

**RAINY RIVER RESOURCES LTD.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**(Stated in Canadian Dollars)**  
**FOR THE YEAR ENDED**  
**SEPTEMBER 30, 2009**

## 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, 2009 and 2008 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, 2009 and 2008 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 7, 2009



**RAINY RIVER RESOURCES LTD.**  
**CONSOLIDATED BALANCE SHEETS**

**AS AT SEPTEMBER 30**

**ASSETS**

	<b>2009</b>	<b>2008</b>
<b>CURRENT</b>		
Cash	\$ 7,562,591	\$ 21,687,369
Short-term investments (Note 3)	10,143,311	10,236,996
Marketable securities (Note 4)	158,400	297,180
Receivables	173,511	160,636
Prepaid expenses	47,563	82,342
	18,085,376	32,464,523
<b>NON-CURRENT</b>		
Equipment (Note 5)	191,806	188,886
Mineral properties (Note 6)	47,734,155	33,056,999
	\$ 66,011,337	\$ 65,710,408

**LIABILITIES**

<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 1,479,921	\$ 1,307,831
<b>NON-CURRENT</b>		
Future income taxes (Note 10)	1,045,000	1,266,000
	2,524,921	2,573,831

**SHAREHOLDERS' EQUITY**

Share capital (Note 7)	70,354,790	68,877,418
Contributed surplus (Note 7)	7,174,685	4,747,364
Deficit	(14,043,059)	(10,488,205)
	63,486,416	63,136,577
	\$ 66,011,337	\$ 65,710,408

**Nature and continuance of operations (Note 1)**  
**Commitment to issue shares (Note 7 (d))**  
**Subsequent events (Note 14)**

**APPROVED BY THE DIRECTORS:**

*“Dale C. Peniuk”*

**Dale C. Peniuk, Director**

*“Raymond W. Threlkeld”*

**Raymond W. Threlkeld, 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**

	<b>2009</b>	<b>2008</b>
<b>EXPENSES</b>		
Amortization	\$ 68,967	\$ 67,344
Audit and legal	163,507	172,957
Consulting	379,000	207,146
Office and miscellaneous	187,734	211,538
Promotion and investor relations	134,936	211,045
Regulatory and filing fees	50,932	105,796
Rent	68,964	56,198
Salaries and benefits	452,970	207,630
Stock-based compensation (Note 7c)	2,626,122	1,278,598
Travel	130,281	169,892
	<b>(4,263,413)</b>	<b>(2,688,144)</b>
<b>LOSS BEFORE OTHER ITEMS AND INCOME TAXES</b>		
<b>OTHER ITEMS</b>		
Interest income	622,822	1,410,998
Loss on sale of marketable securities	(1,307)	-
Unrealized loss on marketable securities	(133,956)	(114,360)
	<b>487,559</b>	<b>1,296,638</b>
<b>LOSS BEFORE INCOME TAXES</b>	<b>(3,775,854)</b>	<b>(1,391,506)</b>
Future income tax recovery (Note 10)	221,000	355,000
	<b>(3,554,854)</b>	<b>(1,036,506)</b>
<b>NET LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>		
<b>DEFICIT, BEGINNING OF THE YEAR</b>	<b>(10,488,205)</b>	<b>(9,451,699)</b>
<b>DEFICIT, END OF THE YEAR</b>	<b>(\$14,043,059)</b>	<b>(\$10,488,205)</b>
<b>BASIC AND DILUTED LOSS PER COMMON SHARE</b>	<b>\$ (0.06)</b>	<b>\$ (0.02)</b>
<b>Weighted average number of common shares outstanding</b>	<b>57,118,182</b>	<b>56,383,329</b>

