# MANAGEMENT DISCUSSION & ANALYSIS

For the year ended July 31, 2012

***Directors and Officers as at October 25, 2012:***

***Directors:***

Gary Arca
Serge Depatie
Robert Eadie
Jordan Estra
Dave Gunning
Michael Gunning
Cory Kent
Ken Sumanik
Federico Villaseñor

***Officers:***

***Executive Chairman, Chief Executive Officer & Interim President*** – Robert Eadie
***Chief Financial Officer*** – Gary Arca
***Chief Operating Officer*** – Dave Gunning
***Corporate Secretary*** – Cory Kent

***Contact Name****:* Gary Arca

***Contact e-mail address***: garca@starcore.com

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**Form 51-102-F1**

# STARCORE INTERNATIONAL MINES LTD.

## MANAGEMENT DISCUSSION & ANALYSIS

For the Year Ended July 31, 2012

### 1. Date of This Report

This MD&A is prepared as of October 25, 2012.

This Management Discussion and Analysis ("MD&A") should be read in conjunction with the consolidated financial statements of Starcore International Mines Ltd. ("Starcore", or the "Company") for the year ended July 31, 2012. **Monetary amounts throughout this MD&A are shown in thousands of Canadian dollars, unless otherwise stated.**

***This MD&A includes certain statements that may be deemed "forward-looking statements". Such statements and information include without limitation: statements regarding timing and amounts of capital expenditures and other assumptions; estimates of future reserves, resources, mineral production and sales; estimates of mine life; estimates of future mining costs, cash costs, minesite costs and other expenses; estimates of future capital expenditures and other cash needs, and expectations as to the funding thereof; statements and information as to the projected development of certain ore deposits, including estimates of exploration, development and production and other capital costs, and estimates of the timing of such exploration, development and production or decisions with respect to such exploration, development and production; estimates of reserves and resources, and statements and information regarding anticipated future exploration; the anticipated timing of events with respect to the Company's minesite and; statements and information regarding the sufficiency of the Company's cash resources. Such statements and information reflect the Company's views as at the date of this document and are subject to certain risks, uncertainties and assumptions, and undue reliance should not be placed on such statements and information. Many factors, known and unknown could cause the actual results to be materially different from those expressed or implied by such forward looking statements and information. Such risks include, but are not limited to: the volatility of prices of gold and other metals; uncertainty of mineral reserves, mineral resources, mineral grades and mineral recovery estimates; uncertainty of future production, capital expenditures, and other costs; currency fluctuations; financing of additional capital requirements; cost of exploration and development programs; mining risks, risks associated with foreign operations; risks related to title issues; governmental and environmental regulation; the volatility of the Company's stock price; and risks associated with the Company's forward sales derivative strategies. Investors are cautioned that any such statements are not guarantees of future performance and that actual results or developments may differ materially from those projected in the forward-looking statements.***

### Application of IFRS

The financial information for the Company for the year ending July 31, 2012, has been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), having previously prepared its financial statements in accordance with pre-changeover Canadian Generally Accepted Accounting Principles ("Pre-changeover GAAP"). As the accompanying consolidated financial statements are the Company's first under IFRS, IFRS 1 First-Time Adoption of International Financial Reporting Standards has been applied.

The financial statements should be read in conjunction with the Company's 2012 annual consolidated financial statements and the explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided Section 13.

## 2. Overall Performance

### *Description of Business*

Starcore is engaged in exploring, extracting and processing gold and silver through its wholly-owned subsidiary, Compañia Minera Peña de Bernal, S.A. de C.V. ("Bernal"), which owns the San Martin mine in Queretaro, Mexico. The Company is a public reporting issuer on the Toronto Stock Exchange ("TSX"). The Company is also engaged in owning, acquiring, exploiting, exploring and evaluating mineral properties, and either joint venturing or developing these properties further or disposing of them when the evaluation is completed. The Company has interests in properties which are exclusively located in Mexico.

### *Recent Events*

*Financing*

During the year ended July 31, 2012, the Company secured an $11 million credit facility (the "Facility"). The Facility bears interest at 11% per annum, compounded and payable monthly, with monthly principal payments commencing May 31st, 2012, with the final payment due on or before April 30, 2013. The Facility may be repaid in full without penalty on or after October 31, 2012. (See Section 4.3 - *Financings, Principal Purposes & Milestones*)

On May 17, 2012, the Company used the funds from the Facility to settle its obligation under the forward sales agreement. The final 10,885 ounces, which were to be settled over the final 9 months to January 31, 2013, were repurchased for $9,042 at a price averaging US $1,562 per ounce. Having repaid the Loan to Investec in January 2012 and repurchasing the forward sales obligations in May 2012, the Company has been released from all commitments under the January 31, 2007, Loan Agreement with Investec Bank.

*New Appointments*

On April 18, 2012, the Company welcomed Dr. Michael Gunning as a member of its Technical Advisory Board and on September 25, 2012, Dr. Gunning was appointed a director of the Company following the resignation of Arturo Prestamo.

Dr. Gunning has more than 25 years of diverse and valuable experience in mineral exploration and geological research, and is widely recognized for his expertise in the uranium sector. Most recently, as CEO of Hathor Exploration, a Vancouver-based junior uranium explorer, he executed successive resource and PEA milestones for the Company's Roughrider uranium deposit discovery, and he guided the Company through a hostile M&A competition to an eventual $654 million acquisition by Rio Tinto, one of the top ten deals in 2011 in the global mining sector. Prior to joining Hathor, Dr. Gunning served as President and CEO of Triex Minerals, during which term Triex raised more than $30 million for its projects, built an accomplished exploration team, and advanced a diverse project portfolio in the U.S. and Canada. Previous to Triex, Dr. Gunning was the principal Mineral Deposits Research Geologist at the Saskatchewan Geological Survey, before which, he was a Senior Project Geologist in Exploration at Teck Cominco Ltd., responsible for all aspects of various exploration programs and initiatives in the Canadian high Arctic, Brazil and Mexico. He has a Ph.D. in mineral deposits and volcanology from the University of Western Ontario, and is a past President of the Saskatchewan Geological Society and the Society of Economic Geologists Student Chapter. Dr. Gunning is currently a director of several public companies listed on the TSX Venture Exchange.

