Introduction to Session 4:
Market Challenges – Outsiders’ Perceptions

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Good morning, everybody. The company I work for – Placer Dome – has 15 property mines on four continents. My specific responsibility with the company is to look at country risk issues in terms of investment and the long-term sustainability of that investment.

I am delighted to be invited today to chair this fourth session of the Forum. Yesterday, we focused principally on the domestic environment, and the challenges it faces. Today, we will take a different perspective: an outside view of some of these issues, as well as having a look at some of the challenges facing outsiders, and their perceptions.

As we all know, often the perception we have of ourselves is significantly different from the perception others have of us. This is true whether we are talking about states, or employer/employee relationships or, indeed, husband and wife.

To address the issues of outside perceptions of Russia, we are fortunate to have four experts, who will present their perspectives on the issues we discussed yesterday somewhat broadly. They will focus on the outsiders’ perceptions of the challenges in transacting precious metals business in Russia, and the opportunities and pitfalls of getting into Russian gold; the impact of changes in legislation on precious metals; and, lastly, but perhaps most important to many of us, as we saw from yesterday’s discussion, taxation and accounting considerations.

As we saw yesterday, as expressed by Russian participants, the operational environment is evolving positively in Russia, although inadequacies remain in some areas and procedures – to some or perhaps indeed all of us – are unnecessarily complex and cumbersome. We can take comfort, however, in the fact that, while the administrative environment in any situation is considered to be a variable, the geology, at least, is a constant. So, with these words, I invite Mr Robert Scott to begin.

First, a few words about Robert. He is a career banker, having started work in the early 80s with National Westminster Bank in their senior management training programme. Initially he was on the foreign exchange dealing floor, and then he moved to natural resources, where he was the relationship manager. Robert had the account responsibility for major corporates involved in mining, and oil and gas. In 1998, Robert joined Standard Bank London Ltd to establish a syndicated loan capability for the bank, with a focus on resource banking in the emerging markets. During the previous three years, Robert has been involved actively in developing the bank’s links with mining companies in Russia and the surrounding regions, in order to develop the bank’s precious metals business.

Thank you very much, Robert. We will now turn to the opportunities and pitfalls of getting into Russian gold, and to make this presentation is Mr Jocelyn Waller, who is the Managing Director of Trans-Siberian Gold.

Mr Waller’s company is an AIM-listed company, with gold-mining licences in Kamchatka at Asacha and Rodnikova, and Krasnoyarsk at Veduga, which he set up in late 2000. Prior to his involvement with TSG, he was the CEO of Avocet Mining plc from 1989 until 2000, where he was responsible for bringing the
Penjom gold mine in Malaysia into production, and listing Avocet on the London Stock Exchange. Prior to that, he spent 22 years with Charter Consolidated plc, holding various management positions, and working in the UK, Malaysia, Thailand, Portugal and Zaïre. He is a graduate of Churchill College, Cambridge.

Thank you, Jocelyn. Now we have a slightly different turn. Most large mining companies – indeed, smaller companies – are concerned with the environment in which they are operating, and typically they address issues such as the security risk of a country, the corruption risk, the legal risk, and the risk associated with the judicial environment; indeed, in some cases, the joint venture risk, because sometimes you have ‘partners from hell’, and I’m not speaking only about Russia – I’m speaking about other countries as well.

The political instability is also a significant issue for foreign investors; the financial transfer – in other words, can you export your profits; and what are the tax and environmental risks? Not least are the social risk and the social issues in the country or community in which you are operating.

Next we turn to the issues of the legislative sector as well as taxation and accounting considerations, and in these areas, we have two experts. I invite Mr Yuri Kravchenko, who is a Senior Associate of MacLeod Dixon, to talk to us about the impact of changes in legislation in the precious metals sector.

Thank you very much, Marcello. We’ve seen three different perspectives on the outsiders’ perceptions of the challenges. In summary, we could probably say that the two issues that remain critical to the success of any operation in Russia are taxation and the legislative framework. We have also seen that there are opportunities in Russia, and, as Mr Waller has described, the opportunities certainly far outweigh the disadvantages.
Good morning. I have been asked to speak on the challenges of transacting gold operations in Russia from an outsider’s perspective. However, before discussing this topic, I believe it is important to outline who Standard Bank is, and define our objectives in the precious metals market as a whole.

Standard Bank is the largest South African banking group, with operations throughout sub-Saharan Africa, Europe, North and South America, and the Middle and Far East. Eleven years ago, the South African authorities relaxed the regulations on South African banks establishing subsidiaries overseas, which allowed Standard Bank to establish Standard Bank London Ltd as a resource-based bank with a focus on providing trading, finance and advisory services to the base metals, energy and precious metals sectors.

