

**RAINY RIVER RESOURCES LTD.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**(Stated in Canadian Dollars)**  
**FOR THE PERIOD ENDED**  
**December 31, 2011**

## **Management's Report**

The accompanying consolidated financial statements of Rainy River Resources Ltd. and other information contained in the management's discussion and analysis are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, and include some amounts that are based on management's estimates and judgment.

The Board of Directors carries out its responsibility for the consolidated financial statements principally through its Audit Committee, which is comprised solely of independent directors. The Audit Committee reviews the Company's annual consolidated financial statements and recommends their approval to the Board of Directors. The Company's auditors have full access to the Audit Committee, with and without management being present. These consolidated financial statements have been audited by PricewaterhouseCoopers LLP, Chartered Accountants.

*(Signed) Raymond W. Threlkeld*

President and Chief Executive Officer

*(Signed) Nicholas Nikolakakis*

Vice President and Chief Financial Officer

Toronto, Ontario, Canada  
March 28, 2012



March 28, 2012

## **Independent Auditor's Report**

### **To the Shareholders of Rainy River Resources Ltd.**

We have audited the accompanying consolidated financial statements of Rainy River Resources Ltd., which comprise the consolidated balance sheet as at December 31, 2011 and the consolidated statements of loss and deficit, accumulated other comprehensive income (loss), comprehensive loss and cash flows for the fifteen-month period then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Rainy River Resources Ltd. as at December 31, 2011 and the results of its operations and its cash flows for the fifteen-month period then ended in accordance with Canadian generally accepted accounting principles.

**Other matter**

The consolidated financial statements as at September 30, 2010 and for the year then ended were audited by another auditor who expressed an opinion without reservation in their report dated December 14, 2010.

**(Signed) “PricewaterhouseCoopers LLP”**

**Chartered Accountants, Licensed Public Accountants**

**RAINY RIVER RESOURCES LTD.**

**CONSOLIDATED BALANCE SHEETS**

	<b>ASSETS</b>		<b>December 31, 2011</b>	<b>September 30, 2010</b>
<b>CURRENT</b>				
Cash and cash equivalents (Note 11)		\$	30,267,342	\$ 71,870,010
Short-term investments (Note 4)			66,186,027	-
Receivables			1,381,846	668,754
Prepaid expenses			53,928	83,336
			97,889,143	72,622,100
<b>NON-CURRENT</b>				
Investments (Note 5)			402,778	1,050,000
Buildings and equipment (Note 6)			1,201,024	454,347
Mineral properties (Note 7)			136,008,971	70,542,980
			\$ 235,501,916	\$ 144,669,427
<b>LIABILITIES</b>				
<b>CURRENT</b>				
Accounts payable and accrued liabilities		\$	8,519,935	\$ 1,922,205
<b>NON-CURRENT</b>				
Future income taxes (Note 12)			4,014,000	978,000
			12,533,935	2,900,205
<b>SHAREHOLDERS' EQUITY</b>				
Share capital (Note 8)			238,092,382	151,052,582
Contributed surplus (Note 8)			24,519,439	10,946,580
Obligation to issue shares (Note 8)			74,714	114,300
Accumulated other comprehensive income (loss)			(85,069)	481,250
Deficit			(39,633,485)	(20,825,490)
			222,967,981	141,769,222
			\$ 235,501,916	\$ 144,669,427

**Commitments (Notes 8a, 8c, 8d and 13)**

**Subsequent event (Note 15)**

**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 AND DEFICIT**

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
	<u>(Note 1)</u>	<u></u>
<b>EXPENSES</b>		
Amortization	\$ 244,857	\$ 158,670
Professional fees	844,818	211,898
Consulting	1,030,265	793,524
Office and miscellaneous	752,202	315,460
Promotion and investor relations	115,969	191,321
Regulatory and filing fees	369,390	136,986
Rent	313,935	108,293
Salaries and benefits	5,520,086	1,226,641
Stock-based compensation (Note 8c)	12,093,326	5,593,477
Travel	994,549	513,568
	<u>                    </u>	<u>                    </u>
<b>LOSS BEFORE OTHER ITEMS AND INCOME TAXES</b>	<u>(22,279,397)</u>	<u>(9,249,838)</u>
<b>OTHER ITEMS</b>		
Interest income	2,097,841	343,272
Unrealized loss on marketable securities	-	(79,519)
Gain on disposal of investments and marketable securities (Note 5)	456,464	5,904
	<u>                    </u>	<u>                    </u>
	<u>2,554,305</u>	<u>269,657</u>
<b>LOSS BEFORE INCOME TAXES</b>	(19,725,092)	(8,980,181)
Future income tax recovery (Note 12)	917,097	2,197,750
	<u>                    </u>	<u>                    </u>
<b>LOSS FOR THE PERIOD</b>	(18,807,995)	(6,782,431)
<b>DEFICIT, BEGINNING OF THE PERIOD</b>	(20,825,490)	(14,043,059)
<b>DEFICIT, END OF THE PERIOD</b>	<u>\$ (39,633,485)</u>	<u>\$ (20,825,490)</u>
<b>BASIC AND DILUTED LOSS PER COMMON SHARE</b>	\$ (0.23)	\$ (0.10)
<b>Weighted average number of common shares outstanding</b>	81,863,886	67,493,814

