

RAINY RIVER RESOURCES LTD.
CONSOLIDATED FINANCIAL STATEMENTS
(Stated in Canadian Dollars)
FOR THE YEAR ENDED
SEPTEMBER 30, 2008

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, 2008 and 2007 and the consolidated statements of loss, comprehensive loss and deficit 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, 2008 and 2007 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 9, 2008



RAINY RIVER RESOURCES LTD.

CONSOLIDATED BALANCE SHEETS

AS AT SEPTEMBER 30

ASSETS

	2008	2007
CURRENT		
Cash and cash equivalents	\$21,687,369	\$39,320,052
Short-term investments (Note 4)	10,236,996	-
Marketable securities (Note 5)	297,180	411,540
Loan receivable from a related party (Note 9)	-	125,000
Receivables	160,636	418,984
Prepaid expenses	82,342	84,414
	<u>32,464,523</u>	<u>40,359,990</u>
NON-CURRENT		
Equipment (Note 6)	188,886	132,411
Mineral properties (Note 7)	33,056,999	18,893,247
	<u>\$65,710,408</u>	<u>\$59,385,648</u>

LIABILITIES

CURRENT		
Accounts payable and accrued liabilities	\$1,307,831	\$568,797
NON-CURRENT		
Future income taxes (Note 14)	1,266,000	-
	<u>2,573,831</u>	<u>568,797</u>

SHAREHOLDERS' EQUITY

Share capital (Note 8)	68,877,418	61,772,099
Contributed surplus (Note 8)	4,747,364	6,496,451
Deficit	(10,488,205)	(9,451,699)
	<u>63,136,577</u>	<u>58,816,851</u>
	<u>\$65,710,408</u>	<u>\$59,385,648</u>

Basis of presentation (Note 1)

Subsequent events (Note 15)

APPROVED BY THE DIRECTORS:

“Dale C. Peniuk”

“Nelson Baker”

Dale C. Peniuk, Director

Nelson Baker, Director

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

RAINY RIVER RESOURCES LTD.

CONSOLIDATED STATEMENTS OF LOSS, COMPREHENSIVE LOSS AND DEFICIT

FOR THE YEAR ENDED SEPTEMBER 30

	2008	2007
EXPENSES		
Amortization	\$ 67,344	\$ 45,960
Audit and legal	172,957	171,159
Office and miscellaneous	211,538	150,732
Consulting	207,146	368,650
Promotion and investor relations	211,045	175,689
Regulatory and filing fees	105,796	89,197
Rent	56,198	61,090
Salaries and benefits	207,630	203,910
Stock-based compensation (Note 8c)	1,278,598	2,746,544
Travel	169,892	183,220
	(2,688,144)	(4,196,151)
LOSS BEFORE OTHER ITEMS AND INCOME TAXES		
OTHER ITEMS		
Interest income	1,410,998	593,509
Gain on sale of marketable securities (Note 5)	-	13,647
Unrealized gain (loss) on marketable securities (Note 5)	(114,360)	220,840
	1,296,638	827,996
LOSS BEFORE INCOME TAXES	(1,391,506)	(3,368,155)
Future income tax recovery (Note 14)	355,000	1,524,000
	(1,036,506)	(1,844,155)
NET LOSS AND COMPREHENSIVE LOSS FOR THE YEAR		
DEFICIT, BEGINNING OF THE YEAR	(9,451,699)	(7,714,539)
Fair value adjustment for financial instruments (Note 2)	-	106,995
DEFICIT, END OF THE YEAR	(\$10,488,205)	(\$9,451,699)
BASIC AND DILUTED LOSS PER SHARE	\$ (0.02)	\$ (0.04)
Weighted average number of common shares outstanding	56,383,329	47,252,232

