What Your Company Should Know About Conflict Minerals

A MetalMiner Guide to Conflict Minerals Legislation and The Audit Process

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Sourcing Requirements For Complying with New Frank-Dodd US Conflict Minerals Law – Part One

February 21, 2011

MetalMiner is pleased to welcome Mr. Lawrence Heim, Director of The Elm Consulting Group International, LLC, an independent environmental, health, and safety consulting practice, as a guest contributor. According to their website, Elm was engaged by a leading US-based electronics manufacturing industry association to conduct the first independent third-party Conflict Minerals supply chain traceability audits, supporting the association's "Conflict-Free Smelter" designation for tantalum.

Supply Chain Traceability Auditing Under the US Conflict Minerals Law

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (signed into law by President Obama on July 21, 2010) establishes what has become known as the Conflict Minerals Law. This series of articles focuses on Section 1502(b), which mandates supply chain due diligence and public disclosure related to the source of the minerals.

Fundamentally, the US Conflict Minerals Law contains two closely connected requirements: independent third-party supply chain traceability audits, and reporting of audit information to the public and the Securities and Exchange Commission (SEC). However, even companies not directly regulated by the SEC will be directly impacted by the audit requirements (we will explore this issue as part of a follow-up post).

"Companies regulated by the SEC must disclose annually whether conflict minerals originated from the DRC/ adjoining country and submit a report conducted by an independent private-sector auditor."

The Secretary of Commerce – and by extension, the SEC – is empowered with the authority for implementation, oversight, enforcement and Congressional reporting of the Law. This is critical in understanding the importance and visibility of the supply chain traceability audits, as well as related risks. These audits, or at least their summaries, are to be incorporated into SEC regulatory filings in some manner. (The form of the SEC regulatory disclosure is not yet known. The full supply chain traceability audit report may only need to be made publicly available on a company's website rather than being directly incorporated into SEC filings.)

Definitions are set forth in Section 1502(e). The term "Conflict Minerals" is defined as:

• Tantalum and columbite-tantalite (coltan);
• Tin and cassiterite;
• Tungsten and wolframite;
• Gold;
• Their derivatives; and
• Any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo (DRC) or an adjoining country (Angola, Burundi, Central African Republic, Congo Republic [a different nation than the DRC], Rwanda, Sudan, Tanzania, Uganda and Zambia).

Companies regulated by the SEC must disclose annually whether conflict minerals originated from the DRC/adjoining country and, where that is the case, submit a report conducted by an independent private-sector auditor that includes:

• A description of due diligence/audit process conducted;
• The name of the auditor;
• The facilities used to process the conflict minerals;
• Country or countries of origin of the conflict minerals; and
• Efforts undertaken to determine the mine or location of origin with the greatest possible specificity.

How can the presence of conflict minerals be identified in products? Companies can use general knowledge of their products and processes, as well as material identification/ tracking systems like Bill of Materials (BOMs), Reduction of Hazardous Substances (RoHS) and Material Safety Data Sheets (MSDS). A basic understanding of common uses of conflict minerals is also helpful.

Metal	Ore, Common Intermediates	Common Products, Uses
Tin	Cassiterite; tetrabutyl tin; tetraoctyl tin	Solder, sheet metal, electrical conductors. A component of chemicals in biocides, fungicides. Used in PVC and high performance paint manufacturing.
Tantalum	Columbite-tantalite ("coltan"); tantalum pentoxide; potassium tantalum fluoride (KTaF)	Powder, capacitors, resistors. In carbide form, used in jet engine/turbine blades and drill bits, end mills and other tools.
Tungsten	Wolframite; ammonium paratungstate	Weights/counterweights, electronics, ammunition, welding equipment. In carbide form, used in tools, drill bits, end mills and other tools.
Gold	—	Jewelry, electronics, dental products. Also present in chemical compounds in certain semiconductor manufacturing processes.

Is there an amount of conflict minerals considered de minimis, or that otherwise exempts products from this requirement? No.

Can internal resources be used to satisfy this requirement? No, the law specifically mandates the use of independent private sector auditors who must themselves operate and be in accordance with standards established by the Comptroller General of the United States. More discussion on audit standards and where internal resources can be used will be included in a follow-up post.

What form will the disclosure and audit take? While specifics are not yet known concerning the form or content of reporting to the SEC, the full audit report must be made publicly available on the company's website. The law does not define what is considered an appropriate due diligence effort for the audits. Instead, this is left to individual companies to take into account unique aspects of their materials and supply chains.

This approach has benefits and risks. While allowing companies flexibility in meeting the requirements, audit processes may be designated by the Secretary of Commerce as unreliable. If this happens, reports based on such processes will be deemed invalid and will not satisfy the reporting requirements.

