# DYNASTY METALS & MINING INC.
**(the "Company")**

## CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
**(unaudited-prepared by management)**
**(Expressed in United States dollars, unless otherwise noted)**

**SEPTEMBER 30, 2012**

## DYNASTY METALS & MINING INC.

## NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

The accompanying unaudited interim financial statements of Dynasty Metals & Mining Inc. (the "Company") have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Vancouver, Canada

November 14, 2012

**DYNASTY METALS & MINING INC.**
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)
Expressed in United States dollars unless otherwise noted

| | For the Nine Months Ended September 30 2012 | For the Nine Months Ended September 30 2011 | For the Three Months Ended September 30 2012 | For the Three Months Ended September 30 2011 |
|---|---|---|---|---|
| **EXPENSES** | | | | |
| Amortization and accretion | $ 427,455 | $ 422,568 | $ 214,128 | $ 114,428 |
| Management fees | 342,256 | 185,916 | 125,188 | 62,398 |
| Office and general | 1,925,279 | 1,933,744 | 668,007 | 549,420 |
| Professional fees | 638,016 | 720,451 | 155,535 | 354,445 |
| Shareholder communication | 64,783 | 45,323 | 20,600 | 8,519 |
| Stock-based compensation (Note 8) | 628,841 | 751,382 | 100,503 | 209,770 |
| Transfer agent and filing fees | 45,522 | 57,207 | 1,753 | 6,751 |
| Travel and entertainment | 225,498 | 364,568 | 57,159 | 211,767 |
| | (4,297,650) | (4,481,159) | (1,342,873) | (1,517,498) |
| **OTHER ITEMS** | | | | |
| Interest income | 2,154 | 11,645 | - | 3,062 |
| Foreign exchange gain (loss) | (115,424) | 35,404 | (165,035) | (11,574) |
| | (113,270) | 47,049 | (165,035) | (8,512) |
| **Loss and comprehensive loss for the period** | (4,410,920) | (4,434,110) | (1,507,908) | (1,526,010) |
| **Basic and diluted loss per share** | $ (0.10) | $ (0.10) | $ (0.04) | $ (0.04) |
| **Weighted average number of shares outstanding** | 42,461,083 | 42,442,384 | 42,461,083 | 42,461,083 |

**DYNASTY METALS & MINING INC.**
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited)
Expressed in United States dollars unless otherwise noted

| | September 30 2012 | December 31 2011 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 771,389 | $ 6,238,514 |
| Receivables | 113,249 | 53,479 |
| Prepaid expenses | 456,679 | 394,450 |
| Inventory (Note 4) | 3,852,960 | 4,575,976 |
| | 5,194,277 | 11,262,419 |
| **Advances and deposits** | 369,506 | 76,688 |
| **Mine properties, plant and equipment** (Note 5) | 53,036,555 | 52,109,644 |
| **Exploration and evaluation properties** (Note 6) | 13,141,104 | 11,993,371 |
| | $ 71,741,442 | $ 75,442,122 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | $ 4,914,311 | $ 4,870,324 |
| **Provision for closure and restoration** (Note 7) | 1,308,158 | 1,270,746 |
| | 6,222,469 | 6,141,070 |
| **Shareholders' equity** | | |
| Capital stock (Note 8) | 89,059,365 | 89,059,365 |
| Contributed surplus (Note 8) | 13,477,683 | 12,848,842 |
| Deficit | (37,018,075) | (32,607,155) |
| | 65,518,973 | 69,301,052 |
| | $ 71,741,442 | $ 75,442,122 |

