

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

CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in United States dollars, unless otherwise noted)

DECEMBER 31, 2012

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Dynasty Metals & Mining Inc.

We have audited the accompanying consolidated financial statements of Dynasty Metals & Mining Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and 2011 and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and 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 International Financial Reporting Standards, 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.

Auditors' 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 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 auditors' 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 auditors consider 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, these consolidated financial statements present fairly, in all material respects, the financial position of Dynasty Metals & Mining Inc. as at December 31, 2012 and 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes conditions and matters that indicate the existence of a material uncertainty that may cast significant doubt about the ability of Dynasty Metals & Mining Inc. to continue as a going concern.

“DAVIDSON & COMPANY LLP”

Vancouver, Canada

Chartered Accountants

March 27, 2013

DYNASTY METALS & MINING INC.
CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS
YEARS ENDED DECEMBER 31,
Expressed in United States dollars unless otherwise noted

	2012	2011
EXPENSES		
Administrative salaries and benefits	\$ 955,417	\$ 827,574
Amortization and accretion	528,971	592,977
Bank interest and fees	85,794	89,302
Insurance	212,466	193,708
Management fees	429,877	245,794
Office and general	1,087,764	741,033
Professional fees	1,141,511	1,110,965
Rent, utilities and maintenance	327,861	244,792
Shareholder communication	74,244	272,939
Stock-based compensation (Note 9)	634,477	2,946,608
Transfer agent and filing fees	47,824	58,957
Travel and entertainment	<u>294,287</u>	<u>332,440</u>
Loss and comprehensive loss for the year	\$ (5,820,493)	\$ (7,657,089)
<hr/>		
Basic and diluted loss per share	\$ (0.14)	\$ (0.18)
<hr/>		
Weighted average number of shares outstanding	42,461,083	42,414,486

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

DYNASTY METALS & MINING INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
Expressed in United States dollars unless otherwise noted

	December 31, 2012	December 31, 2011
ASSETS		
Current assets		
Cash	\$ 433,364	\$ 6,238,514
Receivables	54,021	53,479
Prepaid expenses	805,202	394,450
Inventory (Note 4)	<u>3,064,284</u>	<u>4,575,976</u>
	4,356,871	11,262,419
Advances and deposits	86,764	76,688
Mine properties, plant and equipment (Note 5)	55,564,745	52,109,644
Exploration and evaluation properties (Note 6)	<u>12,836,750</u>	<u>11,993,371</u>
	<u>\$ 72,845,130</u>	<u>\$ 75,442,122</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 6,453,096	\$ 4,870,324
Short term loan (Note 7)	<u>600,000</u>	<u>-</u>
	7,053,096	4,870,324
Provision for closure and restoration (Note 8)	<u>1,676,998</u>	<u>1,270,746</u>
	<u>8,730,094</u>	<u>6,141,070</u>
Shareholders' equity		
Capital stock (Note 9)	89,059,365	89,059,365
Contributed surplus (Note 9)	13,483,319	12,848,842
Deficit	<u>(38,427,648)</u>	<u>(32,607,155)</u>
	<u>64,115,036</u>	<u>69,301,052</u>
	<u>\$ 72,845,130</u>	<u>\$ 75,442,122</u>

Nature and continuance of operations (Note 1)

On behalf of the Board:

"Robert Washer" Director

"Leonard Clough" Director

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

DYNASTY METALS & MINING INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Expressed in United States dollars unless otherwise noted

	Number of Shares	Capital Stock	Deficit	Contributed Surplus	Other Comprehensive Loss	Total
Balance at December 31, 2010	42,068,583	\$ 87,803,364	\$ (24,861,561)	\$ 10,324,566	\$ (88,505)	\$ 73,177,864
Loss for the year	-	-	(7,657,089)	-	-	(7,657,089)
Stock options exercised	392,500	833,669	-	-	-	833,669
Stock option and warrant conversion	-	422,332	-	(422,332)	-	-
Stock-based compensation	-	-	-	2,946,608	-	2,946,608
Functional currency translation adjustment	-	-	(88,505)	-	88,505	-
Balance at December 31, 2011	<u>42,461,083</u>	<u>\$ 89,059,365</u>	<u>\$ (32,607,155)</u>	<u>\$ 12,848,842</u>	<u>\$ -</u>	<u>\$ 69,301,052</u>
Loss for the year	-	-	(5,820,493)	-	-	(5,820,493)
Stock-based compensation	-	-	-	634,477	-	634,477
Balance at December 31, 2012	<u>42,461,083</u>	<u>\$ 89,059,365</u>	<u>\$ (38,427,648)</u>	<u>\$ 13,483,319</u>	<u>\$ -</u>	<u>\$ 64,115,036</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,
Expressed in United States dollars unless otherwise noted