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

**RAINY RIVER RESOURCES LTD.**

**CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
	<u>(Note 1)</u>	<u></u>
<b>Accumulated other comprehensive income, beginning of the period</b>	\$ 481,250	\$ -
Other comprehensive income (loss)		
Reclassification of unrealized gains, net of tax, on disposal of available-for-sale financial asset during the period	(481,250)	-
Unrealized gain (loss) on available-for-sale financial asset arising during the period, net of tax	<u>(85,069)</u>	<u>481,250</u>
<b>Accumulated other comprehensive income (loss), end of the period</b>	<u><u>\$ (85,069)</u></u>	<u><u>\$ 481,250</u></u>

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
	<u>(Note 1)</u>	<u></u>
<b>Loss for the period</b>	\$ (18,807,995)	\$ (6,782,431)
Other comprehensive income (loss)		
Reclassification of unrealized gains, net of tax, on disposal of available-for-sale financial asset during the period	(481,250)	-
Unrealized gain (loss) on available-for-sale financial asset arising during the period, net of tax	<u>(85,069)</u>	<u>481,250</u>
<b>Comprehensive loss for the period</b>	<u><u>\$ (19,374,314)</u></u>	<u><u>\$ (6,301,181)</u></u>

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

**RAINY RIVER RESOURCES LTD.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
	<u>2011</u>	<u>2010</u>
	(Note 1)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Loss for the period	\$ (18,807,995)	\$ (6,782,431)
Items not involving cash:		
Amortization	244,857	158,670
Gain on disposal of investments and marketable securities	(456,464)	(5,904)
Unrealized loss on marketable securities	-	79,519
Interest accrual on short-term investments	(1,186,027)	(82,689)
Stock-based compensation	12,093,326	5,593,477
Future income tax recovery	(917,097)	(2,197,750)
Changes in non-cash working capital items:		
Receivables	(713,092)	(495,243)
Prepaid expenses	29,408	(35,773)
Accounts payable and accrued liabilities	389,742	192,332
	<u>(9,323,342)</u>	<u>(3,575,792)</u>
Cash flows used in operating activities		
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds on issue of share capital	88,799,066	85,115,303
Share issue costs	(3,904,024)	(5,446,643)
	<u>84,895,042</u>	<u>79,668,660</u>
Cash flows provided by financing activities		
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Mineral properties, net of non-cash additions in accounts payable and accrued liabilities	(51,583,009)	(21,175,023)
Short-term investments	(65,000,000)	10,226,000
Proceeds on disposal of investments and marketable securities	956,464	84,785
Purchase of investment	(500,000)	(500,000)
Purchase of buildings and equipment	(1,047,823)	(421,211)
	<u>(117,174,368)</u>	<u>(11,785,449)</u>
Cash flows used in investing activities		
<b>CHANGE IN CASH AND CASH EQUIVALENTS DURING THE PERIOD</b>	(41,602,668)	64,307,419
Cash and cash equivalents - beginning of the period	<u>71,870,010</u>	<u>7,562,591</u>
<b>CASH AND CASH EQUIVALENTS - END OF THE PERIOD</b>	<u>\$ 30,267,342</u>	<u>\$ 71,870,010</u>

Supplemental disclosure with respect to cash flows (Note 11)

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

**RAINY RIVER RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the fifteen-month period ended December 31, 2011**

**1. BASIS OF PRESENTATION**

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). All amounts, unless specifically indicated otherwise, are presented in Canadian dollars.

On September 29, 2011, Rainy River Resources Ltd. (the “Company”) filed a notice with the Ontario, Alberta and British Columbia Securities Commissions to change the year end of the Company from September 30 to December 31. As a result, these financial statements include the results of the Company for the fifteen month period ended December 31, 2011 with comparatives for the twelve month period ended September 30, 2010.

**2. NATURE AND CONTINUANCE OF OPERATIONS**

The Company was incorporated under the laws of British Columbia, Canada, and 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, it has incurred operating losses in the past and continues to incur operating losses; the Company believes it has sufficient financial resources to continue operations throughout the upcoming year.

