

# What 2013 Conflict Minerals Filings Mean For 2014: Part 1

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By Michael R. Littenberg

(Michael Littenberg is a partner at Ropes & Gray. He authored this article with Farzad F. Damania and Andrea Matos, and the Conflict-Free Sourcing Initiative, while a partner at Schulte Roth & Zabel LLP.)

On June 2, 2014, the first filings under the conflict minerals rule were due. This three-part article discusses these filings across a range of metrics and provides other qualitative observations on the filings. It concludes with takeaways and suggestions for calendar 2014 compliance and reporting.

## Filing Statistics

### *Who Filed ... and Who Didn't*

Perhaps the biggest surprise to come out of the calendar year 2013 filings was the relatively small number of filers.

- total of 1,315 Form SDs were filed.
- Since some filings were made by parent and subsidiary registrants that filed joint reports, the number of unique filings was slightly lower.

In its required economic analysis, the [U.S. Securities and Exchange Commission](#) estimated that approximately 6,000 issuers would have filing obligations under the conflict minerals rule. This estimate was based on the number of issuers that fall under the Standard Industrial Classification ("SIC") codes that the SEC believed were most likely to result in filing obligations. Although these numbers were rough estimates, the actual number of Form SD filings was only 22 percent of the SEC's estimate.

### *Filings by Market Capitalization and Annual Revenue*

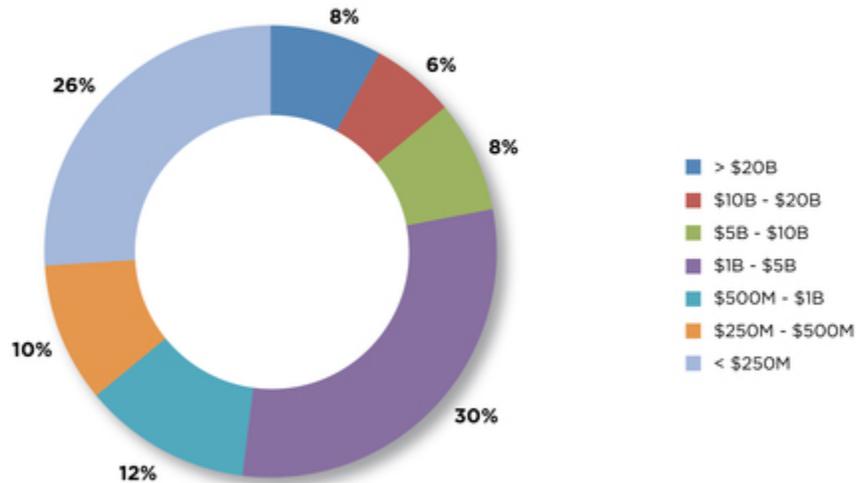
Breaking the filings down by market capitalization, more than half (55 percent) of Form SD filers had a market capitalization exceeding \$1 billion and over a quarter (28 percent) had a market capitalization exceeding \$5 billion. Eleven percent had market capitalizations exceeding \$20 billion.

Eleven percent of the filers with a market capitalization of less than \$250 million were debt-only filers that do not have publicly traded equity. Most of these issuers are what would generally be considered

midsize companies.