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

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the year	\$ (1,036,506)	\$ (1,844,155)
Items not involving cash:		
Amortization	67,344	45,960
Gain on sale of marketable securities	-	(13,647)
Unrealized loss (gain) on marketable securities	114,360	(220,840)
Interest accrual on short-term investments	(236,996)	-
Stock-based compensation	1,278,598	2,746,544
Future income tax recovery	(355,000)	(1,524,000)
Changes in non-cash working capital items:		
Accounts payable and accrued liabilities	9,993	(5,465)
Receivables	258,348	(303,946)
Prepaid expenses	2,072	(65,169)
	<u>102,213</u>	<u>(1,184,718)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds on issue of capital stock	5,456,430	39,971,574
Share issue costs	-	(2,398,082)
Shares purchased under issuer bid	(1,146,346)	-
Repayment of long-term debt	-	(250,000)
	<u>4,310,084</u>	<u>37,323,492</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Mineral properties, net of changes in accounts payable and accrued liabilities	(12,046,161)	(7,303,602)
Purchase of equipment	(123,819)	(99,012)
Purchase of short-term investments	(10,000,000)	-
Proceeds on sale of marketable securities	-	22,971
Proceeds on disposal of investments	-	444,219
Loan receivable from related party	125,000	-
	<u>(22,044,980)</u>	<u>(6,935,424)</u>
CHANGE IN CASH AND CASH EQUIVALENTS DURING THE YEAR	(17,632,683)	29,203,350
Cash and cash equivalents - beginning of year	<u>39,320,052</u>	<u>10,116,702</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 21,687,369</u>	<u>\$ 39,320,052</u>

Supplemental disclosure with respect to cash flows (Note 10)

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

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

1. NATURE 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.

2. SIGNIFICANT ACCOUNTING POLICIES

Generally accepted accounting principles

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. 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 subsidiary, 608457 B.C. Ltd. All inter-company transactions and balances have been eliminated upon consolidation. The Company has determined that it has no variable interest entities as at either September 30, 2008 and 2007.

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 and the assessment of possible impairment of its mineral properties. Actual results may differ from those estimates.

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 an insignificant risk of changes in value.

Short-term investments

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

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

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 statement 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 the 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 plant 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, 2008 and 2007, the Company has no asset retirement obligations.

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 to 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.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

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 were not recognized in previous years, due to the recording of a valuation allowance, are 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.

Financial instruments

Effective October 1, 2006, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) under CICA Handbook Section 1530, *Comprehensive Income*, Section 3251, *Equity*, Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3861, *Financial Instruments – Disclosure and Presentation* and Section 3865, *Hedges*. These new or revised Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide requirements for the recognition and measurement of financial instruments and on the use of hedge accounting. Section 1530 establishes standards for reporting and presenting comprehensive income which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

Under Section 3855, all 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 and derivatives 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.

As a result of the adoption of these new standards, the Company has classified its cash and cash equivalents and marketable securities as held-for-trading; short-term investments are classified as held-to-maturity; receivables are classified as loans and receivables; and accounts payable and accrued liabilities are classified as other liabilities.

As a result of the application of Section 3855, the Company's deficit position as at October 1, 2006 was reduced by \$106,995 to reflect the fair value increase of marketable securities as at September 30, 2006.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Changes in Accounting Policies

Accounting Changes

CICA Handbook Section 1506: "Accounting Changes" ("Section 1506"), which is effective for fiscal years beginning on or after January 1, 2007, establishes standards and new disclosure requirements for the reporting of changes in accounting policies and estimates and the reporting of error corrections. Section 1506 clarifies that a change in accounting policy can be made only if it is a requirement under Canadian GAAP or if it provides reliable and more relevant financial statement information. Voluntary changes in accounting policies require retrospective application of prior period financial statements, unless the retrospective effects of the changes are impracticable to determine, in which case the retrospective application may be limited to the assets and liabilities of the earliest period practicable, with a corresponding adjustment made to opening retained earnings.

Financial Instruments

The Accounting Standards Board of the CICA (the "AcSB") issued CICA Handbook Section 3862, *Financial Instruments – Disclosures*, which requires entities to provide disclosures in their financial statements that enable 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 period and at the balance sheet date, and how the entity manages those risks. The principles in this section complement the principles for recognizing, measuring and presenting financial assets and financial liabilities in Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3863, *Financial Instruments – Presentation*, and Section 3865, *Hedges* (see Note 12).

AcSB issued CICA Handbook Section 3863, *Financial Instruments – Presentation*, which is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. This section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, 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 (see Note 12).

Capital Management

AcSB issued CICA Handbook Section 1535, which establishes standards for disclosing information about an entity's capital and how it is managed (see Note 13).

The Company adopted the above new accounting pronouncements for its fiscal year beginning October 1, 2007. The adoption of these new pronouncements did not effect the Company's financial position or results of operations.