**3. SIGNIFICANT ACCOUNTING POLICIES**

**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 December 31, 2011 or as at September 30, 2010.

**Use of estimates**

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

**Financial instruments**

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

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

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

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

The Company also discloses any financial instruments or 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. The Company has no non-financial derivatives as at December 31, 2011.

**Cash and cash equivalents**

Cash and cash equivalents consist of cash on deposit with banks, and short-term, highly liquid, interest-bearing investments with original maturity dates of 90 days or less, which are readily convertible to known amounts of cash and are subject to insignificant risk of changes in 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%

The following assets are amortized on a straight line basis:

Project Building	10 years
Leasehold improvements	5 years

**Mineral properties**

All costs related to the acquisition, exploration and development of mineral properties are capitalized on a property-by-property basis. If economically recoverable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the unit of production method. When a property is abandoned, all related costs are written off to the statements of loss and deficit, 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 the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete development, and future profitable production or proceeds from the disposition thereof.

**RAINY RIVER RESOURCES LTD.**  
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**3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)**

**Asset retirement obligations**

Asset retirement obligations consider the recognition and measurement of liabilities related to legal obligations associated with the retirement and rehabilitation 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 December 31, 2011 and September 30, 2010, 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. Under this method, the fair value of the stock options at the date of the grant, as determined using the Black-Scholes option pricing model, is recognized as an expense over the vesting period, with the offsetting credit to contributed surplus. If the stock options are exercised, the proceeds are credited to share capital and the fair value of the options exercised is reclassified from contributed surplus to share capital.

**Future income taxes**

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

**Flow-through common shares**

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

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

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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 deficit, and comprehensive loss.

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

**New Accounting Pronouncements to be applied**

**International Financial Reporting Standards**

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly-listed companies will have to adopt International Financial Reporting Standards (“IFRS”) for interim and annual periods for years beginning on or after January 1, 2011. As a result of its change in year end, the effective date for the Company will be January 1, 2012, with a transition date of October 1, 2010 for comparative reporting purposes. The first financial statements reported under IFRS will be for the interim period ending March 31, 2012, with comparative information prepared on an IFRS basis.

The Company will cease to prepare its consolidated financial statements in accordance with Canadian GAAP as set out in Part V of the CICA Handbook – Accounting, for the periods beginning on January 1, 2012, when it will start to apply IFRS as published by the International Accounting Standards Board. Consequently, future accounting changes to Canadian GAAP are not discussed in these consolidated financial statements as they will not be applied by the Company.

**4. SHORT-TERM INVESTMENTS**

Short-term investments represent guaranteed investment certificates maturing on January 9, 2012, with an average interest yield of 1.85% and a principal amount of \$65,000,000 plus accrued interest of \$1,186,027 (September 30, 2010 – Nil). The guaranteed investment certificates were issued on January 7, 2011. Principal and accrued interest totaling \$66.2 million was received by the Company in January 2012, following the maturity of this short-term investment.

**5. INVESTMENTS**

At December 31, 2011, investments consist of shares of Northern Superior Resources Inc. (“Northern Superior”) with an original cost of \$500,000 (Note 7b). These investments are designated as available for sale and are reported at fair value, reflecting their quoted market value as at the balance sheet date. Unrealized gains or losses arising from this treatment are included in other comprehensive income/loss, and reported net of tax, in the statement of comprehensive loss. In 2009, the Company held marketable securities which were disposed of at a gain, in the 12-month period ended September 30, 2010.

**6. BUILDINGS AND EQUIPMENT**

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
<b>December 31, 2011</b>			
Computer equipment	\$ 476,223	\$ 241,258	\$ 234,965
Field equipment	525,783	275,783	250,000
Office furniture and equipment	292,196	105,814	186,382
Project buildings	408,061	56,290	351,771
Leasehold improvements	187,269	9,363	177,906
<b>Total</b>	<b>\$ 1,889,532</b>	<b>\$ 688,508</b>	<b>\$ 1,201,024</b>

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**6. BUILDINGS AND EQUIPMENT (Cont'd)**

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
<b>September 30, 2010</b>			
Computer equipment	\$ 302,155	\$ 152,897	\$ 149,258
Field equipment	354,804	171,988	182,816
Office furniture and equipment	184,751	62,478	122,273
Project buildings	-	-	-
<b>Total</b>	<b>\$ 841,710</b>	<b>\$ 387,363</b>	<b>\$ 454,347</b>

**7. MINERAL PROPERTIES**

	<b><u>December 31, 2011</u></b>	<b><u>September 30, 2010</u></b>
Rainy River Gold Project	\$ 128,440,136	\$ 70,027,892
TPK Property	7,322,409	300,000
Mud Creek Property	246,426	215,088
	<b>\$ 136,008,971</b>	<b>\$ 70,542,980</b>

**a) Rainy River Gold Project, Ontario**

The Company holds a 100% interest in the Rainy River Gold Project, located west of Fort Frances, in the southwest corner of northern Ontario.