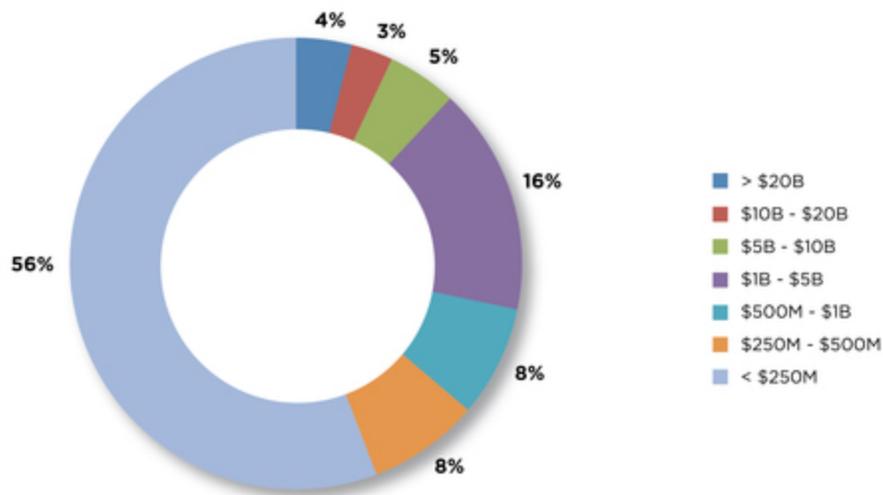
Since market capitalization is not always indicative of an issuer's size, we also broke the filings down by annual revenue. The results were similar. Fifty-two percent of the Form SD filers had annual revenue exceeding \$1 billion, while 22 percent had annual revenue in excess of \$5 billion and 8 percent had annual revenue of more than \$20 billion.

**Chart 2:** Annual Revenue — Form SD Filers

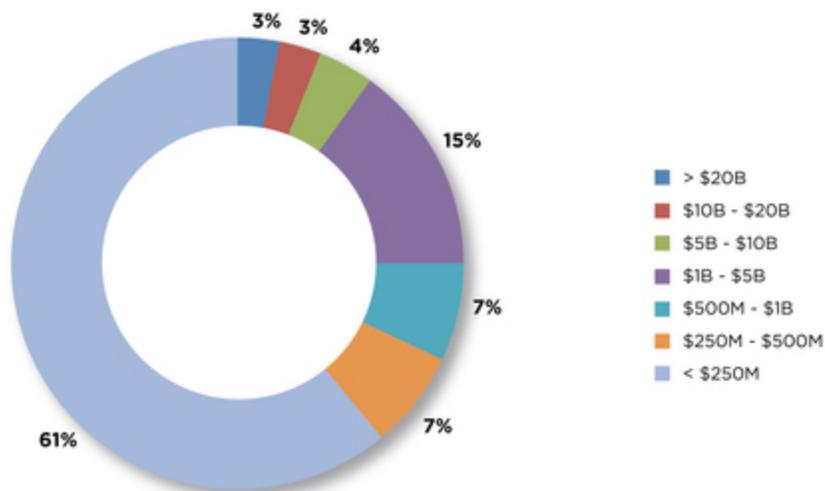


In comparison, the following two charts show the total Exchange Act filer population — which consists of approximately 15,000 issuers — by market capitalization and annual revenue.

**Chart 3: Market Capitalization — All Registrants**



**Chart 4: Annual Revenue — All Registrants**



As indicated by the data in the charts above, the percentage of Exchange Act registrants with a market capitalization or annual revenue under \$250 million that filed a Form SD was significantly less than the percentage of the total number of Exchange Act registrants in that band under either metric. Even after accounting for public shells and taking into account that many smaller public companies are biotech, natural resources or other development-stage companies with no in-scope products and that smaller

public companies are less likely to be engaged in manufacturing, the percentage of smaller companies that filed a Form SD has struck many commentators as low.

Possible explanations include the following:

- We suspect that, in some cases, smaller issuers were more aggressive in their scoping determinations than larger, higher-profile issuers. Although the SEC's adopting release and subsequent FAQs provide some guidance to help issuers determine which of their products are in-scope for purposes of the conflict minerals rule, whether an issuer has "contracted to manufacture" a product or conflict minerals are "necessary to the functionality or production" of a product is dependent on the facts and circumstances and involves judgment calls.
- In other cases, the determination that a filing was not required may have been due to a less in-depth understanding of the requirements of the conflict minerals rule.