Standard Bank London, which received its authorisation under the UK Banking Act 1987 in 1992, is the principal operating subsidiary of the Standard Bank Group in terms of balance sheet, size and profitability, and is authorised and regulated by the Financial Services Authority.

In respect to precious metals, Standard Bank London Ltd is chairman of the twice-daily platinum and palladium fixing in London, and one of the largest physical gold traders in the world. We supply currently gold to all the world’s major physical markets, coordinating this through our offices in London, Moscow, New York, Hong Kong, Singapore and Dubai.

We are involved in the complete gold cycle, and our interest in Russia has developed as a result of this. Standard Bank plays a leading role in Dubai, which is the world’s largest gold redistribution centre, with imports averaging 386 tonnes over the last three years. This includes jewellery and scrap as well as bullion bars. Standard Bank London supplies a range of bullion bars to the wholesale bullion and jewellery sectors in the form of kilo bars, 100g bars, 10 tola bars and, to a lesser extent, 12.5kg bars.

The evolution of the Dubai Metals and Commodities Centre, a Dubai government initiative focused on growing Dubai’s role in the world of physical metals and commodities, will further enhance Dubai’s position as a major gold centre, and Standard Bank, with its close relationships at the highest levels in Dubai, and whose senior executive serves on the Dubai Gold Advisory Group, is well-placed to take advantage of this development and act as a bridge between supply from Russia and demand in Dubai. Originally, we sourced gold mainly from South Africa, but we found quickly that we needed to establish specific sources of supplies and be involved in the complete gold cycle.

Why Russia? Standard Bank had to establish links with a major gold producing region, and looked to identify a region with major growth potential. This producing region would have to be a net exporter.
of gold, with production being sourced from diversified mining operations. The Russian gold sector fits this bill ideally. The Standard Bank Society concentrated on doing business in Russia in 1997.

This coincided with the liberalisation of the Russian gold market. Up to 1997, the industry was controlled by the state through Gokhran. This was due to the fact that Gokhran financed over 80% of the artels’ working capital requirements, the loans being secured against contracts for the delivery of produced gold.

The country is a low-cost producer, with over 5,800 identified deposits, and an average recovery rate of 4.7g to 1.6g per tonne. Russian jewellery consumption accounts for approximately 30 tonnes of production per annum, less than 1% of the world consumption. Internal consumption is increased by domestic investors, but even when they are taken into account, Russia still remains a net exporter.

With the liberalisation of the market, Russian commercial banks started to lend to the artels and actively purchase gold. These banks now provide between $300-400 million funding to the Russian gold mining companies, in the form of both seasonal and term finance, secured against the delivery of produced precious metals. The precious metals are either exported, mainly to western banks active in the precious metals market, or traded in the local Russian market.

Up to last year, only Russian commercial banks were allowed to hold gold export licences and, as such, gold producers could not export their production direct. In 2003, Standard Bank decided to become more active in Russia, and established its own Russian bank.

During the six years we have been active in Russia, and as a result of our decision to become active in the domestic market, the challenges we have encountered can be summarised in eight main areas: gold licences, producers, technical due diligence, managing metal price risk, financing, security, physical export logistics, and compliance.

In order to transact metals business in Russia, Standard Bank is required to hold a precious metals licence, granting it a right to attract precious metal deposits and make precious metal placements. This licence is granted by the Central Bank of Russia. In addition, we need a licence issued by the Ministry of Economic Development for the export of precious metals. The granting of these licences is allowed under Russian law to Russian-registered banks who have the support of the gold mining industry.

However, the process of making the precious metals licence application is quite time-consuming, with a need to provide a full business plan of the intended precious metals operations, financial data on the Russian bank, management structures, and details of ownership. Guidance from the Central Bank is of great assistance here. Once the precious metals licence has been granted, it is necessary to apply for an export licence to the Ministry of Economic Development. This process is not as time-consuming, but it does need to be reviewed annually, and details of the volumes of gold to be exported on an annual basis must be included. In addition, it is necessary to either own or lease a certified vault, which is registered with the state assay chamber.

Russia has in excess of 600 enterprises involved in the precious metals mining industry. The majority of these enterprises are small, employing less than 100 people, and are located in some very remote parts of Russia. Given this, it is important to identify the ones that it is possible to work with. There are a significant number of medium-sized companies producing between one and five tonnes of gold per year, and eight holding companies involved in the full working cycle of gold production. In addition, the majority of Russian gold producers’ production is from placer deposits, which result in seasonal production from relatively small short-term deposits.

Given the location of the gold producers, it is often difficult to undertake due diligence to the levels we would normally require. Heavy reliance is therefore placed on previous years’ production quotas and the review of the production licences that the miners hold. It is important to ensure that the mining licences have been granted in accordance with the legal regulations, and the compliance with the terms of the original tender documents has been maintained. Few Russian mining companies produce accounts to western accounting standards, which makes it difficult to compare operations to the banks’ normal benchmarks.

