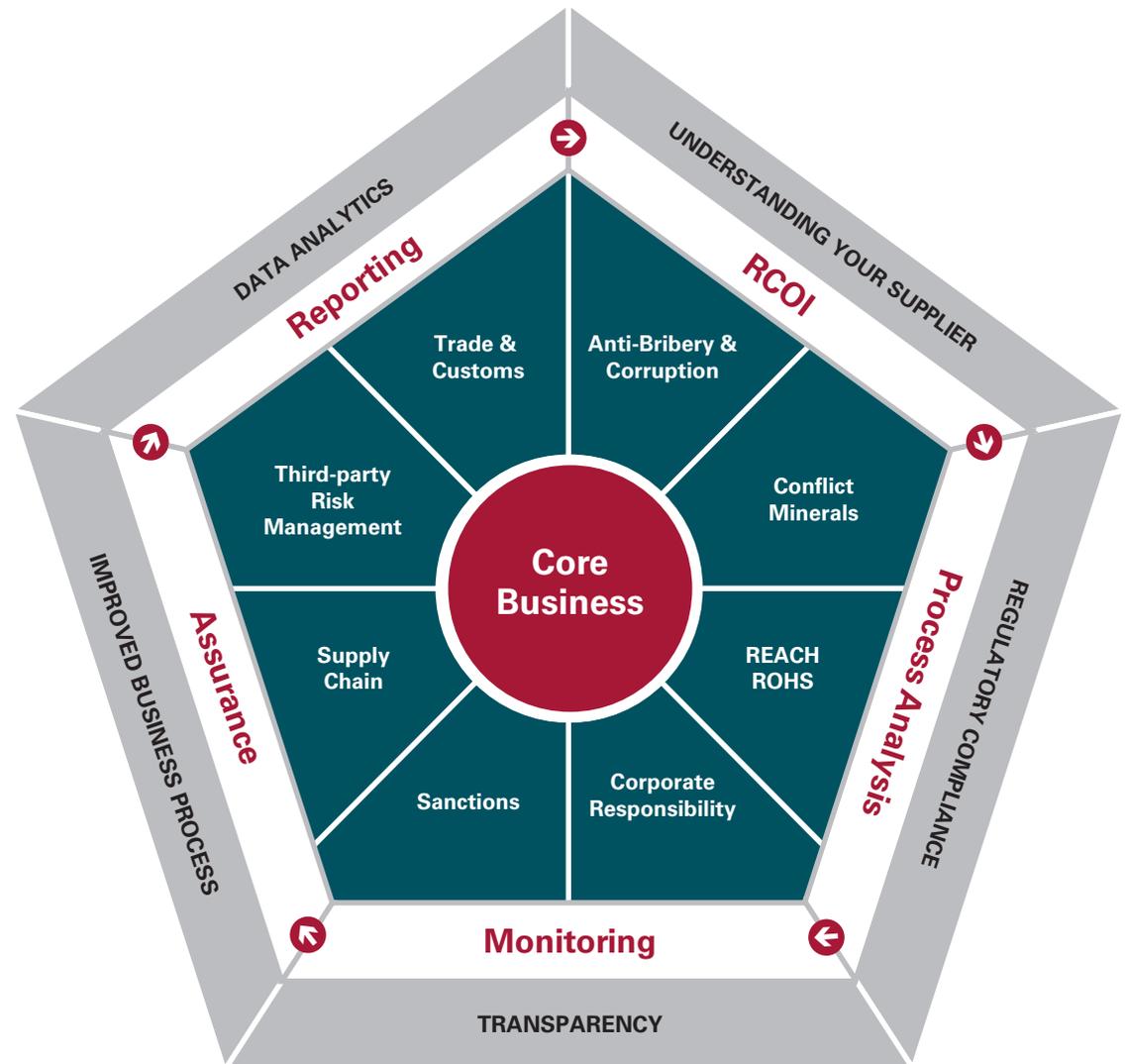
An integrated program review, similar to that of a disclosure committee review (conducted to determine the appropriateness of SEC-required financial statement disclosures), should also reduce the risk of inaccurate reporting. In addition, other regulations may require similar compliance processes; by integrating them, duplication might be avoided and efficiency improved. An example of rules requiring similar due diligence processes are the EU's Regulation⁹ on Registration, Evaluation, Authorization and Restriction of Chemicals (REACH) and the EU's directive¹⁰ regarding Restrictions on Hazardous Substances (RoHS).