3. NEW ACCOUNTING PRONOUNCEMENTS

Assessing Going Concern

AcSB amended CICA Handbook Section 1400 "General Standards on Financial Statement Presentation", to include requirements for management to assess and disclose an entity's ability to continue as a going concern. This section applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company is currently assessing the impact of this new accounting pronouncement on its financial statements.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

3. NEW ACCOUNTING PRONOUNCEMENTS (Cont'd)

International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is 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 ended September 30, 2011. The impact of the transition to IFRS on the Company's consolidated financial statements has not yet been determined.

4. SHORT-TERM INVESTMENTS

At September 30, 2008, short-term investments consist of \$10,000,000 in guaranteed investment certificates plus accrued interest of \$236,996 with an average interest yield of 3.76%, purchased on February 11, 2008 and maturing on February 12, 2009.

5. MARKETABLE SECURITIES

As at September 30, 2008 and September 30, 2007, marketable securities are stated at quoted market value and consist of shares in a publicly traded company with an original cost of \$83,705. During the year ended September 30, 2007, shares in publicly traded companies that had a cost of \$9,324 were sold for proceeds of \$22,971.

6. EQUIPMENT

	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
September 30, 2008			
Computer equipment	161,026	72,297	88,729
Office furniture and equipment	56,596	27,726	28,870
Field equipment	135,164	63,877	71,287
	352,786	163,900	188,886
September 30, 2007			
Computer equipment	102,216	42,723	59,493
Office furniture and equipment	49,188	20,508	28,680
Field equipment	77,563	33,325	44,238
	228,967	96,556	132,411

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

7. MINERAL PROPERTIES

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 are in good standing.

a) Rainy River Property, Ontario

In June 2005, the Company completed the acquisition of a 100-percent interest in the Rainy River property, located in Northwestern Ontario. To acquire its interest, the Company assumed a mortgage from the vendor of \$1,750,000 and issued 2,197,380 common shares together with 6,400,000 units consisting of one common share and one share purchase warrant exercisable at \$0.50 for one year (issued at a value of \$1,691,291, inclusive of other assets of \$215,612). Additionally, the Company granted 1,500,000 stock options valued at \$320,562 in connection with the mineral property acquisition and issued 727,532 common shares valued at \$89,359 as a finder's fee.

The Company is obligated to pay a bonus of \$2,500,000 on commencement of commercial production from the property and a quarterly royalty of \$1 per ton of ore produced from the property, subject to an annual consumer price index adjustment (also see Note 15(e)). The property has a 3% net smelter returns royalty ("NSR") on production, 1% of which can be purchased for \$125,000. A portion of the property is also subject to a 10% net profits interest.

The mortgage was secured by a general security interest over the Company's interest in the property and all other related assets, was non-interest bearing and has been repaid in full.

The Company has entered into several additional property option agreements in the Rainy River District of northwestern Ontario which, together with the aforementioned property, make up the entire Rainy River Property. A summary of the details of these option agreements are as follows:

(i) Wepruck and Off Lake Properties

By two separate agreements dated June 2005, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Richardson and Senn Townships, by making total cash payments of \$165,000 (\$110,000 paid) and issuing a total of 100,000 common shares (80,000 issued at a value of \$261,900) over a four year period.

(ii) Shwedack Property

By an agreement dated June 2005, the Company has an option to earn a 100% interest, subject to a 3% NSR, in certain patented mineral rights in Richardson Township, by making total cash payments of \$100,000 (\$80,000 paid) and issuing a total of 50,000 common shares (40,000 issued at a value of \$120,200) over a four year period. Upon expiry of the option period, on the fifth anniversary date of the agreement, the Company is required to make annual advance royalty payments of \$30,000 for a three year period, totalling \$90,000.

(iii) Roen Property

By an separate agreement dated August 2005, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Richardson Township, by making total cash payments of \$75,000 (\$52,000 paid) and issuing a total of 37,000 common shares (29,500 issued at a value of \$82,235) over a four year period.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