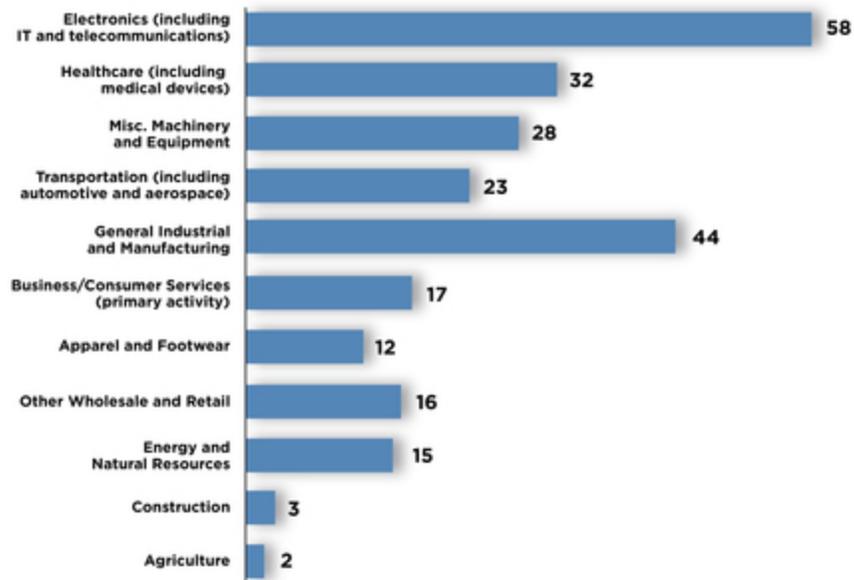
Some commentators have speculated that a significant number of issuers willfully ignored their filing obligations. Across the large number of issuers that we have worked with or otherwise interacted with in this area, we are not aware of a single instance where an issuer made a deliberate decision to ignore its filing obligations under the conflict minerals rule. Accordingly, we believe that instances of deliberate noncompliance were rare, if they occurred at all.

Although not separately broken out in this article, we have also seen a significant difference in the filings made by midsize and larger issuers (whether measured by market capitalization or annual revenue) as compared to smaller issuers. There were of course many thoughtful, comprehensive filings by smaller issuers. However, on balance, their filings tended to be shorter and contained less detail on both their compliance efforts and program. Accordingly, we have in most cases below limited the data presented to a sample of 250 filers with a market capitalization in excess of \$250 million (the "sample group").

#### ***Filings by Industry Category***

The sample group filings were from a broad range of industry categories as follows:

**Chart 5: Filings by Industry Category — Sample Group**

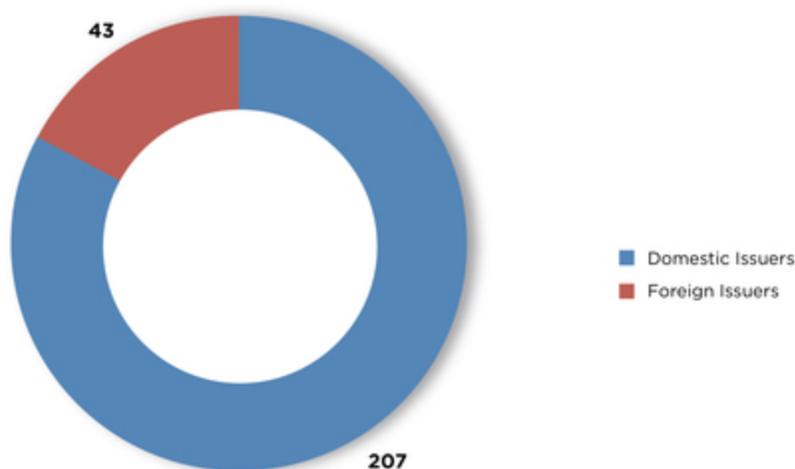


The categories in this chart were based on a combination of reported SIC codes and business and product descriptions in Form 10-Ks and on corporate websites. The industries represented and relative weighting are not surprising. Since many filers operate across multiple business lines and have products of broad application, many of the sample group issuers could have been included under two or more industry categories. However, this chart illustrates that issuers across a wide range of industries made filings under the conflict minerals rule. Out of the total issuer population, companies from 269 individual SIC codes filed.