⁹ http://ec.europa.eu/enterprise/sectors/chemicals/reach/index_en.htm

¹⁰ http://ec.europa.eu/enterprise/policies/european-standards/harmonised-standards/restriction-of-hazardous-substances/index_en.htm

As the diagram seeks to show (see Figure 2), companies would benefit by taking a risk-based approach to compliance, using the Reasonable Country of Origin Inquiry (RCOI) to enable companies to look more deeply into their supply chains to see what sort of risks they face and to identify additional information needed from vendors to assess such risks. That way, they should be able to understand their suppliers and assess the risks in their supply chain, when seen from different areas of regulation. If a company has a low tolerance to risk (say, to discovering it indirectly buys gold from North Korea), then it should calibrate its compliance model accordingly, tightening it to the point where such risks can be managed. With the help of data and analytics, companies will be able to use the findings from its RCOI to create a more robust compliance model, leading to more transparency and improved business processes.

Figure 2: Integration of conflict minerals reporting into compliance model



Source: Conflict minerals and beyond, Part four: Lessons for an integrated compliance program, KPMG International, 2014

Reporting lessons from a diversified industrial company

Project description

Since January 2013, KPMG in the US has been helping a diversified industrials company with its conflict-minerals reporting program. This has entailed:

- (1) training employees and the company's vendors in how to comply with Section 1502 of the Act.
- (2) providing a governance framework and a process for the program.
- (3) helping to select a tool to collect information from suppliers.
- (4) assisting with the preparation of a conflict minerals report and for the possibility of an audit.

The company set up a team of employees devoted to the task of conflict-minerals reporting, with a project manager appointed specifically for the program. The team has been holding regular meetings to review the status of the project and to monitor updates, reporting to the person in charge of filing information to the SEC and ultimately reporting to the Chief Financial Officer and the General Counsel. Unusually, the company drafted a 12-page conflict-minerals report and form SD by early November 2013, even though the deadline was six months away.

Challenges

The company has had to think hard about which parts and vendors to survey. This in part depends on what sort of reader will review the conflict minerals report. If it is consumers or NGOs, the company's consumer products are likely to be more closely scrutinized than its military products. The company has about 50,000 suppliers and 8,000 of them have been surveyed. The company has achieved a 40 percent response rate from the survey. The suppliers that did not respond are considered high-risk vendors that will be followed up with in the second year.

The gathering of information from the suppliers is another challenge; much depends on a timely response from them. Given the large number of suppliers surveyed, the company has been looking specifically for vendors with characteristics that suggested they might be sourcing their minerals from the DRC.

Lessons

The early preparation of a conflict-minerals report may seem unrealistic, but it provides a roadmap for the project. The objective of the program is an auditable process, and if the company has not described what it is doing to gather and analyze the data on the sources of its minerals, it is hard to be sure that the process the company uses is auditable. Describing the framework in the report enables the company to see whether this is the case.

The company has to prepare a response for its corporate customers that are themselves going through the same reporting process. It has already been audited by one customer that wanted to see if it is conflict-free and what processes it has set up to determine this. One more lesson: It is also important to staff the project team adequately, and this is something that requires senior-level support.

Reporting lessons from a large US medical device manufacturer

Project description

A large US medical device manufacturer requested assistance with the design and implementation of its conflict minerals reporting program. The company is highly decentralized, with scores of production and distribution sites around the world. The production sites do business with a total of approximately 10,000 suppliers and the distribution sites with up to 100,000 customers, many of which are themselves asking for information on the company's conflict-minerals reporting program.

Because of the decentralized nature of the business, it is important for the company to convey consistent messages regarding the program, both from the corporate level down to the sites and vice versa. KPMG in the US has helped to define the roles and responsibilities of the central conflict-minerals-reporting team at the corporate level and those of the production sites. The senior management has put its weight behind the reporting program, so the entire company has given it a high priority. The Office of the General Counsel has been driving the project, along with Procurement, and the steering committee includes individuals from Internal Audit, additional sourcing representatives, as well as IT.

The company has determined that the best way to obtain the required information is to contact each supplier based on a risk assessment. Well over 5,000 suppliers are being contacted in this way. Due to the large number of suppliers and customers, the company decided at the start to hire a member of personnel from Procurement to be a full-time project manager. But to ensure the project manager was not overwhelmed with individual inquiries, it was important to establish a format for

communicating with suppliers so that messages throughout the program were consistent and could be properly recorded in case of audit. Designated sourcing representatives at the different sites are responsible for contacting the suppliers, either by email or, failing that, by telephone. If these representatives are unable to obtain the information regarding a reasonable country of origin inquiry, the case is referred up to the second level of global trade compliance. Failing that, the case goes to the project manager. Without this degree of filtering, the project manager would be inundated with individual inquiry tasks.

