

RAINY RIVER RESOURCES LTD.
CONSOLIDATED FINANCIAL STATEMENTS
(Stated in Canadian Dollars)
FOR THE YEAR ENDED
SEPTEMBER 30, 2010

AUDITORS' REPORT

To the Shareholders of
Rainy River Resources Ltd.

We have audited the consolidated balance sheets of Rainy River Resources Ltd. as at September 30, 2010 and 2009 and the consolidated statements of loss and deficit, accumulated other comprehensive income and comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

“DAVIDSON & COMPANY LLP”

Vancouver, Canada

Chartered Accountants

December 14, 2010



RAINY RIVER RESOURCES LTD.

CONSOLIDATED BALANCE SHEETS

AS AT SEPTEMBER 30

ASSETS

	2010	2009
CURRENT		
Cash and cash equivalents	\$ 71,870,010	\$ 7,562,591
Short-term deposits (Note 3)	-	10,143,311
Marketable securities (Note 4)	-	158,400
Receivables	668,754	173,511
Prepaid expenses	83,336	47,563
	72,622,100	18,085,376
NON-CURRENT		
Investments (Note 4)	1,050,000	-
Equipment (Note 5)	454,347	191,806
Mineral properties (Note 6)	70,542,980	47,734,155
	144,669,427	66,011,337
	\$ 144,669,427	\$ 66,011,337

LIABILITIES

CURRENT		
Accounts payable and accrued liabilities	\$ 1,922,205	\$ 1,479,921
NON-CURRENT		
Future income taxes (Note 10)	978,000	1,045,000
	2,900,205	2,524,921

SHAREHOLDERS' EQUITY

Share capital (Note 7)	151,052,582	70,354,790
Contributed surplus (Note 7)	10,946,580	7,174,685
Obligation to issue shares (Note 7)	114,300	-
Accumulated other comprehensive income	481,250	-
Deficit	(20,825,490)	(14,043,059)
	141,769,222	63,486,416
	\$ 144,669,427	\$ 66,011,337

Nature and continuance of operations (Note 1)

Commitments (Notes 7a, 7d and 11)

Subsequent events (Note 15)

APPROVED BY THE DIRECTORS:

"Dale C. Peniuk"

"Raymond W. Threlkeld"

Dale C. Peniuk, Director

Raymond W. Threlkeld, Director

The accompanying notes are an integral part of these consolidated financial statements.

RAINY RIVER RESOURCES LTD.
CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
FOR THE YEAR ENDED SEPTEMBER 30

	<u>2010</u>	<u>2009</u>
EXPENSES		
Amortization	\$ 158,670	\$ 68,967
Audit and legal	211,898	163,507
Consulting	793,524	379,000
Office and miscellaneous	315,460	187,734
Promotion and investor relations	191,321	134,936
Regulatory and filing fees	136,986	50,932
Rent	108,293	68,964
Salaries and benefits	1,226,641	452,970
Stock-based compensation (Note 7c)	5,593,477	2,626,122
Travel	513,568	130,281
	<u>(9,249,838)</u>	<u>(4,263,413)</u>
LOSS BEFORE OTHER ITEMS AND INCOME TAXES		
OTHER ITEMS		
Interest income	343,272	622,822
Realized gain (loss) on sale of marketable securities	5,904	(1,307)
Unrealized loss on marketable securities	(79,519)	(133,956)
	<u>269,657</u>	<u>487,559</u>
LOSS BEFORE INCOME TAXES	(8,980,181)	(3,775,854)
Future income tax recovery (Note 10)	2,197,750	221,000
	<u>(6,782,431)</u>	<u>(3,554,854)</u>
LOSS FOR THE YEAR		
DEFICIT, BEGINNING OF THE YEAR	(14,043,059)	(10,488,205)
DEFICIT, END OF THE YEAR	<u>(\$20,825,490)</u>	<u>(\$14,043,059)</u>
BASIC AND DILUTED LOSS PER COMMON SHARE	\$ (0.10)	\$ (0.06)
Weighted average number of common shares outstanding	67,493,814	57,118,182

The accompanying notes are an integral part of these consolidated financial statements.

RAINY RIVER RESOURCES LTD.

CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME AND COMPREHENSIVE LOSS

FOR THE YEAR ENDED SEPTEMBER 30

	<u>2010</u>	<u>2009</u>
Accumulated other comprehensive income, beginning of year	\$ -	\$ -
Other comprehensive income		
Unrealized gain on available-for-sale financial asset arising during the year	<u>481,250</u>	<u>-</u>
Accumulated other comprehensive income, end of year	<u>\$ 481,250</u>	<u>\$ -</u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE GAIN

FOR THE YEAR ENDED SEPTEMBER 30

	<u>2010</u>	<u>2009</u>
Loss for the year	\$ (6,782,431)	\$ (3,554,854)
Other comprehensive income		
Unrealized gain on available-for-sale financial asset arising during the year	<u>481,250</u>	<u>-</u>
Comprehensive loss for the year	<u>\$ (6,301,181)</u>	<u>\$ (3,554,854)</u>

The accompanying notes are an integral part of these consolidated financial statements.