On April 30, 2012, the Company announced that Dr. Peter Megaw, Consulting Geologist accepted the lead position in Starcore's Technical Advisory Board.

Dr. Megaw, C.P.G. is President of IMDEX/Cascabel and co-founder of Cascabel and MAG Silver Corporation, a company focused on projects located within the Mexican Silver Belt. He has a Ph.D. in geology from the University of Arizona and more than 34 years of relevant experience focused on silver and gold exploration in Mexico. He is a certified Professional Geologist by the American Institute of Professional Geologists and an Arizona Registered geologist. Dr. Megaw has been instrumental in a number of mineral discoveries in Mexico including new ore bodies at existing mines, Excellon Resources' Platosa Mine, and MAG Silver's Juanicipio-Fresnillo, Zacatecas; Platosa, Durango; and Cinco de Mayo-Pozo Seco, Chihuahua. He and his associates also put together the Mexican property portfolio now held by Revolution Resources Corp. and arranged the acquisition of X-Strata's Latin American holdings by Linear Gold. Dr. Megaw has served on the Board of MAG Silver since 2005, Candente Gold since 2009 and Minaurum Gold since 2010. Dr. Megaw was awarded the Society of Mining Engineers 2012 Robert M. Dreyer Award for excellence in Applied Economic Geology and the Carnegie Mineralogical Medal for 2009. He is the author of numerous scientific publications on ore deposits and is a frequent speaker at academic and international exploration conferences.

On May 7, 2012, the Company announced that Jeff Hussey, P. Geo. and currently Executive Vice President, Development of Champion Minerals Inc., joined Starcore's Technical Advisory Board.

Mr. Hussey has been consulting since 2007 and was appointed to the position of Executive Vice President, Development of Champion Minerals in March 2011. He initially joined Champion Minerals as Vice President, Exploration in February 2008, bringing with him over 25 years of international exploration and mining experience, which included 19 years with Noranda Inc. and Falconbridge Ltd. (now part of Xstrata Plc). While working for Noranda and Falconbridge, Mr. Hussey had both exploration and mine operational roles at Brunswick Mines, as Chief Geologist of Mines Gaspe, and as Senior Geologist during the Antamina Mine startup in Peru. After working at Antamina, he was Senior Scientist with the Mining Technical group at the Noranda Technology Centre, and as General Foreman of Open Pit Mines and Surface Projects of Raglan Mines in northern Quebec, where he also led Six Sigma optimization projects for the concentrator and surface projects departments. Mr. Hussey holds a Bachelor of Science degree in Geology from the University of New Brunswick.

On April 10, 2012, the Company announced that Serge Depatie of Montreal, Quebec had joined the Board of Directors.

Serge Depatie is a mining and investment professional with close to 25 years of experience in senior management roles encompassing project management to institutional portfolio management. Mr. Depatie is a founding partner of NCP Investment Management ("NCPIM"), a multi-family organization dedicated to growing its investments through active participations. Prior to NCPIM, Mr. Depatie spent 10 years at Natcan Investment Management Inc., participating in growing assets from \$10 billion to \$32 billion. Mr. Depatie was named top 50 portfolio manager in Canada by Brendan Woods (Top Gun Awards) for 2008-2009 while his team won the Lipper Award; 5 year Performance, Best Canadian Small Cap Fund 2005-2010.

*Newly Discovered Area 27*

In June, 2012, the Company announced drill results from a newly discovered area 27 or San Martin footwall vein, and commenced production on a part of this structure. The following table summarizes recent drill results:

| Mine Area | ddh ID | from (m) | To (m) | Intersection (m) | True width (m) | Assay results | |
|---|---|---|---|---|---|---|---|
| | | | | | | Au g/t | Ag g/t |
| Area 27 San Martin footwall vein | DCSM-104 | 62 | 84.2 | 22.2 | 5 | 2.03 | 5 |
| | DCSM-106 | 0 | 9.4 | 9.4 | 3 | 10.36 | 59 |
| | and | 36.55 | 51.75 | 15.2 | 3.5 | 3.68 | 14 |
| | And* | 62.3 | 80.45 | 18.2 | 4.1 | 14.61 | 113.5 |

* This intersection contained 3 sample intervals which returned results greater than 30 grams per tonne of gold and have not been cut.

In the San Martin footwall vein, work is continuing to explore by drifting and drilling.

Increased metal prices have enabled the development of stopes alongside old production areas. The tronco bodies exploited in the San Martin area as well as area 28 are now being further exploited by stopes in the hangingwall. In some cases these hangingwall stopes are extracting greater widths than that mined originally when lower prices required a much higher cutoff grade.

Some of the structures currently being mined have continued into carbonaceous limestones which past operators considered unfavourable host rock. This fact has opened up some additional areas for exploration which were previously thought to be barren. Metallurgical work is being done to ensure that gold recovery is not affected by this material.
In general terms, the analysis of data by Starcore has resulted in the location of additional ore reserves within the limits of the developed infrastructure of the mine. These discoveries have enabled Starcore to maintain reserves while also increasing production tonnage.

David Gunning, P.Eng., a director of the Company and Chief Operating Officer, is the Company's qualified person on the project as required under NI 43-101and has prepared the technical information contained in this MD&A.