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

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

During the period from June 2005 to December 31, 2011, the Company entered into various agreements whereby the Company has an option to earn a 100% interest, subject to a 2% Net Smelter Return royalty (3% on one property), in certain patented mineral and surface rights in various townships in the Rainy River district, by making payments over the period to December 2015, totaling \$3,878,500 in cash (\$3,350,227 paid to December 31, 2011) and issuing a total of 1,717,000 common shares (1,569,000 common shares issued to December 31, 2011 with a value of \$7,690,506). Upon expiry of the option period on one of the properties, which occurred on the fifth anniversary date of the related agreement during the period ended September 30, 2010, the Company is required to make annual advance royalty payments of \$30,000 for a three year period, totaling \$90,000 (\$60,000 paid to December 31, 2011).

During the period ended December 31, 2011, the Company purchased the surface and mineral rights to property in the Rainy River district for \$5,741,565 (2010 – \$1,368,449).

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

**a) Rainy River Gold Project, Ontario (Cont'd)**

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

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
<b>Acquisition costs</b>		
Opening balance	\$ 15,623,852	\$ 12,236,623
Additions in the period		
Land purchases	5,741,565	1,368,449
Property option payments	5,696,431	2,018,780
Total additions in the period	11,437,996	3,387,229
Ending balance – acquisition costs	27,061,848	15,623,852
<b>Exploration costs</b>		
Opening balance	54,404,040	35,372,935
Additions in the period		
Drilling and assaying	31,889,178	13,903,053
Technical, environmental and other studies	3,253,622	2,046,766
Other exploration costs	11,831,448	3,081,286
Total additions in the period	46,974,248	19,031,105
Ending balance – exploration costs	101,378,288	54,404,040
<b>Cumulative costs –</b>		
<b>Rainy River Gold Project</b>	<b>\$ 128,440,136</b>	<b>\$ 70,027,892</b>

**b) TPK Property, Ontario**

Effective September 9, 2010, the Company entered into an agreement whereby Northern Superior granted the Company an option to earn a 51% interest in the eastern half of Northern Superior's 100% owned Ti-pa-haa-kaaning/Big Dam property in northwestern Ontario (the "TPK Property"). To earn its 51% interest, the Company must make payments totaling \$12,500,000 comprised of \$9,400,000 in exploration expenses over a three year period (\$5,722,409 incurred to December 31, 2011), a cash payment of \$300,000 (paid) upon receipt of regulatory approval and a further cash payment of \$1,300,000 (paid), and complete three equal annual private placements of common shares of Northern Superior of \$500,000 each, for a total investment of \$1,500,000. The first private placement was completed in 2010 and the second was completed in July 2011.

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**For the fifteen-month period ended December 31, 2011**

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

The details of the costs incurred on the Company's TPK Property, excluding the private placements (see Note 5), are as follows:

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
<b>Acquisition costs</b>		
Opening balance	\$ 300,000	\$ -
Additions in the period		
Property option payments	1,300,000	300,000
Ending balance – acquisition costs	1,600,000	300,000
<b>Exploration costs</b>		
Opening balance	-	-
Additions in the period		
Exploration expenditures	5,722,409	-
Total additions in the period	5,722,409	-
Ending balance – exploration costs	5,722,409	-
<b>Cumulative costs – TPK Property</b>	<b>\$ 7,322,409</b>	<b>\$ 300,000</b>

**c) Mud Creek Property, Minnesota**

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

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

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
<b>Acquisition costs</b>		
Opening balance	\$ 17,685	\$ 17,685
Additions in the period	-	-
Ending balance – acquisition costs	17,685	17,685
<b>Exploration costs</b>		
Opening balance	197,403	106,912
Additions		
Survey and lease maintenance costs	31,338	90,491
Total additions in the period	31,338	90,491
Ending balance – exploration costs	228,741	197,403
<b>Cumulative costs – Mud Creek Property</b>	<b>\$ 246,426</b>	<b>\$ 215,088</b>