*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>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss for the year	\$ (3,554,854)	\$ (1,036,506)
Items not involving cash:		
Amortization	68,967	67,344
Loss on sale of marketable securities	1,307	-
Loss on disposal of equipment	1,480	-
Unrealized loss on marketable securities	133,956	114,360
Interest accrual on short-term investments	(281,815)	(236,996)
Stock-based compensation	2,626,122	1,278,598
Future income tax recovery	(221,000)	(355,000)
Changes in non-cash working capital items:		
Accounts payable and accrued liabilities	43,170	9,993
Receivables	(12,875)	258,348
Prepaid expenses	34,779	2,072
	<u>(1,160,763)</u>	<u>102,213</u>
Net cash flows provided by (used in) operating activities		
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds on issue of share capital	-	5,456,430
Shares purchased under issuer bid	(1,122,529)	(1,146,346)
	<u>(1,122,529)</u>	<u>4,310,084</u>
Cash flows provided by (used in) financing activities		
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds on sale of marketable securities	3,517	-
Mineral properties, net of changes in accounts payable and accrued liabilities	(12,147,136)	(12,046,161)
Equipment	(73,367)	(123,819)
Proceeds from redemption of short-term investments	10,375,500	-
Purchase of short-term investments	(10,000,000)	(10,000,000)
Loan receivable from related party	-	125,000
	<u>(11,841,486)</u>	<u>(22,044,980)</u>
Cash flows used in investing activities		
<b>DECREASE IN CASH DURING THE YEAR</b>	<b>(14,124,778)</b>	<b>(17,632,683)</b>
Cash - beginning of year	<u>21,687,369</u>	<u>39,320,052</u>
<b>CASH - END OF YEAR</b>	<b><u>\$ 7,562,591</u></b>	<b><u>\$ 21,687,369</u></b>

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, 2009**

**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**

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, 2009 and 2008.

**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 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.

The Company has classified its cash 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.

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended September 30, 2009**

**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 period 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.

**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.

**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 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, 2009 and 2008, the Company has no asset retirement obligations.

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended September 30, 2009**

**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 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.

**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, 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, 2009**

**2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

**New Accounting Policies Adopted**

**Assessing Going Concern**

Effective October 1, 2008, the Company adopted amended CICA Handbook Section 1400 "General Standards on Financial Statement Presentation", which includes the requirement for management to assess and disclose an entity's ability to continue as a going concern.

**Goodwill and Intangible Assets**

The Canadian Accounting Standards Board ("AcSB") issued CICA Handbook Section 3064 which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. The new standard establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets, including those developed internally. At the same time, the AcSB amended Section 1000, Financial Statement Concepts, to clarify the criteria for recognition of an asset. Therefore items that no longer meet the definition of an asset are no longer recognized with assets. The new standard and amended standard are both effective for annual and interim periods beginning on or after October 1, 2008. The adoption of Section 3064 had no impact on the Company's consolidated balance sheets, consolidated statements of loss and comprehensive loss and consolidated statements of cash flows.

**New Accounting Pronouncements to be Applied**

**International Financial Reporting Standards ("IFRS")**

In 2006, the 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.

**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 standards 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 INVESTMENTS**

At September 30, 2009, short-term investments consist of \$10,000,000 (2008 - \$10,000,000) in guaranteed investment certificates plus accrued interest of \$143,311 (2008 - \$236,996) with an average interest yield of 2.26%, purchased on February 12, 2009 and maturing on February 12, 2010.

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended September 30, 2009**

**4. MARKETABLE SECURITIES**

As at September 30, 2009 and 2008, marketable securities are stated at quoted market value and consist of shares in publicly traded companies with an original cost at September 30, 2009 of \$78,881 (September 30, 2008 - \$83,705). During the year ended September 30, 2009, shares in publicly traded companies that had a cost of \$4,824 were sold for proceeds of \$3,517.

**5. EQUIPMENT**

	Cost \$	Accumulated Amortization \$	Net Book Value \$
<b>September 30, 2009</b>			
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
	<b>420,498</b>	<b>228,692</b>	<b>191,806</b>
<b>September 30, 2008</b>			
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

Equipment with a net book value of \$1,480 was disposed of in the current year for \$nil proceeds. The loss on disposal of \$1,480 was included in office and miscellaneous expense.

**6. 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**

The Company holds a 100-percent 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 ton 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.

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended September 30, 2009**

**6. MINERAL PROPERTIES (Cont'd)**

The property had a 3% net smelter returns royalty ("NSR") on production. 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. Under the terms of the agreement, the Company purchased the underlying vendors rights to the 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 of northwestern Ontario which, together with the aforementioned property, make up the entire Rainy River Property.