## 3. Selected Annual Information

The highlights of financial data for the Company for the three most recently completed financial years are as follows:

| | | **July 31, 2012** | | July 31, 2011 | | July 31, 2010 |
|---|---|---|---|---|---|---|
| | | **IFRS** | | IFRS | | Pre-Changeover GAAP |
| Revenues | **$** | **57,039** | $ | 39,465 | $ | 23,201 |
| Cost of Sales | | **(35,349)** | | (25,511) | | (13,765) |
| Earnings from mining operations | | **21,690** | | 13,954 | | 9,436 |
| Administrative Expenses | | **(3,854)** | | (15,770) | | (2,798) |
| Other Items | | **-** | | - | | (10,718) |
| Total earnings (loss) | | | | | | |
| (i) Total earnings (loss) | **$** | **14,335** | $ | (4,177) | $ | (3,728) |
| (ii) Earnings (loss) per share - basic | **$** | **0.11** | $ | (0.05) | $ | (0.05) |
| (iii) Earnings (loss) per share - diluted | **$** | **0.10** | $ | (0.05) | $ | (0.05) |
| Total assets | **$** | **56,191** | $ | 53,405 | $ | 45,170 |
| Total long-term liabilities | **$** | **13,095** | $ | 20,571 | $ | 17,242 |

## 4. Results of Operations

***Discussion of Acquisitions, Operations and Financial Condition***

The following should be read in conjunction with the consolidated financial statements of the Company and notes attached thereto for the year ended July 31, 2012.

### 4.1 San Martín Mine, Queretaro, Mexico

***Reserves***

The San Martin Mine, an ISO 9001 certified facility located approximately 50km east of the City of Queretaro, State of Queretaro, Mexico, consists of mining concessions covering 12,992 hectares and includes seven underground mining units and four units under exploration, as well as an additional property, San Pedrito, located 50 km west of San Martin. Luismin (now "Goldcorp Mexico") operated the mine from 1993 to 2007 and Starcore expects to continue to operate the mine over an expected mine life of at least 7 years based on the current expected conversion of known resources. Mining at San Martin has been at a rate of approximately 270,000/tonnes per year. Exploration is able to maintain approximately two to three years proven and probable reserves replacing those mined with new reserves. The Company has filed on SEDAR results for a Reserve estimate for its San Martin Mine in Queretaro, Mexico based on data available on July 31, 2011 and dated September 10, 2011.

The results of the July 31, 2011 estimate were Proven and Probable reserves totalling 586,318 tonnes at a grade of 2.29 g Au/t and 39 g Ag/t. In addition to the Proven and Probable Reserves, an Inferred Mineral Resource is estimated as of July 31, 2011 at 1.31 million tonnes at an approximate grade of 2.37 g Au/t and 27 g Ag/t. Inferred Mineral Resources are not known to the same degree of certainty as Mineral Reserves and have not demonstrated economic viability.

The estimate was prepared by mine staff under the direction of Starcore COO David R. Gunning P. Eng. and was independently verified by Joe Campbell P. Geo. both of whom are qualified persons under NI43-101.

The most important assumptions used as the basis of the estimate include:
- Total mining costs of $US65 per metric tonne, a gold price of US$1200 and silver price of US$24,
- Metal Recoveries of 87% for gold and 60% for silver,
- Resultant cut-off grade of 2 grams per tonne gold equivalent,
- Mining dilution of between 10 and 40% depending on the structure,
- Specific Gravity of 2.55.

The ratio of Probable to Proven Reserves is roughly 2.5:1 and in total there is 57,900 contained gold equivalent ounces. San Martin mines roughly 270,000 tonnes annually but in recent years approximately 50% of production has been from reserves and so the proven and probable reserves outlined above are adequate for at least 2 additional years of production from the date of the report.

The technical report has been filed on SEDAR and is available on the Company website www.imining.com.

As of July 31, 2011, reserves and resources at San Martin as reported in "*RESERVES AND RESOURCES IN THE SAN MARTIN MINE, MEXICO AS OF JULY 31, 2011*", dated September 10, 2011 and amended and restated December 19, 2011, prepared by David R. Gunning, P.Eng. and Joe Campbell, P. Geo. (the "Technical Report"), were as follows:

| Classification | Tonnes (000's) | Gold (g/t) | Silver (g/t) | Gold (000's of oz) | Silver (000's of oz) | Gold Equiv. (000's of oz) |
|---|---|---|---|---|---|---|
| ***Reserve:*** | | | | | | |
| ***San Martin Mine*** | | | | | | |
| Proven | 178 | 2.67 | 42 | 15.3 | 240.0 | 20.1 |
| Probable | 408 | 2.12 | 38 | 27.8 | 499.2 | 37.8 |
| **Total Reserve** | **586** | | | **43.1** | **739.2** | **57.9** |
| ***Resource:*** | | | | | | |
| ***San Martin Mine*** | | | | | | |
| Inferred | 1,311 | 2.37 | 27 | 99.9 | 1,138.2 | 122.7 |

- Inferred Mineral Resources are not known to the same degree of certainty as Mineral Reserves and do not have demonstrated economic viability.
- A 50:1 silver to gold equivalency ratio was used to calculate gold equivalent ounces.

See the Technical Report, available on SEDAR, for further information on the San Martin Mine.

***Production***

The following table is a summary of mine production statistics for the San Martin mine for the three and six months ended July 31, 2012 and the cumulative amounts for the twelve months ended January 31, 2012.

| *(Unaudited)* | *Unit of measure* | **Actual results for 3 months ended July 31, 2012** | **Actual results for 6 months ended July 31, 2012** | **Actual results for 12 months ended January 31, 2012** |
|---|---|---|---|---|
| Mine Production of Gold in Dore | *thousand ounces* | **3.7** | **8.3** | **17.7** |
| Mine Production of Silver in Dore | *thousand ounces* | **36.0** | **99.8** | **268.9** |
| Mine Equivalent ounces of Gold | *thousand ounces* | **4.4** | **10.2** | **23.7** |
| Purchased Concentrate Equivalent ounces | *thousand ounces* | **-** | **1.9** | **13.6** |
| Total Mine Production – Equivalent Ounces | *thousand ounces* | **4.4** | **12.1** | **37.3** |
| Silver to Gold Equivalency Ratio | | **57:1** | **54:1** | **46:1** |
| Mine Gold grade | *grams/tonne* | **2.03** | **2.09** | **2.12** |
| Mine Silver grade | *grams/tonne* | **25** | **29** | **39** |
| Mine Gold recovery | *percent* | **75%** | **81%** | **86%** |
| Mine Silver recovery | *percent* | **58%** | **69%** | **72%** |
| Milled | *thousands of tonnes* | **77** | **154** | **300** |
| Mine development, preparation and exploration | *meters* | **2,185** | **3,801** | **5,682** |
| Mine Operating Cost per tonne milled | *US dollars/tonne* | **58** | **54** | **50** |
| Mine Operating Cost per Equivalent Ounce | *US dollars/ounces* | **928** | **781** | **654** |
| Number of employees and contractors at minesite | | **334** | **334** | **332** |