Challenges

Due to the fact that there are disparate ERP systems located throughout the globe, the initial risk assessment process to narrow down the 10,000 suppliers has proved to be difficult because it was not feasible to conduct a bill of materials analysis. They have had to rely on a conservative approach that only removes categories of products known not to contain 3TG to winnow the number of suppliers to several thousand. The company has decided to contact all of these suppliers in the first year of the program.

The company sells products to many SEC registrants, so in addition to its own conflict minerals reporting, it has to be able to report to many customers. In order to respond to requests for information from corporate customers for their own conflict minerals reporting programs, the company has needed to find out which products purchased from which suppliers go into which finished goods. The company has a large number of enterprise resource planning (ERP) systems, so the design of an efficient reporting system was one of the first hurdles. They have designed a process for the first year of the

program that minimizes the number of ERP systems that need to be queried, by conducting a risk-based analysis of the parts the company buys. Only those ERP systems that track finished goods containing potentially high-risk parts have been employed, but even then there are dozens of systems to deal with.

Lessons

The company decided first on a compliance strategy at the outset and then designed the RCOI and the due diligence process around the strategy. Other companies have wanted to find out first the information from the supply chain and then design the strategy. While both can work, the former may be preferable because the long-term benefits to the business of having a clear strategy from the outset can help minimize the short-term costs.

One such cost is to hire a full-time project manager, but due to the size and scope of the project, such a person is likely to have a positive impact on the success of the program. It is also important to involve the right departments in the project; all those functions that have an interest in compliance with the conflict-minerals program should be brought in at the start. Among these departments, and often overlooked, IT plays a critical role.

It is important to communicate consistently throughout the company and along the entire supply chain, so that issues that arise along the chain can be dealt with quickly. This may require standard letters, FAQs, and a clear escalation process to give employees the tools they need to facilitate this communication. And all of this requires the full support from executives at the highest level of the company. Without this, it would be hard to gather the needed resources.

What the rules stipulate

Section 1502 of the Act is intended to curb the funding of militias in the DRC by shining sunlight on the area of mines that supply 3TG's. The rule requires companies to determine whether they use such minerals and conduct a reasonable country of origin inquiry (RCOI) to determine if any of the conflict minerals originate in the covered countries. The companies have to file a Specialized Disclosure form (Form SD) if they determine 3TG is in products manufactured or contracted to be manufactured that are not sourced from covered countries.

These companies must conduct due diligence and file a Conflict Minerals Report (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. Section 1502 requires companies reporting to the SEC that make products containing these metals to declare each year whether they have determined their products to be "DRC Conflict Free," "Not DRC Conflict Free," or "DRC Conflict Undeterminable."

This complex matter was made more uncertain when, in May 2014, the SEC issued

a partial stay¹¹ of the regulations, allowing companies to avoid listing their product status. It is unclear how long this stay will remain in effect, pending court proceedings. Despite the uncertainty, it would be safer for companies to assume that a high bar for disclosure has been set by the regulators and other stakeholders. Our message is that companies should base their compliance strategy on the principle that a transparent supply chain reduces, rather than increases, reputational and other risks.

The SEC's rule calls for companies to describe the measures taken to exercise due diligence on the source and chain of custody of such minerals, including an independent private sector audit (IPSA) of the description of the due diligence measures, if required. The Act also requires companies to describe the products manufactured that are not DRC conflict free (i.e., products containing minerals that finance armed groups in the DRC). In addition, Section 1502 requires the companies to describe the facilities used to process the conflict minerals, their country of origin, "and the efforts to determine the mine or location of origin with the greatest possible specificity."