RAINY RIVER RESOURCES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss for the year	\$ (6,782,431)	\$ (3,554,854)
Items not involving cash:		
Amortization	158,670	68,967
Realized (gain) loss on sale of marketable securities	(5,904)	1,307
Loss on disposal of equipment	-	1,480
Unrealized loss on marketable securities	79,519	133,956
Interest accrual on short-term deposits	(82,689)	(281,815)
Stock-based compensation	5,593,477	2,626,122
Future income tax recovery	(2,197,750)	(221,000)
Changes in non-cash working capital items:		
Accounts payable and accrued liabilities	192,332	43,170
Receivables	(495,243)	(12,875)
Prepaid expenses	(35,773)	34,779
Net cash flows used in operating activities	<u>(3,575,792)</u>	<u>(1,160,763)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds on issue of share capital	85,115,303	-
Share issue costs	(5,446,643)	-
Shares purchased under issuer bid	-	(1,122,529)
Cash flows provided by (used in) financing activities	<u>79,668,660</u>	<u>(1,122,529)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds on sale of marketable securities	84,785	3,517
Mineral properties, net of changes in accounts payable and accrued liabilities	(21,175,023)	(12,147,136)
Proceeds from redemption of short-term deposits	10,226,000	10,375,500
Purchase of investments	(500,000)	-
Purchase of short-term deposits	-	(10,000,000)
Purchase of equipment	(421,211)	(73,367)
Cash flows used in investing activities	<u>(11,785,449)</u>	<u>(11,841,486)</u>
CHANGE IN CASH AND CASH EQUIVLENTS DURING THE YEAR	64,307,419	(14,124,778)
Cash and cash equivalents- beginning of year	<u>7,562,591</u>	<u>21,687,369</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 71,870,010</u>	<u>\$ 7,562,591</u>

Supplemental disclosure with respect to cash flows (Note 9)

The accompanying notes are an integral part of these consolidated financial statements.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

1. NATURE AND CONTINUANCE OF OPERATIONS

Rainy River Resources Ltd. (the “Company”) was incorporated under the laws of British Columbia, Canada. The Company is primarily engaged in the acquisition and exploration of mineral property interests and is considered to be in the exploration stage.

The Company is in the process of exploring its mineral properties and has not yet determined whether the properties contain ore reserves that are economically recoverable. The recoverability of the amounts shown for mineral properties is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain financing to complete the development of those reserves and upon future profitable production or proceeds from the disposition thereof.

Although the Company is not generating revenues, has incurred operating losses in the past and continues to incur operating losses, the Company believes it has sufficient resources to continue operations throughout the upcoming year.

2. SIGNIFICANT ACCOUNTING POLICIES

Generally accepted accounting principles (“GAAP”)

These financial statements are prepared in accordance with Canadian GAAP. All amounts, unless specifically indicated otherwise, are presented in Canadian dollars.

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, 608457 B.C. Ltd. and Rainy River U.S. Inc. All inter-company transactions and balances have been eliminated upon consolidation. The Company has determined that it has no variable interest entities as at September 30, 2010 and 2009.

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Significant estimates that involve highly subjective assumptions by management include the Company’s estimate of stock-based compensation expense, the fair value of financial instruments, the assessment of possible impairment of its mineral properties and future income taxes. Actual results may differ from those estimates.

Financial instruments

Financial instruments are classified into one of five categories: held-for-trading financial instruments, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments are measured in the balance sheet at fair value, except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification. Held-for-trading financial instruments are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial assets are measured at fair value and changes in fair value are recognized in other comprehensive income until the instrument is derecognized or impaired.

The Company has classified its cash and cash equivalents and marketable securities as held-for-trading; short-term deposits are classified as held-to-maturity; receivables are classified as loans and receivables; investments are classified as available-for sale; and accounts payable and accrued liabilities are classified as other liabilities.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Financial instruments (Cont'd)

The Company provides disclosure that enables users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the year and at the balance sheet date, and how the entity manages those risks.

The Company also discloses financial instruments and non-financial derivatives classified from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit with banks and short-term, highly liquid, interest bearing investments of less than 90 days on acquisition that are readily convertible to known amounts of cash and are subject to insignificant risk of changes in value.