During the quarter ended July 31, 2012, the mill operated at a rate of approximately 834 milled tonnes/calendar day. Gold and silver grades were 2.03 g/t and 25 g/t, respectively, compared to prior quarter grades of 2.15 g/t and 33 g/t. Overall equivalent gold production from the mine of 4,400 ounces was lower than the previous quarter production of 5,800 and the average quarterly production for the year ended January 31, 2012 of 5,925 ounces due to much lower gold and silver recoveries in the current quarter coupled with slightly lower ore grade. Ore recoveries decreased significantly during the quarter due to ore characteristics and reclaim water quality. These factors have been mitigated and gold recovery has returned to near historical levels. Overall metal production was also lower than the previous 12 month period average of 9,325 ounces per quarter due to the reduction in metal production from purchased concentrate. The Company's supplier of purchase concentrate, La Guitarra, recently changed control and ceased shipments to San Martin.

Production costs of the mine for the current quarter, excluding purchased concentrate, were US$928/EqOz. This was higher than the average for the twelve months ended January 31, 2012 which was US$654/EqOz and the previous quarter amount of $725/EqOz due mainly to lower production from reduced ore recoveries. Operating costs of US$58/t have increased from the average cost of US$50/t for the twelve months ended January 31, 2012 and the prior quarter's US$55/t, due mainly to additional development and stoping costs and to higher chemical and material costs. Generally, the mine has, during the past 12 months, created many more mineable ore zones causing management to reassess much of the development activity as mineable ores and, thereby, increasing overall mining costs. The offset has been a decrease in mine development capital costs. The mine plan has been developed to ensure the mine is properly developed and mined so as to ensure a constant supply of ore in accordance with currently planned production capacity and ore grades. Changes to the plan that may involve increased production and capital investment are continually being assessed by management. Currently, the Company is continuing underground exploration in order to identify higher grade ore zones and has allocated a higher budget to support year long exploration, exceeding 11,000 metres of exploration drilling for the 2012 calendar year.

During the quarter ended July 31, 2012, the Company incurred approximately US$1,071 in mine capital expenditures, which includes mine development drifting and drilling, machinery and equipment leases and purchases and construction and tailings dam remediation, compared to US$1,616 in the prior quarter.

In addition to the Company's mining operations at San Martin, Starcore had agreements to purchase concentrate ore and charges a processing and marketing fee as a reduction of purchase price paid based on assays of the concentrate. In December 2010, purchased concentrate levels returned to normal levels due to the resumption of activities at the La Guitarra mine owned by Silvermex Resources Inc., which was recently acquired by First Majestic Silver Corp. During the year ended July 31, 2012, the La Guitarra mine informed the Company that it would discontinue selling concentrate to the San Martin mine. This will result in a reduction in equivalent ounces produced by the mine, however, this loss in concentrate purchases will not significantly affect earnings of the Company.

Sales of metals produced by the milled ore from the mine, along with purchased ore concentrate, in the July 31, 2012 quarter of operations approximated 4,053 ounces of gold and 43,822 ounces of silver sold at average prices in the period of US$1,591 and US$28 per ounce, respectively. Sales of metals produced by the milled ore from the mine, along with purchased ore concentrate, for the year ended July 31, 2012 approximated 22,069 ounces of gold and 600,385 ounces of silver sold at average prices in the year of US$1,686 and US$34 per ounce, respectively. For the year ended July 31, 2011, metal sales of approximately 20,002 ounces of gold and 425,414 ounces of silver sold at average prices of US$1,308 per ounce and US$32 per ounce, respectively.

The gold average price realized, however, is effectively reduced compared to market prices, due to the sale of 10,885 ounces of gold for the three months and 21,343 ounces for the twelve months ended July 31, 2012, pursuant to existing gold sales contracts which are fixed at US$731 per ounce, payable based on the month end London Metals Exchange spot gold price. The losses realized on these gold sales contracts, reported separately on the Company's statement of operations and comprehensive income, amounted to $9,068 (US$9,042) for the three months and $19,185 (US$19,130) for the twelve months ended July 31, 2012. At July 31, 2012, the Company had no forward sales remaining, having fully settled its obligation under the Loan Agreement. The realized carrying value of settled contracts, based on mark to market valuations, was $10,129 for the three months and $19,291 for the twelve months ended July 31, 2012. Applied against the cash paid for the settlement of the forward sales during the twelve months ended July 31, 2012, the net gain on forward contracts is $106. This amount is included in "Finance costs" on the Company's statement of operations and comprehensive income.

## 4.2 Property Activity

***San Martin properties – Queretaro, Mexico***

The San Martin mine properties are comprised of mining concessions covering 12,992 hectares, including the San Pedrito property located approximately 50km west of the San Martin mine. In addition to the ongoing mine exploration and development that is currently being performed in development of the mine, management is continually assessing the potential for further exploration and development of the San Martin properties and continually modifying the exploration budget accordingly. The mine operates three underground drill rigs to provide information to assist with mine planning in addition to exploration, with the intent of increasing the reserves and resources on the property, and the Company has budgeted approximately 11,000 metres of exploration drilling in calendar 2012.

David Gunning, P.Eng., a director of the Company and Chief Operating Officer, is the Company's qualified person under NI 43-101, and has reviewed and approved the scientific and technical disclosure on the San Martin Mine disclosed in this MD&A.