During the period from June 2005 to September 2007, 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 totalling \$2,085,000 (\$1,263,610 paid) and issuing a total of 1,049,500 common shares (724,500 issued at a total value of \$2,230,335) over the period to September 2011. Upon expiry of the option period on one of the properties, on the fifth anniversary date of the agreement (June 2010), the Company is required to make annual advance royalty payments of \$30,000 for a three year period, totalling \$90,000.

A summary of the details of the option agreements entered into subsequent to September 30, 2007 is as follows:

- (i) **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 (\$190,000 paid) and issuing 305,000 common shares (125,000 issued at a value of \$336,500) over a four year period.
- (ii) **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 (\$30,000 paid) and issuing 50,000 common shares (20,000 issued at a value of \$52,400) over a four year period.
- (iii) **Bayfield Ventures Corp. Property**  
By an agreement dated November 2007, the Company had an option to earn a 60% interest in certain properties in Richardson Township from Bayfield Ventures Corp. ("Bayfield"), 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. The Company terminated the Bayfield option agreement during the year ended September 30, 2009.
- (iv) **Western Warrior Resources Inc. Property**  
By an agreement dated December 2007, the Company had 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. ("Western") 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. The Company terminated the Western option agreement during the year ended September 30, 2009.
- (v) **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 (\$60,000 paid) and issuing 100,000 common shares (40,000 issued at a value of \$119,600) over a four year period.

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended September 30, 2009**

**6. MINERAL PROPERTIES (Cont'd)**

(vi) 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 (\$50,000 paid) and issuing 25,000 common shares (25,000 issued at a value of \$71,875).

(vii) 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. The Company terminated the Schoenmann / Quandt option agreement during the year ended September 30, 2009.

(viii) Huitikka and Petkau Properties

By two separate agreements dated March 2009, the Company has an option to earn a 100% interest, subject to a 2% NSR, in certain patented mineral rights in Potts and Chapple Townships, by making cash payments of \$100,000 (\$15,000 paid) and issuing 50,000 common shares (10,000 issued at a value of \$21,650) over a four year period.

During the year ended September 30, 2008, the Company completed the 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.

During the year ended September 30, 2009, the Company completed the purchase of surface and mineral rights to two land parcels in Richardson Township for \$75,882.

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the year ended September 30, 2009**

**6. MINERAL PROPERTIES (Cont'd)**

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

	Year ended September 30 2009	Year ended September 30 2008
<b>Acquisition costs</b>		
Opening balance	\$ 8,088,183	\$ 5,122,572
Additions		
Shares issued	2,401,100	1,388,550
Property option payments	658,000	770,000
Royalty and bonus purchase	500,000	-
NSR purchase	475,000	-
Legal costs	17,228	44,246
Staking costs	21,230	3,580
Land rights purchase	75,882	759,235
	4,148,440	2,965,611
Total acquisition costs	12,236,623	8,088,183
<b>Exploration costs</b>		
Opening balance	24,860,578	13,662,437
Additions		
Compilation and analysis	1,459,054	776,387
Drilling	6,317,843	7,601,313
Equipment rental	73,283	138,542
Field technicians and expenses	779,877	803,688
Geological and airborne surveys	-	727,884
Geologists and consultants	1,060,277	860,412
Metallurgical testing	-	91,137
Preliminary geo-technical studies	168,799	-
Site office preparation	68,276	-
Socio-environmental baseline studies	460,603	-
Travel and subsistence	124,345	198,778
	10,512,357	11,198,141
Total exploration costs	35,372,935	24,860,578
<b>Total costs – Rainy River Property</b>	<b>\$ 47,609,558</b>	<b>\$ 32,948,761</b>

**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, 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 2009	Year ended September 30 2008
<b>Acquisition costs</b>		
Opening balance	\$ 17,685	\$ 17,685
Additions		
	-	-
Total acquisition costs	17,685	17,685
<b>Exploration costs</b>		
Opening balance	90,553	90,553
Additions		
Geological consulting	1,006	-
Lease maintenance costs	15,353	-
	16,359	-
Total exploration costs	106,912	90,553
<b>Total costs – Mud Creek Property</b>	<b>\$ 124,597</b>	<b>\$ 108,238</b>
<b>Total all properties</b>	<b>\$ 47,734,155</b>	<b>\$ 33,056,999</b>

