

Report on iPod Manufacturing

August 17, 2006

Like many of you, we were concerned by reports in the press a few weeks ago alleging poor working and living conditions at a manufacturing facility in China where iPods are assembled. Our Supplier Code of Conduct mandates that suppliers of Apple products follow specific rules designed to safeguard human rights, worker health and safety, and the environment. We take any deviation from these rules very seriously.

In response to the allegations, we immediately dispatched an audit team comprised of members from our human resources, legal and operations groups to carry out a thorough investigation of the conditions at the manufacturing site. The audit covered the areas of labor standards, working and living environment, compensation, overtime and worker treatment. The team interviewed over 100 randomly selected employees representing a cross-section of line workers (83%), supervisors (9%), executives (5%), and other support personnel (3%) including security guards and custodians. They visited and inspected factory floors, dormitories, dining halls, and recreation areas. The team also reviewed thousands of documents including personnel files, payroll data, time cards, and security logs. In total, the audit spanned over 1200 person-hours and covered over one million square feet of facilities.

To ensure the accuracy of the investigation, the team cross-referenced multiple sources of information from employees, management and personnel records. For example, working hours and overtime reported in the interviews were corroborated with line-shift reports, badge reader logs, and payroll records of those specific individuals to confirm that they were paid appropriately.

We found the supplier to be in compliance in the majority of the areas audited. However, we did find violations to our Code of Conduct, as well as other areas for improvement that we are working with the supplier to address. What follows is a summary of what we've learned, what's already being done in response, and our commitment to future diligence and action.

Labor Standards

The team reviewed personnel files and hiring practices and found no evidence whatsoever of the use of child labor or any form of forced labor. This review included examining security records targeted at discovering false identification papers — an important check for companies serious about preventing illegal employment of any kind.

Working and Living Environment

The manufacturing facility supports over 200,000 employees (Apple uses less than 15% of that capacity) and has the services you'd expect in a medium city. The campus includes factories, employee housing, banks, a post office, a hospital, supermarkets, and a variety of recreational facilities including soccer fields, a swimming pool, TV lounges and Internet cafes. Ten cafeterias are also located throughout the campus

offering a variety of menu choices such as fresh vegetables, beef, seafood, rice, poultry, and stir-fry noodles. In addition, employees have access to 13 different restaurants on campus. Employees were pleased with the variety and quality of food offerings.

The supplier owns and leases dormitories that are offered at no charge to employees, provided they help in cleaning common areas to maintain the facility. Workers are not required to live in these dormitories, although the majority do. Our team randomly selected and inspected a wide range of dormitories (both supplier-owned on-campus and off-site leased facilities) that collectively house over 32,000 people. Buildings are separated by gender, with female dorms containing a private bathroom/shower for each room and male dorm rooms typically sharing bathroom/shower facilities. The dorms have TV rooms, potable water, private lockers, free laundry service, and public telephones. Many also have ping-pong and snooker tables, and sitting/reading areas. All of the on-campus dorms have air conditioning. Visitors are permitted in the dorms, although a sign-in process is used for security purposes.

Our audit of on-site dormitories found no violations of our Code of Conduct. We were not satisfied, however, with the living conditions of three of the off-site leased dorms that we visited. These buildings were converted by the supplier during a period of rapid growth and have served as interim housing. Two of the dormitories, originally built as factories, now contain a large number of beds and lockers in an open space, and from our perspective, felt too impersonal. The third contained triple-bunks, which in our opinion didn't provide reasonable personal space.

To address this interim housing situation, the supplier acquired additional land and is currently building new dormitories. These plans were in place prior to our audit, and will increase the total living space by 46% during the next four months.

Compensation

Our investigation confirmed that all workers earn at least the local minimum wage, and our sample audit of payroll records showed that more than half were earning above minimum wage. Employees also have the opportunity to earn bonuses. In addition, the supplier provides a comprehensive medical plan including free annual checkups.

