

DYNASTY METALS & MINING INC.
(the “Company”)

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2010 and 2009

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Dynasty Metals & Mining Inc.

We have audited the accompanying consolidated financial statements of Dynasty Metals & Mining Inc. (the "Company") which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, comprehensive loss and deficit, and cash flows for the years then ended, and notes, comprising 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 audits. We conducted our audits 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 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 in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Dynasty Metals & Mining Inc. as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that continuing operations are dependent upon, among other things, the Company's ability to 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 conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

"DAVIDSON & COMPANY LLP"

Vancouver, Canada

Chartered Accountants

March 29, 2011



DYNASTY METALS & MINING INC.
CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
YEARS ENDED DECEMBER 31,

	2010	2009
ASSETS		
Current		
Cash and cash equivalents	\$ 3,161,976	\$ 7,998,940
Receivables	26,835	20,747
Prepaid expenses	283,675	174,800
Inventory (Note 3)	<u>5,213,411</u>	<u>1,311,311</u>
	8,685,897	9,505,798
Advances and deposits	114,786	55,553
Property, plant and equipment (Note 4)	32,265,950	29,710,160
Mine development costs (Note 5)	21,223,724	13,022,320
Mineral properties (Note 6)	<u>19,777,302</u>	<u>18,610,008</u>
	<u>\$ 82,067,659</u>	<u>\$ 70,903,839</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	\$ 2,369,129	\$ 1,076,994
Asset retirement obligation (Note 7)	<u>714,333</u>	<u>658,917</u>
	<u>3,083,462</u>	<u>1,735,911</u>
Shareholders' equity		
Capital stock (Note 8)	93,798,153	80,185,812
Contributed surplus (Note 8)	10,221,765	7,374,054
Deficit	<u>(25,035,721)</u>	<u>(18,391,938)</u>
	<u>78,984,197</u>	<u>69,167,928</u>
	<u>\$ 82,067,659</u>	<u>\$ 70,903,839</u>

Nature and continuance of operations (Note 1)

On behalf of the Board:

 "Robert Washer" Director _____
 "Mark Bailey" Director

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

DYNASTY METALS & MINING INC.
CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
YEARS ENDED DECEMBER 31,

	2010	2009
EXPENSES		
Amortization and accretion	\$ 488,313	\$ 240,402
Management fees	246,683	261,216
Office and general	2,145,314	1,690,110
Professional fees	640,445	470,741
Shareholder communication	125,090	173,659
Stock-based compensation (Note 8)	2,099,120	4,916,663
Transfer agent and filing fees	74,191	63,017
Travel and entertainment	<u>280,599</u>	<u>360,136</u>
Loss before other items	<u>(6,099,755)</u>	<u>(8,175,944)</u>
OTHER ITEMS		
Interest income	40,638	36,071
Write-off of abandoned properties (Note 6)	(192,972)	-
Foreign exchange loss	<u>(391,694)</u>	<u>(171,448)</u>
	<u>(544,028)</u>	<u>(135,377)</u>
Loss and comprehensive loss for the year	(6,643,783)	(8,311,321)
Deficit, beginning of year	<u>(18,391,938)</u>	<u>(10,080,617)</u>
Deficit, end of year	<u>\$ (25,035,721)</u>	<u>\$ (18,391,938)</u>
Basic and diluted loss per share	<u>\$ (0.16)</u>	<u>\$ (0.23)</u>
Weighted average number of shares outstanding	<u>40,999,374</u>	<u>35,644,053</u>

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

DYNASTY METALS & MINING INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31,