Is the audit required if conflict minerals are used as a manufacturing aid but where the end product doesn't contain conflict minerals? The intent is aimed at conflict materials that are incorporated into a product necessary to the functionality or production of a product. An example used in the SEC-proposed regulation is if conflict minerals are present in a hand tool that is used to assemble an automobile, that tool would not trigger the audit/disclosure requirement for the automaker. This point is likely to be subject to future clarification and interpretation.

If the disclosure is required annually, does that mean new audits of the same sites/suppliers must be conducted annually? At this point, the answer appears to be "yes."

Our next post will discuss the audit aspects of implementing regulations that are currently in proposal/public comment status.

Conflict Minerals Law and Supply Chain Traceability - Part Two

February 22, 2011

By Lawrence Heim

Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (signed into law by President Obama on July 21, 2010) establishes what has become known as the Conflict Minerals Law. This series of articles focuses on Section 1502(b), which mandates supply chain due diligence and public disclosure related to the source of the minerals.

The SEC's Proposed Conflict Minerals Regulations

The Conflict Mineral Law requires that implementing regulations be in place by April 21, 2011. On December 15, 2010, the Securities and Exchange Commission ("SEC") issued its proposed regulations implementing the Conflict Minerals Law. The proposal was published in the December 23, 2010 Federal Register (75 Fed. Reg. 80948 – 80975). Originally the public comment period was to be closed on January 31, 2011, but was extended to March 2.

The regulations attempt to provide more detail on the auditing and reporting aspects of the Law. However, the law itself mandates certain key aspects and neither the SEC nor the Secretary of Commerce has the flexibility to authorize anything different, even though comment is being sought on all elements of the proposal. Some of the highlights of the proposal include:

"Reasonable inquiry." A company is to first conduct an internal evaluation of its use/possible use of tin, tungsten, tantalum and gold. Where the company determines that these materials are used in the products in any amount that is necessary to the functionality or production of a product, the company must then conduct a "reasonable inquiry" to determine if its conflict minerals originated in the DRC countries.

"While the applicability of the Conflict Minerals Law to manufacturers seems fairly clear, the law also extends to contract manufacturers and retailers of private-brand products."

- If the company determines that its conflict minerals did not originate in the DRC countries, the issuer would disclose this determination and the reasonable country of origin inquiry it used in reaching this determination in the body of its annual report.

- If the company determines that its conflict minerals did originate in the DRC countries, or if it is unable to conclude that its conflict minerals did not originate in the DRC countries, the company must disclose this conclusion in its annual report and conduct a Conflict Minerals Report.

• "Conflict Minerals Report." This report will be required where the mine/source information from the reasonable inquiry either (a) is inconclusive or (b) shows that material has been sourced from the DRC/adjoining countries. As stated specifically in the statute, the Conflict Minerals Report must be developed by an independent private sector auditor and conducted in accordance with the standards established by the Comptroller General of the United States (i.e., the SEC and related Government Accounting Standards and the American Institute of Certified Public Accountants (AICPA)). The regulation contains clarifications on the applicable auditor standards – including independence, competence and attestations. As discussed in the previous post, the SEC has the authority to deem any audits/Conflict Minerals Reports as unreliable. If this happens, reports based on such processes will be deemed invalid and will not satisfy the reporting requirements.

• Retailers/contract manufacturers. While the applicability of the Conflict Minerals Law to manufacturers seems fairly clear, the law also extends to contract manufacturers and retailers of private-brand products. The proposal clarified that the rules are to apply to companies that have influence over contract manufacturers, as well as generic products under a company's own brand name or a separate brand name that they have established, regardless of whether those companies have any influence over the manufacturing specifications of those products.

The regulations are not intended to apply to retailers "that sell only the products of third parties if those retailers have no contract or other involvement regarding the manufacturing of those products, or if those retailers do not sell those products under their brand name or a separate brand they have established and do not have those products manufactured specifically for them."

Conflict Minerals Law, Supply Chain Due Diligence and Impact on Metal Buying Organizations - Part Three

February 25, 2011

By Lawrence Heim

Additional proposed elements of the Conflict Minerals law include:

Due diligence process not prescribed. Neither the law nor the SEC's proposal specifies the requirements for the scope or execution of a due diligence process for the Conflict Minerals Report. Instead, the SEC's opinion is that it would be inappropriate for them to prescribe any specific guidance on the due diligence efforts. This allows companies/industries to develop a framework reflecting their own unique circumstances, products and supply chain. However, the scope of the effort and the information relied upon must be specifically described in the Report.

Applicability to scrap. The proposal establishes a separate standard for scrap materials. The SEC stated that if companies "obtain conflict minerals from a recycled or scrap source, they may consider those conflict minerals to be DRC conflict free." However, the preamble provides confusing – if not conflicting – language on this point.

