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# Dodd-Frank Act Conflict Minerals (Section 1502)

## Overview

June 2, 2011

Advisory



# Impact of Conflict Minerals section (1502) of Dodd-Frank Act

Overview of section 1502 of D-F act	Law's impact will be widespread
<ul style="list-style-type: none"> <li>● The Dodd-Frank Act, signed into law on July 21, 2010, includes a little known "Section 1502". This section adds <b>additional reporting requirements</b> for companies' SEC filings on the sources of certain "conflict minerals"</li> <li>● The Act's intent is to try and curb the violence and exploitation in the Democratic Republic of Congo (DRC) and neighboring countries by exposing companies that use minerals derived from this region through disclosure and public pressure</li> <li>● Metals covered commonly referred to as '3TG'. They are <b>Tin, Tantalum, Tungsten and Gold</b></li> </ul>	<ul style="list-style-type: none"> <li>● A company will be impacted by this rule if:                             <ul style="list-style-type: none"> <li>– It <b>files reports with SEC</b> under the Exchange Act, and</li> <li>– Conflict minerals are "necessary to the <b>functionality or production</b>" of its products manufactured</li> </ul> </li> <li>● Even companies that don't file with the SEC may need to conduct due diligence on their supply chains, if they happen to be suppliers to impacted SEC filing companies</li> <li>● These metals are widely used in several industries including <b>Electronics and Communications, Aerospace, Automotive, Jewelry, Health care devices, Diversified Industrial Manufacturing</b></li> </ul>
Requirements are challenging, timeline is aggressive	Supply chain due diligence required by the Act
<ul style="list-style-type: none"> <li>● Compliance standards and expectations have <b>not been clearly defined</b> by the Act or by the SEC</li> <li>● Global <b>supply chains are complicated</b>, with multiple layers and suppliers between the mine and the final product</li> <li>● Most industries are <b>yet to act</b> on the issue or develop certification processes/methodologies</li> <li>● Final rule is expected to be adopted by the SEC during August-December 2011. First reporting period is for fiscal year ending 12 months after the final ruling.</li> </ul>	<ul style="list-style-type: none"> <li>● Determine where 3TG metals are being used in products or processes at:                             <ul style="list-style-type: none"> <li>– In-house manufacturing</li> <li>– Contract manufacturers</li> </ul> </li> <li>● Conduct <b>supply chain due diligence, 3rd party verification</b>, and in some cases <b>private sector audits</b> on the sources of these metals – all the way down to mine of origin</li> <li>● Report out the findings of the due diligence on the company's annual SEC filings and website</li> </ul>
Affected functions at client companies	KPMG's capabilities to help with this requirement
<ul style="list-style-type: none"> <li>● Finance/Legal - for preparing forms 10K, 20F, or 40F</li> <li>● Supply Chain/Procurement – for due diligence and supplier requirements</li> <li>● Corporate Sustainability – for policy development</li> </ul>	<ul style="list-style-type: none"> <li>● Supply chain risk assessment and due-diligence</li> <li>● Forensics to trace country of origin etc using tools like ITRAC</li> <li>● SEC requirement compliance, disclosure statements</li> <li>● Industry trends and competitor response analysis</li> <li>● Project Management support</li> </ul>

- Overview of Dodd-Frank Act and Conflict Minerals (Section 1502)
- Industry's response to Conflict Minerals
- Likely implementation timeline

# Overview of the Act

## Dodd-Frank Act Conflict Minerals (Section 1502)

### Section 1502 of Dodd-Frank Act

- The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which President Obama signed into law on July 21, 2010, primarily focuses on financial regulatory reform
- Included in the Act is “Section 1502” that adds additional reporting requirements on Form 10-K, Form 20-F or Form 40-F to the U.S. Securities and Exchange Commission (SEC) on the sources of certain “conflict minerals”

### Purpose of the Act

- The new provision was prompted by the U.S. Congress' concern "that the exploitation and trade of conflict minerals originating in the Democratic Republic of Congo and neighboring countries (together called “DRC countries”) is helping to finance conflict characterized by extreme levels of violence in the eastern DRC, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein”
- The Act’s intent is to try and curb the violence and exploitation by exposing companies that use minerals derived from this region through disclosure and public pressure
- This model attempts to replicate the success in the apparel, forestry and diamond sectors