**Nature and continuance of operations** (Note 1)

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

**DYNASTY METALS & MINING INC.**
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)
Expressed in United States dollars unless otherwise noted

| | Number of Shares | Share Capital | Retained Loss | Contributed Surplus | Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|---|
| **Balance at January 1, 2012** | 42,461,083 | $ 89,059,365 | $ (32,607,155) | $ 12,848,842 | $ - | $ 69,301,052 |
| Issue of share capital, net | - | - | - | - | - | - |
| Net loss for the period | - | - | (4,410,920) | - | - | (4,410,920) |
| Other comprehensive income (loss) | - | - | - | - | - | - |
| Stock options exercised | - | - | - | - | - | - |
| Warrants exercised | - | - | - | - | - | - |
| Stock option and warrant conversion | - | - | - | - | - | - |
| Stock-based compensation (Note 8) | - | - | - | 628,841 | - | 628,841 |
| **Balance at September 30, 2012** | 42,461,083 | $ 89,059,365 | $ (37,018,075) | $ 13,477,683 | $ - | $ 65,518,973 |
| **Balance at January 1, 2011** | 42,068,583 | $ 87,272,609 | $ (24,861,562) | $ 10,855,319 | $ (88,505) | $ 73,177,861 |
| Issue of share capital, net | - | - | - | - | - | - |
| Net loss for the period | - | - | (4,434,110) | - | - | (4,434,110) |
| Other comprehensive income (loss) | - | - | - | - | - | - |
| Stock options exercised | 392,500 | 811,994 | - | - | - | 811,994 |
| Warrants exercised | - | - | - | - | - | - |
| Stock option and warrant conversion | - | 469,824 | - | (469,824) | - | - |
| Stock-based compensation (Note 8) | - | - | - | 751,382 | - | 751,382 |
| **Balance at September 30, 2011** | 42,461,083 | $ 88,554,427 | $ (29,295,672) | $ 11,154,564 | $ (88,505) | $ 70,324,814 |

**DYNASTY METALS & MINING INC.**
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
Expressed in United States dollars unless otherwise noted

| | For the Nine Months Ended September 30 2012 | For the Nine Months Ended September 30 2011 | For the Three Months Ended September 30 2012 | For the Three Months Ended September 30 2011 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| Loss for the period | $ (4,410,920) | $ (4,434,110) | $ (1,507,908) | $ (1,526,010) |
| Items not affecting cash: | | | | |
| Amortization and accretion | 427,455 | 422,568 | 214,128 | 114,428 |
| Stock-based compensation (Note 8) | 628,841 | 751,382 | 100,503 | 209,770 |
| Changes in non-cash working capital items: | | | | |
| (Increase) decrease in receivables | (59,768) | (66,183) | 50,318 | (22,508) |
| (Increase) decrease in prepaid expenses | (62,229) | (44,576) | (67,132) | (32,733) |
| (Increase) decrease in inventory | 2,644,363 | 1,667,004 | 2,027,086 | 210,105 |
| Increase (decrease) in accounts payable | 600,896 | (536,872) | 516,848 | 42,178 |
| Net cash used in operating activities | (231,362) | (2,240,788) | 1,333,845 | (1,004,770) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | |
| Expenditures on exploration and evaluation properties | (1,147,732) | (980,032) | (60,636) | (58,763) |
| Exploration advances and deposits | (292,819) | (18,161) | (118,074) | 91,384 |
| Pre-commercial production revenue credited to mine properties, plant and equipment | 21,590,197 | 25,878,934 | 5,547,122 | 5,108,780 |
| Expenditures on mine properties, plant and equipment | (25,385,409) | (20,840,064) | (7,074,618) | (6,556,079) |
| Net cash recovered (used) in investing activities | (5,235,763) | 4,040,677 | (1,706,206) | (1,414,679) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | |
| Issuance of capital stock and units | - | 829,681 | - | - |
| Issuance costs | - | - | - | - |
| Net cash provided (used) by financing activities | - | 829,681 | - | - |
| **Change in cash for the period** | (5,467,125) | 2,629,570 | (372,361) | (2,419,449) |
| **Cash, beginning of period** | 6,238,514 | 3,179,143 | 1,143,750 | 8,228,162 |
| **Cash, end of period** | $ 771,389 | $ 5,808,713 | $ 771,389 | $ 5,808,713 |
| **Cash paid during the period for interest** | $ - | $ - | $ - | $ - |
| **Cash paid during the period for income taxes** | $ 1,665,234 | $ - | $ 1,665,234 | $ - |