7. MINERAL PROPERTIES (Cont'd)

- (iv) Teeple Property
By an agreement dated August 2006, subsequently amended, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Tait Township, by making total cash payments of \$300,000 (\$70,000 paid) and issuing a total of 150,000 common shares (50,000 issued at a value of \$180,400) over a four year period.
- (v) Cunningham Property
By an agreement dated March 2007, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Senn Township, by making total cash payments of \$45,000 (\$15,000 paid) and issuing a total of 12,500 common shares (5,000 issued at a value of \$23,500) over a four year period.
- (vi) Teeple 2, Davis and Gibb Properties
By three separate agreements dated April 2007, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Richardson Township, by making total cash payments of \$500,000 (\$150,000 paid) and issuing a total of 250,000 common shares (100,000 issued at a value of \$450,900) over a four year period.
- (vii) JSD, Eliuk, Neilson, Herbert and LeBlanc Properties
By five separate agreements dated August 2007, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Sifton and Richardson Townships, by making total cash payments of \$1,000,000 (\$300,000 paid) and issuing a total of 500,000 common shares (200,000 issued at a value of \$640,000) over a four year period. The Company terminated the Herbert option in September 2008.
- (viii) Moose Creek Property
By an agreement dated September 2007, the Company had an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Richardson Township, by making cash payments of \$100,000 (\$10,000 paid) and issuing 50,000 common shares (10,000 issued at a value of \$42,400) over a four year period. The Company terminated its option in September 2008.
- (ix) N. & M. Gerula, N. & M. Gerula 2, B. Gerula, and Teeple 3 Properties
By four separate agreements dated October 2007, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Sifton and Richardson Townships, by making cash payments of \$610,000 (\$70,000 paid) and issuing 305,000 common shares (65,000 issued at a value of \$275,600) over a four year period.
- (x) Fauconnier Property
By an agreement dated November 2007, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Potts Township, by making cash payments of \$100,000 (\$10,000 paid) and issuing 50,000 common shares (10,000 issued at a value of \$42,500) over a four year period.
- (xi) Bayfield Ventures Corp. Property
By an agreement dated November 2007, the Company has an option to earn a 60% interest in certain properties in Richardson Township from Bayfield Ventures Corp, by making cash payments totalling \$200,000 (\$50,000 paid), issuing 60,000 common shares (15,000 issued at a value of \$63,750) and incurring exploration expenditures on the optioned claims totalling \$3,000,000 over a three year period (\$1,000,000, \$1,000,000 and \$1,000,000 respectively) (see Note 15(d)).

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

7. MINERAL PROPERTIES (Cont'd)

(xii) Western Warrior Resources Inc. Property

By an agreement dated December 2007, the Company has an option to earn a 60% interest in certain claim units in Potts, Rainy Lake – Northwest Bay, Senn, Jackfish Lake, Fleming and Menary Townships from Western Warrior Resources Inc. by making cash payments totalling \$225,000 (\$75,000 paid), issuing 60,000 common shares (20,000 issued at a value of \$80,000) and incurring exploration expenditures on the optioned claims totalling \$3,000,000 over a three year period (\$500,000, \$1,200,000 and \$1,300,000 respectively) (see Note 15(d)).

(xiii) Burkeland / Hann Property

By two agreements dated March 2008, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Potts Township, by making cash payments of \$200,000 (\$30,000 paid) and issuing 100,000 common shares (20,000 issued at a value of \$106,000) over a four year period.

(xiv) Katrin / Strand Property

By an agreement dated May 2008, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Sifton Township, by making cash payments of \$50,000 (\$25,000 paid) and issuing 25,000 common shares (12,500 issued at a value of \$45,625) over a one year period.

(xv) Schoenmann / Quandt Property

By an agreement dated June 2008, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Potts Township, by making cash payments of \$200,000 (\$30,000 paid) and issuing 100,000 common shares (20,000 issued at a value of \$62,900) over a four year period.

In June 2008, the Company completed a purchase of additional property in the Rainy River District for \$204,380 and the surface and mineral rights to a land parcel in the Rainy River District for \$524,553.

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

7. MINERAL PROPERTIES (Cont'd)

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

	Year ended September 30 2008	Year ended September 30 2007
Acquisition costs		
Opening balance	\$ 5,122,572	\$ 3,993,067
Additions		
Shares issued	1,388,550	926,600
Property option payments	770,000	190,000
Legal costs	44,246	-
Staking costs	3,580	12,905
Land purchase	759,235	-
	<u>2,965,611</u>	<u>1,129,505</u>
Total acquisition costs	8,088,183	5,122,572
Exploration costs		
Opening balance	13,662,437	6,638,592
Additions		
Compilation and analysis	776,387	512,714
Drilling	7,601,313	5,083,226
Geological and airborne surveys	727,884	-
Metallurgical testing	91,137	-
Equipment rental	138,542	83,639
Geologists and consultants	860,412	786,888
Field technicians and expenses	803,688	460,527
Travel and subsistence	198,778	96,851
	<u>11,198,141</u>	<u>7,023,845</u>
Total exploration costs	24,860,578	13,662,437
Total costs – Rainy River Property	\$ 32,948,761	\$ 18,785,009

b) Mud Creek Property

During the year ended in September 30, 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, the mineral leases expire December 31, 2015.