## 4.3 Results of Operations

The Company recorded net income for the year ended July 31, 2012 of $14,335 as compared with a loss of $4,177 for the year ended July 31, 2011. The details of the Company's operating results and related revenues and expenses are as follows:

| **For the year ended July 31,** | **2012** | 2011 | Variance |
|---|---|---|---|
| **Revenues** | | | |
| Mined ore | **$ 38,524** | $ 29,413 | $ 9,111 |
| Purchased concentrate | **18,515** | 10,052 | 8,463 |
| **Total Revenues** | **57,039** | 39,465 | 17,574 |
| **Cost of Sales** | | | |
| Mined ore | **17,530** | 15,759 | 1,771 |
| Purchased concentrate | **17,819** | 9,752 | 8,067 |
| **Total Cost of Sales** | **(35,349)** | (25,511) | (9,838) |
| **Earnings from mining operations** | **21,690** | 13,954 | 7,736 |
| Financing costs | **(1,328)** | (13,177) | 11,849 |
| Finance revenue | **24** | - | 24 |
| Foreign exchange gain (loss) | **681** | (210) | 891 |
| Impairment | **-** | (300) | 300 |
| Professional and consulting fees | **(711)** | (432) | (279) |
| Management fees and salaries | **(1,075)** | (534) | (541) |
| Office and administration | **(1,097)** | (701) | (396) |
| Shareholder relations | **(348)** | (237) | (111) |
| Write-down of equipment | **-** | (179) | 179 |
| **Earnings (loss) before taxes** | **17,836** | (1,816) | 19,652 |
| **Provision for income and resource taxes** | **(3,501)** | (2,361) | (1,140) |
| **Earnings (loss) for the period** | **$ 14,335** | $ (4,177) | $ 18,512 |

Revenues included sales of gold and silver at average monthly market prices and based on gold sales contracts as discussed under *section 4.1 - "production"* above. The cost of sales above includes non-cash expenses for depreciation and depletion of $4,453, which is calculated based on the units of production from the mine over the expected mine production as a denominator. This calculation is based solely on the San Martin mine proven and probable reserves and a percentage of inferred resources in accordance with the Company's policy of recognizing the value of expected Resources which will be converted to Proven and Probable Reserves, as assessed by management.

The year of operations to July 31, 2012, produced earnings from mine operations of $21,690 compared to $13,954 for the year ended July 31, 2011. Average gold ore grades of 2.17 g/t and silver ore grades of 34 g/t for the year ended July 31, 2012 were comparable to the July 31, 2011 comparative year where grades averaged 2.08 g/t and silver ore grades averaged 36 g/t, which, when combined with increased tonnage production levels, resulted in higher production. This, combined with metal prices averaging $378 per ounce higher for gold and $2 per ounce higher for silver, resulted in substantially higher revenue.

Costs for the year ended July 31, 2012 were higher at an average operating cost of US$781/EqOz compared to an average operating cost of US$634/EqOz in the year ended July 31, 2011. When combined with the increase in equivalent ounces produced, the mined ore costs reported were $1,771 higher at $17,530 as compared to the year

ended July 31, 2011. Also included in mined ore costs in the current year is non-cash stock based compensation expense of $98 and depreciation of $4,453 for the year ended July 31, 2012 compared to $79 and $2,344, respectively for the year ended July 31, 2011. The Company uses the Black-Scholes option valuation model to calculate the fair value of share purchase options at the date of grant. In addition, the Company realized a profit of $696 from the purchase and sale of concentrate ore and an increase in gross revenue of $18,515 and in cost of sales of $17,819. This varies from the prior year due to the resumption of purchasing concentrate in only December 2010.

Changes in other items for the year ended July 31, 2012, resulted in the following significant changes from the year ended July 31, 2011:

- Financing costs for the year decreased by $11,849 to $1,328. Financing costs include the Company's interest on the Loan of $394, unwinding of the discount on the Loan and the $11million Credit Facility of $869, reclamation and closure costs of $148, a management fee paid with respect to the Loan of $39, and the Company's net realized and unrealized forward contract sales loss which is discussed below;
- Management fees and salaries increased by $541 to $1,075 due, primarily to the inclusion of a non-cash, stock based compensation expense to management of $418 and to the addition of members to the Company's technical advisory committee;
- Foreign exchange loss decreased by $891 to a gain of $681 for the year ended July 31, 2012 due to the weakening of the MXN peso in relation to the US$, the functional currency of the mining operations;
- Provision for income and resource taxes of $3,501 includes non-cash adjustments at the consolidation of the entities to account for differences between the tax and the accounting base of assets and liabilities. Taxes payable by the Company are subject to Mexican tax laws which are changing. These estimates reflect the best estimate of tax liability by the Company based on the existing interpretation of these laws. Included in amounts receivable and against the provision for income taxes are $1.85 million relating to a refund of 2009 and 2010 IETU payments. Based on recent tax precedents, management has amended the tax filings for these years to adjust the method in which the forward contract payments are included for IETU calculations;

The net realized and unrealized gain on forward sales contracts included in financing costs of $106 is due to the settlement of the forward contract liability outstanding at July 31, 2011 of US$19,235 for payments during the year of US$19,130. As the Company has consistently settled the obligation through the payment of cash, with the view that this is the more cost effective method of settlement, these gold sales contracts met the definition of derivatives and changes in market value were recorded in the income as they occurred.

Cash flows from operating activities were $17,801 during the year ended July 31, 2012, compared to $12,024 for the year ended July 31, 2011. Cash flows from operating activities were determined by removing non-cash expenses from the earnings and adjusting for non-cash working capital amounts. Overall cash increased during the year ended July 31, 2012 by $1,929 compared to a decrease of $902 in the comparative year ended July 31, 2011. The increase in cash in the current year resulted from the positive cash flows from operations, an $11 million credit facility financing and significant share issuances during the year.

***Investor Relations Activities***

During the year ended July 31, 2012, the Company responded directly to investor inquiries.

***Financings, Principal Purposes & Milestones***

During the year ended July 31, 2012, pursuant to the exercise of warrants, agent warrants and options, the Company issued 23,977,681 shares at $0.15 per share for proceeds of $3,597. Additionally on January 30, 2012, the Company issued 9,010,000 units pursuant to closing a $2,253 non-brokered financing at $0.25 per unit. Each unit consisted of one share and one half of a share purchase warrant. Each whole warrant was exercisable for one additional share at $0.35 until January 30, 2014. The Company paid finders' fees on the transaction of $87 in cash and the issuance of 464,800 non-transferable Agent Warrants. The proceeds of the financing were used to pay out the Investec Loan Facility.