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss for the year	\$ (6,643,783)	\$ (8,311,321)
Items not including cash:		
Amortization and accretion	488,313	240,402
Stock-based compensation	2,099,120	4,916,663
Write-off of abandoned properties	192,972	-
Changes in non-cash working capital items:		
(Increase) decrease in receivables	(6,088)	169,784
Increase in prepaid expenses	(108,875)	(77,234)
Increase in inventory	(3,902,100)	(1,311,311)
Increase (decrease) in accounts payable and accrued liabilities	<u>529,121</u>	<u>(29,008)</u>
Net cash used in operating activities	<u>(7,351,320)</u>	<u>(4,402,025)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures on mineral properties	(1,219,922)	(2,123,805)
Exploration advances and deposits	(59,233)	60,911
Purchase of property, plant and equipment	(4,290,345)	(11,803,790)
Pre-commercial production revenue credited to mine development costs	8,142,120	-
Mine development costs	<u>(14,406,396)</u>	<u>(7,329,498)</u>
Net cash used in investing activities	<u>(11,833,776)</u>	<u>(21,196,182)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of capital stock and units	15,435,712	17,209,254
Issuance costs	<u>(1,087,580)</u>	<u>(1,179,488)</u>
Net cash provided by financing activities	<u>14,348,132</u>	<u>16,029,766</u>
Change in cash and cash equivalents for the year	(4,836,964)	(9,568,441)
Cash and cash equivalents, beginning of year	<u>7,998,940</u>	<u>17,567,381</u>
Cash and cash equivalents, end of year	\$ 3,161,976	\$ 7,998,940
Cash paid during the year for interest	\$ -	\$ -
Cash paid during the year for income taxes	\$ -	\$ -

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.

On April 18th, 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 requires each company 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. There is no assurance that the Company will be able to agree on an exploitation contract and royalty rate that will not adversely affect the Company's business. In the event that the exploitation contract reached with the government impacts 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 mineral properties, property, plant and equipment 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 current year, mine development expenses and overheads have been partially funded from the sale of precious metals produced during mine construction at its Zaruma Gold Project. The Company has 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. 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. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Significant inter-company transactions and balances have been eliminated upon consolidation.

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") 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.

Significant accounts that require estimates relate to the possible impairment of property, plant and equipment, mine development costs and mineral properties, the useful life of assets for amortization, valuation allowances for future income taxes, valuation of stock-based compensation, the estimated economically recoverable resources for depreciating mineral properties and valuation of asset retirement obligations.

Cash and cash equivalents

The Company considers cash and cash equivalents to include amounts held in banks and highly liquid investments redeemable with an initial term to maturity of less than 90 days.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Revenue

Revenue from the sale of gold and silver will be recognized when the quantity of metal sold and the sales price are fixed, title has passed to the buyer and collection is reasonably assured.

Inventory

Inventory consists of materials and supplies and finished goods and is recorded at the lower of weighted average cost or net realizable value.

Property, plant and equipment

Property, plant and equipment is carried at cost less accumulated amortization. Amortization is provided using the straight-line method over the following terms:

Office and exploration equipment	5 years
Vehicles	3 years
Mining equipment	5 years
Drill rigs	5 years
Plant	10 years
Buildings	20 years

Mineral properties and mine development costs

All costs related to the acquisition, exploration, evaluation and development of mineral properties, including mine development costs, are capitalized by property, until such time a mineral property is brought into commercial production, at which time they are depreciated using the units of production method based on the estimated economically recoverable resources to which they relate. When a property is abandoned, all related costs are written off to operations. 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.

Start-up and commissioning costs, net of incidental revenues, are capitalised as mine development costs until the commencement of commercial production. Commercial production is deemed to have occurred when management determines that the completion of operational commissioning of major mine and plant components is completed, operating results are being achieved consistently for a period of time, and there are indicators that these operating results will continue.

The amounts shown for mineral properties and mine development costs 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 the development, and future profitable production or proceeds from the disposition thereof.

Asset retirement obligations

An asset retirement obligation is a legal obligation associated with the retirement of tangible long-lived assets that the Company is required to settle. The Company recognizes the fair value of a liability for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability. The amount added to the long-lived asset will be amortized in the same manner as the related asset. The liability will be increased in each accounting period by the amount of the implied interest ("accretion") inherent in the use of discounted present value methodology, and the increase will be charged against earnings.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Stock-based compensation

The Company uses the fair value method whereby the Company recognizes compensation costs for the granting of all stock options and direct awards of stock. Compensation costs are typically recognized over the vesting period. A corresponding increase in contributed surplus is recorded when stock options are expensed. When stock options are exercised, capital stock is credited by the sum of the consideration paid and the related portion of stock-based compensation previously recorded in contributed surplus.