• Companies claiming the use of scrap/recycled material "would be required to disclose in their annual report, under the 'Conflict Minerals Disclosure' heading, that their conflict minerals were obtained from recycled or scrap sources and that they furnished a Conflict Minerals Report regarding those recycled or scrap minerals." Based on this statement, a full third-party Conflict Minerals Report is required for scrap that is deemed DRC conflict-free.

"The SEC estimated that 1,199 companies will require a full Conflict Minerals Report. The number of additional companies impacted would be 12,000."

• The SEC does not plan to define what is recycled or scrap material. Companies are left to establish their own definition, with supporting explanations and associate due diligence efforts to be provided in the Conflict Minerals Report for the scrap/recycled material. In addition to creating ambiguity for auditors, this will likely result in companies defining "scrap" one way for purposes of the SEC, and another way under EPA regulations. See 40 CFR 261.2(c).

The actual regulations are less ambiguous, stating clearly that Forms 20-F, 40-F and 10-K must contain a Conflict Minerals Report for scrap/recycled conflict mineral materials.

Number of companies affected: Two groups of companies will be directly impacted by the Conflict Minerals Law: companies that are directly regulated by the SEC, and companies that are not SEC-regulated, but are suppliers to impacted companies. For the first category, the SEC estimated that 1,199 companies will require a full Conflict Minerals Report. The methodology for determining this number is worthy of mention. The SEC began by finding the amount of tantalum produced by the DRC in comparison to global production (15% - 20%). The Commission selected the higher figure of 20% and multiplied that by the total number of affected issuers, which they stated is 6,000. (75 Fed. Reg. 80966.) Clearly, this methodology does not consider many additional factors and the actual number of companies that will require

the full audit is certain to be higher. For the second category – the suppliers – no estimate has been made. But if one anticipates 10 suppliers (we have data indicating that the number of suppliers ranges from one to well over 100 for a single directly-regulated company; an average of 10 suppliers may be conservative, especially given the wide range of conflict mineral-containing products) for each company directly regulated, the number of additional companies impacted would be 12,000.

The next guest post will review the proposed requirements in comparison to three of the first-ever Conflict Minerals supply chain traceability audits, conducted from August–November 2010 by independent third-party professional auditors.

Conflict Minerals Law, Supply Chain Due Diligence and Impact on Metal Buying Organizations - Part Four

March 3, 2011

By Lawrence Heim

Up until recently, substantive efforts related to conflict minerals have focused on "bag and tag" programs at mines and voluntary procurement standards based on reputational risk concerns. In 2010, a leading US-based industry association of electronic manufacturers began field trials of a conflict minerals audit program based on tools developed by the association and an international non-governmental organization. Our firm, The Elm Consulting Group International LLC, was one of three firms invited to participate in the field trials; we subsequently conducted the first tantalum supply chain traceability audits encompassing sites in the US and Japan. We also had the opportunity to evaluate an additional site – a scrap metal company in the US.

The major takeaways from our experience include:

• Supply chain auditing takes careful planning. The audit process is far more efficient if it begins close to the point of materials origin and works forward. Starting at the consumer/end use results in the audits being incomplete until all the preceding supply chain links are audited. Once the full chain is completely audited, all the open/incomplete reports must be amended.

• Even though the SEC's jurisdiction is limited to publicly-traded companies, the conflict minerals audit mandate will directly impact non-publicly traded companies as they are likely to be part of the supply chain of directly-regulated companies. Information and audit requests will flow through the entire chain, which is the goal of the law.

• New information sources beyond facility/company files are needed. Some of this information is to be developed by the US government under the Law, but much will be left to the companies and auditors to locate on their own. SEC and other stakeholders have expressed concern about

the veracity of the information regarding activities near the point of extraction/export. This

information need creates an opportunity to leverage emerging information management technologies such as Sentiment360.

• Material buyers are already demanding third party audits/evaluations, demonstrating hesitation to rely on self-declarations by suppliers. This indicates that, although SEC standards allow companies to conduct and rely upon internal due diligence activities and representations, market forces may push companies to engage third party auditors for all its conflict minerals evaluations and related statements.