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**7. SHARE CAPITAL**

**(a) Share capital and contributed surplus**

**Authorized**

Unlimited common shares without par value

	<b>Number of shares</b>	<b>Share Capital \$</b>	<b>Contributed Surplus \$</b>
<b>Issued</b>			
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 repurchased	57,747,190	70,023,764	4,747,364
Treasury shares repurchased in 2008	(627,800)	(1,146,346)	-
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

**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 announced its intention to purchase through the facilities of the TSX-V up to 2,000,000 of its outstanding common shares. It was the Company's intention that all shares purchased under the Bid would be cancelled. The Bid expired on August 29, 2009. The total shares repurchased under the Bid were 1,707,800 at a total cost of \$2,268,875. On January 23, 2009, the Company returned the 1,707,800 shares repurchased to its transfer agent for cancellation; share capital was reduced by \$2,070,000 and contributed surplus was charged with \$198,801, reflecting the amount of premium paid for the cancelled shares over the average equity value per share.

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**7. SHARE CAPITAL (Cont'd)**

**(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.

On February 10, 2009, the Company re-priced and extended the term for 515,000 stock options previously granted to non-insider employees that had an average exercise price of \$5.04 per share, expiring between March 19, 2009 and October 31, 2009, to have an exercise price of \$2.00 per share expiring February 10, 2014 and re-priced 60,000 stock options expiring between June 6, 2013 and August 7, 2013 that had an average exercise price of \$4.44 per share to have an exercise price of \$2.00 per share.

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

	<u>Warrants</u>		<u>Stock options</u>	
	<b>Number of warrants</b>	<b>Weighted Average Exercise Price \$</b>	<b>Weighted Average Number of options</b>	<b>Exercise Price \$</b>
<b>Outstanding, September 30, 2007</b>	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
<b>Outstanding, September 30, 2008</b>	<b>3,317,475</b>	<b>5.94</b>	<b>2,780,000</b>	<b>3.40</b>
Granted/issued	-	-	3,400,000	1.66
Exercised	-	-	-	-
Expired/cancelled	(3,317,475)	5.94	(1,605,000)	3.75
<b>Outstanding, September 30, 2009</b>	<b>-</b>	<b>-</b>	<b>4,575,000</b>	<b>1.61</b>
<b>Exercisable, September 30, 2009</b>	<b>-</b>	<b>-</b>	<b>1,858,332</b>	<b>1.37</b>

The following incentive stock options were outstanding at September 30, 2009:

	<b>Number of shares</b>	<b>Exercise Price \$</b>	<b>Expiry Date</b>
Stock options	500,000	0.28	March 17, 2010
	100,000	4.50	June 6, 2013 (2/3 not vested)
	50,000	2.00	June 6, 2013 (2/3 not vested)
	10,000	2.00	August 6, 2013 (2/3 not vested)
	1,000,000	0.83	November 11, 2013 (2/3 not vested)
	515,000	2.00	February 9, 2014 (2/3 not vested)
	1,900,000	2.00	February 9, 2014 (2/3 not vested)
	500,000	2.01	June 22, 2014 (2/3 not vested)
	<b>4,575,000</b>	<b>1.61</b>	

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**7. SHARE CAPITAL (Cont'd)**

**(c) Stock-based compensation**

During the year ended September 30, 2009, the Company granted 3,400,000 (2008 – 970,000) stock options with a total estimated fair value of \$3,836,151 (2008 - \$2,005,023) and re-priced 575,000 (2008 – nil) stock options that the Company estimated had a fair value incremental increase of \$696,732 (2008 – \$nil). The fair value per option granted was \$1.13 (2008 - \$2.07) and per re-priced option was \$1.21 (2008 – \$nil). Vesting periods ranged from date of grant to a period of three years. For the year ended September 30, 2009, the Company recorded \$2,626,122 (2008 - \$1,278,598) as stock-based compensation expense.

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

	<b>Year ended September 30, 2009</b>	<b>Year ended September 30, 2008</b>
Risk free interest rate	2.16%	3.68%
Expected life	5 years	3.4 years
Expected stock volatility	90%	86%
Expected dividend yield	Nil	Nil

**(d) Commitment to issue shares**

In June 2009, the Company agreed to issue 50,000 common shares 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.