### Minerals covered

#### Metals and their minerals covered

- “3T” metals
  - Tin: Cassiterite
  - Tantalum: Columbite-tantalite (Coltan)
  - Tungsten: Wolframite
- Gold
- Others determined by the Secretary of State to be financing conflict in DRC

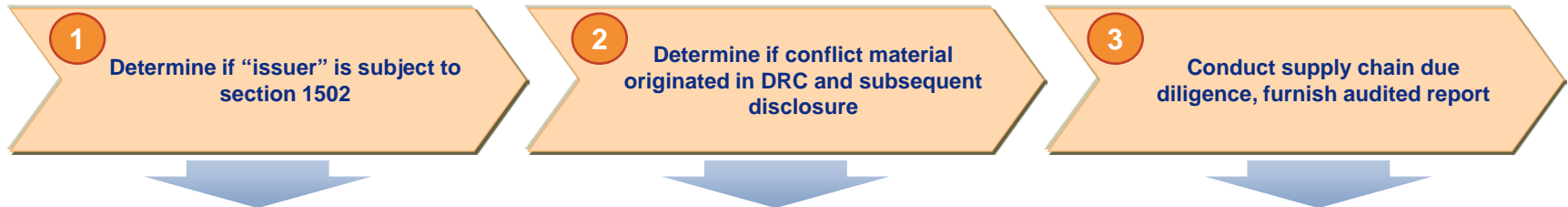


#### Examples of industries affected

- Electronics and Communications
- Aerospace
- Automotive
- Jewelry
- Diversified Industrial Manufacturing

Sources: 1. SEC Release No. 34-63547; File No. S7-40-10  
2. Wikipedia

# SEC has proposed a 3-step disclosure requirements process for Section 1502



## Act would apply to issuer (company filing SEC reports) if:

- Issuer **files reports with SEC** under the Exchange Act
- Conflict minerals are “necessary to the **functionality or production** of product manufactured by that person”. Even though “necessary” is not defined, it can be inferred that the
  - Provision applies to issuers even if they contract the manufacturing of their products
  - Provision applies even if the metal is not ultimately found in the final product, as long as it is “necessary” in the manufacturing process
- Act applies to **retailers** who carry private labeled products (and hence carry a contract or have influence in the manufacturing).
- Products made with **recycled or scrap** may be considered DRC conflict free, but the company must nevertheless furnish a Conflict Minerals Report (and related audit report) about the use of the recycled or scrap minerals and the supply chain due diligence process.

## Determination and disclosure requirements:

- SEC expects a “reasonable” **country of origin inquiry**
  - “reasonable” is not defined and depends on the available infrastructure available at any given point in time
  - SEC expects that the issuer will conduct a thorough investigation and that the burden to meet the standards would be “significant”
- Subsequent to the inquiry, the issuer will need to declare whether its conflict minerals are “DRC conflict free” in its **annual reports**
  - Disclosure requirements include the investigation it undertook to make the determination
- Disclosure also extends to the company’s **website**, with the address provided in the annual reports
- If the issuer is unable to determine if the minerals are DRC conflict free or if the minerals did originate from the region, this disclosure needs to be made in the annual report and the website as well.

## If the issuer uses minerals from DRC or is unable to verify source:

- A **Conflict Minerals Report** will need to be generated that includes details such as:
  - description of the due diligence efforts undertaken
  - specifics of private sector audit performed on the supply chain and source
  - Description of the products manufactured and facilities where DRC materials may have been used, etc.
- The SEC expects issuers to perform **due diligence** on the source and supply chain of conflict minerals
  - no standards prescribed by SEC but *Organisation for Economic Co-operation and Development’s* (OECD) standards referenced as a good starting point
- The SEC recommends that an **independent private sector audit** form part of the due diligence.
  - Audits need to conform to domestic and international standards such as those set by the Comptroller General of the US.