Short-term deposits

Short-term deposits consist of guaranteed investment certificates with a term of one year. These short-term deposits are stated at cost plus accrued interest (amortized cost) and their carrying value approximates their fair value.

Equipment

Equipment is recorded at cost. Amortization is recognized using the declining balance method over the estimated useful lives of the equipment at the following annual rates, commencing when the related asset is available for use:

Computer equipment	25%
Office furniture and equipment	20%
Field equipment	30%

Mineral properties

All costs related to the acquisition, exploration and development of mineral properties are capitalized on a property-by-property basis. If economically recoverable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the unit of production method. When a property is abandoned, all related costs are written off to the statements of loss and comprehensive loss. If, after management review, it is determined that the carrying amount of a mineral property is impaired, that property is written down to its estimated net realizable value. A mineral property is reviewed for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

The amounts shown for mineral properties represent costs incurred to date and do not necessarily represent present or future values. Their recoverability is dependent upon discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete development, and future profitable production or proceeds from the disposition thereof.

Asset retirement obligations

Asset retirement obligations consider the recognition and measurement of liabilities related to legal obligations associated with the retirement of mineral properties and equipment. These obligations are initially measured at fair value and subsequently adjusted for the accretion of the discount and any changes in the underlying estimated future cash flows. The asset retirement cost is to be capitalized to the related asset and amortized to earnings over time. At September 30, 2010 and 2009, the Company has no asset retirement obligations.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Stock-based compensation

The Company uses the fair value based method of accounting for stock options granted to employees and directors and compensatory warrants issued on private placements. Under this method, the fair value of the stock options at the date of the grant, as determined using the Black-Scholes option pricing model, is recognized as expense over the vesting period, and the fair value of compensatory warrants at the date of issuance, as determined using the Black-Scholes model, is recognized as share issuance costs, with the offsetting credit to contributed surplus. If the stock options or warrants are exercised, the proceeds are credited to share capital and the fair value of the options or warrants exercised are reclassified from contributed surplus to share capital.

Future income taxes

Future income taxes are recorded using the asset and liability method under which future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change of tax rates is recognized in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

Flow-through common shares

Canadian tax legislation permits a company to issue flow-through shares whereby the deduction for tax purposes relating to qualified resource expenditures is claimed by the investors rather than the Company. Capitalizing these expenditures for accounting purposes gives rise to taxable temporary differences.

When flow-through expenditures are renounced, a portion of the future income tax assets that was not recognized in previous years, due to the recording of a valuation allowance, may be recognized as a recovery of income taxes in the statements of loss and comprehensive loss.

Loss per share

Basic loss per share is calculated using the weighted-average number of common shares outstanding during the year. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method, the dilutive effect on basic loss per share is recognized on the use of the proceeds that could be obtained upon exercise of these instruments. It assumes that the proceeds would be used to purchase common shares at the weighted average market price during the period. For the years presented, this calculation proved to be anti-dilutive.

Foreign currency translation

The monetary assets and liabilities of the Company that are denominated in foreign currencies are translated at the rate of exchange at the balance sheet date and non-monetary items are translated at historical rates. Revenues and expenses are translated at rates approximating those in effect at the time of the transaction. Exchange gains and losses arising on translation are included in the statements of loss and comprehensive loss.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

New Accounting Policies Adopted

Amendment to Financial Instruments – Disclosures

The Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3862, Financial Instruments – Disclosures was amended to require disclosure of the inputs used in making fair value measurements, including their classification within a hierarchy that prioritizes their significance. The amendments are effective for annual financial statements for fiscal years ended after September 30, 2009. The amendments are consistent with recent amendments to financial instrument disclosure standards in International Financial Reporting Standards (“IFRS”).

The three levels of the fair value hierarchy are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

See Note 13 for relevant disclosures.

New Accounting Pronouncements to be applied

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board announced that IFRS will replace Canadian GAAP for publicly-listed companies for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date for the Company will be October 1, 2011 and will require the restatement for comparative purposes of amounts reported for the year ending September 30, 2011.

Business Combinations

In January 2009, the CICA issued Handbook Sections 1582 “Business Combinations”, 1601 “Consolidated Financial Statements” and 1602 “Non-Controlling Interests”, which replace CICA Handbook Sections 1581 “Business Combinations” and 1600 “Consolidated Financial Statements”. Section 1582 establishes a standard for the accounting for business combinations that is equivalent to the business combination accounting standard under IFRS. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. These sections are applicable for the Company’s interim and annual consolidated financial statements for its fiscal year beginning on or after January 1, 2011. Early adoption of these Sections is permitted, although all three Sections must be adopted concurrently.