The classification of mining resources is carried out under Russian guidelines, which are different from western standards. Managing metal price risk is a problem. Under Russian law, it is not possible to automatically close out trades utilising cash deposited as either initial margin for the trade or subsequent margin calls. The client is required to give a direct instruction to close the trade, in effect resulting in the need to trade on open account terms. Historically, banks have been required to provide seasonal financing to secure the purchase
of precious metals. This involves the use of our balance sheet, and the need to analyse risk.

Under Russian law, it is not allowed to establish the type of security normally seen in western transactions. It is not possible to effect a pledge over the producers’ mining assets and equipment. To exercise the pledge, the goods have to be sold at public auction. Mining licences are not freely transferable and cannot be pledged. Additionally, contracts cannot be fully assigned under Russian law.

In respect of the logistics involved in the physical export of precious metals, these are time consuming and labour intensive. The production season for the majority of mines is constrained by seasonal weather conditions, and individual production levels can be low. Therefore, it is important to achieve economies of scale in respect of each export shipment. This involves either trading gold on the domestic market, or stockpiling prior to export, thus introducing some price risk. All gold exports have to be custom-cleared prior to shipment. This involves the production of a significant amount of paperwork. If the paperwork is not right, shipments can be delayed by over 14 days while the issues are resolved.

Compliance is a major consideration for Standard Bank Group. The lead regulator is South African – the South African Reserve Bank; Standard Bank London Ltd’s operations are authorised and regulated by the FSA. These regulations do not just apply to our London operations, but to all operations as agented by other Standard Bank companies. The regulations in the UK and Europe are in place to help prevent criminal activities, including money laundering, drug trading, and terrorism.

Though we support this action, it does present us with additional procedures that we have to comply with. The FSA’s regulations impact most directly on our gold operations in respect to complete what is known as ‘know your customer procedures’. These procedures require us to produce specific documentary evidence identifying the directors, the beneficial owners of our client, the original source of funds used to establish the company, and the legal status of the company.

To demonstrate how compliance actually impacts, following is the disclaimer that needs to be included in all written presentations.

In order to complete our objective of being active in the complete gold cycle, Standard Bank has addressed the main challenges in the following ways. The gold licences are intrinsic to the development of our Russian business. We have opened a bank in Russia – in actual fact, it’s our first birthday today – which has been fully resourced. We have devoted time and resources in the production of our application and making staff available to the Central Bank and the Ministry to answer their questions and address their concerns in respect of our gold licence. Staff at both organisations have been helpful in this respect.

In respect to the producers and technical due diligence, it is important to develop close links with all sectors involved in the precious metals industry. We have developed close links with the main Russian commercial banks, which have an excellent knowledge of the gold producers’ operations. Our intention is not to compete with these banks, but to work with them to provide finance to the artels. With the assistance of the Russian commercial banks, we have also visited the main gold-producing regions in Russia.

For the larger transactions, we will employ specialist technical advisors to undertake due diligence studies in the same way as they are employed for all mining projects worldwide. In addition, Standard Bank is one of the founding members of the Russian Mining Advisory Council, which is the body that includes miners, banks, Government bodies and legal firms within its membership. The executive director of the Mining Advisory Council is also a member of the Export Council under the Committee of Natural Resources of the State Duma – the Russian Federation.

To manage price risk, our Russian bank will act in an agency capacity for Standard Bank, with margin trading undertaken with clients in London. In addition, we are working on other structures that I do not wish to discuss here.
In respect to establishing acceptable security for the transactions we are undertaking, it is necessary to work with a good quality legal firm that can advise on Russian regulations on a case-by-case basis. We have addressed this issue by transferring shares of the company owning the mining licences, and lending to the mining companies through local banks. In truth, however, there is no easy solution, and you just have to ensure the best available legal structure is used. In respect to the required legal due diligence for the mining licences, here again it is important to work with a legal firm that has expertise in the relevant laws and regulations.

To address the challenges in respect of physical gold exports, Standard Bank ZAO intends to look at establishing a wholesale operation in Moscow, which will actively require economies of scale and introduce increased liquidity to the market. In respect of FSA regulations, we just have to live with these and ensure that they are met.

In summary, Standard Bank’s aim in Russia is to help secure the supply of gold for its other operations, and to build on the strong relationships with the people and organisations who really know the industry. This will allow us to grow as the Russian precious metal industry grows and develops. Thank you.
Opportunities and Pitfalls: Getting into Russian Gold

Jocelyn Waller
Managing Director, Trans-Siberian Gold

Thank you. First of all, I should say that I am not alone. I have brought along a colleague, the person responsible for our Moscow office, Marsha Whyte. This is in case I get asked any tricky questions, because Marsha and her colleagues have to deal every day with the actualities of operating in Russia, so I’m glad she’s come along. I was told, when I was asked to give this paper, that this was not to be a ‘plug’ for Trans-Siberian Gold. However, since my experience, and our experience, is largely to do with the development of our company, I would like to tell you just a little bit about it, so you understand the context of my remarks.