We did find, however, that the pay structure was unnecessarily complex. An employee's wage was comprised of several elements (base pay, skill bonus, attendance bonus, housing allowance, meal allowance, overtime), making it difficult to understand and communicate to employees. This structure effectively failed to meet our Code of Conduct requirement that how workers are paid must be clearly conveyed. The supplier has since implemented a simplified pay structure that meets the Code of Conduct.

We also discovered that the process for reporting overtime was manual and monthly, and while not a violation of the Code of Conduct, it was subject to human error and relied too much on memory for dispute resolution. To address this issue, the supplier will link the payroll system and electronic badge system, which will automate the recording of hours worked and pay calculations. This update will be completed by October 1.

Overtime

We found no instances of forced overtime and employees confirmed in interviews that they could decline overtime requests without penalty. We did, however, find that employees worked longer hours than permitted by our Code of Conduct, which limits normal workweeks to 60 hours and requires at least one day off each week. We reviewed seven months of records from multiple shifts of different production lines and found that the weekly limit was exceeded 35% of the time and employees worked more than six consecutive days 25% of the time. Although our Code of Conduct allows overtime limit exceptions in unusual circumstances, we believe in the importance of a healthy work-life balance and found these percentages to be excessive.

The supplier has enacted a policy change to enforce the weekly overtime limits set by our Code of Conduct. The policy change has been communicated to supervisors and employees and a management system has been implemented to track compliance with the Code of Conduct. Supervisors must receive approval from upper level management for any deviation.

Worker Treatment

Employees work in factories that are generally bright, clean and modern with air-conditioned assembly line areas, and are provided with protective gear. There's an employee grievance process in place, including a telephone hotline, a CEO mailbox for complaints and employee suggestion boxes.

Our interviews with employees revealed areas of both satisfaction and dissatisfaction. A majority of employees interviewed were pleased with the work environment and specifically noted the opportunity for advancement, widespread year-end bonuses, and the reputation of the supplier in the industry. Additionally, employees consistently mentioned that they felt safe and secure in both the workplace and the dormitories.

Employees expressed dissatisfaction with some aspects of the workplace. The single largest complaint (approximately 20% of interviewed workers) was the lack of overtime during non-peak periods. The second largest complaint (less than 10%) was the transportation schedule for employees living in off-campus dorms, which they felt was inadequate outside of working hours. Results of the interviews have been shared with management, and will be addressed where appropriate. For example, the transportation schedule is being reviewed for adjustment.

During our interviews with employees, we explicitly asked every line worker whether they had ever been subjected to or witnessed objectionable disciplinary punishment. Two employees reported that they had been disciplined by being made to stand at attention. While we did not find this practice to be widespread, Apple has a zero tolerance policy for any instance, isolated or not, of any treatment of workers that could be interpreted as harsh. The supplier has launched an aggressive manager and employee training program to ensure such behavior does not occur in the future.

The Future

Recognizing that some aspects of workplace auditing (such as health and safety) lie beyond our current expertise, we've engaged the services of Verité, an internationally recognized leader in workplace standards dedicated to ensuring that people around the world work under safe, fair and legal conditions. We are committed to ensuring compliance with our Code of Conduct and will complete audits of all final assembly suppliers of Mac and iPod products in 2006.

We recognize that monitoring compliance is an ongoing process requiring continual progress reviews. When violations are discovered in any supplier, we will require corrective action plans, with a focus on prevention and systemic solutions. We will also ensure that action plans are implemented and in cases where a supplier's efforts in this area do not meet our expectations, their contracts will be terminated.

We are encouraged with the actions to date in response to our audit. However, we realize that auditing compliance is only one step in the journey toward driving change. We have also joined the Electronic Industry Code of Conduct (EICC) Implementation Group, which has established industry-wide standards and offers valuable resources for evaluating suppliers. The EICC was a key benchmark when our own Code of Conduct was created and as an industry leader, Apple will make important contributions to this group.

Apple is committed to the highest standard of social responsibility in everything we do and will always take necessary action accordingly. We are dedicated to ensuring that working conditions are safe and employees are treated with respect and dignity wherever Apple products are made.