• Auditor selection is critical to reducing risk. In the previous article, we discussed the SEC's position in its proposal that they do not intend to establish specific guidance on the due diligence activities. Companies will be heavily dependent on auditors to understand the law and to implement regulations, and to determine what should constitute an acceptable audit scope. (Section 1502(b) of the Law specifically authorizes the SEC to deem audit activities and reports as "unreliable" if the SEC determines that those do not meet the Commission's expectations or standards established.) But the risk extends far beyond potential SEC action: customers, the media and shareholders will all respond to the audit results. There are a number of auditor certifications that could be considered applicable to this scope of audit, but none should be considered to automatically qualify an auditor for these engagements. These audits require a unique blend of expertise in general auditing processes/procedures, environmental knowledge, accounting basics, chemistry/industrial processes, procurement controls, contracts and supply chain fundamentals. Finally, the auditor must be able to execute the engagement in accordance with the auditor/engagement standards of the Government Auditing Standards, such as the standards for Attestation Engagements or the standards for Performance Audits (GAO–07–731G). GAO-07-731G contains standards on auditor independence. At this time – and without further guidance from the SEC – it is unclear whether an audit sponsored, actively managed and reported through an industry association would conform to GAO-07-731G's (or any other audit standard) standards on auditor independence. Associations consist of multiple members who have varying degrees of business relationships with each other and the audited entities, putting the auditor in a position of serving "multiple masters" relative to influence over the audit scope, process, information, report and payment. Our research and inquiries to qualified experts in SEC auditing requirements indicate that there appears to be no precedent in any other legally required audit in the US that has been fulfilled in this manner.

"Companies will be heavily dependent on auditors to understand the law and to implement regulations, and to determine what should constitute an acceptable audit scope."

Other existing international standards, such as the Organization for Economic Cooperation and Development (OECD) draft Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas and the Supplement on Tin, Tantalum and Tungsten are currently voluntary standards and may not completely meet the SEC's more stringent auditor standards.

The SEC's audit cost estimate of $25,000 in their proposal is reasonable on a per-audit basis for a third party auditor, but not for a complete supply chain assessment/audit. The total program cost for a company will reflect internal labor effort costs for managing/supporting the external auditors, reviewing the audit report, and addressing customer/vendor requests that are sure to follow.

Of course, these costs will increase to reflect the number of audits required. Our research indicates that some companies have well over 100 suppliers that will require an audit.

Loophole in Conflict Minerals Law Creates Opportunity for Scrap Dealers

February 24, 2011

By Lisa Reisman

As a former metals trader (not ring, mind you, but import/export), I learned many tricks of the trade, so to speak. Unscrupulous traders once (perhaps still) easily circumvented US law in a variety of ways by creating false companies, transshipping products (knowing full well the products would end up in the hands of US adversaries) and outright falsifying the actual "end use" of said product. Nonetheless, sometimes laws get circumvented legally because the language of the law lacks specificity. But as an ex-Arthur Andersen consultant, I can appreciate the difference between the letter of the law and the spirit and intent of the law (Enron anyone?). Our contacts in the rare earth metals world tell us that tantalum scrap traders have found profitable ways to skirt the new Frank-Dodd Conflict Minerals Law.

"According to our source, traders have said to him, 'nothing is going to change…African origin material will find a way to get into the market.'"

These scrap dealers have followed market developments closely, attending any/all meetings and conferences having to do with conflict minerals. According to our source, traders have said to him, "nothing is going to change…African origin material will find a way to get into the market."

To understand how the scrap supply chain works, we refer to an earlier MetalMiner post covering tantalum forms: "Tantalum comes in basically three forms: tantalum ore and concentrate (where our sources tell us long-term pricing could easily exceed $120/lb with African spot prices at $60/lb, though one can't actually buy African tantalum at that price), tantalum oxide/salts (which essentially double the ore prices) and finally, capacitor-grade tantalum powder, now at approximately $300/lb according to our sources. It's this last grade that finds its way into the electronics we own." With tantalum prices mounting, the lure of finding loopholes in the law may prove too tempting. So we inquired how the tantalum scrap supply chain may operate in comparison to the non-scrap supply chain.

Basic premise: Tantalum oxide concentrate currently in the $120-$150/lb range with Congo ore currently in the $40-60/lb range -- an approximate $100/lb difference.

We have identified the following approximate costs and process steps to use scrap and avoid traceability requirements:

1. Extract metal from concentrate $15/lb
2. Refine metal to powder $15/lb
3. Refine metal powder to ingot $15/lb
4. Chop to ingot $10/lb (this is the only additional cost and is not traceable)

The scrap chain would still allow for an increase in the basic price of Congolese material. From a price perspective, the above-referenced process still undercuts or matches the "clean material." In other words, the "alternative" non-regulated supply chain can operate profitably at today's tantalum market prices.

The Enough Project, original advocates of the legislation, along with the NGO Global Witness are said to have begun work anew with the SEC to explain the loophole within the law. Clause 1502 of the legislation defines what needs to be reported to the SEC, but the portion of the law relating to scrap and recycled materials contains some ambiguity.

In the meantime, buying organizations will want to pay careful attention to both the new legal requirements as well as this new loophole.

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For more information on any of these opportunities, contact us at 773-525-9750 or drop us a line at info@agmetalminer.com.