**Supplemental disclosure with respect to cash flows** (Note 10)

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

## 1. NATURE AND CONTINUANCE OF OPERATIONS

The Company was incorporated under the laws of the Yukon Territory on June 28, 2000. The Company is in the business of acquiring, exploring and developing mineral concessions. All such concessions are currently situated in Ecuador. The address of the Company's corporate office and principal place of business is #270 – 666 Burrard Street, Vancouver, British Columbia, Canada, V6C 2X8.

On April 18, 2008, Ecuador`s Constitutional Assembly passed a Constituent Mandate resolution (the "Mining Mandate"), which provided, among other provisions, for the suspension of mineral exploration activities for 180 days, or until a new Mining Law was approved. In January 2009, the new Mining Act was published. In November 2009, the regulations and procedures to operate under the new Mining Act were signed by the President of Ecuador and published in the Official Registry, after which the new Mining Act and Regulations (collectively, the "Mining Law") were enacted. The new Mining Law distinguishes between small scale and large scale operations. A small scale operation is an operation where the daily tonnage mined does not exceed 300 tonnes of mined material per concession per day. To date, the Company has obtained small scale mining licenses for five concessions at its Zaruma Gold Project. Such licenses permit the Company to mine up to 300 tonnes per day from each concession which has obtained the small scale mining license at a royalty rate of 3%, payable to the Ecuador government, and no windfall tax on the extraction and sale of precious metals. Although these five concessions are the focus of the Company's current mine development plans at its Zaruma Gold Project, there is no assurance that the Company will be able to obtain additional small scale mining licenses for other concessions within the Zaruma Gold Project to the extent they may become necessary based on the Company's development plans in the future.

Operations which mine in excess of 300 tonnes per day from each concession are required to enter into an exploitation contract with the government which will set out the specific terms and conditions of each mining operation, including the royalty payable to the government and the application of the windfall tax. The Company's other principal projects are expected to fall into this category and may therefore require the Company to enter into exploitation contracts for these projects in the future. There is no assurance that the Company will be able to agree on an exploitation contract and royalty rate on terms satisfactory to the Company based upon its business, operational and financial requirements. In the event that an exploitation contract with the government is determined to adversely impact the viability of the Company's principal projects, it may be necessary, in the future, to re-evaluate the carrying value of the Company's mine properties, plant and equipment, exploration and evaluation properties and certain other capital assets and the Company's ability to exploit these properties.

From inception, the Company has funded substantially all of its operating and capital expenses with proceeds from the sale of capital stock. In the year ended December 31, 2011 and the current year to date, mine development expenses and overheads have been primarily funded from the sale of precious metals produced during mine construction at the Zaruma Gold Project. The Company is in the pre-commercial stage of operations having yet to reach the stage of sustainable commercial production. Therefore, continuing operations are dependent upon the Company's ability in the future to mitigate the risks and overcome the challenges generally associated with comparable development stage enterprises, most significantly, it must either generate sufficient cash flow from the sale of precious metals in the future or secure additional working capital as required, neither of which is assured.

These condensed interim consolidated financial statements have been prepared using International Financial Reporting Standards ("IFRS") applicable to a going concern, which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. As mentioned above, there are conditions and matters which indicate the existence of a material uncertainty that may cast significant doubt about the ability of the Company to continue as a going concern. In the event the Company is unable to produce sufficient precious metals for sale in the future or secure additional working capital, from debt or equity financings or through the profitable sale of capital assets, these consolidated financial statements may require adjustments relating to the recoverability and classification of recorded assets and liabilities.

