PINCOCK Perspectives

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CALENDAR

- **2006 SME Annual Meeting & Exhibit**
  March 27–29, 2006
  America's Center
  St. Louis, Missouri
  e-mail: sme@smenet.org
  Visit us at Booth 413

- **Asia Mining Congress 2006**
  March 27–31, 2006
  Grand Hyatt
  Singapore
  www.terrapinn.com/2006/asiamining

- **MiningWorld Russia 2006**
  April 25–28, 2006
  Crocus Expo - International Exhibition Centre
  Moscow, Russia
  e-mail: miningexplo@primexplo.ru

- **MinSands 2006**
  May 18–19, 2006
  Hyatt Regency
  Perth, WA, Australia
  e-mail: enquiries@informa.com.au

- **EXPOMIN 2006**
  May 23–27, 2006
  Venue Espacio Riesco
  Santiago, Chile
  e-mail: info@fisa.com

- **National Coal Show 2006**
  June 13–15, 2006
  David L. Lawrence Convention Center
  Pittsburg, Pennsylvania
  e-mail: share@mining-media.com

What Does Sarbanes-Oxley Mean For Ore Reserve Reporting

History of Sarbanes-Oxley

The United States Congress signed the Sarbanes Oxley Act (SOX) into law on July 30, 2002, "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." SOX was in response to accounting and corporate governance scandals in the United States and was the most comprehensive federal securities legislation in recent history and the most comprehensive ever for corporate governance. SOX is intended to improve the quality and reliability of financial information in the United States through more oversight and compliance in the financial process. This is achieved thorough more and faster disclosure by United States listed companies, the stiffening of penalties for fraud, and by the creation of a new mechanism for policing the accounting industry. Auditing control systems now need to be in place for all corporate functions pertaining to corporate revenue and assets. In the case of mining companies, ore reserves are a large part of the asset base that also needs auditing control system consideration.

It is noted that even before SOX, the Securities and Exchange Commission (SEC) engineering staff had begun to impose stricter requirements for reserve reporting, including having a feasibility study to support the determination of reserves and that all permits were either complete or nearly complete, as well as increased focus on asset impairment. In some cases this resulted in reserve restatements. Details of the current SEC position are not contained in formal releases or publications, which can cause difficulties in the understanding of policy. To help improve this situation, a study group was set up under the sponsorship of the Society for Mining, Metallurgy and Exploration (SME). The SEC Reserves Working Group of the SME Resources And Reserves Committee, has worked to create a set of working papers on critical issues for resource and reserve reporting. These papers have been presented to the SEC for consideration in the development of more definitive guidelines for public disclosure of resources and reserves. It is noted for the subsequent discussion that the current SEC policy is to used the term "mineralized material" rather than the term "resources," which is used in other jurisdictions.

Titles of Sarbanes-Oxley

SOX applies to all U.S. and non-U.S. companies and their management and auditors if securities are listed on a U.S. stock exchange or are registered under the Securities Exchange Act. The SOX consists of eleven titled sections.

Title I – Public Company Accounting Oversight Board

Title II – Auditor Regulation

Title III – Corporate Responsibility

Title IV – Enhanced Financial Disclosures

Title V – Analyst Conflicts of Interest

Title VI – Commission Resources and Authority

Title VII – Studies and Reports

Title VIII – Corporate and Criminal Fraud Accountability

Title IX – White Collar Crime Penalty Enhancements

Title X – Corporate Tax Returns

Title XI – Corporate Fraud and Accountability

With regard to ore reserve reporting by mining companies, two more relevant parts of the SOX are Title III - Corporate Responsibility and Title IV – Enhanced Financial Disclosures.

Title III sets out certification requirements for CEOs and CFOs. Section 301 of Title III provides for standards as to the composition and functioning of the audit committee of the board of directors. These requirements include that the audit committee be directly responsible for the appointment, compensation, and oversight of the work of the independent auditor, whose work the executives are required to certify. Section 302 of Title III presents requirements for the CEO/ CFO to certify quarterly and annually that public disclosures are correct and that they are responsible for disclosure controls, which would include reserve statements in the annual reports.

Title IV calls for better financial disclosure methods and procedures. Section 404 of Title IV presents requirements regarding work by independent financial auditors.

Select Provisions of Specific Titles

CFO/CEO Certifications (Section 302)

Section 302 requires the CEO and CFO of each public company to prepare a statement to accompany each quarterly and annual report to certify the reliability of the financial statements and disclosures in the report. CEO/CFO must certify that:

- Report does not contain any untrue statements or omit any material facts (this would pertain to ore reserves)
- Financial statements fairly present, in all material respects, the financial condition and results of operations
- They are responsible for the establishment and maintenance of internal controls; and have designed such internal controls to ensure that material information is made known; have evaluated the effectiveness of their internal controls; and have presented in the report conclusions about the effectiveness of their internal controls. (Internal controls are designed to ensure the reliability of the company's financial reporting)
- Deficiencies and material weaknesses in internal control have been disclosed to the company's auditors and to the companies audit committee of the board of directors; as well as any fraud involving anyone with a significant role in the company's internal control process.
- Significant changes in internal control have been reported, including any corrective actions with regard to significant deficiencies and material weaknesses.

Severe criminal penalties apply for knowingly and willingly certifying financial statement when they do not comply.