Additionally during the year ended July 31, 2012, the Company secured an $11 million Loan Facility. The Facility bears interest at 11% per annum, compounded and payable monthly, with monthly principal payments to be made commencing May 31st, 2012, with the final payment due on or before April 30, 2013. The Facility may be repaid in full without penalty on or after October 31, 2012.

In consideration for the Facility, the Company paid, during the year ended July 31, 2012, a structuring fee of $220 and issued one million common shares. The Facility is guaranteed by the Company's wholly owned subsidiary, Bernal, and is secured by a fixed and floating charge and specific registration over all of the assets of the Company and Bernal, including the San Martin gold and silver mine in Queretaro, Mexico, and a pledge of all of the shares of Bernal held by the Company.

On May 17, 2012, the Company used the funds from the Facility to settle its obligation under the forward sales agreement. The final 10,885 ounces which were to be settled over the final 9 months to January 31, 2013, were repurchased for $9,042 at a close out price averaging $1,562 per ounce. Having fully repaid the forward contracts, the Company has been released from all commitments under the Investec Bank Loan.

## 5. Summary of Quarterly Results

The following is a summary of the Company's financial results for the eight most recently completed quarters:

| | Q4<br>31-Jul-12<br>IFRS | Q3<br>30-Apr-12<br>IFRS | Q2<br>31-Jan-12<br>IFRS | Q1<br>31-Oct-11<br>IFRS |
|---|---|---|---|---|
| Total Revenue | $ 7,626 | $ 13,989 | $ 15,025 | $ 20,399 |
| Earnings from mining operations | $ 3,877 | $ 4,972 | $ 5,524 | $ 7,317 |
| Earnings (loss) | $ 3,499 | $ 4,172 | $ 3,501 | $ 3,163 |
| Per share – basic | $ 0.02 | $ 0.03 | $ 0.03 | $ 0.03 |
| Per share – diluted | $ 0.02 | $ 0.03 | $ 0.03 | $ 0.02 |

| | Q4<br>31-Jul-11<br>IFRS | Q3<br>30-Apr-11<br>IFRS | Q2<br>31-Jan-11<br>IFRS | Q1<br>31-Oct-10<br>IFRS |
|---|---|---|---|---|
| Total Revenue | $ 9,501 | $ 13,859 | $ 9,655 | $ 6,450 |
| Earnings from mining operations | $ 2,517 | $ 5,162 | $ 3,425 | $ 2,767 |
| Net Income (loss) | $ (1,194) | $ (1,003) | $ 1,418 | $ (3,398) |
| Per share – basic | $ (0.01) | $ (0.01) | $ 0.02 | $ (0.04) |
| Per share – diluted | $ (0.01) | $ (0.01) | $ 0.01 | $ (0.04) |

***Discussion***

The Company reports earnings for the quarter of $3,499 compared to a loss of $1,194 in the comparative quarter ended July 31, 2011. The earnings from mining operations increased during the current quarter due to higher financing costs in the 2011 comparative quarter stemming from the net realised and unrealised loss forward contract. Revenues from mining operations decreased in this quarter to $7,626 from the comparative quarter of $9,501 as a result of the reduced revenues from the purchased concentrate and to lower ore production. For more detailed discussion on the quarterly production results and financial results for the quarter ended July 31, 2012, please refer to *Sections 4.1 and 4.3 under "Results of Operations"*.

## 6. Liquidity, Commitments and Going Concern

The Company expects to continue to receive income and cash flows from the mining operations at San Martin (*section 4.1*). Management expects that this will result in sufficient working capital and liquidity for the Company for the next twelve months.

As at July 31, 2012, the Company had the following commitments:

a) As at July 31, 2012, the Company has management contracts with officers and directors totalling $600 per year, payable monthly, expiring in January, 2017.

b) The Company has secured an $11 million credit facility with Sprott Resource Lending. The outstanding principal balance at July 31, 2012 was $8,250. The Facility bears interest at 11% per annum, compounded and payable monthly, with monthly principal payments of $917 commencing May 31, 2012, with the final payment due on or before April 30, 2013. The Facility may be repaid in full without penalty on or after October 31, 2012.

| Obligations due within twelve months of July 31, | 2012 | 2013 | 2014 | 2015 | 2016 and beyond |
|---|---|---|---|---|---|
| Trade and other payables | $ 1,684 | $ - | $ - | $ - | $ - |
| Loan payable | 8,250 | - | - | - | - |
| Rehabilitation and closure cost provision | - | - | - | - | 1,505 |
| Other long-term liabilities | - | - | - | - | 2,724 |

## 7. Capital Resources

The capital resources of the Company are the mining interests, plant and equipment, with an amortized historical cost of $43,060 as at July 31, 2012. The Company is committed to further expenditures of capital required to maintain and to further develop the San Martin mine which management believes will be funded directly from the operating cash flows of the mine.

## 8. Off Balance Sheet Arrangements

The Company has no off balance sheet transactions.

## 9. Transactions with Related Parties

There were no material reportable related party transactions.

## 10. Fourth Quarter

Due to mine operating activity of the San Martin mine discussed throughout this MD&A and as detailed in Section 4.1, the operations and activities are similar to previous quarters (see section 5).

## 11. Proposed Transactions

N/A

## 12. Critical Accounting Estimates

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in accounting estimate is recognized prospectively by including it in the Company's profit or loss in the period of the change, if it affects that period only, or in the period of the change and future periods, if the change affects both.