Foreign currency translation

The Company's subsidiaries are integrated foreign operations and are translated into Canadian dollars using the temporal method. Monetary items are translated at the exchange rate in effect at the balance sheet date and non-monetary items are translated at historical exchange rates. Income and expense items are translated at rates approximating those in effect at the time of the transactions. Translation gains and losses are reflected in the results of operations.

Impairment of long lived assets

Long-lived assets are continually reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Income taxes

Future income taxes are recorded using the asset and liability method whereby 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, or substantively 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 in tax rates is recognized in income 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.

Loss per share

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 loss per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the year. For the years presented, this calculation proved to be anti-dilutive.

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year.

Financial instruments – recognition and measurement

Financial instruments are required to be measured at fair value on initial recognition. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The Company has implemented the following classifications for its financial instruments:

- a) Cash and cash equivalents have been classified as held-for-trading.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Financial instruments – recognition and measurement (cont'd)

- b) Receivables have been classified as loans and receivables and measured at amortized cost.
- c) Accounts payable and accrued liabilities have been classified as other financial liabilities and are measured at amortized cost.

Financial instruments – disclosure and presentation

The Company follows CICA Handbook Section 3862, Financial Instruments – disclosures, which requires entities to provide disclosures in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks.

The Company follows CICA Handbook Section 3863, Financial Instruments – presentation, which establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

Amendment to financial instruments - disclosures

CICA Handbook Section 3862, Financial Instruments – Disclosures was amended to require disclosure about the inputs used in making fair value measurements, including their classification within a hierarchy that prioritizes their significance. The three levels of fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and

Level 3 – Inputs that are not based on observable market data.

Cash and cash equivalents is the only financial instrument applicable to the fair value hierarchy disclosure and is classed within Level 1.

Comprehensive income

Comprehensive income is defined as the change in equity (net assets) from transactions and other events from non-owner sources. Other comprehensive income is defined as revenues, expenses, gains and losses that, in accordance with primary sources of GAAP, are recognized in comprehensive income, but excluded from net income. This would include holding gains and losses from financial instruments classified as available-for-sale.

Financing charges

Financing charges that reflect the cost to obtain new debt financing are expensed as incurred. Financing charges that reflect the cost to obtain new equity financing are deducted from shareholders equity.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Comparative amounts

Comparative amounts have been reclassified, where necessary, to conform to the presentation adopted in the current year.

New accounting standards

Business Combinations, Non-controlling Interest and Consolidated Financial Statements

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 1582 is applicable for the Company’s business combinations with acquisition dates on or after January 1, 2011. Early adoption of this Section is permitted. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company’s interim and annual consolidated financial statements for its fiscal year beginning January 1, 2011. Early adoption of this Section is permitted and all three Sections must be adopted concurrently.

International Financial Reporting Standards (“IFRS”)

In February 2008 the Canadian Accounting Standards Board 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 of January 1, 2010 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company has begun assessing the adoption of IFRS for 2011, and is considering the accounting policy changes under IFRS.

3. INVENTORY

	2010	2009
Materials and supplies	\$ 1,999,617	\$ 863,577
Finished goods	<u>3,213,794</u>	<u>447,734</u>
	<u>\$ 5,213,411</u>	<u>\$ 1,311,311</u>

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.

