

Vendor Plant 18

ICCA Formal Audit

1. INTRODUCTION

The following report pertains to the findings of a field audit of Mattel's Vendor Plant 18, and performed by the International Center for Corporate Accountability (ICCA). These audits are conducted to evaluate all aspects of a vendor's operations and to ascertain their compliance with Mattel's Global Manufacturing Principles (GMP).

The implementation of Plant 18's audit was carried out according to detailed standards covering various principles of GMP. These standards are tailored to meet the specific legal requirements of each country as well as Mattel's GMP. Where local regulations are either non-existent or lower than the plant's standards, the higher Mattel's standards are considered applicable.

2. PLANT AND RELATED FACILITIES

Plant 18 is located in the Dongguan Province of the Peoples Republic of China (PRC). Plant facilities consist of four buildings, three of which were constructed in 1996 and the fourth one was constructed in 2004. Production buildings cover an area of approximately 90,000 square meters. The factory manufactures a variety of toys with Mattel being one of its major customers. According to information provided in Plant 18's

MCR, primary production processes include: injection molding, tempo printing, spray-painting, electronics, rotocasting, sewing, and assembly/packing operations.

3. ANTECEDENTS TO THE SECOND FORMAL AUDIT

This plant had received an informal consultation visit by ICCA in August 2000. This was followed by ICCA's first formal audit of Plant 18 in December 15, 2005. However, this audit was terminated by the ICCA team due to revelations that certain actions on the part of Plant 18's management, immediately prior to the day of the audit, had compromised the integrity of the audit process. It was, therefore, impossible to generate information that would accurately reflect the extent to which Plant 18 was in compliance with Mattel's GMP principles.

Both Mattel and ICCA agreed that Plant 18 would be given an opportunity to undertake the necessary corrective action following which the plant would be formally audited by ICCA. The second formal audit took place on July 10 – 11, 2006. The second audit also followed all of ICCA's audit regimes to ensure that plant's compliance with GMP standards are verified in a manner that is comprehensive, objectively measured, interpreted in a meaningful manner, and independent of any other consideration except the compliance standards specified in the GMP.

4. AUDIT FINDINGS

ICCA's overall finding with regard to the second formal audit is quite disappointing. It would seem that Plant 18's management had made little progress

toward improving any of the most important shortfalls noted in the previous audit in the area of wages and working hours, health and safety standards, and environmental protection.

Working Hours

Plant 18 has applied for and received a 'Consolidated Working Hours Permission' from the local government. This permission allows the Plant to schedule up to 3 hours of overtime per day, for a total of 66 hours a week (11 hours per day for a six-day workweek). Plant 18's Management Compliance Report (MCR) states that all departments are scheduled to work in excess of 60 hours per week throughout the year. In addition, during times of urgent business needs, workers may work up to 80 hours a week, for up to 30 consecutive days without a rest day in between.

ICCA's audit of Plant 18's worker payroll records revealed that during the first six months (26 weeks) in 2006, all major processing departments had operated in excess of 60.0 hours per week for periods ranging between 14 and 23 weeks. Likewise, company records showed that all departments had exceeded the GMP limit of a 72-hour workweek for 6-14 weeks during the first half of 2006. ICCA's audit revealed that some workers had worked for up to 17 hours per day during the audited period of May, 2006. Plant 18's records also showed that during a sampled period of 3 months, all departments had scheduled consecutive workdays in excess of 13. These ranged between 14 and 31 days in electrical and assembly

departments, which cover about 50% of the workforce. Analysis of total overtime hours for the audited sample indicated that all workers had exceeded the Consolidated Hours Permission's limit of 216. The total overtime hours ranged between 263 to 334 hours during the first six months of 2006.

Payroll Records and Payment of Wages

Workers at Plant 18 are paid their monthly wages in three different installments.

1. The first installment, paid through bank transfer, covers payment for regular week of 40 hours per week, and some undisclosed number of overtime hours worked during the pay period.
2. The second installment, also through a separate bank transfer, represents payment for regular workday overtime hours (for a maximum of 4 hours per day), and rest-day overtime hours (for a maximum of 1 day per month). Both bank transfers are made within 30 days of the pay period end.
3. The third installment is paid in cash and disbursed one week after the bank transfer date. It covers regular workday and rest day overtime wages that were not covered by the first two installments above.

Plant 18's management indicated that the three types of payments were intended to meet the requirements of different foreign buyers as to the maximum allowable working hours. Notwithstanding, the management of Plant 18 contended that all workers were paid accurate wages for all work done. ICCA, however, finds it difficult to accept Plant 18's explanation at face value. Although cash payments to workers

are matched by receipts from the workers, It is impossible to ascertain whether workers may have been given other cash payments for yet more working hours, but not disclosed to ICCA. In other words, ICCA cannot ascertain the integrity of plant 18's payroll records and thus cannot verify their accuracy and transparency.

Information generated through one-on-one confidential interviews with a randomly selected group of workers painted a markedly different picture. Interviewed workers were unanimous in stating that they worked a normal week of 60 hours comprising of 6.67 hours per day in regular hours and 3.33 hours in overtime hours. Workers also stated that they rarely, if ever, worked on their rest days.

