



How the Mining LPRM can support investor risk assessment

This brief describes how the Mining Local Procurement Reporting Mechanism (LPRM) can support investors to assess the comprehensiveness of local procurement strategies implemented by their mining-related investments as a risk mitigation measure. Local procurement is one of the many issues that investors should be aware of in terms of performance by companies and implications for risk. Where relevant, aspects were drawn directly from the Mining LPRM which can be downloaded at: www.commdev.org/mining-local-procurement-reporting-mechanism/.

INTRODUCTION

Those who provide capital for mining-related investments yield considerable influence over the practices of individual mine sites. The efforts to promote responsible mining practices on behalf of financing institutions may be borne not only out of a concern for ethical behaviour, but also as a central risk mitigation tool for their investments. Mine sites that do not demonstrate a reasonable level of economic benefit for host countries and their communities are prone to poor relations with stakeholders, leading to conflicts, delays, and even the prevention of mine construction – all of which greatly hurt returns for investors. A study by Davis and Franks found that a “mining project with capital expenditure of between US\$3-5 billion will suffer costs of roughly US\$20 million per week of delayed production in Net Present Value (NPV) terms, largely due to lost sales.”¹ Additionally, there are significant risks for corruption that can arise during the procurement process in any sector, in both developing and advanced economies. Given the scale of procurement in the mining sector reaching up to hundreds of millions of dollars each year at each site, corruption is a significant risk that can ensnare companies in high-profile disputes and criminal charges.²

Investors seeking to determine if there are risks associated with mining projects and operations stemming from a lack of

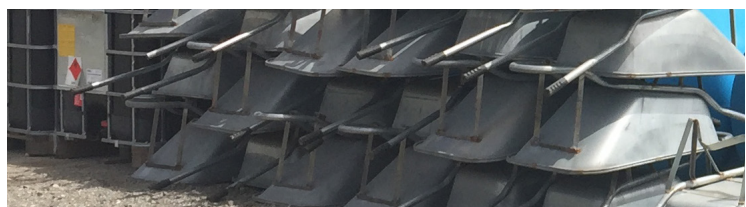
local procurement, or the potential for corruption, can utilise public reporting from mining companies to support their research. However, to determine the nature of local procurement practices and results as it pertains to risk for a particular investment, it is necessary to have data and practical information available at the *mine site level*. While local procurement is included in the Global Reporting Initiative (GRI), as well as various sustainability systems in use by mining companies, approaches and the level of detail being provided by companies drastically differ across the industry. Importantly, few mining companies currently report at the level of each individual mine site, leaving investors unable to assess individual current and potential investments for risks related to local procurement. For example, impressive reporting on local procurement in a company-wide sustainability report may hide the fact one site has problematic systems in place.

The Mining Local Procurement Reporting Mechanism (LPRM) is a set of publicly available disclosures on local procurement by the mining industry that seeks to address the gaps in current reporting frameworks and sustainability systems, and to help standardise the way the sector and host countries talk about the issue. Its use facilitates comprehensive reporting on local procurement spending at a site level, as well as increased detail on mining company procurement processes and due diligence practices.

¹ Davis, R. and Franks, D. (2014). Costs of Company-Community Conflict in the Extractives Sector, page 8. Harvard Kennedy School, Shift, and The University of Queensland: Australia. Retrieved from: https://sites.hks.harvard.edu/m-rcbg/CSRI/research/Costs%20of%20Conflict_Davis%20%20Franks.pdf

² The OECD's Corruption in the Extractive Value Chain Typology of Risks, Mitigation Measures and Incentives outlines the various ways that corruption, which may include the misuse of local content requirements, can occur at each stage of the mining life cycle.

As such, investors that encourage use of the LPRM as a condition of investment not only help support practices that create more economic benefits for host economies, they also help mitigate risks for their investment. **Mining projects and operations that are not able to provide information on their procurement processes and results, raise warning signs for a lack of sophisticated management systems that may be indicative of major risks for the investment.** A company using the LPRM to disclose information on their local procurement assures investors that reasonable policies and procedures are in place. Using the LPRM is particularly helpful for proposed mining projects as well as operations with underdeveloped corporate social responsibility (CSR) and local procurement systems, where requiring use of the LPRM gives mining companies a roadmap to guide the setup of their local procurement strategy.



Ways investors can use the LPRM to support risk mitigation measures:

- Use the LPRM disclosures to assess the level of local procurement best practice in a particular mine project or operation; the more disclosures a site is providing information on, the higher the likelihood the company is approaching the issue strategically.
- Use LPRM disclosures on local procurement as a base to engage with a company about its practices and strategy, challenges, and opportunities.
- Include site level procurement information, along with other site level environmental, social and governance data, to identify sites of higher or lower risk of instability or disruption.
- Encourage, incentivize, or require use of the Mining LPRM as a condition of investment.