***Domestic vs. Foreign Filers***

Within the sample group, filings between domestic and foreign issuers broke out as follows:

**Chart 6:** Breakdown Between Domestic and Foreign Filers — Sample Groups



Seventeen percent of the sample group were foreign issuers. In comparison, approximately 8 percent of all Exchange Act filers are foreign issuers. We attribute this percentage difference to the significant number of large dual-listed foreign manufacturers relative to the broader foreign issuer population.

#### ***Audits***

As expected, there were few audits for calendar year 2013. Under the conflict minerals rule and as clarified in a subsequent SEC FAQ, an independent private sector audit ("IPSA") is not required during a temporary transition period if, after exercising due diligence over the source and chain of custody of its conflict minerals, the issuer determined that at least one of its products may be described as "DRC conflict undeterminable." This transition period runs through calendar year 2016 for smaller reporting companies and calendar year 2014 for all other issuers. Subsequently, in its April 29, 2014 statement on the effect of the April 14, 2014, D.C. Circuit Court of Appeals' decision on the conflict minerals rule, the SEC further scaled back the IPSA requirement, indicating that, pending further action, an IPSA will not be required unless an issuer voluntarily elects to describe a product as "DRC conflict free" in its conflict minerals report ("CMR").

Given the current voluntary nature of the IPSA, there were only four IPSAs for calendar year 2013. The issuers and auditors are indicated below.

Issuer: [Intel Corp.](#)

Auditor: [Ernst & Young LLP](#)

Issuer: Kemet Corp.

Auditor: Douglas Hileman Consulting LLC

Issuer: Koninklijke Philips NV  
Auditor: KPMG Accountants NV

Issuer: [Signet Jewelers Ltd.](#)  
Auditor: SGS United Kingdom Ltd.

Under the conflict minerals rule, an IPSA must be performed in accordance with Generally Accepted Government Auditing Standards, also known as the Yellow Book, established by the [Government Accountability Office](#). The IPSA can take the form of either an attestation engagement or a performance audit. Only CPA firms can perform attestation engagements. Non-CPAs also can perform performance audits.

Other observations from the calendar year 2013 audits include the following:

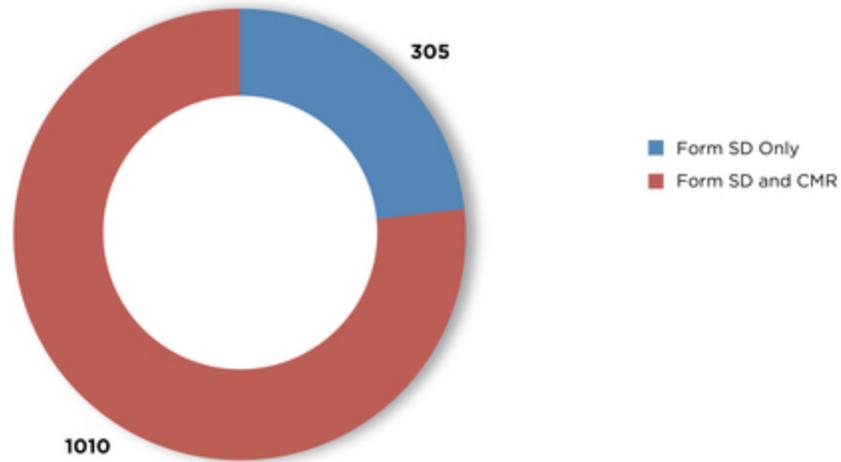
- Market practice was split down the middle, with two attestation engagements by CPA firms and two performance audits by non-CPAs.
- Larger issuers were not automatically drawn to attestation engagements.
- Both of the issuers that had attestation engagements performed used their financial statement auditor to conduct the audit. The IPSA is treated as a non-audit service and is therefore subject to the audit committee pre-approval requirements for non-audit services. However, this did not appear to be an impediment to issuers that decided to opt for attestation engagements.

We expect that there also will be relatively few audits for calendar year 2014, since most issuers are not likely to voluntarily undertake an audit. However, some issuers, especially larger issuers with well-known consumer brands, may receive pressure from nongovernmental organizations to conduct an audit for this year. In any case, expect market practice around audits to continue to evolve as more IPSAs are conducted.