From the organisation chart you can see that Trans-Siberian Gold is a holding company, listed on the AIM market of the London Stock Exchange. We have four subsidiaries in Russia at the moment; two of them are operating –TZ in Kamchatka holding the Asacha and Rodnikova licences and Amikan in the Krasnoyarsk krai, with the Veduga mining licence and exploration licence. We also have set up a company in Yakutya. We have a management company operating in Moscow that provides services to these companies.

I’m asked to talk about the opportunities and the pitfalls. Well, the opportunity is actually Russia itself; a vast country with very interesting geology and many mineral deposits, the mining of which was established in Soviet times. Although you can’t see much detail in this map, it gives you an idea of the scope of what we’re talking about.

I came to Russia for the first time in the middle of 2000 – exactly four years ago – to a mining conference in Krasnoyarsk, on a ship on the Yenisei river, which was very interesting, although I have to say that much of the time, I wasn’t totally sober. But I got a very good idea of how things were from talking to the delegates. I asked a geologist I met – a Russian geologist – ‘How many geologists were working in the Soviet times in the summer season?’ He said ‘250,000’, which gave me an idea of the amount of work that had been done on a basic level in Russia. Yet there weren’t that many developed, what I’d call high-tech, mines – there was a lot of artisanal mining.

But in fact things have changed quite significantly between 2000, when we came here, and today in 2004. When I was thinking about the question of opportunities, I realised that the situation has changed. Although the country risk has clearly diminished with the stability of the government and the reform process, the opportunities have, in fact, reduced, and I’ll explain why. By the same token, many of the practical difficulties which we have found in operating in Russia still continue.

All the major deposits in Russia are effectively privatised, bar Sukhoi Log, which I think everybody knows about. Since 2000, some of the foreign operators – Highland Gold, Peter Hambro Mining, Celtic – have become better and more strongly established; they have acquired licences,
they are ambitious. Another feature which is very evident and wasn’t around in the year 2000 is that Russian companies that are strongly financed and have technical know-how are getting into the gold industry – Norilsk Nickel buying Polyus; Olimpiada; Polymetal, with quite a number of licences throughout Russia; Alrosa beginning to get involved and making very ambitious statements; and there are others too.

The other thing is that ‘the cat’s out of the bag’ – it’s gotten much more expensive. People have seen how properties in Russia have been taken and marketed in the London Stock Exchange and places like that, so the cost of entry is much higher. I don’t think we’d be able to do what we did in 2000 – 2001 today: that is, to put the properties together as a small company, obviously professional, but without major resources. So when people talk about opportunities in Russia, you have to realise that they are somewhat different to what they were.

Actually, if you really look at what the opportunity is – and this goes back to the map and to the 250,000 geologists – it’s exploration. There is much ground that needs detailed exploration, and that is where the next challenge is going to be – to actually turn P2 and P3 resources into bankable resources, and that requires getting the licences, setting up, and putting in exploration programmes.

However, there are problems. The law is still rather uncertain in this area: the whole business of what the rights are under an exploration licence; what happens when you make a discovery; a lot of these things have not been tested. The licensing process is still very complicated; the ground has to be gazetted. You then have to apply – that can take a year. Exploration is a long-term process, and it is risky: you might not hit, and so it’s all very well saying ‘It’s a great place to explore’ – which it obviously is – but it’s going to take deep pockets and patience.

Just to mention some of the things that we live with every day: let’s take the human factor. There is a highly educated population in Russia. However, I have to say without being too rude – it is often dated. It is modernising, but a lot of the attitudes, we find, are quite dated. There is a dearth of young, skilled professionals in the disciplines that we’re looking for. It’s very difficult to find good people – Russians. Every week we look for Russian engineers, geologists, specialists, environmentalists, and we are finding them, but they’re difficult to find.

The third one is a very tricky one. We’re trying to build mines to best modern practice. That’s a global thing – it hasn’t really reached Russia in totality. We have to bring foreign experts in. They have to work with the Russians. It doesn’t always work very well. Russians can be suspicious; foreigners can be overbearing. I spend a lot of my management time ‘knocking heads together’ and making sure that they work together. It is a challenge. It’s getting better, but it’s a very challenging thing, and it doesn’t always work.