Internal Control Report (Section 404)

Section 404 requires annual reports to contain an internal control report prepared by the company. For this, internal controls are considered to be controls over financial reporting that provides for a process that has reasonable assurance with regard to the reliability of the financial reporting. Internal controls include management controls over maintenance of transaction records, the recording of transactions, and the prevention of unauthorized transactions. The internal control report includes:

- Statement of the responsibility of management for establishing an adequate internal control structure and procedures for financial reporting.

- Contains the company's assessment of the effectiveness of the internal control procedures.

This requires that the company's independent auditor attest to and report on the company's assessment. It also requires that both the company's assessment and the auditor's attestation will appear in the annual filing with the SEC. It further requires that companies establish the necessary procedures both to collect information and to demonstrate that internal controls and procedures are effective to accomplish their intended purposes. Many companies have developed sub-certification procedures that have other officers and/or employees certify required information within their areas of responsibility in order to assist the senior executives in meeting their certification requirements.

Information Subject To Internal Control Procedures

All information which has a material impact on financial report is subject to internal control structures required by Section 404. The following are traditional processes requiring review processes:

- Purchases and Payables
- Revenues and Receivables
- Fixed Assets
- General Ledger
- Closing
- Payroll

Broader focus is now including the evaluation of other key business processes specific to individual companies. For mining companies, ore reserves generally constitute the most important financial asset. The quantification of these reserves originate from the application of appropriate estimation techniques and reasonable assumptions by mining professionals and management. The resulting mineral reserves are the basis for cash flow plans, depreciation, depletion and amortization, asset impairment, and other significant financial reporting items.

The importance of the accurate reporting of reserves cannot be understated as these are the foundation for much of the financial projections of corporate revenue. For mining companies, in order for financial projections to be reasonable, the reserves estimates must reflect actual deposit characteristics. Reserve estimates should be subject to a system of internal controls to ensure the reasonable, accurate, and consistent reporting in order to allow the mining company's financial reporting to be materially correct.

Explicit regulatory requirements for the implementation of internal controls for technical processes related to reserve estimation are still evolving, but many companies are instituting programs in recognition that such programs will be advantageous in the long run. One benefit of having a reserve control process is to allow for a more complete CFO/CEO certification as required by Section 302. Technical internal control processes for reserve estimation are anticipated to become a standard practice for mining companies over the coming years.

Controls applied to resource/reserve reporting should ensure that supporting data, as well as the estimation procedures, are reasonably developed in line with industry standard procedures and practices. Industry standards are variably documented. Good summaries of best practices have been prepared by the individual country representatives of the CMMI Mineral Reserves International Reporting Standards Committee (CRIRSCO). One version of the standards is the Canadian Institute of Mining, Metallurgy and Petroleum's (CIM) *Estimation Of Mineral Resources And Mineral Reserves Best Practices Guidelines*, adopted by CIM Council on November 23, 2003. The Society For Mining, Metallurgy And Exploration's (SME) *A Guide For Reporting Exploration Information, Mineral Resources, And Mineral Reserves*, dated March 1, 1999, contains a checklist of assessment criteria.

In order to ensure that industry standard practices are applied, a system of technical function tracking and professional sign-off should be put in place to serve as internal process controls. Application of these controls will help ensure that technical processes are reasonably conducted and adequately documented. These controls would apply to each basic step of the resource/reserve estimation process. In addition to in-place reserves, process controls should also apply to procedures for the estimation of minerals contained in stockpiles and minerals resident in process solutions, which can be significant at certain mining operations. Internal control procedures for resource/reserve estimation would reasonably address the following basic estimation steps:

- Compilation of fundamental geologic and sampling data
- Construction of geologic resource models
- Engineering of mine plans
- Estimation of ore reserves
- Support of overall project economics to support reserves
- Legal right to mine (land ownership and permits)
- Development of reclamation and environmental plans

Internal process controls should be structured to document several considerations for a given control step or item. An assessment format for the documentation of an internal process control item could be as follows (with a very simplistic example):

- Internal Control Item (i.e., drill hole database integrity)
- Role Of Item In Overall Process (i.e., database accurately reflects deposit mineralization)
- Potential Technical and Financial Risk Of Item (i.e., incorrect data will affect the resulting resource and reserve estimates)
- Process Control Checks In Place For Item (i.e., database validation procedures in-place)
- Conclusion About Item (i.e., quality and completeness of database)
- Responsible Party Sign Off (i.e., geologist or engineer responsible for item)

The above discussion represents an example for a formalization of a structure for technical controls related to resource/reserve estimation processes that could be applied internally by mining companies. This would allow for more effective external auditing of technical information. Financial auditing companies are generally not prepared with geologists and engineers to evaluate the mining specific technical processes. Mining professionals will increasingly need to work in conjunction with financial auditors, in order to honor the intent of SOX reporting. This will allow for auditor sign-off on the effectiveness of internal control structures, as well as the overall reasonableness of the resulting ore reserves.

United States listed mining companies are anticipating more stringent applications under SOX and have been developing control processes and audit procedures that will provide for more internal and external controls. Although, currently this is a developing situation with regard to regulations in the United States, having a system of internal controls for reserve estimation processes in place is a prudent management practice with mining companies regardless of the company's listing location.

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