3. SHORT-TERM DEPOSITS

At September 30, 2009, short-term deposits consisted of \$10,000,000 in guaranteed investment certificates plus accrued interest of \$143,311 with an average interest yield of 2.26%, purchased on February 12, 2009 and maturing on February 12, 2010. Upon maturity on February 12, 2010, these funds were invested in cash and cash equivalents.

4. MARKETABLE SECURITIES AND INVESTMENTS

During the year ended September 30, 2010, shares in publicly traded companies with a cost of \$78,881 classified as marketable securities were sold for proceeds of \$84,785. At September 30, 2009, marketable securities were stated at fair value and consisted of shares in publicly traded companies with an original cost of \$78,881.

At September 30, 2010, investments consist of shares of Northern Superior Resources Ltd. (“Northern Superior”) with an original cost of \$500,000 (Note 6c).

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

5. EQUIPMENT

	Cost	Accumulated	Net Book
	\$	Amortization	Value
	\$	\$	\$
September 30, 2010			
Computer equipment	302,155	152,897	149,258
Office furniture and equipment	184,751	62,478	122,273
Field equipment	354,804	171,988	182,816
	841,710	387,363	454,347
September 30, 2009			
Computer equipment	201,462	103,144	98,318
Office furniture and equipment	55,953	31,909	24,044
Field equipment	163,083	93,639	69,444
	420,498	228,692	191,806

6. MINERAL PROPERTIES

	<u>September 30, 2010</u>	<u>September 30, 2009</u>
Rainy River Property	\$ 70,027,892	\$ 47,609,558
Mud Creek Property	215,088	124,597
TPK Property	300,000	-
	\$ 70,542,980	\$ 47,734,155

Title to mineral properties involves inherent risks due to difficulties of determining the validity of certain mineral claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mining properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties is in good standing.

a) Rainy River Property, Ontario

The Company holds a 100% interest in the Rainy River property, located in the southwest corner of northern Ontario.

At the time of original acquisition, the Company was obligated to pay a bonus of \$2,500,000 on commencement of commercial production from the property and a quarterly royalty of \$1 per tonne of ore produced from the property, subject to an annual consumer price index adjustment. In December 2008, the Company completed an agreement with Nuinsco Resources Limited (“Nuinsco”) pursuant to which the Company purchased Nuinsco’s right to the production tonnage royalty and the bonus payment due on the property. Under the terms of the agreement, the Company purchased Nuinsco’s rights to the royalty and the bonus payment by making a cash payment of \$500,000 and issuing a total of 200,000 common shares valued at \$130,000.

Upon acquisition, the property also had a 3% net smelter returns royalty (“NSR”) on production payable to the original rights holders. In May 2009, the Company completed an agreement with the underlying vendors pursuant to which the Company purchased the underlying vendors right to the 3% NSR by making a cash payment of \$475,000 and issuing a total of 600,000 common shares valued at \$1,710,000.

A portion of the property is also subject to a 10% net profits interest.

The Company has entered into several additional property option agreements in the Rainy River District which, together with the aforementioned property, make up the entire Rainy River Property.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

6. MINERAL PROPERTIES (Cont'd)

During the period from June 2005 to September 30, 2010, the Company entered into various agreements whereby the Company has an option to earn a 100% interest, subject to a 2% NSR (3% on one property), in certain patented mineral rights in various townships in the Rainy River District, by making cash payments totaling \$3,395,000 (\$1,953,610 paid) and issuing a total of 1,689,500 common shares (1,226,500 issued at a total value of \$4,203,830) over the period to June 2014. Upon expiry of the option period on one of the properties, on the fifth anniversary date of the agreement (fiscal 2010), the Company is required to make annual advance royalty payments of \$30,000 for a three year period, totaling \$90,000 (\$30,000 paid).

During fiscal 2008, 2009 and 2010, the Company also paid a total of \$210,000 and issued 82,500 shares (issued at total value of \$276,625) in connection with five option agreements entered into during fiscal 2007 and 2008 that were terminated in 2009 and 2010.

During the year ended September 30, 2010, the Company completed the purchase of surface and mineral rights to four land parcels in Richardson Township for \$1,162,346 (2009 – two parcels for \$75,882).