## 2. BASIS OF PRESENTATION

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the IASB ("International Accounting Standards Board") applicable to the preparation of interim financial statements, including International Accounting Standard ("IAS") 34- Interim Financial Reporting. The accounting policies followed in these condensed interim consolidated financial statements are the same as those applied in the Company's audited annual financial statements for the year ended December 31, 2011.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of November 14, 2012, the date the Audit Committee approved the statements. Any subsequent changes to IFRS after this date could result in changes to the consolidated financial statements for the period ended September 30, 2012.

These consolidated financial statements have been prepared on a historical cost basis except for certain financial instruments which are measured at fair value. The condensed interim consolidated financial statements do not contain all disclosures required under IFRS and should be read in conjunction with Company's audited annual consolidated financial statements and the notes thereto for the year ended December 31, 2011.

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates and, as such, estimates and underlying assumptions are reviewed on an ongoing basis. Revisions are recognized in the period in which the estimates are revised and in any future period affected.

Significant accounts that require estimates relate to the possible impairment of property, plant and equipment, mine development costs and exploration and evaluation properties, the useful life of assets for amortization, recognition of deferred tax assets, valuation of stock-based compensation, the estimated economically recoverable resources for depreciating mineral properties and valuation of asset retirement obligations. Key judgments and estimates made by management with respect to these areas have been disclosed in the notes to these financial statements as appropriate.

The determination of mineral resources also requires the use of estimates. The Company estimates its mineral resources based on information compiled by Qualified Persons as defined in accordance with Canadian Securities Administrators National Instrument 43-101, *Standards for Disclosure of Mineral Projects*. There are numerous uncertainties inherent in estimating mineral resources and assumptions that are valid at the time of estimation may change significantly when new information becomes available. Changes in the forecasted prices of commodities, exchange rates, production costs or recovery rates may change the economic status of resources and may result in changes to resource estimates.

## 3. NEW ACCOUNTING STANDARDS AND INTERPRETATION

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2013, including IAS 1 *Presentation of Financial Statements,* IAS 19 *Employee Benefits,* IFRS 9 *Financial Instruments,* IFRS *10 Consolidated Financial Statements,* IFRS 11 *Joint Arrangements,* IFRS 12 *Disclosure of Interest of Other Entities,* IFRS 13 *Fair Value Measurement,* and IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Company, except for IFRS 9 *Financial Instruments* ("IFRS 9"), which becomes mandatory for the Company's 2015 consolidated financial statements and could change the classification and measurement of financial assets. The extent of the effects of the new accounting standards on the condensed interim consolidated financial statements has not been determined.

Expressed in United States dollars unless otherwise noted

## 4. INVENTORY

| | September 30 2012 | December 31 2011 |
|---|---|---|
| Materials and supplies | $ 2,559,783 | $ 1,859,963 |
| Finished goods | 1,293,177 | 2,716,013 |
| | $ 3,852,960 | $ 4,575,976 |

Materials and supplies are valued at the lower of average cost and net realizable value, with replacement costs being the typical measure of net realizable value. Finished goods inventory consists of metal available for sale in dore bar form and is valued at the lower of average production cost and net realizable value less estimated royalties, refining and transportation charges.

## 5. MINE PROPERTIES, PLANT AND EQUIPMENT

Net carrying costs at September 30, 2012 and December 31, 2011 are as follows:

| | Mines Under Construction | Plant and Equipment | Land and Buildings | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance as at December 31, 2010 | $ 26,694,463 | $ 31,248,412 | $ 3,292,747 | $ 61,235,622 |
| Additions | 31,934,711 | 1,285,810 | - | 33,220,521 |
| Disposals | - | (457,327) | - | (457,327) |
| Net-off of pre-commercial sales | (34,185,254) | - | - | (34,185,254) |
| Balance as at December 31, 2011 | 24,443,920 | 32,076,895 | 3,292,747 | 59,813,562 |
| Additions | 24,683,260 | 1,306,048 | - | 25,989,308 |
| Disposals | - | (279,658) | - | (279,658) |
| Net-off of pre-commercial sales | (21,590,197) | - | - | (21,590,197) |
| **Balance as at September 30, 2012** | **$ 27,536,983** | **$ 33,103,285** | **$ 3,292,747** | **$ 63,933,015** |
| **Accumulated amortization** | | | | |
| Balance as at December 31, 2010 | $ - | $ 4,102,735 | $ 93,643 | $ 4,196,378 |
| Amortization | - | 3,874,496 | 31,287 | 3,905,783 |
| Disposals | - | (398,243) | - | (398,243) |
| Balance as at December 31, 2011 | - | 7,578,988 | 124,930 | 7,703,918 |
| Amortization | - | 3,282,524 | 23,465 | 3,305,989 |
| Disposals | - | (113,447) | - | (113,447) |
| **Balance as at September 30, 2012** | **$ -** | **$ 10,748,065** | **$ 148,395** | **$ 10,896,460** |
| **Net book value** | | | | |
| At December 31, 2011 | $ 24,443,920 | $ 24,497,907 | $ 3,167,817 | $ 52,109,644 |
| At September 30, 2012 | $ 27,536,983 | $ 22,355,220 | $ 3,144,352 | $ 53,036,555 |

Expressed in United States dollars unless otherwise noted

## 5. MINE PROPERTIES, PLANT AND EQUIPMENT (cont'd)

**Mines under construction**

Mines under construction include all direct costs associated with the acquisition, exploration, evaluation and development of portals to access the Company's resource at its Zaruma Gold Project as well as pre-commercial operating costs. It also includes the operating costs of the processing plant from June 30, 2010. Revenue from the sale of metals prior to the commencement of commercial production has been credited to mines under construction.

**Plant and equipment**

The Company has completed the construction of a production facility to process material extracted from its Zaruma Gold Project. Plant construction includes the cost of engineering, materials, construction labor, machinery, equipment and the operating costs of commissioning the plant until June 30, 2010. Subsequent to this date the Company commenced amortizing the plant over its estimated useful life. As at September 30, 2012 the Zaruma Gold Project was in pre-commercial production having not yet finished the start-up phase of mine development activities.

Until such time as commercial production commences, the plant's operating costs will be capitalized to mines under construction.

Equipment includes all mining equipment includes various machinery and equipment being used in the development of portals and to mine material from the Zaruma Gold Project.

**Land and building**

The Company purchased the land on which the Zaruma Gold Project Plant is located as well as certain land to secure surface access to parts of the Dynasty and Zaruma exploration and development projects. The Company also owns office buildings in Quito.

## 6. EXPLORATION AND EVALUATION PROPERTIES

Title to exploration and evaluation properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties, and, to the best of its knowledge, titles to all of its properties, except as described below, are properly registered and in good standing.

| | Dynasty Project | Jerusalem Project | Other Projects | Total |
|---|---|---|---|---|
| **Balance, January 1, 2011** | $ 9,290,426 | $ 1,484,632 | $ 170,169 | $ 10,945,227 |
| **Costs** | | | | |
| Camp supplies and field costs | 18,490 | - | - | 18,490 |
| Geological consulting | 71,719 | 11,951 | - | 83,670 |
| Mineral concession rights | 761,987 | 6,974 | - | 768,961 |
| Project administration | 95,691 | 32,539 | - | 128,230 |
| Travel and related costs | 47,723 | 1,070 | - | 48,793 |
| Additions for the period | 995,610 | 52,534 | - | 1,048,144 |
| **Balance, December 31, 2011** | $ 10,286,036 | $ 1,537,166 | $ 170,169 | $ 11,993,371 |