#### ***What Was Filed?***

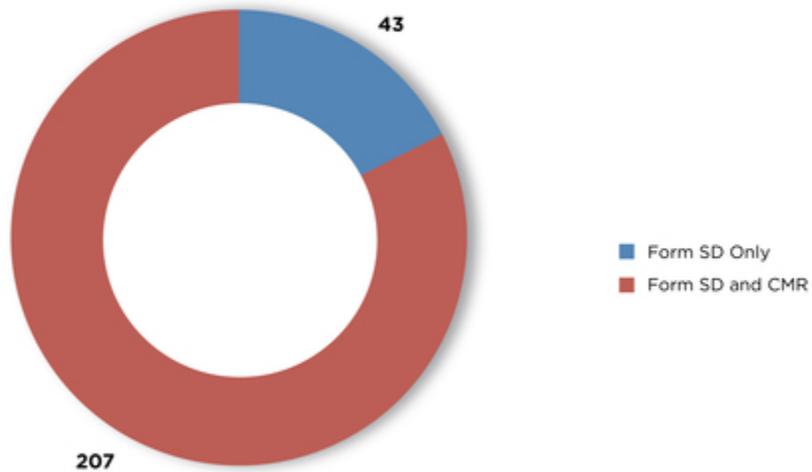
Most issuers filed both a Form SD and a CMR. CMRs were filed with 77 percent of the Form SDs filed. In its economic analysis, the SEC estimated that approximately 75 percent of Form SD filers also would be required to file a CMR.

**Chart 7: Filing Components — All Filers**



In line with both the total filer population and the SEC's estimates, 82 percent of the sample group filed both a Form SD and a CMR.

**Chart 8: Filing Components — Sample Group**

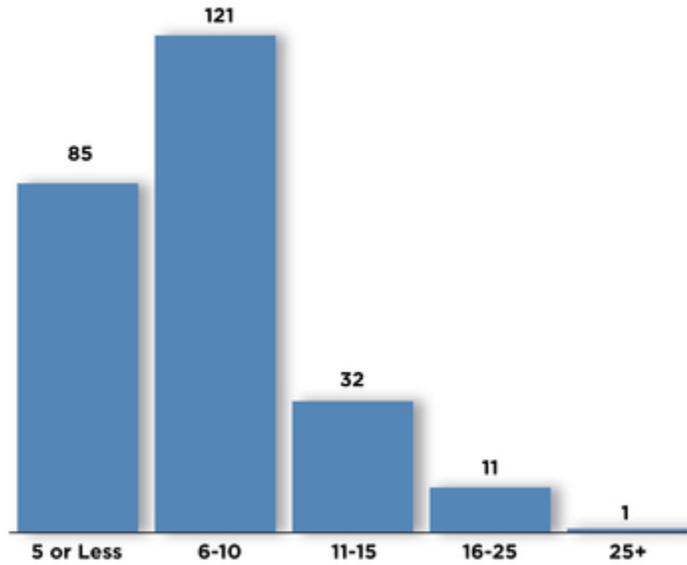


**Filing Length**

As expected, the length of filings ran the gamut, with filings ranging from very brief, with less than one