¹¹ <http://www.sec.gov/rules/other/2014/34-72079.pdf>





Lessons for the future

The annual filing of a conflict minerals report to the SEC is not the end of the matter. Companies can, over time, expect to see increased pressures for supply chain transparency and to meet stricter disclosure requirements in the future. Since Section 1502 is a regulatory fact, filers should not regard it merely as a box-ticking exercise but as an opportunity to build a compliance program in which the links between different regulations are clearer and the management of regulatory risk is made more coherent. Five lessons stand out:

- Companies should set up systems and processes to meet increasing demands for supply chain transparency.
- A risk-based approach to compliance should help companies to gain deeper insights into their supply chain and to optimize their operations. A little knowledge of the supply chain is a dangerous thing; knowing more can only improve the way to run a business.
- By integrating conflict minerals reporting compliance with other regulations, companies should be able to see how regulatory risks are connected. A holistic approach to compliance should improve efficiency and help companies to manage risk more effectively.
- An integrated review of filings reduces the risk of inaccurate reporting and thus the risk of non-compliance; accurate reporting will help compliance.
- The risk of being found non-compliant with an important regulation affects a company's reputation. Public trust in a company's behavior is a priceless asset that can easily be jeopardized through a faulty compliance program. A rigorous approach to conflict minerals reporting can enhance a company's reputation.



Appendix

Regulations relating to the supply chain

Name of regulation	Relevant statute	Administered by	Purpose	URL	Other countries with similar regulations
Conflict minerals	Dodd-Frank Act Section 1502	SEC	Companies filing to the SEC must report annually whether they use conflict minerals from DRC and surrounding areas	http://www.sec.gov/rules/final/2012/34-67716.pdf	EU, Australia, various cities, colleges and states in the US
Financial transparency in the extractive industries	Dodd-Frank Act Section 1504	SEC	Companies filing to the SEC in extractive industries provide data about any payment to governments, in the US and elsewhere, for the commercial development of these resources	http://www.sec.gov/rules/final/2012/34-67717.pdf	
Conflict diamonds	Clean Diamond Trade Act	Customs and Border Protection	Prohibits the importation of diamonds whose mining fuels the conflict in the country of origin. All diamonds imported to the US must have a Kimberley Diamonds Process Certificate	http://www.cbp.gov/trade/trade-community/programs-outreach/conflict-diamonds	Canada, South Africa
Trade and economic sanctions	Range of statutes, many targeting individual countries and persons	OFAC	Blocks ownership of assets and trade to accomplish foreign policy and national security goals	http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx	EU
Anti-bribery and corruption	Foreign Corrupt Practices Act	DOJ and SEC	Unlawful to make payments to foreign government officials to assist in retaining or obtaining business	http://www.justice.gov/criminal/fraud/fcpa/guide.pdf	UK, OECD, Brazil, Russia, India, China
Drug supply chain security	Drug Quality and Security Act	FDA	Facilities responsible for compounding drugs to report biannually to the Department of Health and Human Services and prohibits reselling drugs labeled "not for resale"	http://www.fda.gov/drugs/guidancecomplianceregulatoryinformation/pharmacycompounding/default.htm	

Name of regulation	Relevant statute	Administered by	Purpose	URL	Other countries with similar regulations
Free trade agreements	The US has FTAs with 20 countries	Customs and Border Protection	Companies must show imported goods are from the country covered by the free trade agreement to qualify for preferential tariffs	http://www.ustr.gov/trade-agreements/free-trade-agreements	EU
Regulation on registration, evaluation, authorisation and restriction of chemicals	European Parliament and Council Regulation 2006/1907/EC	Member states authorities and the European Chemicals Agency	Companies are responsible for assessing and managing the risks posed by chemicals and providing appropriate safety information to their users	http://ec.europa.eu/enterprise/sectors/chemicals/reach/index_en.htm	
Waste electrical and electronic equipment directive	Directive 2002/96/EC of the European Parliament	Member states authorities	Sets collection, recycling and recovery targets for all types of electrical goods	http://ec.europa.eu/environment/waste/weee/pdf/final_rep_okopol.pdf	
Restriction of the use of certain hazardous substances	Directive 2011/65/EC of the European Parliament	Member states authorities	Restricts the use of six hazardous materials in the manufacture of electronic and electrical equipment	http://ec.europa.eu/enterprise/policies/european-standards/harmonised-standards/restriction-of-hazardous-substances/index_en.htm	
Protection of personal data	Directive 1995/46/EC	Member states authorities	A regulatory framework intended to protect individual privacy. Storage device or PC manufacturers and authorized service agents are affected when they move customers' equipment from their premises at end of service life	http://europa.eu/legislation_summaries/information_society/data_protection/l14012_en.htm	

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Designed by Evalueserve.

Publication name: Conflict minerals and beyond – Part four

Publication number: 131696

Publication date: October 2014