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss for the year	\$ (5,820,493)	\$ (7,657,089)
Items not affecting cash:		
Amortization and accretion	528,971	592,977
Stock-based compensation	634,477	2,946,608
Changes in non-cash working capital items:		
Increase (decrease) in receivables	(542)	(26,394)
Increase (decrease) in prepaid expenses	(410,752)	(109,235)
(Increase) decrease in inventory	1,734,431	610,881
Increase (decrease) in accounts payable	<u>2,184,575</u>	<u>(200,727)</u>
Net cash used in operating activities	<u>(1,149,333)</u>	<u>(3,842,979)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures on exploration and evaluation properties	(843,379)	(1,048,144)
Exploration advances and deposits	(10,076)	38,721
Pre-production revenue credited to mine properties, plant and equipment	28,401,178	34,185,254
Expenditures on mine properties, plant and equipment	<u>(32,803,540)</u>	<u>(27,107,150)</u>
Net cash recovered (used) in investing activities	<u>(5,255,817)</u>	<u>6,068,681</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of capital stock and units	-	833,669
Issuance of short term debt	<u>600,000</u>	<u>-</u>
Net cash provided by financing activities	<u>600,000</u>	<u>833,669</u>
Change in cash for the year	(5,805,150)	3,059,371
Cash, beginning of year	<u>6,238,514</u>	<u>3,179,143</u>
Cash, end of year	\$ 433,364	\$ 6,238,514
<hr/>		
Cash paid during the year for interest	\$ -	\$ -
<hr/>		
Cash paid during the year for income taxes	\$ 1,665,234	\$ -
<hr/>		
Cash received during the year for interest	\$ 2,154	\$ 14,646
<hr/>		

Supplemental disclosure with respect to cash flows (Note 11)

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 years ended December 31, 2012 and December 31, 2011, 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 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 consolidated financial have been prepared in accordance with IFRS as issued by the International Accounting Standards Board (“IASB”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”). The accounting policies, methods of computation and presentation applied in these consolidated financial statement are consistent with those of the previous financial year. These consolidated financial statements have been prepared on a historical cost basis except for certain financial instruments which are measured at fair value. The Board of Directors has approved the audited consolidated financial statements on March 27, 2013.

3. SUMMARY OF 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.

Name of Subsidiary	Place of Incorporation	Percentage Ownership
Empire Sun Investments Limited	British Virgin Islands	100%
Elipe S.A.	Ecuador	100%
Polimines Corporation	Panama	100%
Golden Valley Planta S.A.	Ecuador	100%
Greentrade Ecuador Overseas Inc.	Panama	100%
Operaciones Greentrade S.A.	Ecuador	100%
Operaciones Greenmining S.A.	Ecuador	100%
Minsupport S.A.	Ecuador	100%

Estimates, risks and uncertainties

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 provisions for closure and restoration. 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 carrying value and recoverability of mineral properties requires management to make certain estimates, judgments and assumptions about each project. Management considers the economics of the project, including the latest resources prices and the long-term forecasts, and the overall economic viability of the project. 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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Estimates, risks and uncertainties (con't)

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.

In estimating the provision for closure and restoration, the Company makes assumptions about activities that occur many years into the future including the cost and timing of such activities. The ultimate financial impact is not clearly known as decommissioning costs and techniques are constantly changing, as are legal, regulatory, environmental, political, safety and other such considerations. In arriving at accounts recorded, numerous assumptions and estimates are made on ultimate settlement amounts, inflation factors, discount rates, timing and expected changes in legal, regulatory, environmental, political, and safety requirements.

The determination of income tax is inherently complex and requires making certain estimates and assumptions about future events. While income tax filings are subject to audits and reassessments, the Company has adequately provided for all income tax obligations. However, changes in facts and circumstances as a result of income tax audits, reassessments, jurisprudence and any new legislation may result in an increase or decrease in our provision for income taxes.