Information about critical judgements in applying accounting policies that have the most significant risk of causing material adjustment to the carrying amounts of assets and liabilities recognized in the consolidated financial statements within the next financial year are discussed below:

a) Economic Recoverability and Profitability of Future Economic Benefits of Mining Interests

Management has determined that mining interests, evaluation, development and related costs incurred which have been capitalized are economically recoverable. Management uses several criteria in its assessments of economic recoverability and probability of future economic benefit including geologic and metallurgic information, history of conversion of mineral deposits to proven and probable reserves, scoping and feasibility studies, accessible facilities, existing permits and life of mine plans.

b) Rehabilitation Provisions

Rehabilitation provisions have been created based on the Company's internal estimates. Assumptions, based on the current economic environment, have been made which management believes are a reasonable basis upon which to estimate the future liability. These estimates take into account any material changes to the assumptions that occur when reviewed regularly by management. Estimates are reviewed annually and are based on current regulatory requirements. Significant changes in estimates of contamination, restoration standards and techniques will result in changes to provisions from period to period. Actual rehabilitation costs will ultimately depend on future market prices for the rehabilitation costs, which will reflect the market condition at the time of the rehabilitation costs are actually incurred. The final cost of the currently recognized rehabilitation provision may be higher or lower than currently provided for.

The inflation rate applied to estimated future rehabilitation and closure costs is 5% and the discount rate currently applied in the calculation of the net present value of the provision is 11%

c) Income Taxes

Significant judgment is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The company recognizes liabilities and contingencies for anticipated tax audit issues based on the Company's current understanding of tax law. For matters where it is probable that an adjustment will be made, the Company records its best estimate of the tax liability including the related interest and penalties in the current tax provision. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

In addition, the Company recognizes deferred tax assets relating to tax losses carried forward to the extent there are sufficient taxable temporary differences (deferred tax liabilities) relating to the same taxation authority and the same taxable entity against which the unused tax losses can be utilized. However, utilization of the tax losses also depends on the ability of the taxable entity to satisfy certain tests at the time the losses are recuperated.

d) Share-Based Payment Transactions

The Company measures the cost of equity-settled transactions with employees, and some with non-employees, by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them.

## 13. Changes in Accounting Policies

The Company's consolidated financial statements for the year ending July 31, 2012, are the first annual consolidated financial statements that will be prepared in accordance with IFRS. IFRS 1, First time Adoption of International Financial Reporting Standards, requires that comparative financial information be provided for all periods presented. As a result, the first date at which the Company has applied IFRS was August 1, 2010 (the "Transition Date"). IFRS 1 requires first time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company will be July 31, 2012. However, it also provides certain optional exemptions and mandatory exceptions for first time IFRS adoption. Prior to Transition to IFRS, the Company prepared its financial statements in accordance with Pre-changeover GAAP.

In preparing the Company's opening IFRS consolidated financial statements, the Company has adjusted amounts reported previously in the consolidated financial statements prepared in accordance with Pre-changeover GAAP.

### Optional Exemptions

The IFRS 1 applicable exemptions and exceptions applied in the conversion from Pre-changeover GAAP to IFRS are as follows:

*Business Combinations*

The Company elected to not retrospectively apply IFRS 3 Business Combinations to any business combinations, prior to its Transition Date.

*Share-Based Payment Transactions*

The Company has elected to not retrospectively apply IFRS 2 to equity instruments that were granted and had vested before the Transition date. As a result of applying this exemption, the Company will apply the provision of IFRS 2 only to all outstanding equity instruments that are unvested at the Transition Date.

*Compound Financial Instruments*

The Company has elected to not retrospectively separate the liability and equity components of compound instruments for which the liability component is no longer outstanding at the Transition Date.

*Changes in Existing Decommissioning, Restoration and Similar Liabilities*

The Company has elected to apply the exemption from full retrospective application of decommissioning provisions as allowed under IFRS 1. As a result, the Company has re-measured the provisions at August 1, 2010 under IAS 37 Provisions, Contingent Liabilities and Contingent Assets and estimated the amount to be included in the cost of the related asset by discounting the liability to the date at which the liability first arose.

*Borrowing Costs*

The Company has elected to not apply the transitional provisions of IAS 23 Borrowing Costs, which permits prospective capitalization of borrowing costs on qualifying assets from the Transition Date.

### Mandatory Exemptions

*Derecognition of Financial Assets and Liabilities*

The Company has applied the derecognition requirements of IAS 39 Financial Instruments: Recognition and Measurement, prospectively from the Transition Date. As a result, any non-derivative financial assets or non-derivative financial liabilities derecognized prior to the Transition Date in accordance with Pre-changeover GAAP have not been reviewed for compliance with IAS 39.

*Estimates*

The estimates previously made by the Company under Pre-changeover GAAP were not revised for the application of IFRS except where necessary to reflect any differences in accounting policy or where there was objective evidence that those estimates were in error. As a result, the Company has not used hindsight to reverse estimates.

*Reconciliation of Pre-Changeover GAAP Equity and Comprehensive Loss to IFRS*

IFRS 1 requires an entity to reconcile equity, comprehensive income and cash flows for prior periods. The changes made to the statements of financial position as shown below have resulted in reclassifications of various amounts on statements of comprehensive income and the statement of cash flows, however as there have been no material adjustments to the net cash flows, no reconciliation of the statements of cash flows has been prepared.

i) Foreign Denominated Warrants

In conjunction with the Investec Loan, the Company issued 19,236,000 detachable share purchase warrants which were exercisable in USD to the extent that the Investec Loan was still outstanding and thereafter in CAD.

Under Pre-changeover GAAP, the Investec Loan discount was determined as being the difference between the face value of the original Investec Loan, US$13,000 or $15,301 less the portion of the Investec Loan classified as a liability, US$12,059 or $13,867. Using the effective interest rate method and the 11.0% implicit in the calculation, the difference of $1,108, was characterized as the note discount which was charged to the consolidated Statement of Operations and Comprehensive Income (Loss) as the Investec Loan was repaid. The $1,108 discount was allocated to equity reserve, as the value assigned to the warrants and the warrants were included in the share capital note disclosure of the consolidated financial statements.