Yes, we’ve got free enterprise, private ownership, a market economy, but a lot of the old bureaucracy remains. State approval is still needed for so many mundane things. When asked about this, I’ve got an illustration. You had the old state-controlled economy, and they said ‘Right, we’re going to change; we’re going to have a market economy’. So, what do they do? They plonked it on top of the state economy. It’s gradually sorting itself out, and the old system is being replaced by the new, but it’s a long process. It’s already taken ten years; it’s going to take another ten, in my view, and this is a serious problem. I think the government and people are recognising that, but somebody told me about an oil development that needed 1,700 approvals. It’s tricky.

Other people will talk about the law. It is said, and there are cases, where the law was manipulated in the past for people to sequester other people’s assets, to get a judgement in court and get possession – something like that. But the situation is improving. A lot of the pitfalls are exposed, people know tricks of the trade, but it means you have to be very careful; your housekeeping has to be first-class; you’ve got to be very tidy that you don’t leave any loose ends; you comply with the law. Marsha would say, today, the law, if properly harnessed, can be a protection rather than a threat. We’re not afraid to go to law to enforce our rights. Take a simple issue like VAT recovery. We went to court, and we got a favourable judgement. It’s a correct judgement. So we will use the law to pursue our business if it’s required, and that’s a big change, and a very positive one.

So you have a system where the private investor is taking the risk, but still needs to get state approval for pretty well every step of the way, and yet they’re not taking the risk. Before we can start a feasibility study to get the permitting, we have to get our reserves state approved.

Now, for example, you can’t use Datamine modern computer modelling to get your GKZ reserves done, so it has to be done two ways: the Russian way, which is rather different and has been superseded, in most cases; and a modern way, which is used by most mining companies using the
latest software, which is the most effective. It’s just an example.

In order to develop a mine, you have to get the permits to mine. You have to go through a series of feasibility studies, and a lot of the norms to which those studies are done are from a book that was written in 1987 and hasn’t been updated. You can get a situation where you’re doing, for example, a bankable feasibility study for a study, and it has to be done to the most modern and best practice criteria. Yet you have to do something for Russia for your permits, which is not the same, and this is a really serious problem.

One of my colleagues attended a mining meeting in April in Moscow, and a Russian from Norilsk Nickel got up and said ‘It is ridiculous that it takes 14 years to get a mine into production’ – this was an example he cited. In a comparable western situation, the state cares about safety, the environment, and issues like that – for which a set of regulations are put in place – but when you’re taking the risk, you should be allowed to take the risks on whether the reserves are worth mining or not.

So, what is the crux of all this? I’ve said it already, but I’ll repeat it. Whereas all the financial risks are being taken by the developer, the state still sets criteria norms that are often outdated and largely unnecessary. The consequence is an over-elaborate, lengthy, and excessively costly process to bring mines into production. Reform is needed, and I have been told that this is being contemplated. I think it’s a very, very important and significant step, if what I’m hearing is correct, that a lot of these restrictions will be removed in the next couple of years, but it is essential for the development of the mining industry in Russia.

It is a wonderful country with incredible indigenous resources, excellent geology, a stable government that looks like it will remain stable, an economic environment that gets healthier by the day, and all the benefits of the reform process – that’s why we’re in Russia.

The competition is intensifying – that’s clear; that’s a commercial thing, but it is absolutely clear. There is still excessive red-tape, as I have been describing. There is just the general challenge of the Russian environment, which is strange to us, and exciting.

That brings us on to the lure of Russia. Despite the many practical difficulties, it is an exciting place to be as a mine developer. There is excellent potential for discoveries and for growth. Every company wants to have a growth profile, and I think that this is what we get if we come to Russia. It’s a genuinely rewarding experience – not just the vodka – but in many, many ways for those lucky, and somehow brave enough, to be here in Russia.

Looking at this slide – here we are, drilling in -40°C – a lot of fun, but we’re turning 75 to 100 tonnes of gold with those rigs, maybe more, so that’s a little bit of our experience in bringing us to where we are now.
The Impact of Changes in Legislation on the Precious Metals Sector

Yuri Kravchenko
Senior Associate, MacLeod Dixon

Good morning, ladies and gentlemen. I would like to speak about recent developments in Russian legislation that may affect mining operations in Russia, and various companies playing in that market.

As you may know, Russian legislation is constantly changing, and although the Russian Parliament adopts many, many laws, still it seems that that process will last forever. There are still a lot of additional legislations to be adopted, and usually even the laws that were passed require amendments and additions because they were not prepared properly. In these circumstances, it is very important to follow all these changes, because they may affect your operations, and you never know how they will affect your operations. You should be prepared for various surprises.

Today, I would like to speak about the new law in currency regulation, which is generally good news for mining companies and lenders. However, although the law on currency control and currency regulation is significantly reformed in principle, still certain provisions may have adverse consequences on your operations. The new law was adopted last year.