Share-based payments are subject to estimation of the value of the award at the date of grant using pricing models such as the Black-Scholes option valuation model. The option valuation model requires the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options and because the subjective input assumptions can materially affect the calculated fair value, such value is subject to measurement uncertainty.

Foreign currency translation

The presentation currency and the functional currency of the Company and all of the Company's operations is the United States Dollar ("USD"). The Company's foreign currency transactions are translated into USD at the rate of exchange in effect at the date of the transaction. Monetary assets and liabilities are translated using period end exchange rates with any gains and losses included in the determination of operating results. Non-monetary assets and liabilities are translated using historical rates.

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.

Pre-commercial sales

Pre-commercial sales 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Mineral exploration, evaluation and development properties

Exploration and evaluation properties

Once a license to explore an area has been secured, expenditures on exploration and evaluation activities are capitalized to exploration and evaluation. Exploration and evaluation expenditures relate to the initial search for deposits with economic potential and to detailed assessments of deposits or other projects that have been identified as having economic potential.

Once an economically viable project has been determined for an area and the decision to proceed with development has been approved, exploration and evaluation assets attributable to that area are first tested for impairment and then reclassified to mines under construction within mine properties, plant and equipment.

Subsequent recovery of the resulting carrying value depends on successful development or sale of the undeveloped project. If a project does not prove viable, all irrecoverable costs associated with the project net of any impairment provisions are written off.

Development properties

When economically viable projects have been determined and the decision to proceed with development has been approved, the expenditures related to construction are capitalized as mines under construction and classified as a component of mine properties, plant and equipment. Costs associated with the commissioning of new assets, in the pre-commercial period before they are operating in the way intended by management, are capitalized, net of any pre-production revenues. Commercial production is deemed to have occurred when management determines that the completion of operational commissioning of major mine components has been reached, operating results are being achieved consistently for a period of time, and there are indicators that these operating results will continue. In the Company's judgement these criteria have not been met for the year ended December 31, 2012.

Mine properties, plant and equipment

Upon completion of mine construction, the assets are transferred into properties, plant and equipment or mine properties. Items of property, plant and equipment and mine properties are stated at cost, less accumulated depreciation and accumulated impairment losses.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the rehabilitation obligation, and for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

When a mine construction project moves into the stage of operating in the way intended by management, the capitalization of certain mine construction costs ceases and costs are either regarded as inventory or expensed, except for costs which qualify for capitalization relating to mining asset additions or improvements, underground mine development or mineable resource development.

Amortization methods and useful lives are reviewed at each annual reporting date and adjusted as appropriate. Where an item of plant and equipment comprises major components with different useful lives, the components are accounted for as separate items of plant and equipment. 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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Provision for closure and restoration

The Company recognizes provisions for statutory, contractual, constructive or legal obligations associated with the decommissioning and reclamation of mine properties, plant and equipment, when those obligations result from the acquisition, construction, development or normal operation of the assets. A liability is recognized at the time environmental disturbance occurs and the resulting costs are capitalized to the corresponding asset. The provision for reclamation and rehabilitation obligations is estimated using expected cash flows and is discounted at a pre-tax rate specific to the liability. The capitalized amount is amortized on the same basis as the related asset. The liability is adjusted for the accretion of the discounted obligation and any changes in the amount or timing of the underlying future cash flows.

In subsequent periods, the liability is adjusted for any changes in the amount or timing of the estimated future cash costs and for the accretion of discounted underlying future cash flows. The unwinding of the effect of discounting the provision is recorded as an expense in the Consolidated Statements of Loss and Comprehensive Loss.

Stock-based compensation

Certain employees (including directors and senior executives) of the Company receive a portion of their remuneration in the form of stock options. The cost of these stock options is measured using the estimated fair value at the date of the grant determined using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of subjective assumptions, including the expected term of the option and stock price volatility. The expected term of options granted is determined based on historical data on the average hold period before exercise, expiry or cancellation. Expected volatility is estimated with reference to the historical volatility of the share price of the Company. These estimates involve inherent uncertainties and the application of management's judgment. The costs are recognized over the vesting period of the option. The total amount recognized as an expense is adjusted to reflect the number of options expected to vest at each reporting date. The corresponding credit for these costs is recognized in contributed surplus in shareholders' equity.