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**8. SHARE CAPITAL**

**a) Share capital and contributed surplus**

**Authorized**

Unlimited common shares without par value

	Number of shares	Share Capital \$	Contributed Surplus \$	Obligation to issue shares \$
<b>Issued</b>				
As at September 30, 2009	57,161,890	70,354,790	7,174,685	-
Stock-based compensation	-	-	5,378,677	214,800
Stock options exercised	1,191,959	1,635,413	-	-
Fair value allocation on exercise of options	-	1,606,782	(1,606,782)	-
Fair value allocation on obligation shares issued	50,000	100,500	-	(100,500)
Warrants exercised	25,000	177,500	-	-
Property option agreements	302,000	1,423,780	-	-
Private placements	16,488,500	83,262,460	-	-
Share issue costs	-	(5,446,643)	-	-
Tax benefits of the renunciation of flow-through expenditures to shareholders	-	(2,062,000)	-	-
As at September 30, 2010	75,219,349	151,052,582	10,946,580	114,300
Stock-based compensation	-	-	15,065,824	269,414
Stock options exercised	601,235	1,579,663	-	-
Fair value allocation on exercise of options	-	1,492,965	(1,492,965)	-
Fair value allocation on obligation shares issued	50,000	309,000	-	(309,000)
Warrants exercised	1,719,000	12,204,900	-	-
Property option agreements	496,998	4,376,796	-	-
Private placement	5,930,000	75,014,500	-	-
Share issue costs, net of tax	-	(2,928,024)	-	-
Tax benefits of the renunciation of flow-through expenditures to shareholders	-	(5,010,000)	-	-
<b>As at December 31, 2011</b>	<b>84,016,582</b>	<b>238,092,382</b>	<b>24,519,439</b>	<b>74,714</b>

**Private placements**

On January 7, 2011, the Company closed a private placement of 5,930,000 common shares of the Company at a price of \$12.65 per share, for gross proceeds of \$75,014,500. In connection with the offering, the Company paid a total of \$3,750,725 as financing fees to the underwriters.

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

On February 25, 2010, the Company closed a brokered private placement raising gross proceeds of \$55,014,300 through the issuance of 11,114,000 units at a price of \$4.95 per unit on a bought deal basis. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitled the holder to acquire one additional common share at a price of \$7.10 per common share until February 27, 2012 (Note 15). The Company paid a finance fee of \$3,300,858 in connection with the private placement.

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

On November 2, 2009, the Company closed a brokered private placement raising gross proceeds of \$8,247,090 through the issuance of 2,924,500 flow-through common shares at a price of \$2.82 per common share. The agents were paid a total of \$494,825 as financing fees. At September 30, 2010, the Company had incurred all of the flow-through expenditures agreed to be incurred by December 31, 2010, in connection with this flow-through private placement.

**b) Stock options and warrants**

The Company has a shareholder-approved, rolling stock option plan, whereby from time to time, at the discretion of the Board of Directors, stock options may be granted to directors, officers, employees and consultants. The number of shares reserved for issuance under the plan shall not exceed 10% of the issued and outstanding common shares of the Company. The exercise price of each option is based on the market price of the Company's common shares at the date of the grant. The options may be granted for a maximum of five years and vesting is determined by the Board of Directors. Warrants are generally issued in connection with certain private placement financings. Stock options and share purchase warrant transactions are summarized as follows:

	<u>Stock options</u>		<u>Warrants</u>	
	Number	Weighted	Number	Exercise
	of options	Average	of warrants	Price
		Exercise Price		Price
		\$		\$
<b>Outstanding, September 30, 2009</b>	<b>4,575,000</b>	<b>1.61</b>	-	-
Granted	1,980,000	5.36	5,557,000	7.10
Exercised	(1,191,959)	1.37	(25,000)	7.10
Expired/cancelled	(143,334)	3.50	-	-
<b>Outstanding, September 30, 2010</b>	<b>5,219,707</b>	<b>3.04</b>	<b>5,532,000</b>	<b>7.10</b>
Granted	3,830,000	9.86	-	-
Exercised	(601,235)	2.63	(1,719,000)	7.10
Expired/cancelled	(205,003)	11.78	-	-
<b>Outstanding, December 31, 2011</b>	<b>8,243,469</b>	<b>6.02</b>	<b>3,813,000</b>	<b>7.10</b>
Exercisable, December 31, 2011	5,491,798	4.50	3,813,000	7.10

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

The following stock options and warrants were outstanding at December 31, 2011:

	<b>Number of shares</b>	<b>Exercise Price \$</b>	<b>Expiry Date</b>	<b>Exercisable</b>
Stock options	100,000	4.50	June 6, 2013	100,000
	800,000	0.83	November 11, 2013	800,000
	1,535,134	2.00	February 9, 2014	1,535,134
	500,000	2.01	June 22, 2014	500,000
	250,000	2.98	December 11, 2014	250,000
	590,002	5.00	February 16, 2015	381,667
	120,000	6.09	April 7, 2015	70,000
	300,000	6.18	May 18, 2015	200,000
	400,000	6.75	June 17, 2015	266,667
	500,000	9.15	October 28, 2015	333,333
	1,478,333	12.65	January 10, 2016	498,331
	25,000	10.00	June 7, 2016	8,333
	45,000	10.00	August 15, 2016	15,000
	300,000	6.75	November 9, 2016	100,000
	1,300,000	7.28	December 15, 2016	433,333
	<b>8,243,469</b>			<b>5,491,798</b>
Warrants	3,813,000	7.10	February 26, 2012	3,813,000

Vesting of options may be accelerated under certain conditions.

