CPAB exchange

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Industry Insights – *Mining*

Industry Insights

This publication is part of CPAB's *Industry Insights* series developed to support audit committees in their oversight of the audit by enhancing the dialogue between the audit committee and the auditor.

Industry Insights – Mining discusses certain common areas of focus for an audit of a company operating in the mining industry, with a focus on producing companies. These areas may be considered together with the audit committee's knowledge of the industry and the company. An audit approach is a matter of professional judgment influenced by auditing standards, industry risks and specific characteristics of the company. This publication is not intended to prescribe an audit approach nor the areas of focus in an audit.

Common Areas of Audit Focus in the Mining Industry

1. Financial statement estimates supported by the life of mine (LOM) plan

As a company moves a project out of the exploration and evaluation phase to the development and production phases, it usually prepares a LOM plan to demonstrate the project's commercial viability and technical feasibility. The LOM plan provides the basis for a number of estimates in the financial statements including the:

1. mineral reserve/resource base used for depreciation and depletion calculations,
2. fair value of mineral properties acquired in a business combination,
3. recoverable amount for mineral property impairments and reversals and goodwill impairments, and
4. timing of decommissioning obligations.

Management's judgment as to going concern disclosures may also be based on an estimate of short-term operating results provided by the LOM plan.

Management relies on internal and/or external experts to prepare the LOM plan. LOM plans are supported by pre-feasibility and feasibility studies prepared by a Qualified Person (QP) in accordance with National Instrument 43-101, *Standards for Disclosure for Mineral Projects* (NI 43-101). LOM plans need to be reviewed at the end of a reporting period and, if necessary, updated to reflect current assumptions and experience, which is not necessarily the case for NI 43-101 studies.

The auditor's procedures in considering financial statement estimates supported by the company's LOM plan may include:

- Assessment of the objectivity, competency and capabilities of experts (internal or external to the company) and their reliance for purposes of the audit.
- Testing of the operating effectiveness of internal controls over the development and updating of LOM plans including reviewing controls at various levels, for example up to a reserve/resource committee of the board of directors.
- Assessment of the reasonability of significant judgments and assumptions made by management, such as those in respect of impairment indicators, future production quantities, commodity prices, foreign currency exchange rates, operating and capital costs, discount rates, etc.

The auditor may also respond by involving an auditor's expert to assist in the assessment of significant management estimates.

2. Presentation of costs

Information regarding costs is one of the most important mining key performance indicators. In response to investor demand, mining companies may go beyond GAAP measures and disclose non-GAAP per unit cost measures (such as cash costs, all-in sustaining costs and all-in costs) in their MD&A. Presentation of costs may be an area of some judgment and it may be necessary for the company to have well documented accounting policies and procedures to assist its staff in appropriately classifying costs.

In many cases, the GAAP presentation of costs as capital, inventory or operating costs may be very important as the initial presentation forms the basis to derive non-GAAP cost measures. In considering this area, the auditor may:

- Test the operating effectiveness of internal controls over cost presentations.
- Perform tests of details, including journal entry testing, or other substantive procedures to audit the allocation between capital and expense and cost classifications including presentation of items within the cash flow statement.

3. Auditing in foreign jurisdictions

Canadian mining companies often have projects in foreign jurisdictions, some of which can create additional challenges for auditors and audit committees. In some cases, the firm engaged in the audit of the parent company (group auditor) may use the work performed by an auditor located in the foreign jurisdiction (component auditor).

Regardless of the level of involvement of component auditors, the group auditor is responsible for the overall audit strategy and audit plan, including effective supervision of the work performed by the component auditors. Audit plans for these entities need to respond to risks that are specific to entities in the foreign jurisdiction.

The auditor needs to have an awareness of the business practices, legal structures, customs and cultural norms in the foreign jurisdiction to identify risks and develop an appropriate audit strategy.

4. Income tax strategies

The company may adopt strategies to optimize taxation that involve complex arrangements across multiple jurisdictions, including intercompany financing arrangements. The types of taxes that a company is subject to, and the complexity of certain tax strategies, may require specialized knowledge. Management also determines the price for intercompany exchanges of goods and services (transfer pricing). The company may also be subject to uncertain tax positions including on-going audits by tax authorities and tax positions for which legislation is unclear, especially in foreign countries with less developed tax rules. Management applies judgment to determine the amount of any liability for such tax positions and must also consider updates to tax treaties, interpretations and court decisions relevant to clarifying legislation.

The audit team may involve tax specialists to evaluate the income, commodity or other tax consequences of certain transactions and to evaluate the accounting for complex tax strategies. The auditor may also need to conduct procedures to evaluate the recoverability of deferred tax assets.

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Questions for Audit Committees

Depending on the risks and materiality in the particular business, audit committees may choose to discuss the following questions with their auditor (and management, where applicable).

Financial statement estimates supported by LOM plans

1. What was your assessment of the objectivity, competence and capabilities of management's experts?
2. Did you read the most recent NI 43-101 and the LOM plan reports and discuss them with the Qualified Persons?
3. What were the significant assumptions and how did you assess their appropriateness?
4. Did you obtain a roll-forward analysis and perform procedures on mineral reserves/resources to understand the changes in the year? Were there any significant unexplained changes?
5. Were there any cash generating units where reasonable changes in assumptions could result in potential impairments?

Presentation of costs

1. Does the company have well documented policies and procedures on capitalization or expensing as period or inventory costs and the allocation of costs within the income statement?
2. What audit procedures were performed to ensure these policies were consistently followed?
3. How did you audit the presentation of costs?
4. Did you perform journal entry testing in response to any assessed risk the company is inappropriately moving period costs to capital costs?

Auditing in foreign jurisdictions

1. What components did you identify as having a higher risk? How was this addressed in your audit plan?
2. How were the laws, regulations and business customs different in our significant components? What impact did these differences have on the audit approach?
3. How were you involved in the supervision of the work performed by component auditors?

Income tax strategies

1. What procedures did you perform over the recoverability of deferred income tax assets?
2. What tax strategies, including international finance structures, did you assess as having a greater risk of material misstatements and how were these tested?
3. Have you reviewed the company's transfer pricing policies and do they seem appropriate?
4. Are you aware of any significant tax disputes in foreign subsidiaries?

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