4. PROPERTY, PLANT AND EQUIPMENT

	December 31, 2010		
	Cost	Accumulated Amortization	Net Book Value
Office equipment	\$ 346,548	\$ 215,580	\$ 130,968
Exploration equipment	410,621	213,580	197,041
Drill rigs	950,974	485,231	465,743
Vehicles	688,568	374,268	314,300
Land	2,793,319	-	2,793,319
Buildings	615,052	92,032	523,020
Plant under construction	21,892,253	1,038,046	20,854,207
Mining equipment	9,332,503	2,345,151	6,987,352
	\$ 37,029,838	\$ 4,763,888	\$ 32,265,950
	December 31, 2009		
	Cost	Accumulated Amortization	Net Book Value
Office equipment	\$ 287,493	\$ 163,378	\$ 124,115
Exploration equipment	387,119	173,627	213,492
Drill rigs	950,974	295,037	655,937
Vehicles	466,180	218,606	247,574
Land	2,767,296	-	2,767,296
Buildings	615,052	61,280	553,772
Plant under construction	18,476,470	-	18,476,470
Mining equipment	7,546,178	874,674	6,671,504
	\$ 31,496,762	\$ 1,786,602	\$ 29,710,160

Plant

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 December 31, 2010 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 mine development costs.

Mining equipment

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

4. PROPERTY, PLANT AND EQUIPMENT (cont'd)

Land

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.

5. MINE DEVELOPMENT COSTS

Mine development costs include all direct costs associated with the 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 mine development costs.

6. MINERAL PROPERTIES

Title to mineral 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.

The Company considers the Zaruma Gold Project to be a development project while the others are considered exploration projects. The following table summarizes mineral property expenditures, by property.

	Dynasty Project	Zaruma Project	Jerusalem Project	Other Projects	Total
Balance, December 31, 2008	\$ 8,312,327	\$ 6,214,864	\$ 1,500,287	\$ 306,119	\$ 16,333,597
Costs					
Camp supplies and field costs	9,325	345,247	8,069	-	362,641
Geological consulting	147,222	110,005	58,408	1,505	317,140
Laboratory fees	-	29,449	1,952	-	31,401
Mineral concession rights	671,499	81,680	6,493	26,676	786,348
Project administration	143,221	292,716	49,201	2,984	488,122
Travel and related costs	59,118	212,395	19,246	-	290,759
	<u>1,030,385</u>	<u>1,071,492</u>	<u>143,369</u>	<u>31,165</u>	<u>2,276,411</u>
Balance, December 31, 2009	\$ 9,342,712	\$ 7,286,356	\$ 1,643,656	\$ 337,284	\$ 18,610,008
Costs					
Camp supplies and field costs	14,811	-	5,669	-	20,480
Geological consulting	111,789	16,897	23,269	-	151,955
Laboratory fees	4,891	1,802	1,237	-	7,930
Mineral concession rights	795,327	151,441	5,621	22,029	974,418
Project administration	68,642	53,045	25,241	-	146,928
Travel and related costs	49,566	8	7,818	1,163	58,555
Write-off of abandoned properties	-	-	-	(192,972)	(192,972)
	<u>1,045,026</u>	<u>223,193</u>	<u>68,855</u>	<u>(169,780)</u>	<u>1,167,294</u>
Balance, December 31, 2010	\$ 10,387,738	\$ 7,509,549	\$ 1,712,511	\$ 167,504	\$ 19,777,302

6. MINERAL PROPERTIES (cont'd)

Zaruma Gold Project

The Zaruma Gold Project comprises 46 concessions, located in the El Oro Province of southwestern Ecuador, in the vicinity of the towns of Zaruma and Portovelo. As of the date of this report, 43 of the concessions are 100% owned, one is 50% owned and one is 25% owned and subject to a concession sharing arrangement. The Company has title to the remaining concession and has paid the majority of applicable option payments on this concession.

Two of the concessions are subject to a 1% Net Smelter Return ("NSR") Royalty payable to a company controlled by a director, three concessions are subject to a 2% NSR Royalty and 39 are subject to a 1.5% NSR Royalty payable to IAMGOLD Ecuador S.A. ("IAMGOLD"). The Company has no work obligations with respect to the project concessions.

The Company is aware of actions taken by other parties to secure ownership of a concession within the Zaruma Gold Project and access certain other concessions. The Company believes that these actions are unlawful and has taken steps to protect its interest.

Jerusalem Project

The Jerusalem Project consists of one, 100% owned concession.

The project is subject to 1% NSR royalty, payable to a company controlled by a director. The Company has no work obligations with respect to the project property.