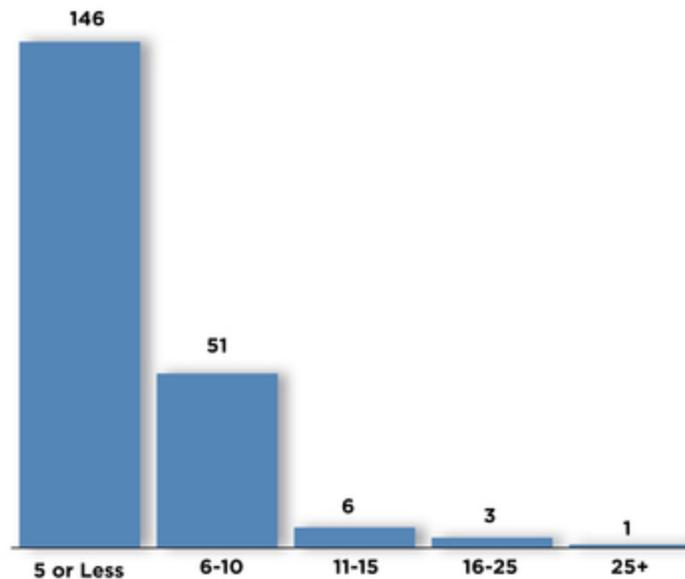
full page of substance, to lengthy. Slightly less than half (48 percent) of the sample group filings — Form SD and CMR combined — were in the six- to 10-page range. Most of the filings that totaled five pages or less did not include a CMR.

**Chart 9: Total Filing Page Length (Form SD and CMR) — Sample Group**



As noted in the "Filing Components" charts above, most of the sample group issuers, and filers generally, filed a CMR as an exhibit to their Form SD. The sample group's CMRs averaged approximately five pages, and most of those that were in the "five or less pages" category in the chart below were four to five pages long. The following chart contains additional information on sample group CMR page length.

**Chart 10: CMR Page Length — Sample Group**



As discussed in more detail later in this article, there was significant variation in both the content and layout of the CMRs filed by issuers. However, general observations on the content and layout of the CMRs include the following:

- Longer CMRs often included smelter and refiner information.
- Longer CMRs generally contained more background on the applicability of the conflict minerals rule to the issuer and a more methodical discussion of the application of the Organization for Economic Cooperation and Development's Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (the "OECD guidance").
- In addition, longer CMRs often contained bullets or sub-paragraphs, which resulted in more white space on each page.
- In a few instances, issuers included charts or other graphics in their filings, including of their mineral supply chain and/or smelter and refiner data. However, this was rare.

***Discussion of Due Diligence Framework Generally***

Most of the issuers in the sample group expressly indicated that they used the OECD guidance for their due diligence. This was expected, since the conflict minerals rule requires that an issuer's due diligence conform to a nationally or internationally recognized due diligence framework for conflict minerals to the extent available, and the OECD guidance is the only framework that satisfies this requirement.

Sixty-one percent of the sample group subset that filed a CMR tracked the OECD guidance's five-step framework in the CMR, either by organizing the discussion under section headings that were consistent with those used in the OECD guidance for each of the framework steps or by generally following the order of the five-step framework. (Where indicated, percentages are stated as a percentage of the sample group subset that filed a CMR, rather than of the entire sample group population, if the statistic related primarily to CMR disclosure.)

The five steps of the framework in the OECD guidance are:

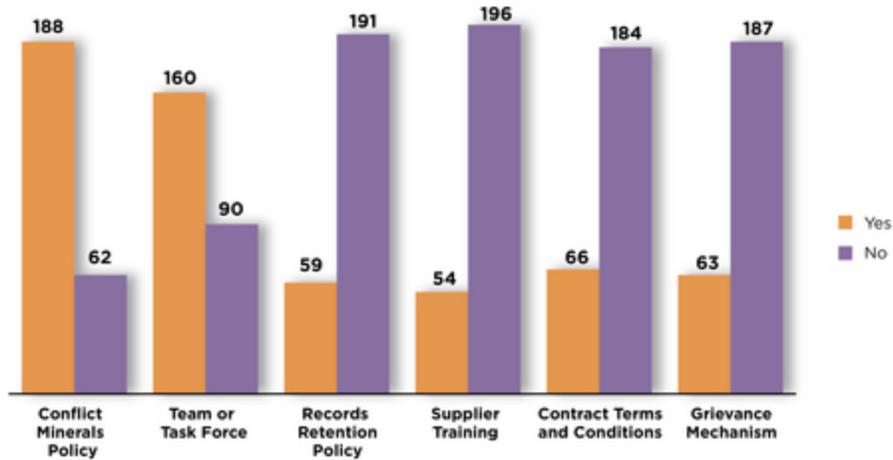
- Establish strong company management systems;
- Identify and assess risk in the supply chain;
- Design and implement a strategy to respond to identified risks;
- Carry out independent third-party audit of supply chain due diligence at identified points in the supply chain; and
- Report on supply chain due diligence.