# Challenges to implementation of the Conflict Mineral Section

## Uncertainties regarding the scope of the requirement

### ● Loosely defined terms

- “Reasonable country of origin search”
- “Substantial to the functionality”
  - What about material inadvertently used,
  - What if alternative materials exist?

### ● Implications for retailers

- Extent of influence on manufacturing

### ● Treatment of recycled materials

- Extent of due-diligence required for recycled materials?
- What about gold where 1/3<sup>rd</sup> of metal is recycled and only <1% is mined in DRC?

## Mapping the supply chain is an onerous task

### ● Even companies like Intel have not been able to fully map the entire supply chain

- Substantial clout over suppliers
- Efforts underway since 2009
- No lack of resource or resolve
- One company claims > than 15,000 suppliers

### ● Supply chain for each industry is very different and what works for one may not work for another

### ● Use of distributors makes supply chain less transparent

## Uncertainties regarding audit standards

### ● Nature and objective of audit:

Reaching conclusion as to

- Conformity with a recognized standard
- Whether the issuer performed the due-diligence procedures
- Origin of the conflict minerals

### ● Applicable professional standards for audit. Choice between:

- Attestation or
- Performance audit

### ● Independence requirement. Standards set by:

- SEC/PCAOB or
- GAO

*KPMG's comment to the SEC:*

<http://www.sec.gov/comments/s7-40-10/s74010-110.pdf>

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# What are companies doing on Conflict Minerals?

## ***Supply chain due diligence and Audit***

- **Have audits conducted of its suppliers of these minerals to determine mine of origin and chain of custody**
  - HP, Intel, Microsoft, Apple, Nokia, and Acer surveyed suppliers, visited factories, and attempted to find loopholes in suppliers' answers on their sourcing of minerals
  - RIM, Philips, Toshiba, SanDisk, and LG have also begun individual tracing in recent months
- **Educate and inform suppliers**
  - Representatives from Chrysler, Ford, GM, Honda of America, Nissan North America, and Toyota North America, issued a joint letter to suppliers informing them of the upcoming requirements and told suppliers that it is the intention of the companies to ensure that the parts and assemblies in vehicles do not contain Conflict Minerals which have contributed to the armed conflict in the DRC.

## ***Publish results, develop policies***

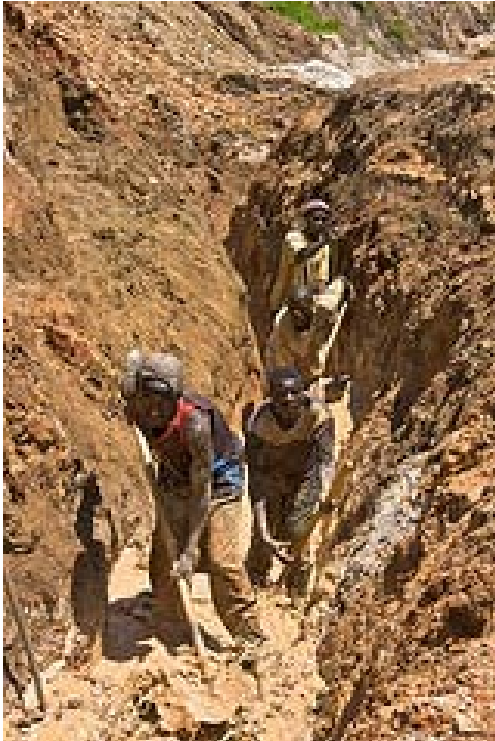
- **Publish results**
  - HP and Intel have published the names of their leading suppliers for these metals, including some smelters
- **Implement contractual obligations**
  - Several companies including Motorola, and Intel have added requirements to their supplier contracts to trace and certify origin of minerals used in components

**Source:**

- "Getting to Conflict-Free. Assessing Corporate Action on Conflict Minerals" by the Enough Project1 December 2010
- Individual companies' websites and reports on Corporate Sustainability
- [www.prweb.com/releases/prwebconflict\\_mineral/Republic\\_of\\_Congo/prweb8430202.htm](http://www.prweb.com/releases/prwebconflict_mineral/Republic_of_Congo/prweb8430202.htm)