Dynasty Project

The Dynasty Project, also known as the Dynasty Copper-Gold Belt consists of 52, 100% owned concessions.

Five of the project concessions are subject to a 1% NSR royalty, payable to a company controlled by a director. The Company has no work obligations with respect to the project property.

Other Projects

The Company abandoned several concessions located at other projects during the year ended December 31, 2010. These concessions were not significant to the Company's future exploration or development plans. Costs that had been previously capitalized relating to these concessions were written-off.

7. ASSET RETIREMENT OBLIGATION

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 December 31, 2010 to be \$714,333 (December 31, 2009 - \$658,917). The present value of the future reclamation obligation assumes an inflation rate of 2.5% and a discount rate of 8.0%, 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.

DYNASTY METALS & MINING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 and 2009

7. ASSET RETIREMENT OBLIGATION (cont'd)

	2010	2009
Balance, beginning of year	\$ 658,917	\$ 314,742
Liabilities incurred in the year	-	318,331
Accretion expense	<u>55,416</u>	<u>25,844</u>
Balance, end of year	<u>\$ 714,333</u>	<u>\$ 658,917</u>

8. CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Capital Stock		Contributed Surplus
	Number of Shares	Amount	
Authorized Unlimited common shares without par value			
As at December 31, 2008	32,891,129	\$ 63,930,998	\$ 2,695,239
Exercise of options	1,204,629	1,209,254	-
Private placements (b), (c)	4,000,000	16,000,000	-
Share issue and transaction costs (b), (c)	-	(1,558,638)	366,350
Stock-based compensation	-	-	4,916,663
Option conversion	<u>-</u>	<u>604,198</u>	<u>(604,198)</u>
As at December 31, 2009	38,095,758	\$ 80,185,812	\$ 7,374,054
Exercise of warrants	40,000	169,600	-
Exercise of options	182,825	266,112	-
Private placements (a)	3,750,000	14,106,587	893,413
Issuance and transaction costs	-	(1,171,992)	97,212
Stock-based compensation	-	-	2,099,120
Option and warrant conversion	<u>-</u>	<u>242,034</u>	<u>(242,034)</u>
As at December 31, 2010	<u>42,068,583</u>	<u>\$ 93,798,153</u>	<u>\$ 10,221,765</u>

Share issuances

During the year ended December 31, 2010, the Company:

- a) Issued 3,750,000 Units at a price of \$4.00 per Unit on April 1, 2010 for gross proceeds of \$15,000,000, by way of an underwritten private placement. Each Unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant will be exercisable at a price of \$5.00 until April 1, 2011. The warrants were valued at \$893,413 using the Black-Scholes option pricing model with a weighted average expected volatility of 51.67%, risk free interest rate of 2.02%, expected life of 1 year and dividend yield of 0%.

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

Share issuances (cont'd)

In connection with the transaction, the Company paid a cash commission of \$900,000, other issuance costs of \$174,903 and granted the agent warrants to purchase 225,000 common shares at \$4.16 per share for a period of one year. The agents warrants were valued at \$171,439 using the Black-Scholes option pricing model with a weighted average expected volatility of 51.67%, risk free interest rate of 2.02%, expected life of 1 year and dividend yield of 0%.

During the year ended December 31, 2009, the Company:

- b) Issued 2,500,000 common shares at \$4.00 per share on February 19, 2009 for gross proceeds of \$10,000,000, by way of a brokered private placement. In connection with the transaction, the Company paid a cash commission of \$600,000, other issuance costs of \$140,267 and granted the agent warrants to purchase 100,000 common shares at \$4.24 per share for a period of one year. The warrants were valued at \$260,000 using the Black-Scholes option pricing model with a weighted average expected volatility of 133.80%, risk free interest rate of 1.25%, expected life of 1 year and dividend yield of 0%.
- c) Issued 1,500,000 common shares at \$4.00 per share on November 3, 2009 for gross proceeds of \$6,000,000, by way of a brokered private placement. In connection with the transaction, the Company paid a cash commission of \$360,000, other issuance costs of \$92,021 and granted the agent warrants to purchase 90,000 common shares at \$4.60 per share for a period of one year. The warrants were valued at \$106,350 using the Black-Scholes option pricing model with a weighted average expected volatility of 85.78% risk free interest rate of 1.40%, expected life of 1 year and dividend yield of 0%.