**c) Stock-based compensation**

During the fiscal year ended December 31, 2011, the Company granted 3,830,000 (2010 – 1,980,000) stock options with a total estimated fair value of \$18,178,377 (2010 - \$6,548,869). The average fair value per option granted was \$4.75 (2010 - \$3.31). The vesting periods ranged from date of grant to a period of two years. For the fiscal year ended December 31, 2011, the Company recorded a total of \$15,065,824 (2010 - \$5,378,677) as stock-based compensation expense from option grants and \$269,414 (2010 – \$214,800) related to its commitments to issue shares (Note 8d). Net of the \$3,241,912 capitalized to mineral properties, stock based compensation expense included in net loss for the period is \$12,093,326 (2010 - \$5,593,477).

The fair value of stock options granted 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>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
Risk free interest rate	0.97%	1.94%
Expected life	3.7 years	5 years
Expected stock volatility	71%	80%
Expected dividend yield	Nil	Nil

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

**d) Commitments to issue shares**

On May 18, 2010, the Company agreed to issue 50,000 common shares (valued at \$309,000) as a signing bonus to the Company's then new Vice President and Chief Financial Officer on May 18, 2011, being the first anniversary of the date of his appointment. This share issuance was approved by shareholders at the Company's Annual General Meeting of shareholders on April 6, 2011, and 50,000 common shares were issued on May 18, 2011. Upon issuance, \$309,000 was transferred from the obligation to issue shares, to share capital, reflecting the grant-date fair value.

On October 5, 2011, the Company agreed to issue 50,000 common shares (valued at \$337,500) as a signing bonus to the Company's new Chief Operating Officer on November 1, 2012, being the first anniversary of the commencement of his employment, provided that the Chief Operating Officer continues to be employed by the Company at that time. The value is being amortized over the period to the issuance of the shares, and to December 31, 2011, \$74,714 has been charged to stock-based compensation expense, with obligation to issue shares being credited.

**9. RELATED PARTY TRANSACTIONS**

During the fiscal year ended December 31, 2011, the Company entered into transactions with related parties as follows:

- a) paid or accrued consulting fees of \$Nil (2010 - \$90,000) to a company controlled by the former Vice-Chair of the Board of Directors who was formerly the Company's President and Chief Executive Officer;
- b) paid or accrued consulting and other fees, included in exploration costs, of \$465,469 (2010 - \$163,684) and consulting and termination fees of \$130,000 (2010 - \$120,000 in consulting fees) to a company controlled by the Company's former Vice President Exploration, who is also a director;
- c) paid or accrued consulting fees and bonus of \$601,345 (2010 - \$120,000 in consulting fees) to a company controlled by the Vice President and General Counsel, who is also a director; and
- d) paid or accrued directors fees of \$277,913 (2010 - \$78,500) to directors of the Company.

As at December 31, 2011, accounts payable and accrued liabilities includes \$23,333 due to related parties (September 30, 2010 - \$67,321).

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.

**10. PROPERTY AND FINANCIAL RISK FACTORS**

**a) Property Risk**

Although the Company has interests in three mineral properties, the most advanced property and the one which is the focus of the majority of the Company's activities is the Rainy River Gold Project ("RRGP"). If the Company's two other mineral properties do not lead to significant resources, and if the RRGP were to encounter significant obstacles impeding its development into a commercially viable, producing gold mine, it would have a material adverse effect on the Company's financial condition and results of operations.

**b) Financial Risk**

The Company's activities expose it to a variety of financial risks, including liquidity risk, market risk and credit risk. Risk management is carried out by the Company's management team with guidance from the Audit Committee under policies approved by the Board of Directors. The Board of Directors also provides regular guidance for overall risk management.

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**10. PROPERTY AND FINANCIAL RISK FACTORS (Cont'd)**

Liquidity Risk

The Company takes a very conservative approach to managing liquidity risk, guided by the need to ensure it will have sufficient liquidity to meet liabilities when due. At December 31, 2011, the Company had cash and cash equivalents and short-term investments totaling \$96,453,369 (September 30, 2010 - \$71,870,010); to settle current liabilities of \$8,519,935 (September 30, 2010 -\$1,922,205). All of the Company's financial liabilities have contractual maturities of less than 30 days and are subject to normal trade terms. The Company remains dependent upon financing from capital markets.