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# Apple, Intel Vow to Stop Using Conflict Minerals From Africa



*Tantalum miners in Congo*

*Photograph used with permission from Sasha Lezhnev of the Enough Project*

## Apple, Intel Vow to Stop Using Conflict Minerals From Africa

“Conflict minerals include valuable commodities such as gold, titanium, tungsten and tin, which generate massive revenues used to fund wars in Central Africa, and, more specifically, in the Democratic Republic of Congo. Beginning next year, all U.S. companies will be required by law to disclose their mineral supplies and identify any purchases that may be linked to the Congo conflict. **By agreeing to the Conflict-Free Smelter program, though, Apple and Intel have effectively given themselves a head-start**, which could help mitigate future controversy.”

Apr 4, 2011, <http://www.switched.com/>

## Examples of industry groups addressing the issue

Resource	Link	General mission	Role in conflict minerals resolution
Electronics Industry Citizenship Coalition (EICC)	<a href="http://www.eicc.info/">www.eicc.info/</a>	Improve efficiency and social responsibility in the global supply chain.	Collaborating to launch a Conflict-Free Smelter (CFS) program to identify smelters that can demonstrate through an independent third-party assessment that the raw materials they procured did not originate from sources that contribute to conflict in the DRC
Global eSustainability Initiative (GeSI)	<a href="http://gesi.org">http://gesi.org</a>	Promote technologies that foster sustainable development in the information and communication technologies (ICT) sector	Spearheaded efforts for the development and implementation of a "bag and tag" scheme at the mine as a key element of credible traceability for Cassiterite from the mine of origin to the processing facility
International Tin Research Institute (ITRI)	<a href="http://www.itri.co.uk/">www.itri.co.uk/</a>	Support and encourage the use of tin in existing and new applications	Educating and preparing suppliers for reporting that will enable compliance with provisions of the Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act).
Automotive Industry Action Group	<a href="http://www.aiag.org">www.aiag.org</a>	Continuously improve business processes and practices involving trading partners throughout the supply chain.	

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## NGOs actively promoting the issue

Resource	Link	General mission	Role in conflict minerals resolution
Enough Project	<a href="http://www.enoughproject.org/conflict-minerals">www.enoughproject.org/conflict-minerals</a> <a href="http://www.raisehopeforcongo.org">www.raisehopeforcongo.org</a>	“Enough” is a project of the Center for American Progress to end genocide and crimes against humanity	Conduct field research, advocacy, and communications to bolster a grassroots movement. Track companies’ actions on the issue
Global Witness	<a href="http://www.globalwitness.org/">www.globalwitness.org/</a>	Run campaigns against natural resource-related conflict and corruption and associated environmental and human rights abuses	Campaign aimed at documenting, exposing and ultimately break these links between politicians, military and militia groups
Resolv	<a href="http://www.resolv.org/">www.resolv.org/</a>	Seeks to create enduring solutions to environmental, social, and health challenges, by collaborating with community, business, government, and NGOs	Conducted research with EICC and GeSi to see how companies can trace supply chain back to the mine of origin
Friends of the Congo	<a href="http://www.friendsofthecongo.org">www.friendsofthecongo.org</a> <a href="http://conflictminerals.org/">http://conflictminerals.org/</a>	Work in partnership with Congolese to bring about peaceful and lasting change in the Democratic Republic of Congo (DRC), formerly Zaire.	Advocate an aggressive diplomatic path with an emphasis on pursuing a regional political framework. Especially pressuring Rwanda and Uganda to end regional conflict.