Stock options and warrants

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 based on 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.

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

Stock options and warrants (cont'd)

	Warrants		Stock options	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Balance, December 31, 2008	-	\$ -	2,996,954	\$ 2.64
Granted	190,000	4.42	2,735,000	4.91
Exercised	-	-	(1,204,629)	1.00
Cancelled	-	-	(300,000)	5.00
Expired	-	-	<u>(103,000)</u>	7.30
Balance, December 31, 2009	190,000	\$ 4.42	4,124,325	\$ 4.34
Granted	2,100,000	4.92	580,300	4.14
Exercised	(40,000)	4.24	(182,825)	1.46
Cancelled	-	-	-	-
Expired	<u>(150,000)</u>	4.46	<u>(271,200)</u>	4.74
Balance, December 31, 2010	2,100,000	\$ 4.92	4,250,600	\$ 4.41

The weighted average fair value per stock option granted during fiscal 2010 was \$2.62 (2009 - \$3.13) per option.

The following stock options were outstanding as at December 31, 2010:

Exercise price range	Options outstanding			Options exercisable	
	Number of stock options outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number of stock options exercisable	Weighted average exercise price \$
\$2.00 - \$3.01	801,250	1.73	2.17	648,000	2.13
\$3.48 - \$4.53	975,300	3.12	3.92	512,995	3.95
\$5.00 - \$5.45	2,294,050	3.30	5.21	1,751,550	5.27
\$6.00 - \$7.44	180,000	1.54	6.83	176,000	6.85
	4,250,600	2.89	4.41	3,088,545	4.48

As at December 31, 2010 there were outstanding warrants to purchase 225,000 common shares at \$4.16 expiring on April 1, 2011 and outstanding warrants to purchase 937,500 common shares at a price of \$5.00 expiring on April 1, 2011.

Subsequent to December 31, 2010, the Company granted options to purchase 169,000 common shares at \$3.63 per share; granted options to purchase 10,000 common shares at \$3.05 per share; issued 360,000 common shares upon the exercise of stock options for proceeds of \$756,000 and issued 6,250 common shares upon the exercise of stock options for proceeds of \$12,500.

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

Stock options and warrants (cont'd)

Stock-based compensation

The Company uses the Black-Scholes option pricing model to determine the fair value of options granted. During fiscal 2010, the Company granted 580,300 (2009 – 2,735,000) options with a fair value of \$1,519,686 (2009 - \$8,473,200), which is being recognized over the vesting periods of the options. Total stock-based compensation recognized in the Statement of Operations, Comprehensive Loss and Deficit for the year ended December 31, 2010 was \$2,099,120 (2009 - \$4,916,663). This amount represents the value of vested options.

The following weighted average assumptions were used for the valuation of stock options:

	2010	2009
Risk-free interest rate	1.80%	1.66%
Expected life	4.01 years	3.97 years
Annualized volatility	87.56%	92%
Dividend rate	0.00%	0.00%

9. RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with related parties during the years ended December 31, 2010 and 2009:

- a) paid or accrued professional fees of \$97,827 (2009 - \$64,003) to a law firm in Ecuador with which a director of the Company is affiliated;
- b) paid or accrued professional fees of \$161,524 (2009 - \$51,221) to a director of the Company of which \$126,631 (2009 - \$nil) were capitalized and included in mine development costs; and
- c) paid management fees of \$309,034 (2009 - \$342,410) to a company controlled by the President and Chief Executive Officer of the Company of which \$231,776 (2009 - \$256,807) were capitalized and included in either mineral property, mine development or plant construction costs;