ALIGNMENT WITH EXISTING SUSTIANABILITY FRAMEWORKS

As mentioned above, there are a number of sustainability frameworks that cover local procurement aspects in various ways however, these lack the necessary depth and linked guidance to comprehensively assess local procurement strategies (see pages 70-76 of the Mining LPRM for a detailed review³). Frameworks that are particularly relevant for Environmental, Social, and Governance (ESG) investors are examined below.

| Framework | Section of framework focusing on aspects of local procurement | Gaps in comprehensiveness of framework | Overlap with the Mining LPRM |
|-------------------------------|--|---|---|
| Equator Principles III (2013) | Principles to support financial institutions to ensure that projects reflect responsible environmental and social best practices. ⁴ Potentially relevant aspects to local procurement include: <ul style="list-style-type: none"> • Principle 1: Review and categorisation of the magnitude of environmental and social risks and impacts • Principle 2: Environmental and social risks and impacts assessment • Principle 3: Address compliance with relevant host country laws, regulations, permits as well as in designated cases (see Equator Principles), compliance with IFC Performance Standards and World Bank Group Environmental, Health and Safety • Principle 4: Development Environmental and Social Management System as well as an Action Plan to close the gaps | No specific guidance on local procurement best practices. | Potentially <i>Equator Principles</i> could overlap with Mining LPRM in the impact categorisation and assessment. However, given the lack of guidance provided, it is unlikely that this topic is being addressed comprehensively and that the full risks and impacts related to this issue are being considered. |

³ Note: only frameworks that explicating mentioned local procurement or supplying of goods and services from local businesses were included.

⁴ Equator Principles III (2013). The Equator Principles, page 2. Retrieved from: <http://equator-principles.com/about/>

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| | <ul style="list-style-type: none"> • Principle 8: Covenants in the financing documentation related to compliance with above standards and objectives • Principle 9: Independent monitoring and reporting • Principle 10: Public reporting and transparency of related data (ex. ESIA) | | |
| Mining and Metals: Sustainability Accounting Standards (2014) | <p><i>Sustainability Accounting Standards</i> support investors and public to understand material sustainability information of publicly-listed mining companies, specifically they are designed for mandatory filings to Securities and Exchange Commission (SEC) in the US.⁵ Potentially relevant aspects to local procurement include:</p> <ul style="list-style-type: none"> • Accounting Metrics: NR0302-13 <ul style="list-style-type: none"> • 73: Disclose to what degree policies are practices align with IFC’s Performance Standards 4, 5, & 8. • 74: Discuss how the above policies and practices outlined in .73 apply to contractors, sub-contractors, suppliers, and joint venture partners. • Accounting Metrics: NR0302-17 <ul style="list-style-type: none"> • 99: Discuss how engagement and due diligence practices undertaken by the company, apply to contractors, suppliers, and joint venture partners. • Accounting Metrics: NR0302-21 <ul style="list-style-type: none"> • 111: The registrant shall discuss its management system and due diligence procedures for assessing and managing corruption and bribery risks internally and associated with business partners in its value chain. Relevant business partners include customers, suppliers, contractors, subcontractors, and JV partners. | <p>No specific guidance on local procurement best practices.</p> | <p>Potentially <i>Sustainability Accounting Standards</i> could overlap with Mining LPRM in engagement and due diligence aspects. However, given the lack of guidance provided, it is unlikely that this topic is being addressed comprehensively and that the full risks and impacts related to this aspect are being considered.</p> |
| Global Reporting Initiative (last updated 2016) | <p><i>Global Reporting Initiative</i> develops sustainability reporting standards for organisations which are free public use. The standards require companies to disclose their management approach for procurement practices using <i>GRI 103: Management Approach</i> as well as their procurement spend under <i>GRI 204: Procurement Practices</i>.</p> <p>Specifically, companies are to report on the following disclosures:</p> <ul style="list-style-type: none"> • Disclosure 103-2: “For each material topic, the reporting organisation shall report the following information: a. An explanation of how the organisation manages the topic. b. A statement of the purpose of the management approach. | <p>While there is specific guidance on reporting local procurement spend, management disclosures are less specific on the best practice local procurement processes, policies, and procedures.</p> | <p>Overlap with local procurement corporate policies and procedures could potentially include the following disclosures of the Mining LPRM:</p> <ul style="list-style-type: none"> • Disclosure 201: Policy on local suppliers • Disclosure 202: Accountability on local suppliers • Disclosure 203: Major contractors and local suppliers • Disclosure 204: Procurement process |

⁵ Sustainability Accounting Standards Board (2014). Mining and Metals: Sustainability Accounting Standards, pages 27, 32. Retrieved from: https://www.sasb.org/wp-content/uploads/2014/06/NR0302_ProvisionalStandard_MetalsMining.pdf