This is a highly unusual situation. For the first time ever in ICCA's experience, the workers' reported hours fell considerably short of the actual hours worked and reported by a plant's management. In every other case of ICCA's audit of vendor plants, it is the workers who report working higher number of hours than those reported by the plant's management. Furthermore, an analysis of interviewed workers' responses in this and other topics has forced ICCA to conclude that workers had been thoroughly coached by Plant 18's management to give pre-determined answers to all questions pertaining to wages, working hours, overtime and other related issues.

Benefits and Deductions

Plant 18 pays all legally mandated social insurance and related benefits. ICCA auditors have confirmed that all benefits were paid according to the applicable laws, and that company practices have been approved by the local social insurance bureau. For 25% of the workers, Plant 18 pays medical, social, unemployment, and retirement insurance premiums, and 50% of the workers receive work accident insurance.

Workers are charged 2 RMB for bank transfer fees. This fee is charged twice each month since the plant makes two bank transfer payments each month. Charging workers 2.0 RMB for the second installment of their wages is unjustified. The second transfer is designed to meet the plant's own requirements and does not provide any extra benefit to the workers.

Workers who live in the dormitories are charged 80 RMB per month. Canteen charges are administered through meal tickets which are purchased in cash by workers. Workers' total living expenses comply with GMP standards.

Plant 18 also provides 5-14 days annual leave depending on employees' length of employment at the factory. Annual leave benefits are not made available to workers upon completion of their one year of service with the plant. Instead, eligible workers are compensated in cash upon their return from the Chinese New Year Holidays. Workers who do not return, forego their entitlement. Current implementation of annual leave policies results in some workers foregoing their entitled benefit payments. This policy needs to be revised to ensure that when workers resign or decide not to return from the

Chinese New Year holidays, annual leave payments are accrued and paid to those who are entitled.

Plant 18 has a stated policy of offering 90 days of paid maternity leave benefits. This new policy went into effect in June 2006, and would need to be monitored by Mattel's internal audit department to ensure that eligible workers are paid their maternity benefits while on leave.

4. ENVIRONMENTAL HEALTH AND SAFETY STANDARDS

The first formal audit of Plant 18, conducted on December 15, 2005 had found serious deficiencies in almost every aspect of the plant's physical operations. During this visit, Plant 18's management repeatedly stated – in response to virtually every negative findings – that required corrections and improved were in progress or being planned. It was expected that a significant part of these improvements/corrections would have been implemented by the time of the second formal audit.

Unfortunately, ICCA's second formal audit showed that little had been accomplished by the company with regard to EHS improvements during the past seven (7) months. The following is an itemization of problems that exist at the present time. It effectively demonstrates that Plant management has not made meaningful changes toward resolving or correcting the problems that were found in the December 2005 audit.

AUDIT FINDINGS

4.1. Air, Water and Ground Contamination

The audit revealed that no 'Environmental Impact Assessment, Completion Inspection Approval, Pollution Discharge Permit and Pollution Discharge Registration Form' were available on site at the time of the audit. As per an air emission monitoring report for industrial operations conducted by the Dongguan Municipal Environmental Monitoring Station (EMS) on 11 July 2005, the benzene component in the air emission did not comply with the 'Air Pollution Emission Limits of Guangdong Province (DB44/27-2001)'. No updated monitoring reports were available for review. There was also no signed waste collection contract between the company and a certified collector at the time of ICCA's visit.

The sedimentation tanks of the six (6) wet scrubbing units on the roof of Block A were not rain-proof. In addition, two sedimentation tanks were not operable. There was considerable water leakage from two of the scrubbers. The company states that all wet scrubbing units will be replaced with new improved ones by August 2006.

Water quality assessments reports for the operation area and the living areas were prepared by the Dongguan Institute of Metrology and Quality after testing on 12 December 2005. Tests had shown that the level of turbidity in potable water exceeded the required limits (Drinking Water Standard - GB5749-1985).

Wastewater is discharged directly in to the municipal wastewater system directly. There was no wastewater monitoring at the plant. If the water is being treated by the municipality, with a fee being levied against the plant for the service, then direct

wastewater discharge is permissible. Storm water drainage was observed near the hazardous waste storage areas. No designated pollution discharge sign was posted on the wastewater discharge point and air emissions sources onsite.

Condensate from the air compressors and generators in the generator room were discharged in the nearby storm water floor drain. Oil staining was observed on the paved area around the generators and the outlets indicating possible ground contamination.

No designated warning signs and labels were available at the chemical warehouses and the diesel storage tanks at the time of the audit. Oil stains were observed in the immediate vicinity of the above ground oil diesel storage tank (AST). Cracks were observed at the secondary containment of the AST. The two ASTs on the roof of the generator room were heavily corroded. No secondary containment was provided.

It appears that there is an insufficient ventilation in the assembly area on floor 5, block C and at several soldering stations.