Under IFRS, share purchase warrants issued with exercise prices denominated in foreign currencies are classified and presented as derivative liabilities and measured at fair value. The fair value of the warrants calculated under IFRS was, $2,953 using the Black-Scholes method of valuation. Subsequent to initial recognition, the fair value of the warrants would have been recalculated with any fluctuations being included in the Company's profit or loss. As the warrants were considered derivative liabilities, they have been removed from the share capital note disclosure and are discussed in Note 12 of the Company's consolidated financial statements.

As of July 31, 2011 and August 1, 2010, the fair value of the foreign denominated warrants was $Nil. In the conversion from Pre-changeover GAAP to IFRS, equity reserve was reduced by $1,108 and accumulated deficit was increased for the full amount due to the current fair value of the warrants being $Nil. The Investec Loan balance, shown net of the discount is reduced $589 at August 1, 2010 and $452, at July 31, 2011 for the increase in the initial discount to $2,953 as discussed above.

ii) Deferred Income Taxes

Under Pre-changeover GAAP, current and non-current deferred income tax assets and liabilities were grouped to the extent that they would be applicable against one another as they were realized and were classified as current and non-current depending on when the timing differences are expected to reverse. IFRS requires deferred tax items to be classified as non-current and to be presented separately and similarly, requires the segregation of deferred tax assets and liabilities.

## 14. Financial and Other Instruments

All significant financial assets, financial liabilities and equity instruments of the Company are either recognized or disclosed in the consolidated financial statements together with other information relevant for making a reasonable assessment of future cash flows, interest rate risk and credit risk. Where practicable the fair values of financial assets and financial liabilities have been determined and disclosed; otherwise only available information pertinent to fair value has been disclosed.

In the normal course of business, the Company's assets, liabilities and forecasted transactions are impacted by various market risks, including currency risks associated with inventory, revenues, cost of sales, capital expenditures, interest earned on cash and the interest rate risk associated with floating rate debt.

Currency risk is the risk to the Company's earnings that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to foreign currency risk. At July 31, 2012 the company had the following financial assets and liabilities denominated in Canadian dollars (CDN) and denominated in Mexican Pesos:

| | In '000 of CDN Dollars | In '000 of Mexican Pesos (MP) |
|---|---|---|
| Cash and cash equivalents | $ 1,918 | MP 941 |
| Other working capital amounts - net | $ 1 | MP 118,658 |
| Long-term Liabilities | $ - | MP 36 |

At July 31, 2012, US dollar amounts were converted at a rate of $1.002 Canadian dollars to $1 US dollar and Mexican Pesos were converted at a rate of MP13.283 to $1 US Dollar.

During the year ended July 31, 2012, the Company settled the Loan agreement and the forward sales agreements, entered into on the acquisition of the San Martin Mine, which required that the Company sell 81,876 ounces of gold at a price of US$731 per ounce until January, 2013. These gold sales contracts met the definition of derivatives because, although the obligation may have been met by the physical delivery of gold, historically it had been more economical to settle these obligations with cash. As a result of settling the remaining gold sales contracts during the year, the fair value of the remaining gold sales contracts as at July 31, 2012 was US$Nil (July 31, 2011 – US$19,235; August 1, 2010 - US$15,883 based on a per ounce gold value of July 31, 2011 - US$1,621; August 1, 2010 – US$1,180). (*see section 4.3 - Financings, Principal Purposes & Milestones).*

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## 15. Other

### 15.1 Disclosure of Outstanding Share Capital as at October 24, 2012

| | Number | Book Value |
|---|---|---|
| **Common Shares** | **139,881,151** | **$43,069** |

The following summarizes changes in options from July 31, 2011 to July 31, 2012:

| Grant Date mm/dd/yy | Expiry Date mm/dd/yy | Exercise Price | Opening Balance | During the Year Granted | Exercised | Cancelled/ Forfeited | Closing | Closing, Vested and Exercisable |
|---|---|---|---|---|---|---|---|---|
| 11/09/09 | 11/09/14 | $0.15 | 7,050,000 | - | (800,000) | (250,000) | **6,000,000** | **6,000,000** |
| 01/10/10 | 01/10/15 | $0.21 | 1,000,000 | - | - | - | **1,000,000** | **1,000,000** |
| 03/26/10 | 03/26/15 | $0.15 | 400,000 | - | - | - | **400,000** | **400,000** |
| 10/06/10 | 10/06/15 | $0.15 | 750,000 | - | (750,000) | - | **-** | **-** |
| 05/06/11 | 05/06/16 | $0.15 | 210,000 | - | - | - | **210,000** | **139,996** |
| 01/16/12 | 01/16/17 | $0.20 | - | 700,000 | - | (200,000) | **450,000** | **149,998** |
| 01/27/12 | 01/27/17 | $0.25 | - | 2,160,000 | - | (165,000) | **1,995,000** | **664,991** |
| 04/13/12 | 04/13/17 | $0.37 | - | 3,250,000 | - | - | **3,250,000** | **-** |
| | | | 9,410,000 | 6,110,000 | (1,550,000) | (665,000) | **13,305,000** | **8,354,985** |
| Weighted Average Exercise Price | | | $0.16 | $0.31 | $0.15 | $0.19 | **$0.22** | **$0.17** |

As at July 31, 2012, the following warrants were outstanding and exercisable to purchase one common share for each warrant held:

| Number of Shares | Exercise Price | Expiry Date |
|---|---|---|
| 464,800 | $0.25 | January 30, 2013 |
| 3,261,814 | $0.15 | April 7, 2013 |
| 4,505,000 | $0.35 | January 30, 2014 |
| **8,231,614** | **$0.27** | |

## 15.2 Disclosure Controls and Procedures

***Disclosure Controls and Procedures***

The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures. Based upon the results of that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by the Company in reports it files is recorded, processed, summarized and reported, within the appropriate time periods and forms.

***Internal Controls Over Financial Reporting***

The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, are responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision of the Chief Financial Officer, the Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The Company's controls include policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the annual financial statements or interim financial statements.

There has been no change in the Company's internal control over financial reporting during the Company's year ended July 31, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

***Limitations of Controls and Procedures***

The Company's management, including the Chief Executive Officer and Chief Financial Officer, believe that any disclosure controls and procedures or internal controls over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.