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

	Year ended September 30 2008	Year ended September 30 2007
Acquisition costs		
Opening balance	\$ 17,685	\$ 17,685
Additions	-	-
Total acquisition costs	17,685	17,685
Exploration costs		
Opening balance	90,553	66,137
Additions		
Field technicians and expenses	-	127
Geologists and consultants	-	24,289
	-	24,416
Total exploration costs	90,553	90,553
Total costs – Mud Creek Property	\$ 108,238	\$ 108,238
Total all properties	\$ 33,056,999	\$ 18,893,247

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8. SHARE CAPITAL

(a) Share capital and contributed surplus

Authorized

Unlimited Common shares without par value

	Number of shares	Capital Stock \$	Contributed Surplus \$
Issued			
As at September 30, 2006	43,261,828	24,703,421	3,842,493
Stock-based compensation	-	-	2,746,544
Private placements	6,615,000	35,070,000	-
Compensatory warrants issued on private placements	-	-	815,400
Warrants exercised	4,023,610	4,020,914	-
Stock options exercised	639,800	880,660	-
Stock-based compensation on exercise of warrants and options	-	907,986	(907,986)
Property option agreements	200,000	926,600	-
Share issue costs	-	(3,213,482)	-
Tax benefits renounced to flow-through share subscribers	-	(1,524,000)	-
As at September 30, 2007	54,740,238	61,772,099	6,496,451
Stock-based compensation	-	-	1,278,598
Stock options exercised	2,597,200	5,415,025	-
Warrants exercised	17,252	41,405	-
Stock-based compensation on exercise of warrants and options	-	3,027,685	(3,027,685)
Property option agreements	392,500	1,388,550	-
Tax benefits renounced to flow-through share subscribers	-	(1,621,000)	-
Balance before treasury shares	57,747,190	70,023,764	4,747,364
Treasury shares repurchased in fiscal 2008	(627,800)	(1,146,346)	-
As at September 30, 2008	57,119,390	68,877,418	4,747,364

Private placement

On August 2, 2007, the Company closed a brokered private placement raising gross proceeds of \$35,070,000 through the issuance of 5,775,000 units at a price of \$5.20 per unit and 840,000 flow-through common shares at a price of \$6.00 per share. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to subscribe for one additional common share at a price of \$6.00 until February 2, 2009. The agents were paid a total of \$2,314,550 and were issued 429,975 agent warrants valued at \$815,400 as financing fees. Each agent warrant enables the agent to acquire one common share at \$5.50 until February 2, 2009.

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8. SHARE CAPITAL (cont'd)

Normal course issuer bid

In August 2008, the Company filed with the TSX Venture Exchange (the "TSX-V") a notice of intention to make a normal course issuer bid (the "Bid") for certain of its common shares. Pursuant to the Bid, the Company intends to purchase through the facilities of the TSX-V up to 2,000,000 of its outstanding common shares. It is the Company's intention that all shares purchased under the Bid will be cancelled. The Bid commenced on August 29, 2008 and will continue for a one year period.

(b) Stock options and warrants

The Company has a 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:

	Warrants		Stock options	
	Number of warrants	Weighted Average Exercise Price \$	Number of options	Weighted Average Exercise Price \$
Outstanding, September 30, 2006	4,040,862	1.01	3,601,000	1.72
Granted/issued	3,317,475	5.94	1,505,000	3.39
Exercised	(4,023,610)	1.00	(639,800)	1.38
Expired/cancelled	-	-	-	-
Outstanding, September 30, 2007	3,334,727	5.92	4,466,200	2.33
Granted/issued	-	-	970,000	4.77
Exercised	(17,252)	2.40	(2,597,200)	2.08
Expired/cancelled	-	-	(59,000)	2.94
Outstanding, September 30, 2008	3,317,475	5.94	2,780,000	3.40
Exercisable, September 30, 2008	3,317,475	5.94	2,420,000	3.27

The following incentive stock options and warrants were outstanding at September 30, 2008.