Stock based compensation arrangements in which the Company receives goods or services as consideration for its own equity instruments are accounted for as equity settled share based payment transactions and measured at the fair value of goods or services received. If the fair value of the goods or services received cannot be estimated reliably, the share based payment transaction is measured at the fair value of the equity instruments granted at the date the Company receives the goods or the services.

Impairment on non-financial assets

At each date of the statement of financial position, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash generating unit to which the assets belong. Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset (or cash generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of comprehensive loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease. Where an impairment loss subsequently reverses, the carrying amount of the asset (cash generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash generating unit) in prior years.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Income taxes

The Company recognizes the deferred tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred 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 deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. Deferred tax assets are recognized to the extent that recovery is estimated to be probable.

Loss per share

The Company computes the dilutive effect of options, warrants and similar instruments. 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 assets

Financial assets, other than derivatives, are designated as available-for-sale, loans and receivables held to maturity or at fair value through profit or loss ("FVTPL"). Financial assets classified as available-for-sale are measured on initial recognition plus transaction costs and subsequently at fair value with unrealized gains and losses recognized in other comprehensive income (loss) except for financial assets that are considered to be impaired in which case the loss is recognized in net income or loss. The Company has not classified any assets as available-for-sale for the years presented.

Financial assets classified as held-to-maturity are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in the statement of loss and comprehensive loss.

Financial assets classified as loans and receivables are measured initially at fair value plus transaction costs and subsequently at amortized cost using the effective interest rate method. The Company's receivables are classified as loans and receivables.

Financial assets classified as FVTPL are measured on initial recognition and subsequently at fair value with unrealized gains and losses recognized in income or loss. Transaction costs are expensed for assets classified as FVTPL. The Company's cash is classified as FVTPL.

Financial liabilities

Financial liabilities, other than derivatives, are initially recognized at fair value less directly attributable transaction costs. Subsequently, financial liabilities are measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and allocating the interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period. The Company's accounts payable and accrued liabilities are measured at amortized cost.

Financial liabilities classified as FVTPL include financial liabilities held for trading and financial liabilities designated upon recognition as FVTPL. Fair value changes on these liabilities are recognized in net income or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Segment reporting

The chief operating decision-maker has been identified as the Chief Executive Officer of the Company (the "CEO"). The Company has identified one reportable segment (the exploration, mine development and extraction of precious metals, primarily gold). All such concessions and substantially all the capital assets of the Company are situated in one geographic area, Ecuador as at the reporting date.

New accounting standards and interpretations

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 IFRS 9 on the consolidated financial statements have not been determined.

4. INVENTORY

	December 31 2012	December 31 2011
Materials and supplies	\$ 1,774,381	\$ 1,859,963
Finished goods	<u>1,289,903</u>	<u>2,716,013</u>
	<u>\$ 3,064,284</u>	<u>\$ 4,575,976</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.

DYNASTY METALS & MINING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011
Expressed in United States dollars unless otherwise noted

5. MINE PROPERTIES, PLANT AND EQUIPMENT

Net carrying costs at December 31, 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	34,884,907	1,502,581	-	36,387,488
Disposals	-	(279,658)	-	(279,658)
Net-off of pre-commercial sales	(28,401,178)	-	-	(28,401,178)
Balance as at December 31, 2012	\$ 30,927,649	\$ 33,299,818	\$ 3,292,747	\$ 67,520,214
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	-	4,333,715	31,287	4,365,002
Disposals	-	(113,451)	-	(113,451)
Balance as at December 31, 2012	\$ -	\$ 11,799,252	\$ 156,217	\$ 11,955,469
Net book value				
At December 31, 2011	\$ 24,443,920	\$ 24,497,907	\$ 3,167,817	\$ 52,109,644
At December 31, 2012	\$ 30,927,649	\$ 21,500,566	\$ 3,136,530	\$ 55,564,745

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 since June 30, 2010. Pre-commercial sales from the sale of metals prior to the commencement of commercial production have 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 December 31, 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.