Some of the individual elements of the OECD guidance are discussed in the sections that follow.

#### ***Management Systems***

With respect to Step 1 of the OECD guidance, the establishment of strong company management systems, the sample group discussed the following Step 1 program elements as indicated in the chart below.

**Chart 11: Management Systems Elements Discussed — Sample Group**



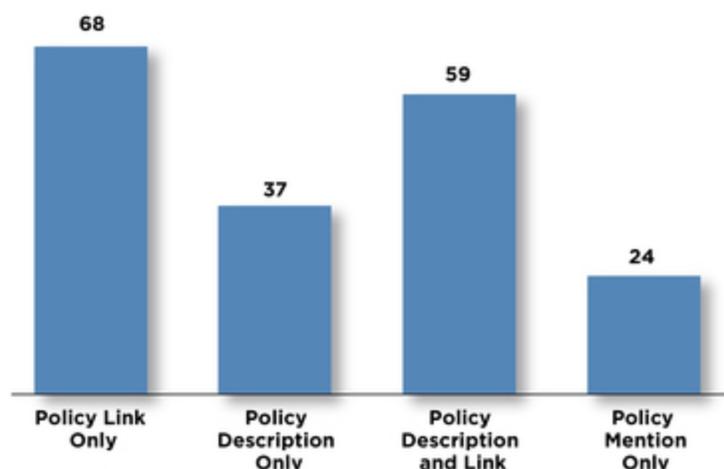
### *Conflict Minerals Policy*

The most frequently cited Step 1 program element was the conflict minerals policy, which was cited by 75 percent of the sample group. Placement of the discussion of the policy varied. Some issuers discussed the policy in the base Form SD, and others included the policy discussion in the CMR, while some discussed the policy in both locations.

Issuers in the sample group that indicated that they had a policy took different approaches in discussing the policy:

- 36 percent provided a link to the policy but did not describe the policy in the filing.
- 20 percent described the policy but did not provide a link.
- 31 percent both described and provided a link to the policy.
- The remaining 13 percent of this sample group subset indicated that they had a policy but did not describe the policy or provide a link to the policy.

**Chart 12: Conflict Minerals Policy Discussion — Sample Group**



Some of the issuers that discussed the substance of the policy reproduced the policy verbatim, while other issuers instead provided a summary of the material elements of the policy.

Many of the 62 issuers that did not indicate that they already had a policy in place indicated that they intend to adopt a conflict minerals policy during 2014. We expect that most issuers will have adopted a policy by the end of 2014 and will therefore reference a policy in their calendar year 2014 filings.

#### *Conflict Minerals Working Group*

The next most frequently cited Step 1 program element was the designation of a conflict minerals team or working group. This program element was cited by 64 percent of the Sample Group, mostly in the CMR.

Here, sample group issuers also took different approaches:

- Some issuers only indicated that they had designated a team for compliance.
- Some issuers went further, indicating the principal departments or job functions involved with the compliance effort.
- Some issuers also indicated the title of the individual with oversight of conflict minerals compliance.
- A small number of issuers indicated the number of employees involved with their compliance efforts.

Some issuers in the sample group also indicated that they were assisted by outside professional advisers or information technology firms, although this was in most cases discussed generically, without listing the firms by name.

### *Other OECD Guidance Step 1 Elements*

The other OECD guidance Step 1 elements included in the "Management Systems Elements Discussed — Sample Group" chart above were discussed by substantially fewer issuers. This was expected, since many issuers are still in the process of building out their compliance program. If only those sample group issuers that filed a CMR are included, the percentage of the population discussing these program elements increases substantially. As a result of the continuing development of compliance programs this year, as well as enhancements to filings based on calendar year 2013 filings by competitors and peers, we expect references to at least some of these other program elements to increase in the next filing.