4.2. Personnel Protection Equipment (PPE)

The usage of Personal Protective Equipment (PPE) did not appear to be effectively implemented. Faults in the implementation were reflected by lack of hard toed shoes in the warehouses and maintenance workshops plus non-use of protective masks at the soldering stations on floor 3 of Block A and in the sample room on floor 2,

Block A. ICCA auditors also noted inappropriate PPE informational signs that did not comply with governmental regulations.

4.3. Personnel Safety Outside Of PPE

Occupational disease hazards such as heat stress have not been evaluated and/or tested. Hearing tests were conducted by the Dongguan Taiping Hospital for employees working under high noise levels on 24 June 2006. Out of twelve employees tested five indicated hearing loss.

Tests by ETS-Testconsult Limited on 16 January 2002 and 9 May 2005 indicate chrysotile was detected in gaskets and insulating material. A roto injection machine showed evidence of chrysotile. As of this date no abatement and/or replacement actions had been taken.

Eight Halon 1211 fire extinguishers are in the intermediate warehouse. Halon 1211 fire extinguishers have to be replaced by government regulation. Other plant wise fire extinguishers should be examined and replaced if they contain Halon 1211.

Only one fire fighting system approval has been obtained by the company from the applicable governmental agency. That is for Block D. No other approvals have been obtained for other buildings.

Some fire extinguishers in workshops and dormitory were expired. Many fire extinguishers were corroded and the attached hoses were damaged. Many of the fire hydrant boxes were severely corroded. In a significant number of cases, the hoses and

support nozzles located in the fire hydrant boxes were in poor shape. The escape route in the Block A warehouse, second floor, was blocked.

Fire escape signs in the dormitory were not properly labeled. The indicated escape route was incorrect. In general, emergency lighting equipment throughout the site was in a very bad condition. It was mounted poorly and was quite dirty, especially the lenses. Although not tested by ICCA, it was doubtful whether these units were indeed functional. There were no indication they that had ever been tested.

Fire drills are not conducted regularly and during all shifts. In the workshops one daytime drill was conducted on March 31, 2006. No night time fire drill has been conducted. In the dormitory, one night-time drill was conducted on June 26, 2006. No daytime fire drill has been conducted.

A workshop is located immediately south of the hazardous chemical warehouse C. The exit door of the electrical parts warehouse located at the eastern section of the site was locked during the site visit.

Following ICCA last audit visit in December 2005, Plant 18 had built individual noise abatement enclosures around the regrinding machinery in the regrind room. However, during the current audit visit, we noted that the sound-proof doors were left wide open during the regrinding operations. Hence the enclosures served no sound proofing purpose.

MSDS in places such as the hazardous chemical storage areas and paint mixing areas are not complete. Sections of them are missing. Some of the MSDS are only in English instead of being both in English and Chinese. No warning signs, labels,

secondary containment and wind/rain-proof facilities were available at two hazardous waste storage sites located at the northwestern and northeastern corner of the sites.

There is no effective 'lockout/tagout' system in the injection molding area on floor 1, block A.

4.4. Plant Maintenance and Housekeeping

Electrical wiring in many parts of the plant such as in the workshops, dormitories, and kitchen is in poor and potentially dangerous condition. Many wires and leads are frayed and jury rigged. Piping throughout the plant is in need of maintenance.

The condition of male toilets in Block A are exceptionally poor. They are not well maintained and have a highly offensive odor. The floors of both kitchens were slippery and the concrete floors are in poor repair. Domestic wastes were observed outside the general garbage storage area.

The ventilation systems in both kitchens were dirty and grease encrusted. One chain supporting a vent hood was completely encrusted with grease and dirt and may be supporting fungus growths. There was also possible fungus growths on the roofs of the kitchens.

Fungus growths were also observed and could be smelled on a large area of a wall on floor 3, Block A.

5. ICCA'S OVERALL OVSERVATIONS AND COMMENTS

In ICCA's experience of vendor audits, Plant 18 has by far the worst record of compliance with the GMP standards in important areas dealing with employees' work and safety standards. The management has also failed to operate its physical plant with due regard to applicable environmental protection measures.

The issue of excessive overtime hours remains a vexing concern and potentially a major problem. The recent revision of GMP, which significantly extended the limits on maximum allowable overtime hours, was intended to take into account the concerns of the vendors and find a more realistic and enforceable standard. However, this does not appear to be the case. Rather than complying with the expanded overtime limits, the new standard has instead become the minimum starting point. With few exceptions, most vendors audited by ICCA express strong reluctance to comply with GMP standards with regard to overtime hours.

Plant 18 is among the worst offenders of Mattel's GMP guidelines regarding overtime hour limits. In addition to violating the Mattel's overtime hours code, the plant is also engaging in deceptive practices in terms of its legal payroll reporting obligations.

The current situation is untenable. Given our experience during the two formal audits of Plant 18, ICCA does not have much faith in the management of Plant 18 that it would make the necessary improvements in its management style and operational policies. This observation is further reinforced by the lack of success on the part of

Mattel's internal audit department to induce Plant 18's management to effect even the minimal improvement that it has repeatedly promised but rarely implemented.