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| | <p>c. A description of the following, if the management approach includes that component: i. Policies i. Commitments iii. Goals and targets iv. Responsibilities v. Resources vi. Grievance mechanisms vii. Specific actions, such as processes, projects, programmes and initiatives”</p> <ul style="list-style-type: none"> • Disclosure 103-3: “For each material topic, the reporting organisation shall report the following information: a. An explanation of how the organisation evaluates the management approach, including: i. the mechanisms for evaluating the effectiveness of the management approach; ii. the results of the evaluation of the management approach; iii. any related adjustments to the management approach”.⁶ • Requires reporting of proportion of spending on local suppliers at significant locations of operation (204-1). Specifically, the: <ul style="list-style-type: none"> • “percentage of the procurement budget spent on suppliers local to that operation (such as percentage of products and services purchased locally) at each significant location of operation; • organisation’s geographical definition of “local”; and • definition used for ‘significant locations of operation’”.⁷ | | <ul style="list-style-type: none"> • Disclosure 401: Due diligence processes • Disclosure 402: Anti-corruption policy • Disclosure 403: Training and guidance for suppliers • Disclosure 501: Commitments • Disclosure 502: Preference in scoring of bids • Disclosure 503: Preference in scoring of bids for significant local contributions • Disclosure 504: Non-scoring methods to incentivise local purchasing • Disclosure 505: Supporting suppliers to understand the tender process • Disclosure 506: Special payment procedures for local suppliers • Disclosure 507: Encouraging procurement from particular groups • Disclosure 601: Regulations • Disclosure 602: Other agreements and contracts <p>Overlap related to procurement spend includes:</p> <ul style="list-style-type: none"> • Disclosure 301: Categorizing suppliers, reporting organisation to describe how they define local. • Disclosure 302: Breakdown of procurement spend, reporting organisation to break down their procurement spend for each category of supplier provided in <i>Disclosure 301: Categorising suppliers</i>, including international suppliers. |

⁶ Global Reporting Initiative, GRI 103: Management Approach 2016, pp. 8-10. 2016. Retrieved from <https://www.globalreporting.org/standards/media/1038/gri-103-management-approach-2016.pdf>.

⁷ Global Reporting Initiative, GRI 204: Procurement Practices 2016, p. 7. 2016. Retrieved from <https://www.globalreporting.org/standards/gri-standards-download-center/gri-204-procurementpractices/?g=575e0041-59e8-4bd2-bb36-c8c5f5b5a903>

As highlighted above, frameworks that are commonly referenced and used to support the development of ESG assessments and evaluation criteria for mining-related investments often lack comprehensive guidance and reporting requirements related to local procurement in the mining sector. While the Global Reporting Initiative (GRI) does ask companies to cover management processes related to procurement, it lacks the necessary detail to support mining companies and their investors to understand the specific policies and practices that should be disclosed. Also, related to reporting local spend, the focus on “significant locations of operation” leads to a lack of consistent reporting on the performance of all mine sites. In addition, “local” is defined in terms of geography, such as businesses registered within the country or province, which may not reflect the local expectations or regulatory requirements within the country related to local business ownership, employment, and production. For example, a mine site may be defining “local” as simply goods and services purchased in a host country, even if these products originate outside of the country. This leads to a risk where on paper a mine site is achieving a high percentage of local procurement but, in reality, it is not creating many meaningful local economic benefits, leading to the possibility of tensions and conflict.

Finally, the GRI reporting standard does not recommend that mining companies provide a breakdown of local procurement by spend families. A breakdown of spend families is ideal because it can help existing and potential suppliers identify opportunities within the broad categories of a mine site’s spend, and it can support supplier development programmes to better target their activities. The LPRM responds to these gaps by providing a comprehensive set of specific procurement process disclosures to improve transparency and disclosure related to procurement policies, accountability, procurement systems, and due diligence processes. It allows ESG investors to develop an understanding of the internal processes and risk mitigation strategies related to procurement, as well as activities to reduce barriers to local business participation in the supply chain. The LPRM also encourages mining companies to work with local stakeholders to develop a definition of “local” that reflects their priorities and promotes improved outcomes and reporting of procurement spend in line with this definition. This is important as it can help reduce host community and country tensions related to demonstrating economic benefit in the areas that are most important to these stakeholders. As such, ESG investor requests for reports that are in accordance with the LPRM support investors to gauge responsible mining behaviour, and in doing so, help to determine material project risks.

OPPORTUNITIES TO PROMOTE USE OF THE MINING LPRM

Financing institutions can promote use of the Mining LPRM in a variety of ways, ranging from dissemination and promotion of the mechanism to requiring use of the LPRM as a condition of investment. Implementation could include integrating all or select Mining LPRM disclosures into existing mining company reporting requirements, investment evaluation criteria, or as part of sustainability frameworks, such as those mentioned above, that guide CSR practices of invested companies.

In the short-term, activities could include:

- Development of guidance and provision of training to investors and investees on how the LPRM could support current reporting and transparency efforts as well as improve internal management, mitigate risks, and contribute to the social licence to operate.
- Commitments by financing institutions to support and promote the LPRM.

The LPRM is a flexible reporting system and will provide different value based on the country context and how well host country stakeholders utilize the reported information. Ultimately, the implementation of the LPRM will vary by country, but the more data is publicly available and used, the more effective it will be in informing improved local procurement practices and helping to deter corruption.

For more information about the Mining LPRM and how you can use it in your work, please contact Jeff Geipel (jeffgeipel@ewb.ca) or Janne Kaiser-Tedesco (janne.kaiser@giz.de). Special thanks to Delaney Greig of the Shareholder Association for Research and Education (SHARE) and Natural Resources team at European Bank for Reconstruction and Development (EBRD) for their advice in developing this guidance.

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