The details of the costs incurred on the Company's Rainy River Property are as follows:

	Year ended September 30 2010	Year ended September 30 2009
Acquisition costs		
Opening balance	\$ 12,236,623	\$ 8,088,183
Additions		
Shares issued	1,423,780	2,401,100
Property option payments	565,000	658,000
Royalty and bonus purchase	-	500,000
NSR purchase	-	475,000
Advance royalty payments	30,000	-
Legal costs	204,288	17,228
Staking costs	1,815	21,230
Land rights purchase	1,162,346	75,882
	3,387,229	4,148,440
Total acquisition costs	15,623,852	12,236,623
Exploration costs		
Opening balance	35,372,935	24,860,578
Additions		
Compilation and analysis	2,077,801	1,459,054
Core saw building improvements	111,842	-
Drilling	11,825,252	6,317,843
Equipment rental	108,416	73,283
Field technicians and expenses	1,635,085	779,877
Geologists and consultants	976,055	1,060,277
Geologic metallurgy framework study	57,595	-
Mine waste and geotechnical studies	106,308	-
Preliminary economic assessment	12,460	-
Preliminary geotechnical studies	843,886	168,799
Site office preparation	49,728	68,276
Socio-environmental baseline studies	1,026,517	460,603
Travel and subsistence	200,160	124,345
	19,031,105	10,512,357
Total exploration costs	54,404,040	35,372,935
Total costs – Rainy River Property	\$ 70,027,892	\$ 47,609,558

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

6. MINERAL PROPERTIES (Cont'd)

b) Mud Creek Property, Minnesota

In September 2006, the Company acquired a 100% interest in certain mineral leases in St. Louis County in northern Minnesota, U.S.A. referred to as the Mud Creek Property. Based on mineral tenure provisions in Minnesota, subject to performance and payment of rental, these mineral leases expire in September 2055.

The details of the costs incurred on the Company's Mud Creek Property are as follows:

	Year ended September 30 2010	Year ended September 30 2009
Acquisition costs		
Opening balance	\$ 17,685	\$ 17,685
Additions	-	-
Total acquisition costs	17,685	17,685
Exploration costs		
Opening balance	106,912	90,553
Additions		
Geological consulting	440	1,006
Electromagnetic geotechnical survey	80,356	-
Lease maintenance costs	9,695	15,353
	90,491	16,359
Total exploration costs	197,403	106,912
Total costs – Mud Creek Property	\$ 215,088	\$ 124,597

c) TPK Property, Ontario

Effective September 9, 2010, the Company entered into an agreement whereby Northern Superior granted the Company an option to earn a 51% interest in the eastern half of Northern Superior's 100% owned Ti-pa-haa-kaaning/Big Dam property in northwestern Ontario (the "TPK Property"). To earn its 51% interest, the Company must fund a total of \$9,400,000 in exploration expenses over a three year period, make cash payments of \$300,000 (paid) upon receipt of regulatory approval and a further \$1,300,000 in January 2011, and complete three equal annual private placements of common shares of Northern Superior of \$500,000 each for a total investment of \$1,500,000 (2,500,000 common shares in Northern Superior acquired for \$500,000 - see Note 4). The Company may terminate the option agreement after completing its year one obligations of incurring exploration expenditures of \$1,400,000 and making the cash payments totaling \$1,600,000.

The details of the costs incurred on the Company's TPK Property are as follows:

	Year ended September 30 2010	Year ended September 30 2009
Acquisition costs		
Opening balance	\$ -	\$ -
Additions		
Property option payments	300,000	-
Total acquisition costs	300,000	-
Exploration costs		
Opening balance	-	-
Additions	-	-
Total exploration costs	-	-
Total costs – TPK Property	\$ 300,000	\$ -

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended September 30, 2010

7. SHARE CAPITAL

(a) Share capital and contributed surplus

Authorized

Unlimited common shares without par value

	Number of shares	Share Capital \$	Contributed Surplus \$	Obligation to issue shares \$
Issued				
As at September 30, 2008	57,119,390	68,877,418	4,747,364	-
Stock-based compensation	-	-	2,626,122	-
Property option agreements	322,500	561,100	-	-
Royalty and bonus purchase (Note 6(a))	200,000	130,000	-	-
NSR purchase (Note 6(a))	600,000	1,710,000	-	-
Treasury shares repurchased and cancelled	(1,080,000)	(1,122,529)	-	-
Premium paid on treasury shares repurchased and cancelled	-	198,801	(198,801)	-
As at September 30, 2009	57,161,890	70,354,790	7,174,685	-
Stock-based compensation	-	-	5,378,677	214,800
Stock options exercised	1,191,959	1,635,413	-	-
Fair value allocation on exercise of options	-	1,606,782	(1,606,782)	-
Fair value allocation on obligation shares issued	50,000	100,500	-	(100,500)
Warrants exercised	25,000	177,500	-	-
Property option agreements	302,000	1,423,780	-	-
Private placements	16,488,500	83,302,390	-	-
Share issue costs	-	(5,486,573)	-	-
Tax benefits of the renunciation of flow-through expenditures to shareholders	-	(2,062,000)	-	-
As at September 30, 2010	75,219,349	151,052,582	10,946,580	114,300

Private placements

On September 8, 2010, the Company closed a flow-through private placement raising gross proceeds of \$20,041,000 through the issuance of 2,450,000 flow-through common shares at a price of \$8.18 per common share. The agents were paid a total of \$1,202,460 as financing fees. At September 30, 2010, the Company has incurred \$1,680,000 of the flow-through expenditures agreed to be incurred by December 31, 2011.