DYNASTY METALS & MINING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011
Expressed in United States dollars unless otherwise noted

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

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, December 31, 2010	<u>\$ 9,290,426</u>	<u>\$ 1,484,632</u>	<u>\$ 170,169</u>	<u>\$ 10,945,227</u>
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	<u>47,723</u>	<u>1,070</u>	<u>-</u>	<u>48,793</u>
Additions for the year	<u>995,610</u>	<u>52,534</u>	<u>-</u>	<u>1,048,144</u>
Balance, December 31, 2011	<u>\$ 10,286,036</u>	<u>\$ 1,537,166</u>	<u>\$ 170,169</u>	<u>\$ 11,993,371</u>
Costs				
Camp supplies and field costs	21,965	679	-	22,644
Geological consulting	79,561	-	-	79,561
Mineral concession rights	580,522	6,670	-	587,192
Project administration	76,027	45,337	-	121,364
Travel and related costs	<u>32,569</u>	<u>49</u>	<u>-</u>	<u>32,618</u>
Additions for the year	<u>790,644</u>	<u>52,735</u>	<u>-</u>	<u>843,379</u>
Balance, December 31, 2012	<u>\$ 11,076,680</u>	<u>\$ 1,589,901</u>	<u>\$ 170,169</u>	<u>\$ 12,836,750</u>

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.

6. EXPLORATION AND EVALUATION PROPERTIES (cont'd)

Zaruma Gold Project(cont'd)

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. 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.

7. SHORT TERM LOAN

As at December 31, 2012 the Company had a short term loan totalling \$600,000 (2011 - \$nil) 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.

8. 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 December 31, 2012 to be \$1,676,998 (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 \$1,758,000 and the commencement of reclamation activities after the life of the mine, which is estimated at 15 years.

	December 31 2012	December 31 2011
Balance, beginning of year	\$ 1,270,746	\$ 1,222,781
Liabilities incurred in the year	352,840	-
Accretion expense	<u>53,412</u>	<u>47,965</u>
Balance, end of year	<u>\$ 1,676,998</u>	<u>\$ 1,270,746</u>

9. CAPITAL STOCK AND CONTRIBUTED SURPLUS

Authorized and issued shares

At December 31, 2012, the Company had unlimited authorized common shares and 42,461,083 shares outstanding (2011 – 42,461,083). All per share amounts below are in Canadian dollars (CAD) which, at December 31, 2012, is equivalent to 1.0105 US dollars.

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 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 \$634,477 for the year ended December 31, 2012 (2011 - \$2,946,608) with a corresponding credit to contributed surplus. The fair value of the stock options 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%	1.23%
Expected life	3.30 years	3.39 years
Annualized volatility	70.16%	82.46%
Pre-vest forfeiture rate	10.00%	10.00%
Dividend rate	0.00%	0.00%

During fiscal 2012, the Company granted 340,000 (2011 – 1,688,000) options with a fair value of \$263,115 (2011 - \$2,795,273), 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	<u>(2,100,000)</u>	4.92	<u>(50,000)</u>	3.48
Balance, December 31, 2011	-	-	4,540,350	4.19
Granted	-	-	340,000	3.00
Forfeited	-	-	(40,000)	3.00
Expired	<u>-</u>	-	<u>(404,050)</u>	5.08
Balance, December 31, 2012	-	\$ -	4,436,300	\$ 4.03

DYNASTY METALS & MINING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011
Expressed in United States dollars unless otherwise noted

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

Stock options and warrants (cont'd)

The following stock options were outstanding as at December 31, 2012:

Exercise price range	Options outstanding			Options exercisable	
	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	2.77	2.58	377,000	2.31
\$3.05 - \$3.20	1,327,000	3.92	3.07	1,327,000	3.07
\$3.21 - \$4.77	595,300	2.88	3.87	460,225	3.96
\$4.78 - \$5.31	930,000	1.24	5.00	930,000	5.00
\$5.32 - \$5.45	960,000	1.86	5.45	960,000	5.45
	4,436,300	2.61	4.03	4,054,225	4.11

In 2012, no options were exercised (2011 – 392,500) which resulted in the issuance of an equal number of common shares. The weighted average fair value per stock option granted during fiscal 2012 was \$0.94 (2011 - \$1.73) per option.

As at December 31, 2012, the non-vested stock-based compensation expense not yet recognized was \$183,014 which is to be recognized over the next 15.8 months.