However, the major part of the new law will enter into force in a couple of weeks, on 19 June this year. The law establishes different principles and regime of currency control in Russia. As compared with the existing regime, the main principle will be that any currency operation is permitted, unless it is expressly restricted in the law. Today, we have a different system, where you can do only those operations that are expressly allowed in the law.

Another feature of the new currency regime is that the authority of state bodies will be restricted. It means that they can only adopt those regulations that are, and in those instances which are provided in the law, whereas today the Central Bank has a broader authority with respect to issuing acts on currency regulation and currency control. Of course, all these changes will affect the marketplace, some of them positively, as you will see, although this may be unusual for foreign investors especially.

Very often foreign investors coming into the Russian market are looking for local partners that may help them study the market, deal with Russian state authorities, and develop mineral deposits. To a certain extent, this is due to the fact that, as Mr Waller told us, many deposits have been privatised, and they are owned by local companies that need investment and they are ready to sell part of the projects.

The question arises as to how the joint venture between foreign investors and Russian partners should be structured. Under current law, the purchase of shares in foreign companies is permitted. However, a Russian company that is willing to purchase shares in a foreign company requires a licence from the Central Bank of Russia. Obtaining this licence is a very time-consuming and complex procedure, and it may take several months.

That’s why Russian companies prefer not to be involved in foreign joint ventures, and usually foreign investors have to participate directly in foreign companies. The issue arises of how their rights may be protected, because local partners may be dangerous at times; they have operator control over the project, and unfortunately Russian law is not perfect, and very often the Russian court system doesn’t work.
A solution in these circumstances may be the creation of a foreign joint venture. This solution seems to be more practical, because the new law abolishes the requirement to obtain a licence for those companies that are willing to participate with foreign companies. There may be certain other requirements imposed, such as the requirement to reserve up to 100% of the amount of investment in the foreign company, but this doesn’t seem to be a very expensive requirement for Russian companies.

The structure may be as follows: foreign companies and Russian companies may create foreign joint ventures, and such joint ventures may own 100% of a Russian company which holds a mineral licence. The structure may give certain benefits to foreign investors, for example, appropriate flexible corporate structure and additional projection of rights of participants. Also it is often easier to enforce contractual arrangements between the parties abroad. Of course, you should choose the relevant jurisdiction with a legal system that will help you to enforce your rights, and select an appropriate corporate structure.

The next issue that has often arisen in the course of the development of the project is financing of projects. Under the current law, financing of projects may be done without any restrictions if it’s done through debt financing, when foreign lenders simply give loans to Russian companies. The new law is more restrictive on this issue, as restrictions may be imposed on Russian borrowers seeking financing from foreign investors. As such, a Russian borrower may be required to reserve up to 20% of the amount of the loan for a period of up to one year.

In order for this restriction to apply, there should be detailed regulations relating to the reserve requirement, which should be issued by the Central Bank of Russia. So far, the Central Bank has not issued anything, but it is likely that the maximum requirement will be imposed. Also, we now expect – and this information is confirmed – that by 18 June, the Central Bank will issue a regulation where the maximum requirement will be applicable. Therefore, if you anticipate any financing shortly, you have approximately two weeks to avoid the application of this requirement, because 20% is a significant amount. It will lead to additional expenses for the Russian borrower and possibly foreign investors.

Starting from 18 June 2005, Russian companies will be permitted to open bank accounts abroad without any restrictions. Sometimes foreign enterprises request that Russian miners open such accounts in order to secure indebtedness of Russian companies, so this is a significant issue. However, although Russian companies will be able to open bank accounts abroad, they will still have to repatriate foreign currency proceeds from the export of goods, which means that the money should be returned to Russia.

The new law provides for certain exemptions from the repatriation requirement. As such, Russian companies are not required to repatriate export proceeds in the event that those funds are transferred to bank accounts abroad in order to secure payments under the loan agreements, where loans are due to foreign lenders. Those loans should meet certain criteria in order to be eligible for the exemption. The term of respective loan agreements should exceed two years, and the foreign lenders should be located in countries that are members of the OECD and FATAF. Of course, the existence of accounts abroad with money kept on them is very attractive to foreign lenders, as they will have additional security that may be enforced in jurisdictions where the bank accounts are located, and very often the enforcement in those countries is easier than in Russia. Obviously, this provision will facilitate the financing of Russian mining projects, as the risk for foreign lenders will be reduced to a certain extent.

According to the new law on currency control and currency regulation, precious metals are no longer subject to currency regulation. However, there are still a lot of other restrictions that apply to the circulation of precious metals. For example, according to the law on foreign trade, the export of precious metals is determined by the President. Currently, under Presidential Decree 742, authorised banks and producers of gold and silver are allowed to export refined precious metals that are in their ownership. On the other hand, the decree prohibits the export of other projects, such as ore concentrate – doré – containing gold and silver. There is also a prohibition to export products for processing abroad, so this obviously restricts the operations of the company, and unfortunately this will not change unless some amendments are approved by the President.