	Number of shares	Exercise Price \$	Expiry Date
Stock options	535,000	2.12	October 27, 2008 (expired unexercised)
	100,000	4.12	February 1, 2009
	50,000	4.25	March 19, 2009
	525,000	4.70	April 19, 2009
	70,000	4.85	June 1, 2009
	30,000	4.22	September 11, 2009
	510,000	5.25	October 31, 2009
	500,000	0.28	March 17, 2010
	100,000	4.12	April 10, 2013
	150,000	4.50	June 6, 2013 (not vested)
	210,000	4.12	August 7, 2013 (not vested)
	2,780,000	3.40	

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8. SHARE CAPITAL (cont'd)

Warrants	2,887,500	6.00	February 2, 2009
	429,975	5.50	February 2, 2009
	<u>3,317,475</u>	<u>5.94</u>	

(c) Stock-based compensation

During the year ended September 30, 2008, the Company granted 970,000 (2007 – 1,475,000) stock options with a total estimated fair value of \$2,005,023 (2007 - \$2,646,727). The fair value per option was \$2.07 (2007 - \$1.79). Vesting periods ranged from date of grant to a period of three years. For the year ended September 30, 2008, the Company recorded \$1,278,598 (2007 - \$2,746,544) as stock-based compensation expense.

The fair value of stock options and compensatory warrants granted is estimated on the grant or issue 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, 2008	Year ended September 30, 2007
Risk free interest rate	3.68%	4.12%
Expected life	3.4 years	2 years
Expected stock volatility	86%	89%
Expected dividend yield	Nil	Nil

9. RELATED PARTY TRANSACTIONS

During the year ended September 30, 2008, the Company entered into transactions with related parties as follows:

- (a) paid or accrued consulting fees of \$120,000 (2007 - \$122,000) to a company controlled by the Chief Executive Officer and President;
- (b) paid or accrued consulting fees of \$Nil (2007 - \$160,651) to a company controlled by the former Chairman and Chief Executive Officer;
- (c) paid or accrued consulting fees of \$60,000 (2007 - \$40,000) to a company controlled by the Chief Financial Officer;
- (d) paid or accrued consulting fees of \$Nil (2007 - \$15,000) to the former Chief Financial Officer or a company controlled by the former Chief Financial Officer;
- (e) paid or accrued consulting fees, included in exploration costs, of \$260,728 (2007 – \$104,763) to a company controlled by a director;
- (f) accrued interest income of \$625 (2007 - \$3,750) on a loan from the President; and
- (g) paid or accrued legal fees of \$Nil (2007 - \$10,000) to a company controlled by a director.

On November 24, 2005, the Company entered into a loan agreement, subsequently amended, with the President under which the Company agreed to loan the President \$125,000. The loan was repaid in November 2007, along with accrued interest totalling \$7,500.

As at September 30, 2008, accounts payable and accrued liabilities includes \$25,376 due to related parties for the above fees (2007 - \$1,140).

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.

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10. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Cash and cash equivalents consist of:	September 30,	September 30,
	<u>2008</u>	<u>2007</u>
Cash on deposit with banks	\$ 21,687,369	\$ 16,520,052
Guaranteed investment certificates	-	22,800,000
	<u>\$ 21,687,369</u>	<u>\$ 39,320,052</u>

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

For the year ended September 30, 2008, the Company's significant non-cash financing and investing transactions consisted of:

- a) The accrual in mineral properties of deferred exploration costs incurred of \$1,192,646 as at September 30, 2008.
- b) The issuance of common shares valued at \$1,388,550 related to mineral property option agreements.
- c) The recognition of a fair value component of \$3,027,685 in respect of options and warrants exercised.
- d) The recording of a \$1,621,000 decrease to share capital, an increase to future income tax recovery of \$355,000 and an increase to future income tax liability of \$1,266,000 from the renunciation of flow-through shares.

For the year ended September 30, 2007, the Company's significant non-cash financing and investing transactions consisted of:

- a) The accrual in mineral properties of deferred exploration costs incurred of \$463,605 as at September 30, 2007.
- e) The recording of a fair value increase to marketable securities of \$106,995 with a corresponding decrease to deficit.
- f) Common shares valued at \$926,600 were issued related to mineral property option agreements.
- g) The recording of a \$1,524,000 decrease in share capital, and an increase to future income tax recovery resulting from the renunciation of flow-through shares.
- h) Compensatory warrants valued at \$815,400 were issued for share issue costs.
- i) The recognition of a fair value component of \$907,986 in respect of options and warrants exercised.

11. 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 7.