10. KEY MANAGEMENT PERSONNEL COMPENSATION

Key management personnel include executive officers and directors of the Company. Compensation of the Company's key management personnel is comprised of the following:

	December 31 2012	December 31 2011
Executive salaries and short-term benefits ⁽¹⁾	\$ 595,000	\$ 475,000
Non-executive directors fees	-	-
Fees paid to companies affiliated with non-executive directors ⁽²⁾	350,113	384,041
Stock-based compensation	168,331	2,162,169
	<u>\$ 1,113,444</u>	<u>\$ 3,021,210</u>

(1) \$316,125 and \$225,000 of these expenses in the year ended December 31, 2012 and 2011, respectively, were capitalized and included in either mineral property, mines under construction or plant construction costs.

(2) \$116,655 and \$213,326 of these expenses in the year ended December 31, 2012 and 2011, respectively, were capitalized and included in mines under construction.

11. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

- a) During the year ended December 31, 2012, the Company acquired inventory at a cost of \$703,572, acquired land at a cost of \$80,000, incurred capital expenditures of \$332,625 and incurred mine development expenditures of \$2,703,913 through accounts payable. In addition, the Company capitalized \$1,534,744 and \$2,088,886 of amortization on mining equipment and the plant, respectively to mine development costs.
- b) During the year ended December 31, 2011, the Company acquired inventory at a cost of \$480,633, acquired land at a cost of \$80,000, incurred capital expenditures of \$270,753 and incurred mine development expenditures of \$3,590,327 through accounts payable. In addition, the Company capitalized \$1,349,970 and \$1,961,997 of amortization on mining equipment and the plant, respectively to mine development costs.

12. INCOME TAXES

The reconciliation of the combined Canadian federal and provincial income tax rate to the income tax recovery presented in the accompanied consolidated statements of comprehensive loss is provided below:

	2012	2011
Accounting loss before income taxes	\$ (5,820,493)	\$ (7,657,089)
Combined federal and provincial statutory income tax rate	25.0%	26.5%
Income tax (recovery) at statutory rates	\$ (1,455,000)	\$ (2,029,000)
Impact of different foreign statutory tax rates on earnings of subsidiaries	(398,000)	2,813,000
Non-deductible expenditures and non-taxable revenues	178,000	1,384,000
Impact of future tax rates applied versus current statutory rate	-	(87,000)
Change in unrecognized deductible temporary differences and other	1,675,000	(1,613,000)
	\$ -	\$ 468,000

The Canadian income tax rate decline during the year due to changes in the law that reduced corporate income tax rates in Canada.

The significant components of the Company's deferred tax assets and liabilities are as follows:

	2012	2011
Deferred tax assets (liabilities):		
Mine properties, plant and equipment	\$ (4,325,000)	\$ (3,810,000)
Exploration and evaluation properties	-	(2,317,000)
Non-capital losses	4,325,000	6,127,000
Net deferred tax liability	\$ -	\$ -

DYNASTY METALS & MINING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012 and 2011
Expressed in United States dollars unless otherwise noted

12. INCOME TAXES (cont'd)

The significant components of the Company's deferred tax assets that have not been set up are as follows:

	2012	2011
Share issue costs	\$ 168,000	\$ 320,000
Non-capital losses	2,504,000	1,956,000
Mine properties, plant and equipment	38,000	317,000
Exploration and evaluation properties	<u>3,271,000</u>	<u>-</u>
Total	\$ 5,981,000	\$ 2,593,000

Significant components of deductible and taxable temporary differences, unused tax losses and unused tax credits that have not been included on the consolidated statements of financial position are as follows:

	2012	Expiry Date Range	2011	Expiry Date Range
Share issue costs	\$ 671,000	2033 to 2034	\$ 1,278,000	2032 to 2034
Non-capital losses	10,181,201	2015 to 2032	8,204,000	2012 to 2031
Mine properties, plant and equipment	164,799	No expiry	1,271,000	No expiry
Exploration and evaluation properties	14,219,000	No expiry	-	

13. CAPITAL DISCLOSURE

The Company's capital currently consists of common shares, options and warrants. As the Company is in the early stage production phase for the year ended December 31, 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 year ended December 31, 2012.

14. 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 year. Cash is 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.

14. FINANCIAL INSTRUMENTS (cont'd)

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 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.

A portion of the Company's cash, 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 significant 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.