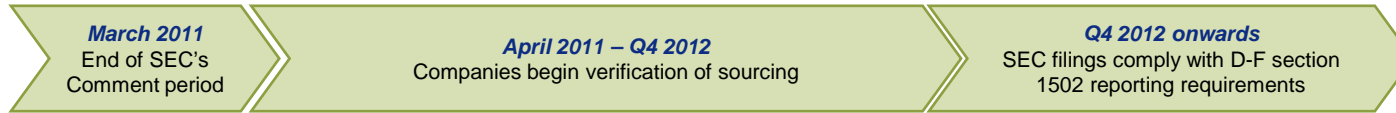
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# Industry's response to Conflict Minerals

## Likely implementation timeline



### In 2011-2012, affected companies will need undertake:

#### 1. Internal analysis

- Determine if 3TG metals are “necessary” for the manufacturing of its product (most electronics, aerospace, automotive, jewelry, medical technology and industrial tools manufacturers should be covered. Retailers who have custom manufactured products may be covered as well)
- Determine where 3TG metals are being used in products or processes at:
  - In-house manufacturing
  - Contract manufacturers

#### 2. Supply chain due diligence inquiries

- Develop list of suppliers (to both in-house and contract manufacturer) of these metals
- Survey suppliers on their sources of the 3TG metals - down to smelters and mining region. Seek 3rd party certification if necessary
- If any of the metals' sources are from DRC countries or are not traceable, seek/conduct an audit of the source to check if mine operation supports DRC conflict

#### 3. Changes to policy and procedures (optional)

- Publish results of supplier due diligence/audit on corporate website (mandatory for fiscal year ending after Q4, 2012)
- Develop policy statement on not using 3TG metals from mines that fund DRC conflict
- Mandate usage and certification of DRC conflict-free sources of 3TG metals in supplier contracts

# KPMG Contacts on Conflict Minerals

## Preet Nagvanshi

Director - KPMG LLP  
345 Park Avenue  
New York, NY 10154

Tel 212-872-6731  
Fax 718-228-6650  
Cell 734-395-8218  
mnagvanshi@kpmg.com

## Jim Low

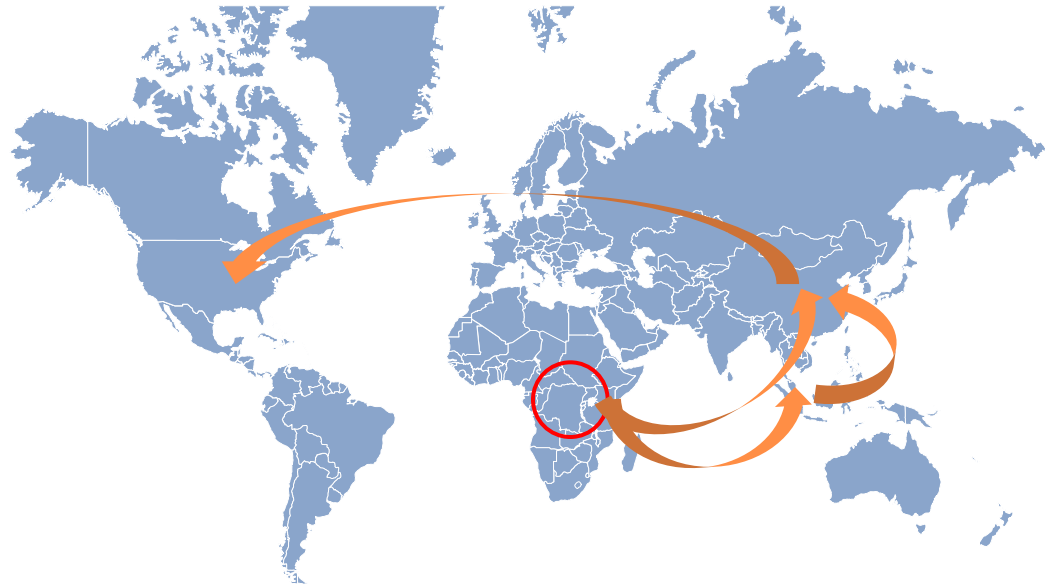
Partner - KPMG LLP  
345 Park Avenue  
New York, NY 10154

Tel 212-872—3205  
Cell 646-229-9787  
jhlw@kpmg.com

## Bala Lakshman

Manager - KPMG LLP  
Suite 3100  
717 North Harwood Street  
Dallas, TX 75201

Tel 214-840-4005  
Fax 214-580-7949  
Cell 972-352-7022  
blakshman@kpmg.com





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