The domestic sale of precious metals will still be subject to first priority rights of the state, and this requirement is provided in the law on precious metals and precious stones, and changes to the law on currency control and currency regulation do not affect this requirement.

Also, there is still a certain regulation that requires gold and silver producers to sell their production to either the Russian state or Russian banks.
This legislation contradicts the current law on precious metals and precious stones. However, there may be different interpretations of that law, and very often certain companies try to comply with all the requirements of Russian legislation, so some of them prefer not to sell their production to Russian banks. We hope that soon those contradictions will be eliminated by the introduction of relevant amendments to the law.

The restrictions provided by the law on currency control and regulation will not apply until the state authorities adopt a detailed subordinate act relating to the application. This is the general rule provided by the law. To date, almost no such subordinate acts have been issued. To a certain extent, this may be due to recent administrative reform of state bodies, because now the state authorities are busy trying to identify their authority. However, according to information from the Central Bank of Russia, it is planned to issue the required acts shortly after 18 June 2004, and I think yesterday the Chairman of the Central Bank confirmed in his presentation that now the Central Bank, together with the government, are trying to coordinate the creation of all necessary documents.

Finally, I would like to mention a few provisions of draft amendments to the legislation on precious metals. As you may be aware, such draft law on the introduction of amendments in addition to the federal law on precious metals and precious stones is currently prepared by the Ministry of Finances. The Ministry is planning to submit the draft law to the State Duma shortly. Generally, the law has many technical amendments, and the law on precious metals and precious stones will be brought into compliance with other pieces of legislation in terms of distribution of authority of state bodies. Also, the law will be more specific and will cover only those issues that are related to the circulation of precious metals and precious stones, whereas other provisions will be moved to other laws.

There are still certain specific amendments that are worth mentioning. According to the draft law, the first priority rights of the state to buy precious metals from producers will remain.

However, while the existing law on precious metals and precious stones provides for certain conditions of exercise of the first priority rights, the draft law only has a general wording about the first priority rights. Accordingly, those conditions of exercise of the priority rights will be abolished. Currently, these conditions are prior conclusion of purchase and sale agreements regarding precious metals – such agreements should be made at least three months before the contemplated date of purchase of precious metals – and advanced payment made under such agreements.

There may be positive interpretations of the removal of these conditions, because for some companies the three-month prior period may be too long. However, those changes imply that there will be less certainty for gold producers, as you never know when the state will show up, trying to exercise its right of first refusal. Also, the removal of the requirement to make advanced payment under the agreement as a condition of the exercising of the first priority right leads to potential advantages for the marketplace, because now the state will not want to advance the purchase price of the gold.

Similarly, the general provision relating to the obligation of the state to make advanced payment for purchase of precious metals is abolished, which, as I said before, is not beneficial for the producers of precious metals, it seems that such provision will protect state authorities which may experience certain difficulties with financing gold supplies.

This draft is currently in preparation by the Ministry of Finance. However, there are also other draft amendments, and gold producers are now trying to lobby for more favourable amendments to the draft. Given that the draft hasn’t yet been submitted to the State Duma, now is the time to try lobbying for such positive changes, and I think gold producers should be active in this matter.
Taxation and Accounting Considerations

Marcello Gerashvili
Ernst & Young

Thank you. As was mentioned, I’m substituting for Doug Gardner, who is the leader of the Financial Services Group at Ernst & Young – he had to go to an emergency client meeting in Paris.

The main concept of accounting for gold and other precious metals is simply following the state of the business affairs in this area, because, as mentioned previously, the facts are that, in the past, this market was controlled exclusively by the state, and there were very few participants in this market – namely the Central Bank of Russia, the gold producers, and Gokhran, which is the de facto custodian and administrator for bullion stock.

Starting from the mid-1990s, I would say that the market was given a little bit more freedom, and there were private investors coming into the sector and the banking area as well, which is probably the main driving force for the development of the market in this area. When we think about the accounting aspects and tax aspects of this, we should remember that the shape of the business affairs in this market was at such a level that it did not require very sophisticated accounting treatments or an understanding of the business sense of transactions, because basically the government was the only player in this market.

Therefore, it is our experience that accounting and taxation did not get sufficient attention from the regulators to get the development that it needed to follow the business development.

I was going to spend a few minutes on legislation, but presenters before me have pretty much covered all the main points. However, I would still mention that Federal Law 41, with certain amendments over time, still outlines the main principles of the circulation of gold and precious metals in Russia.

As far as accounting is concerned, there are two parts. The Ministry of Finance prescribes the accounting principles and norms for non-banking institutions, and the Central Bank plays the major role in doing the same for banks and financial players.