## 6. EXPLORATION AND EVALUATION PROPERTIES (cont'd)

| | Dynasty Project | Jerusalem Project | Other Projects | Total |
|---|---|---|---|---|
| **Balance, December 31, 2011** | $ 10,286,036 | $ 1,537,166 | $ 170,169 | $ 11,993,371 |
| **Costs** | | | | |
| Camp supplies and field costs | 18,747 | 679 | - | 19,426 |
| Geological consulting | 48,876 | - | - | 48,876 |
| Laboratory fees | - | - | - | - |
| Mineral concession rights | 958,413 | 6,670 | - | 965,083 |
| Project administration | 56,440 | 34,021 | - | 90,461 |
| Travel and related costs | 23,838 | 49 | - | 23,887 |
| Additions for the period | 1,106,314 | 41,419 | - | 1,147,733 |
| **Balance, September 30, 2012** | $ 11,392,350 | $ 1,578,585 | $ 170,169 | $ 13,141,104 |

## 7. PROVISION FOR CLOSURE AND RESTORATION

The Company's environmental permit at the Zaruma Gold Project requires that it reclaim any land it disturbs during the mine and plant construction and operations. Although the timing and the amount of the actual expenditures are uncertain, the Company has estimated the present value of the future reclamation obligation arising from its activities to September 30, 2012 to be $1,308,158 (December 31, 2011 - $1,270,746). The present value of the future reclamation obligation assumes an inflation rate of 2.5% and a discount rate of 4.0%, an undiscounted amount to settle the obligation of $1,324,000 and the commencement of reclamation activities after the life of the mine, which is estimated at 15 years.

| | September 30 2012 | December 31 2011 |
|---|---|---|
| **Balance, beginning of year** | $ 1,270,746 | $ 1,222,781 |
| Accretion expense | 37,412 | 47,965 |
| **Balance, end of year** | $ 1,308,158 | $ 1,270,746 |

## 8. CAPITAL STOCK AND CONTRIBUTED SURPLUS

**Authorized and issued shares**

At September 30, 2012, the Company had unlimited authorized common shares and 42,461,083 shares outstanding (December 31, 2011 – 42,461,083). All per share amounts below are in Canadian dollars (CAD) which, at September 30, 2012, is equivalent to 1.017 US dollars.

Expressed in United States dollars unless otherwise noted

## 8. **CAPITAL STOCK AND CONTRIBUTED SURPLUS** (cont'd)

### Stock options

The Company has an incentive stock option plan, pursuant to which its Board of Directors grants stock options, from time to time, to directors, officers, employees and certain consultants. The exercise price of each option is no less than the market price of the Company's common shares at the date of grant. The options can be granted for a maximum term of 10 years. The Company's Board of Directors determines the vesting requirements for options granted. The Company received shareholder approval at its 2009 Annual General Meeting to grant a maximum of 7,118,225 options.

The Company uses a fair value method of accounting for all stock-based payments. Under this method, the Company recorded a stock-based compensation expense of $628,841 and $100,503 for the nine and three months ended September 30, 2012, respectively ($751,382 and $209,770 for the nine and three months ended September 30, 2011, respectively) with a corresponding credit to contributed surplus. The fair value of the stock options granted during the nine months ended September 30 is estimated as at the date of the grant using the Black-Scholes pricing model assuming the following weighted average assumptions:

| | 2012 | 2011 |
|---|---|---|
| Risk-free interest rate | 1.15% | 1.10% |
| Expected life | 3.30 years | 3.20 years |
| Annualized volatility | 70.15% | 84.35% |
| Pre-vest forfeiture rate | 10.00% | 10.00% |
| Dividend rate | 0.00% | 0.00% |