Included in accounts payable at December 31, 2010 is \$34,893 (December 31, 2009 - \$4,587) due to a director 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 year ended December 31, 2010, the Company incurred mineral property expenditures of \$424,096, acquired land at a cost of \$79,568, incurred plant construction expenditures of \$136,131 and incurred mine development expenditures of \$1,025,128 through accounts payable. In addition, the Company capitalized \$1,354,069 and \$1,038,046 of amortization on mining equipment and the plant, respectively to mine development costs, and incurred share issuance costs of \$97,212 relating to the issuance of agent's warrants.
- b) During the year ended December 31, 2009, the Company incurred mineral property expenditures of \$283,752, acquired land at a cost of \$84,080, incurred plant construction expenditures of \$79,208, incurred mine development expenditures of \$442,069 and incurred share issuance costs of \$12,800 through accounts payable. In addition, the Company capitalized \$747,014 of amortization on mining equipment to mine development costs, incurred plant construction expenditure of \$115,748 through asset retirement obligations, incurred mine development expenditures of \$202,583 through asset retirement obligations and incurred share issuance costs of \$366,350 relating to the issuance of agent's warrants
- c) Cash and cash equivalents consisted of cash of \$3,161,976 (2009 - \$4,121,440) and short-term investments of \$nil (2009 - \$3,877,500).

11. INCOME TAXES

A reconciliation of income taxes at statutory rates with reported taxes is as follows:

	2010	2009
Loss before income taxes	\$ (6,643,783)	\$ (8,311,321)
Income tax (recovery) at statutory rates	\$ (2,180,814)	\$ (2,624,353)
Share issuance costs deductible for tax purposes	(326,495)	(261,240)
Non-deductible items	798,123	1,566,615
Unrecognized benefit of net operating losses	<u>1,709,186</u>	<u>1,318,978</u>
	\$ -	\$ -

Significant components of the Company's future income tax assets and liabilities are as follows:

	2010	2009
Future income tax assets:		
Capital assets	\$ 148,000	\$ 84,000
Non-capital loss carry forwards	2,457,000	1,898,000
Share issuance costs	<u>529,000</u>	<u>530,000</u>
Total future income tax assets	\$ 3,134,000	\$ 2,512,000
Future income tax liabilities:		
Mineral properties	<u>(2,762,000)</u>	<u>(1,915,000)</u>
Net future income tax assets (liabilities)	372,000	597,000
Less valuation allowance	<u>(372,000)</u>	<u>(597,000)</u>
Net future income tax liabilities	\$ -	\$ -

11. INCOME TAXES (cont'd)

The Company has available for deduction against future taxable income non-capital losses of approximately \$9,800,000 in Canada. These losses, if not utilized, will expire up to 2030. Future tax benefits which may arise as a result of these tax assets have not been recognized in these financial statements and have been offset by a valuation allowance.

12. CAPITAL DISCLOSURE

The Company's capital currently consists of common shares, options and warrants. As the Company is in the development stage its principal source of funds is from the issuance of common shares 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 year ended December 31, 2010.

13. FINANCIAL INSTRUMENTS

Fair Values

As at December 31, 2010, the carrying values of receivables, accounts payable and accrued liabilities approximate their fair values due to their short term to maturity.

Credit Risk

Financial instruments that potentially subject the Company to credit risk consist of cash and receivables. The Company deposits cash 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.

Currency Risk

The Company's significant subsidiaries are located in Ecuador for which the U.S. dollar is considered the functional currency. As such, at December 31, 2010, a significant portion of the Company's cash was held in U.S. dollars and were therefore subject to fluctuation against the Canadian dollar. Based on the balances as at December 31, 2010, if the U.S. dollar had weakened (strengthened) against the Canadian dollar, with all other variables held constant, by 1%, net loss would have increased (decreased) by approximately \$4,137. 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 U.S. 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.

13. FINANCIAL INSTRUMENTS (cont'd)

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.

14. SEGMENTED INFORMATION

The Company's one reportable operating segment is the acquisition, exploration and development of mineral property concessions. Geographic information is as follows:

	2010	2009
Capital assets:		
Canada	\$ 3,062	\$ 3,622
Ecuador	<u>73,263,914</u>	<u>61,338,866</u>
	<u>\$ 73,266,976</u>	<u>\$ 61,342,488</u>