On February 25, 2010, the Company closed a brokered private placement raising gross proceeds of \$55,014,300 through the issuance of 11,114,000 units at a price of \$4.95 per unit on a bought deal basis. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at a price of \$7.10 per common share until February 26, 2012. The Company paid a finance fee of \$3,300,858 in connection with the private placement.

On November 2, 2009, the Company closed a brokered private placement raising gross proceeds of \$8,247,090 through the issuance of 2,924,500 flow-through common shares at a price of \$2.82 per common share. The agents were paid a total of \$494,825 as financing fees.

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7. SHARE CAPITAL (Cont'd)

(b) Stock options and warrants

The Company has a shareholder-approved, rolling stock option plan, whereby from time to time, at the discretion of the Board of Directors, stock options may be granted to directors, officers, employees and consultants. The number of shares reserved for issuance under the plan shall not exceed 10% of the issued and outstanding common shares of the Company. The exercise price of each option is based on the market price of the Company's common stock at the date of the grant less an applicable discount. The options may be granted for a maximum of five years and vesting is determined by the Board of Directors.

Stock options and share purchase warrant transactions are summarized as follows:

	<u>Stock options</u>		<u>Warrants</u>	
	Number of options	Weighted Average Exercise Price \$	Number of warrants	Exercise Price \$
Outstanding, September 30, 2008	2,780,000	3.40	3,317,475	5.94
Granted/issued	3,400,000	1.66	-	-
Exercised	-	-	-	-
Expired/cancelled	(1,605,000)	3.75	(3,317,475)	5.94
Outstanding, September 30, 2009	4,575,000	1.61	-	-
Granted/issued	1,980,000	5.36	5,557,000	7.10
Exercised	(1,191,959)	1.37	(25,000)	7.10
Expired/cancelled	(143,334)	3.50	-	-
Outstanding, September 30, 2010	5,219,707	3.04	5,532,000	7.10
Exercisable, September 30, 2010	2,750,541	2.56	5,532,000	7.10

The following stock options and warrants were outstanding at September 30, 2010:

	Number of shares	Exercise Price \$	Expiry Date
Stock options	100,000	4.50	June 6, 2013 (1/3 not vested)
	50,000	2.00	June 6, 2013
	3,500	2.00	August 6, 2013 (3,333 not vested)
	866,667	0.83	November 11, 2013 (333,333 not vested)
	195,136	2.00	February 9, 2014 (78,333 not vested)
	1,680,235	2.00	February 9, 2014 (606,666 not vested)
	500,000	2.01	June 22, 2014 (1/3 not vested)
	250,000	2.98	December 11, 2014 (2/3 not vested)
	724,169	5.00	February 16, 2015 (504,167 not vested)
	150,000	6.09	April 7, 2015 (2/3 not vested)
	300,000	6.18	May 18, 2015 (2/3 not vested)
	400,000	6.75	June 17, 2015 (2/3 not vested)
	5,219,707		
Warrants	5,532,000	7.10	February 26, 2012
	5,532,000		

Vesting of options may be accelerated under certain conditions.

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7. SHARE CAPITAL (Cont'd)

(c) Stock-based compensation

During the year ended September 30, 2010, the Company granted 1,980,000 (2009 – 3,400,000) stock options with a total estimated fair value of \$6,548,869 (2009 - \$3,836,151) and re-priced nil (2009 – 575,000) stock options that the Company estimated had a fair value of \$nil (2009 - \$696,732). The fair value per option granted was \$3.31 (2009 - \$1.13) and per re-priced option was \$nil (2009 - \$1.21). The vesting periods ranged from date of grant to a period of two years. For the year ended September 30, 2010, the Company recorded a total of \$5,378,677 (2009 - \$2,626,122) as stock-based compensation expense from option grants and \$214,800 (2009 – \$ nil) related to its commitments to issue shares (Note 7d).

The fair value of stock options granted and re-priced is estimated on the grant/re-price date using the Black-Scholes option-pricing model. The weighted average assumptions used in the calculation of fair value are as follows:

	Year ended September 30, 2010	Year ended September 30, 2009
Risk free interest rate	1.94%	2.16%
Expected life	5 years	5 years
Expected stock volatility	80%	90%
Expected dividend yield	Nil	Nil

(d) Commitments to issue shares

In June 2009, the Company agreed to issue 50,000 common shares (valued at \$100,500) as a signing bonus to the Company's new President and Chief Executive Officer on June 22, 2010, being the first anniversary of the date of the appointment, provided the President and Chief Executive Officer continues to be employed by the Company at that time. The value has been recorded as stock-based compensation expense with obligation to issue shares being credited. The shares were issued in fiscal 2010 and the amount initially credited to obligation to issue shares was transferred to share capital.