Market Risk

Market risk is the risk of potential losses arising from market factors such as interest rates, commodity and equity prices, and foreign exchange rates.

i) Interest Rate Risk

The Company has cash balances and no interest-bearing debt. The Company's current policy is to invest surplus cash in conservative positions with major financial institutions. The Company periodically monitors the investments it makes, and is satisfied with the credit ratings of its banks.

ii) Price Risk

The Company is exposed to the risk of changes in the prices of commodities and equity prices. Equity price risk applies to the Company's market-traded available-for-sale investments, as well as to the general performance of equity capital markets, and of the gold equities in particular, where poor market conditions and depressed equity valuations could hamper the Company's ability to effectively raise capital to advance its activities. Commodity price risk represents the possibility that volatile metal prices, or inflationary conditions for key inputs such as oil or tires, could adversely affect the Company's economic performance. The Company's management team regularly surveys market conditions, and evaluates possible tactics to mitigate price risk, including the possibility to lock in prices by making early down payments for equipment with long lead times for manufacturing and/or delivery, for example.

iii) Foreign Currency Risk

The Company's functional currency and reporting currency is the Canadian dollar, and major purchases are transacted in Canadian dollars. As such, the Company's exposure to foreign currency risk is minimal. The Company's planned expenditures on the Mud Creek property in the US state of Minnesota are nominal and do not represent an appreciable exposure to the US dollar.

Credit Risk

Credit risk is the risk of loss associated with the inability of a counterparty to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash and cash equivalents, short term investments, accounts receivable, and possible future advance payments that may be made to equipment suppliers or other key vendors. Cash and cash equivalents and short term investments are held and invested with major financial institutions which are closely monitored by management. Accounts receivable balances principally reflect HST receivable from government agencies in Canada, and are in good standing as at December 31, 2011. Management believes that credit risk associated with cash and cash equivalents, short term investment and accounts receivable balances is negligible.

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**10. PROPERTY AND FINANCIAL RISK FACTORS (Cont'd)**

**Sensitivity Analysis**

The Company's financial instruments held as at December 31, 2011 consist of the following:

Cash in bank accounts	\$716,269
30-day cashable guaranteed investment certificates ("GIC's)	\$29,551,073
Locked-in GIC's (maturing on January 9, 2012)	\$66,186,027
Available-for-sale investments	\$402,778
Accounts receivable	\$1,381,846
Accounts payable	\$8,519,935

The above carrying values of the Company's financial instruments reflect their approximate fair value, as at December 31, 2011. Based on management's experience and technical understanding of financial markets, the Company believes the following movements are "reasonably possible" over a twelve month period:

- i) Held-to-maturity assets include the Company's two forms of guaranteed investment certificate, with a combined carrying value of \$95,737,100, which are subject to changing interest rates over time. Sensitivity to a plus-or-minus 1% change in interest rates would affect the reported net loss by approximately \$900,000 (September 30, 2010 - \$650,000).
- ii) Available-for-sale investments represent shares of a publicly-traded company. Sensitivity to a plus-or-minus 10% change in the market value of the investment would affect other comprehensive income and comprehensive loss by approximately \$40,000.
- iii) Accounts receivable and cash in bank accounts are classified as loans and receivables, and are measured at amortized cost. These financial instruments are exposed to the credit risk of the counterparties with which the Company holds the assets, respectively, the Canada Revenue Agency and a major Canadian bank. The Company believes that the credit risk associated with loans and receivables is negligible.
- iv) Accounts payable obligations are classified as other liabilities, and are measured at amortized cost. Accounts payable consist of trade payables and accrued liabilities which are expected to be settled within 30-60 days.

**Fair value hierarchy**

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: based on quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: based on inputs which have a significant effect on fair value, that are observable, either directly or indirectly, from market data; and
- Level 3: based on inputs which have a significant effect on fair value, that are not observable from market data.

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**10. PROPERTY AND FINANCIAL RISK FACTORS (Cont'd)**

The following table illustrates the classification of the Company's financial instruments within the fair value hierarchy as at December 31, 2011 and September 30, 2010:

<b>As at December 31, 2011:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets</b>				
30-day cashable guaranteed investment certificates ("GIC"s)		\$ 29,551,073		\$ 29,551,073
Locked-in GIC's (maturing on January 9, 2012)		66,186,027		66,186,027
Available-for-sale investments	\$ 402,778			402,778
<hr/>				
<b>As at September 30, 2010:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Financial assets</b>				
30-day cashable guaranteed investment certificates		\$ 66,246,816		\$ 66,246,816
Available-for-sale investments	\$ 1,050,000			1,050,000