It is my experience that we come across transactions that need to be reported in the Russian statutory accounting books, mostly when we audit banks and certain investment and brokerage houses. We do not have many clients that actually produce gold, and there are reasons for that. Mainly, as I said, it’s coming from the old days, when there was not a need for such services for state companies. Secondly, the fact that there are so many small producers spread all around eastern Russia says that they simply do not need our services. They would rather use local accounting firms, and whenever they require auditing, they would rather use a local firm. I don’t think the big four accounting firms have sufficient experience in accounting aspects of gold mining, but rather in tax and legal advice.

I will spend a couple of minutes taking you through accounting in banks. It’s important to give you a general overview of the state of accounting in Russia, which has been moving towards international financial reporting standards for the past couple of years. The banks, being the leading institutions in this sense, will start preparing international accounting reports, beginning in the fourth quarter this year.

Those reports will be used by the Central Bank for information purposes only – they will not be used for tax computation or for financial filing reporting purposes. The reasoning is that, taking into account the large number of banks we have in
Russia and the very small number of people who are qualified to prepare financial statements in accordance with IFRS, it is very difficult for Russian banks to prepare financial statements to IFRS accounting standards.

At the same time, the Central Bank itself does not have enough qualified personnel to be able to check the correctness of the preparation of those financial statements. Therefore, it was decided to start preparing financial statements from the fourth quarter this year, and then some time in 2005 or 2006 – depending on how this experiment goes – Russian banks will switch to IFRS accounting. Manufacturing companies and other non-banking institutions will probably convert to IFRS reporting later on.

As far as banks are concerned, current accounting and reporting requirements pretty much follow the concept of cash-basis accounting, and the general problem with reading financial statements prepared under Russian accounting standards is that the concept known in the west, which is familiar to all western users as substance over form accounting, does not always prevail in local books. Sometimes you see a reflection of a very formal approach. Therefore, it may not be very useful for the reader of the information, unless he or she knows the background of the transaction and has access to the information that’s been supporting this or that transaction.

There are more than 20 accounts on banks’ balance sheets, which are designed and intended to be used for reporting transactions with gold. They differ by the type of precious metals that the bank has, the term at which that precious metal has been either placed with another bank, or given in this or that business deal. Approximately 20 or 25 accounts are used to report gold, so it’s important to know the exact name of the account in order for you to be able to find out what it represents.

Another issue that I would say Russian banks have is that the revaluation of precious metals accounts is done daily, but the effect of the revaluation does not show up on a bank’s P&L account until the end of the quarter. I don’t know how many accountants are in the room, but the transaction is a credit or debit to an asset account, and a debit or credit to a valuation account, which is on the balance sheet. The effect is written into the P&L at the end of the quarter, so it’s only then that you can see the real effect of the revaluation.

That concerns precious metals that are on the banks’ balance sheets. Those that are not fall under two categories. One is spot trading, and derivative trading in gold and other precious metals. The reason spot trades are not recorded on the balance sheet is that Russian accounting does not require showing an asset on the balance sheet until either the metal is delivered or the cash is paid for that delivery. Normally, delivery may take up to three to five days, so during that period of time, the spot trade will be shown in the bank’s records. The revaluation is done, but it’s done on the off-balance sheet account, and the effect is not recorded in the bank’s financial statements.

In the same way, futures and other derivative products that we see on banks’ balance sheets are not reported until the actual settlement or payment happens and, depending on the length of the derivative contract, this may be from three to 12 months or more.

The last thing is the valuation of metals. The Central Bank of Russia publishes market quotes that are used for Russian statutory accounting purposes as an indication of pricing of gold and other precious metals, and normally they are pretty close to those reported on other large international exchanges such as London, New York and Tokyo.

### Tax Aspects:

**Fiscal regime applicable to gold producers**

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Rate</th>
<th>Basis</th>
<th>Beneficial authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit tax</td>
<td>24%</td>
<td>Net profit</td>
<td>Federal 5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Regional 17%</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Municipal 2%</td>
</tr>
<tr>
<td>Social charges</td>
<td>Sliding scale from 2% to 35.6%</td>
<td>Payroll</td>
<td>Federal 32.2%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Regional 3.4%</td>
</tr>
<tr>
<td>Royalties</td>
<td>6%</td>
<td>Gold sales</td>
<td>Federal 2.4%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Regional 3.6%</td>
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<tr>
<td>Property tax</td>
<td>2.2%</td>
<td>Fixed assets</td>
<td>Regional 2.2%</td>
</tr>
</tbody>
</table>

This table gives a very brief but useful summary of the tax rates and the beneficiary authorities that receive those tax payments, and the basis at which the taxes are calculated, which are pretty similar to other general industries.