During the nine months ended September 30, 2012, the Company granted 340,000 (2011 – 361,000) options with a fair value of $369,486 (2011 - $742,893), which is being recognized over the vesting periods of the options. The continuity of incentive stock options and warrants issued and outstanding is as follows:

| | **Warrants** | | **Stock options** | |
|---|---|---|---|---|
| | **Number** | **Weighted Average Exercise Price (CAD$)** | **Number** | **Weighted Average Exercise Price (CAD$)** |
| **Balance, December 31, 2010** | 2,100,000 | $ 4.92 | 4,250,600 | $ 4.41 |
| Granted | - | - | 1,688,000 | 3.13 |
| Exercised | - | - | (392,500) | 2.09 |
| Forfeited | - | - | (955,750) | 4.20 |
| Expired | (2,100,000) | 4.92 | (50,000) | 3.48 |
| **Balance, December 31, 2011** | - | - | 4,540,350 | 4.19 |
| Granted | - | - | 340,000 | 3.00 |
| Forfeited | - | | (40,000) | 3.00 |
| Expired | - | 4.92 | (404,050) | 5.08 |
| **Balance, September 30, 2012** | - | $ - | 4,436,300 | $ 4.10 |

Expressed in United States dollars unless otherwise noted

## 8. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd)

**Stock options** (cont'd)

The following stock options were outstanding as at September 30, 2012:

| | Options outstanding | | | Options exercisable | |
|---|---|---|---|---|---|
| **Exercise price range** | **Number of stock options outstanding** | **Weighted average remaining contractual life (years)** | **Weighted average exercise price CAD$** | **Number of stock options exercisable** | **Weighted average exercise price CAD$** |
| $2.00 - $3.04 | 624,000 | 3.02 | 2.59 | 377,000 | 2.31 |
| $3.05 - $3.20 | 1,327,000 | 4.17 | 3.07 | 1,327,000 | 3.07 |
| $3.21 - $4.77 | 595,300 | 3.13 | 3.87 | 455,225 | 3.95 |
| $4.78 - $5.31 | 930,000 | 1.49 | 5.00 | 926,250 | 5.00 |
| $5.32 - $5.45 | 960,000 | 2.11 | 5.45 | 960,000 | 5.45 |
| | 4,436,300 | 2.86 | 4.03 | 4,045,475 | 4.11 |

The weighted average fair value per stock option granted during the nine months ended September 30, 2012 was $1.35 (2011 - $2.06) per option.

As at September 30, 2012, the non-vested stock-based compensation expense not yet recognized was $281,234 which is to be recognized over the next 17 months.

## 9. RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with related parties during the nine months ended September 30, 2012 and 2011:

a) paid or accrued professional fees of $158,918 (2011 - $96,326) to a law firm in Ecuador with which a director of the Company is affiliated;

b) paid or accrued professional fees of $161,310 (2011 - $114,589) to a director of the Company; and

c) paid or accrued management fees of $315,000 (2011 - $225,000) to a company controlled by the President and Chief Executive Officer of the Company of which $236,250 (2011 - $168,750) were capitalized and included in either mineral properties, plant and equipment and exploration and evaluation properties.

Included in accounts payable at September 30, 2012 is $56,167 (December 31, 2011 - $51,352) due to a law firm with which a current director is affiliated and $nil (December 31, 2011 - $44,655) due to directors and companies controlled by directors of the Company.

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

## 10. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

a) During the nine months ended September 30, 2012, the Company acquired inventory at a cost of $2,401,980, acquired land at a cost of $80,000, incurred plant construction expenditures of $111,840 and incurred mine development expenditures of $1,270,983 through accounts payable. In addition, the Company capitalized $1,118,924 and $1,569,082 of amortization on mining equipment and the plant, respectively to mine development costs.

b) During the nine months ended September 30, 2011, the Company acquired inventory at a cost of $514,396, acquired land at a cost of $80,000, incurred plant construction expenditures of $298,592 and incurred mine development expenditures of $1,192,234 through accounts payable. In addition, the Company capitalized 960,769 and $919,612 of amortization on mining equipment and the plant, respectively to mine development costs.