**11. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS**

The Company did not pay cash for interest expense or income taxes for either of the fiscal years presented. The cash and cash equivalents consist of:

	<u><b>December 31,</b></u> <u><b>2011</b></u>	<u><b>September 30,</b></u> <u><b>2010</b></u>
Cash	\$ 716,269	\$ 5,623,194
Guaranteed investment certificates	29,551,073	66,246,816
Short-term investments <sup>1</sup>	66,186,027	-
	<u>\$ 96,453,369</u>	<u>\$ 71,870,010</u>

For the period ended December 31, 2011, the Company's significant non-cash financing and investing transactions consisted of:

- a) The accrual in mineral properties of deferred exploration costs incurred of \$7,739,576 as at December 31, 2011;
- b) The issuance of common shares valued at \$4,376,796 related to mineral property option agreements;
- c) The recognition of a fair value component of \$1,492,965 in respect of options exercised;
- d) The inclusion in mineral properties of capitalized amortization of project buildings, in the amount of \$56,290; and
- e) The recording of a reduction to share capital of \$5,010,000 on the renunciation of flow-through expenditures to shareholders and a corresponding increase to future income tax liability related thereto.

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

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

**RAINY RIVER RESOURCES LTD.**  
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**12. INCOME TAXES**

A reconciliation of income tax recovery for the periods ended December 31, 2011 and September 30, 2010, respectively, at statutory rates with reported taxes, follows:

	<b>15 months ended December 31, 2011</b>	<b>12 months ended September 30, 2010</b>
Loss before income taxes	\$ (19,725,092)	\$ (8,980,181)
Expected income tax recovery	\$ 5,301,000	\$ 2,593,000
Non-deductible expenses	(3,113,000)	(1,687,000)
Financing costs and other	(1,270,903)	1,291,750
Income tax recovery	\$ 917,097	\$ 2,197,750
Represented by:		
Income tax recovery	-	-
Future income tax recovery	\$ 917,097	\$ 2,197,750

The tax effects of temporary differences that give rise to significant components of future income tax assets and liabilities as at December 31, 2011 and September 30, 2010, respectively, are as follows:

	<b>December 31, 2011</b>	<b>September 30, 2010</b>
Future income tax assets:		
Financing costs	\$ 1,487,000	\$ 1,217,000
Investment tax credit	4,984,000	2,409,000
Non-capital losses carried forward	4,792,000	2,112,000
Non-capital losses (pre-January 1, 2006)	179,000	179,000
Net capital losses carried forward	506,000	562,000
Investments	12,000	-
Equipment	170,000	93,000
	<u>12,130,000</u>	<u>6,572,000</u>
Valuation allowance	(5,681,000)	(2,902,000)
Net future income tax assets	<u>6,449,000</u>	<u>3,670,000</u>
Future income tax liabilities:		
Marketable securities	-	-
Investments	-	(69,000)
Mineral properties	(10,463,000)	(4,579,000)
	<u>(10,463,000)</u>	<u>(4,648,000)</u>
Net future income tax liabilities	\$ (4,014,000)	\$ (978,000)

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

Subject to certain restrictions, at December 31, 2011, the Company has operating losses of approximately \$19,887,000 (2010 - \$9,164,000) available to reduce taxable income of future years. Unless utilized, these losses will expire through 2031. In addition, the Company has exploration and development expenditures of approximately \$94,157,000 (2010 - \$50,547,000) available to reduce taxable income of future years. The Company also has net capital loss carry-forwards of approximately \$4,050,000 (2010 – \$4,499,000).

The Company renounced certain deductions for Canadian exploration expenditures incurred and to be incurred on the Company's resource properties, resulting in a future income tax liability and a charge against share capital in connection with the flow-through shares issued. As at December 31, 2011, the Company has incurred all of the \$20,041,000 flow-through expenditures agreed to be incurred by December 31, 2011.

**13. COMMITMENTS**

The Company is party to certain contracts relating to operating leases for office space, site vehicles and office equipment. Future minimum payments under these agreements, as at December 31, 2011, are as follows:

2012	\$ 407,500
2013	402,724
2014	390,933
2015	351,660
2016	<u>353,551</u>
Total commitments	<u>\$ 1,906,368</u>

**14. 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 7c.

**15. SUBSEQUENT EVENT**

Subsequent to December 31, 2011, the Company received proceeds of \$25,889,795 from the exercise of 3,646,450 warrants with an exercise price of \$7.10. These proceeds were credited to share capital. The Company had issued 5,557,000 warrants under a financing which closed on February 25, 2010. By the expiry, on February 27, 2012, a total of 5,390,450 warrants were exercised, including the 3,646,450 warrants exercised subsequent to December 31, 2011.