In May 2010, the Company agreed to issue 50,000 common shares (valued at \$309,000) as a signing bonus to the Company's new Vice President and Chief Financial Officer on May 18, 2011, being the first anniversary of the date of the appointment, provided the Vice President and Chief Financial Officer continues to be employed by the Company at that time. The value is being amortized over the period to issuance and to September 30, 2010, \$114,300 has been charged to stock-based compensation expense with obligation to issue shares being credited.

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8. RELATED PARTY TRANSACTIONS

During the year ended September 30, 2010, the Company entered into transactions with related parties as follows:

- (a) paid or accrued consulting fees of \$90,000 (2009 - \$120,000) to a company controlled by the former Vice-Chair of the Board of Directors who was formerly the Company's President and Chief Executive Officer;
- (b) paid or accrued consulting fees of \$60,000 (2009 - \$60,000) to a company controlled by the Company's former Chief Financial Officer to July 4, 2010, who is now the Company's Assistant Controller;
- (c) paid or accrued consulting and other fees, included in exploration costs, of \$163,684 (2009 - \$38,703) and consulting fees of \$120,000 (2009 - \$80,000) to a company controlled by the Company's former Vice President Exploration, who is also a director;
- (d) paid or accrued consulting fees of \$120,000 (2009 - \$80,000) to a company controlled by the Vice President Administration, who is also a director; and
- (e) paid or accrued directors fees of \$78,500 (2009 - \$nil) to independent directors of the Company.

As at September 30, 2010, accounts payable and accrued liabilities includes \$67,321 due to related parties (2009 - \$18,985).

These transactions were in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

9. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

The Company did not pay cash for interest expense or income taxes for any of the years presented.

At September 30, 2010, cash and cash equivalents consists of:

	<u>2010</u>	<u>2009</u>
Cash	\$ 5,623,194	\$ 299,234
Guaranteed investment certificates	<u>66,246,816</u>	<u>7,263,357</u>
	<u>\$ 71,870,010</u>	<u>\$ 7,562,591</u>

For the year ended September 30, 2010, the Company's significant non-cash financing and investing transactions consisted of:

- a) The accrual in mineral properties of deferred exploration costs incurred of \$1,531,588 as at September 30, 2010;
- b) The accrual in share issue costs of share issue costs incurred of \$39,930 as at September 30, 2010;
- c) The issuance of common shares valued at \$1,423,780 related to mineral property option agreements;
- d) The recognition of a fair value component of \$1,606,782 in respect of options exercised;
- e) The recognition of \$100,500 in respect of the issue of 50,000 obligation shares; and
- f) The recording of a decrease to share capital of \$2,062,000 on the renunciation of flow-through expenditures to shareholders, and a corresponding increase to future income tax liability.

For the year ended September 30, 2009, the Company's significant non-cash financing and investing transactions consisted of:

- a) The accrual in mineral properties of deferred exploration costs incurred of \$1,321,566 as at September 30, 2009;
- b) The issuance of common shares valued at \$561,100 related to mineral property option agreements;
- c) The issuance of common shares valued at \$130,000 related to the purchase of royalty and bonus rights;
- d) The issuance of common shares valued at \$1,710,000 related to the purchase of NSR rights; and
- e) The allocation of a share repurchase premium of \$198,801 from share capital to contributed surplus on cancellation of treasury shares repurchased.

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10. INCOME TAXES

A reconciliation of income tax expense (recovery) for the years ended September 30, 2010 and 2009 at statutory rates with reported taxes follows:

	Years ended	
	September 30, 2010	September 30, 2009
Loss before income taxes	\$ (8,980,181)	\$ (3,775,854)
Expected income tax recovery	\$ (2,593,000)	\$ (1,137,476)
Non deductible expenses	1,687,000	854,712
Non-capital losses and financing costs	(1,291,750)	61,764
Income tax recovery	\$ (2,197,750)	\$ (221,000)
Represented by:		
Income tax recovery	-	-
Future income tax recovery	\$ (2,197,750)	\$ (221,000)

The tax effects of temporary differences that give rise to significant components of future income tax assets and liabilities as at September 30, 2010 and 2009 are as follows:

	September 30, 2010	September 30, 2009
Future income tax assets:		
Financing costs	\$ 1,217,000	\$ 284,000
Investment tax credit	2,408,000	1,411,000
Non-capital losses carried forward	2,291,000	1,134,000
Net capital losses carried forward	562,000	563,000
Equipment	94,000	54,000
	6,572,000	3,446,000
Valuation allowance	(2,902,000)	(1,964,000)
Net future income tax assets	3,670,000	1,482,000
Future income tax liabilities:		
Marketable securities	-	(10,000)
Investments	(69,000)	-
Mineral properties	(4,579,000)	(2,517,000)
	(4,648,000)	(2,527,000)
Net future income tax liabilities	\$ (978,000)	\$ (1,045,000)

Subject to certain restrictions, at September 30, 2010, the Company has operating losses of approximately \$9,164,000 available to reduce taxable income of future years. Unless utilized, these losses will expire through 2030. In addition, the Company has exploration and development expenditures of approximately \$50,547,000 available to reduce taxable income of future years. The Company also has net capital loss carry forwards of approximately \$4,499,000.

During fiscal 2010, the Company renounced certain deductions for Canadian exploration expenditures incurred and to be incurred on the Company's resource properties in connection with the flow-through shares issued in November 2009, and agreed to renounce certain deductions for Canadian exploration expenditures incurred and to be incurred on the Company's resource properties in connection with the flow-through shares issued in September 2010, resulting in an increase in future income tax liability of \$1,007,000, a future income tax recovery of \$1,055,000, and a charge against share capital of \$2,062,000. At September 30, 2010, the Company has incurred \$1,680,000 of the \$20,041,000 flow-through expenditures agreed to be incurred by December 31, 2011.

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11. COMMITMENTS

The Company is party to certain contracts relating to operating leases for equipment and for office space. Future minimum payments under these agreements as at September 30, 2010 are as follows:

2011	\$ 231,617
2012	205,276
2013	149,593
2014	151,856
2015	<u>99,908</u>
Total	<u>\$ 838,250</u>

12. SEGMENTED INFORMATION

The Company operates in one segment being the acquisition and exploration of mineral properties. All of the Company's assets are located in Canada, except for certain mineral property interests disclosed in Note 6.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair values.

The carrying value of cash and cash equivalents is determined using level one of the fair value hierarchy.

The carrying value of short-term deposits, receivables, accounts payable and accrued liabilities approximate their fair value because of the short-term nature of these instruments. Marketable securities and investments are adjusted to quoted market value at each reporting period.

The carrying value of investments is determined using level one of the fair value hierarchy.

Financial risk factors

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

Credit risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash and cash equivalents, marketable securities and investments. Management believes that the credit risk concentration with respect to cash and cash equivalents, marketable securities and investments is remote. Receivables are due primarily from a government agency.

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when they come due. As at September 30, 2010, the Company had a cash and cash equivalents balance of \$71,870,010 to settle current liabilities of \$1,922,205. All of the Company's financial liabilities are subject to normal trade terms.

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13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Cont'd)

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices. These fluctuations may be significant.

(a) Interest rate risk

At September 30, 2010, the Company has cash and cash equivalents balances of \$71,870,010 and no debt. The Company's current policy is to invest excess cash and cash equivalents in investment-grade short-term deposit certificates issued by its banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. A 1% change in interest rates would have an effect of approximately \$718,700 on interest income for the fiscal year.

(b) Foreign currency risk

The Company is exposed to foreign currency risk on fluctuations related to cash and cash equivalents, receivables and accounts payable and accrued liabilities that are denominated in United States Dollars. However, management believes the risk is not currently significant as less than 0.1% of the Company's assets and none of its liabilities as at September 30, 2010 are denominated in United States Dollars.

(c) Price risk

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company closely monitors commodity prices of gold and other precious and base metals, individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company. Fluctuations in pricing may be significant.

14. CAPITAL MANAGEMENT

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. The Company defines capital that it manages as share capital, cash and cash equivalents and short-term deposits.

The properties in which the Company currently has an interest are in the exploration stage; as such the Company has historically relied on the equity markets to fund its activities. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. The Company is not subject to externally imposed capital restrictions.

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15. SUBSEQUENT EVENTS

Subsequent to September 30, 2010, the Company:

- a) issued 303,667 common shares on exercise of stock options for proceeds of \$619,334;
- b) issued 100,000 common shares and paid \$200,000 towards existing mineral property option agreements;
- c) issued 589,550 common shares on exercise of warrants for proceed of \$4,185,805;
- d) granted 500,000 stock options to acquire common shares exercisable at \$9.15 per option to October 28, 2015; and
- e) announced the proposed issuance on a bought-deal basis by way of a private placement, of 5,140,000 common shares of the Company at a price of \$12.65 per share, for gross proceeds of approximately \$65 million. In addition, granted an option to the underwriters to increase the size of the offering by up to an additional 790,000 common shares of the Company, for additional gross proceeds of up to \$10 million. This proposed transaction is subject to approval by the TSX Venture Exchange.