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

RAINY RIVER RESOURCES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended September 30, 2008

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

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 equivalents and short-term investments. Management believes that the credit risk concentration with respect to financial instruments included in cash equivalents and short-term 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, 2008, the Company had a cash and cash equivalents balance of \$21,687,369 (2007 - \$39,320,052) to settle current liabilities of \$1,307,831 (2007 - \$568,797). All of the Company's financial liabilities are subject to normal trade terms.

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

The Company has cash balances and no interest-bearing debt. The Company's current policy is to invest excess cash 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. In addition to cash on interest-bearing deposits with banks of \$21,687,369 as of September 30, 2008, the Company has \$10,000,000 in interest-bearing investment-grade short-term investments. A 1% change in interest rates would have an effect of \$316,874 on interest income.

(b) Foreign currency risk

The Company is exposed to foreign currency risk on fluctuations related to cash, 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, 2008 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.

RAINY RIVER RESOURCES LTD.
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13. 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 equivalents and short-term investments.

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.

14. INCOME TAXES

A reconciliation of income tax expense (recovery) for the year ended September 30 at statutory rates with reported taxes follows:

	Sept. 30, 2008	Sept. 30, 2007
Loss before income taxes	\$ (1,391,506)	\$ (3,368,155)
Expected income tax recovery	\$ (443,960)	\$ (1,166,000)
Non deductible expenses	467,957	1,146,000
Non-capital losses and financing costs	(378,997)	(1,504,000)
Income tax expense, (recovery)	\$ (355,000)	\$ (1,524,000)
Represented by:		
Income tax expense (recovery)	-	-
Future income tax expense, (recovery)	\$ (355,000)	\$ (1,524,000)

RAINY RIVER RESOURCES LTD.
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14. INCOME TAXES (Cont'd)

The tax effects of temporary differences that give rise to significant components of future income tax assets and liabilities as at September 30, 2008 and September 30, 2007 are as follows:

	Sept. 30, 2008	Sept. 30, 2007
Future income tax assets:		
Financing costs	\$ 475,000	\$ 761,000
Investment tax credit	796,000	-
Non-capital losses carried forward	842,000	900,000
Net capital losses carried forward	586,000	684,000
Equipment	38,000	15,000
	<hr/> 2,737,000	<hr/> 2,360,000
Valuation allowance	<hr/> (1,354,000)	<hr/> (628,000)
Net future income tax assets	<hr/> 1,383,000	<hr/> 1,732,000
Future income tax liabilities:		
Marketable securities	(28,000)	(50,000)
Mineral properties	(2,621,000)	(1,682,000)
	<hr/> (2,649,000)	<hr/> (1,732,000)
Net future income tax assets (liabilities)	<hr/> \$ (1,266,000)	<hr/> \$ -

Subject to certain restrictions, at September 30, 2008 the Company has operating losses of approximately \$3,240,000 available to reduce taxable income of future years. Unless utilized, these losses will expire through 2028. In addition, the Company has exploration and development expenditures of approximately \$22,988,000 available to reduce taxable income of future years. The Company has net capital loss carry forwards of approximately \$4,505,000.

During the year ended September 30, 2008, the Company renounced \$5,040,000 (2007 - \$4,401,540) of flow-through share expenditures resulting in a future income tax liability and a charge against share capital of \$1,621,000.

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15. SUBSEQUENT EVENTS

Subsequent to September 30, 2008, the Company:

- a) continued to acquire shares under its normal course issuer bid (Note 8). To date the Company has acquired 1,707,800 of its own shares at a cost of \$2,268,986;
- b) granted 1,000,000 stock options with an exercise price of \$0.83 per share to certain directors of the Company expiring November 14, 2013;
- c) issued 110,000 common shares, valued at \$107,200, pursuant to existing mineral property option agreements (Note 7);
- d) terminated the option agreements with Bayfield Ventures Corp. and Western Warrior Resources Inc. (Note 7); and
- e) entered into an agreement with Nuinsco Resources Limited ("Nuinsco") pursuant to which the Company will buy out Nuinsco's right to a product tonnage royalty and a bonus payment due on the Rainy River Property. (Note 7) Under the agreement, the Company will buy out Nuinsco's rights to the Royalty and the Bonus Payment for an aggregate one-time purchase price of \$500,000 cash and 200,000 common shares (issued) in the capital of Rainy River. This agreement is subject to TSX-V acceptance.