## 11. CAPITAL DISCLOSURE

The Company's capital currently consists of common shares and options. As the Company is in the early stage production phase for the nine months ended September 30, 2012 its principal source of funds is from the production and sale of precious metals and it is not subject to any externally imposed capital restrictions. The Company's capital management objectives are to safeguard its ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders, and to have sufficient capital to be able to meet the Company's property development and exploration plans. These objectives have not changed during the nine months ended September 30, 2012.

## 12. FINANCIAL INSTRUMENTS

Financial assets and liabilities

The fair value hierarchy establishes three levels in which to classify the inputs of valuation techniques used to measure fair value. Level 1 inputs are quoted market prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly, such as prices, or indirectly (derived from prices). Level 3 inputs are unobservable (supported by little or no market activity) such as non-corroborative indicative prices for a particular instrument provided by a third party.

There were no transfers between Level 1 and 2 or any transfers into or out of Level 3 during the nine months ended September 30, 2012. Cash and cash equivalents are stated at fair value and classified within Level 1. The fair values of receivable and accounts payable and accrued liabilities approximate carrying values because of the short term nature of these instruments.

Credit Risk

Financial instruments that potentially subject the Company to credit risk consist of cash and cash equivalents and receivables. The Company deposits cash and cash equivalents with high quality financial institutions as determined by rating agencies in Canada and Treasury Bills issued by the Federal Government of Canada, for which management believes the risk of loss to be minimal. The Company holds minimal balances in banks in Ecuador.

Receivables mainly consist of employee advances and sales tax refunds from the Federal Governments of Canada and Ecuador. Management believes that the credit risk concentration with respect to receivables is minimal.

## 12. FINANCIAL INSTRUMENTS (cont'd)

Currency Risk

The Company's operations in Canada and Ecuador create exposure to foreign currency fluctuation. Some of the Company's operating expenditures are incurred in Canadian dollars, and the fluctuation of the US dollar in relation to the Canadian dollar will have an impact upon the profitability of the Company and may also affect the value of the Company's financial assets and liabilities. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks.

At September 30, 2012, a significant portion of the Company's cash and cash equivalents were held in Canadian dollars and were therefore subject to fluctuation against the US dollar. Based on the balances as at September 30, 2012, if the Canadian dollar had weakened (strengthened) against the US dollar, with all other variables held constant, by 1%, net loss would have increased (decreased) by approximately $40. There would be no effect in other comprehensive loss. Additionally, a portion of the Company's receivables and accounts payable and accruals are denominated in the Canadian dollar and are therefore subject to fluctuation in exchange rates, however these balances are not large enough to expose the Company to significant foreign exchange risk.

Interest Rate Risk

The Company maintains short-term deposits in instruments that are redeemable at any time without penalty, thereby reducing its exposure to interest rate fluctuations thereon. The Company has no interest bearing debt and other interest rate risks on the Company's operations are not considered material.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they become due. The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. The Company manages its liquidity risk by forecasting cash flows from operations and anticipating any investing and financing activities. Management and the Board of Directors are actively involved in the review, planning and approval of significant expenditures and commitments.

Price risk

The Company is exposed to price risk with respect to commodity and equity prices. The ability of the Company to explore its mineral properties and the future profitability of the Company are directly related to the market price of gold and other precious metals. The Company monitors gold and other commodity prices to determine the appropriate course of action to be taken by the Company.

## 12. SUBSEQUENT EVENTS

On November 9, 2012 the Company received proceeds of $600,000 from entering into a loan agreement with a local Ecuadorian bank. The Loan is secured with the Company's owned office premises in Quito; the loan principal is repayable in six equal payments of $100,000 every 61 days commencing on January 8, 2013 and ending on November 9, 2013; and interest is charged based on the Ecuador Central Bank "Referential Passive" Interest Rate plus 4.1%, the aggregate of which is currently 8.25% and is due on the date principal repayments are made.