**8. RELATED PARTY TRANSACTIONS**

During the year ended September 30, 2009, the Company entered into transactions with related parties as follows:

- (a) paid or accrued consulting fees of \$120,000 (2008 - \$120,000) to a company controlled by the Vice-Chair of the Board of Directors who is formerly the Company's President and Chief Executive Officer;
- (b) paid or accrued consulting fees of \$60,000 (2008 - \$60,000) to a company controlled by the Chief Financial Officer;
- (c) paid or accrued consulting fees, included in exploration costs, of \$38,703 (2008 – \$260,728) and other consulting fees of \$80,000 (2008 - \$Nil) to a company controlled by the Vice President Exploration, who is also a director; and
- (d) paid or accrued consulting fees of \$80,000 (2008 - \$Nil) to a company controlled by the Vice President Administration, who is also a director.

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

As at September 30, 2009, accounts payable and accrued liabilities includes \$18,985 due to related parties (September 30, 2008 - \$25,376).

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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**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.

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.

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; and
- 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.

**10. INCOME TAXES**

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

	September 30, 2009	September 30, 2008
Loss before income taxes	\$ (3,775,854)	\$ (1,391,506)
Expected income tax recovery	\$ (1,137,476)	\$ (443,960)
Non deductible expenses	854,712	467,957
Non-capital losses and financing costs	61,764	(378,997)
<b>Income tax expense (recovery)</b>	<b>\$ (221,000)</b>	<b>\$ (355,000)</b>
Represented by:		
Income tax expense (recovery)	-	-
Future income tax expense (recovery)	\$ (221,000)	\$ (355,000)

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**10. 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, 2009 and 2008 are as follows:

	<b>September 30, 2009</b>	<b>September 30, 2008</b>
Future income tax assets:		
Financing costs	\$ 284,000	\$ 475,000
Investment tax credit	1,411,000	796,000
Non-capital losses carried forward	1,134,000	842,000
Net capital losses carried forward	563,000	586,000
Equipment	54,000	38,000
	<u>3,446,000</u>	<u>2,737,000</u>
Valuation allowance	<u>(1,964,000)</u>	<u>(1,354,000)</u>
Net future income tax assets	<u>1,482,000</u>	<u>1,383,000</u>
Future income tax liabilities:		
Marketable securities	(10,000)	(28,000)
Mineral properties	<u>(2,517,000)</u>	<u>(2,621,000)</u>
	<u>(2,527,000)</u>	<u>(2,649,000)</u>
Net future income tax assets (liabilities)	<u>\$ (1,045,000)</u>	<u>\$ (1,266,000)</u>

Subject to certain restrictions, at September 30, 2009, the Company has operating losses of approximately \$4,536,000 available to reduce taxable income of future years. Unless utilized, these losses will expire through 2029. In addition, the Company has exploration and development expenditures of approximately \$37,665,000 available to reduce taxable income of future years. The Company has net capital loss carry forwards of approximately \$4,506,000.

During the year ended September 30, 2009, the Company renounced \$Nil (2008 - \$5,040,000) of flow-through share expenditures resulting in a future income tax liability and a charge against share capital of \$Nil (2008 - \$1,621,000).

**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 6.

**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, 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 quoted market value at each reporting period.

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**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 and short-term investments. Management believes that the credit risk concentration with respect to cash 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, 2009, the Company had a cash balance of \$7,562,591 (September 30, 2008 - \$21,687,369) to settle current liabilities of \$1,479,921 (September 30, 2008 - \$1,307,831). 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, short-term investments 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 in interest-bearing demand deposits with banks of \$7,562,591 (September 30, 2008 - \$21,687,369), the Company has \$10,000,000 (September 30, 2008 - \$10,000,000) in interest-bearing investment-grade short-term investments. A 1% change in interest rates would have an effect of approximately \$176,000 on interest income for the fiscal year.

(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, 2009 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.

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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 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. SUBSEQUENT EVENTS**

Subsequent to September 30, 2009, the Company:

- a) issued 80,000 common shares in connection with existing mineral property option agreements (Note 6(a)); and
- b) completed a flow through private placement of 2,924,500 common shares at \$2.82 per share for gross proceeds of \$8,247,090. A finders' fee of \$559,281 and other transaction costs of \$62,840 were paid related to this placement.