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

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

JUNE 30, 2012

DYNASTY METALS & MINING INC.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

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

Vancouver, Canada

August 13, 2012

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

	For the Six Months Ended June 30 2012	For the Six Months Ended June 30 2011	For the Three Months Ended June 30 2012	For the Three Months Ended June 30 2011
EXPENSES				
Amortization and accretion	$ 213,327	$ 308,141	$ 49,690	$ 133,972
Management fees	217,068	123,518	143,652	62,171
Office and general	1,257,272	1,384,324	489,186	619,873
Professional fees	482,481	366,006	175,765	157,142
Shareholder communication	44,183	36,804	12,643	6,936
Stock-based compensation (Note 8)	528,338	996,602	92,957	377,290
Transfer agent and filing fees	43,770	50,456	6,959	3,952
Travel and entertainment	168,339	152,801	79,700	72,480
	(2,954,778)	(3,418,652)	(1,050,552)	(1,433,816)
OTHER ITEMS				
Interest income	2,154	8,583	609	4,880
Foreign exchange gain (loss)	49,611	46,978	36,536	(43,468)
	51,765	55,561	37,145	(38,588)
Loss and comprehensive loss for the period	(2,903,013)	(3,363,091)	(1,013,407)	(1,472,404)
Basic and diluted loss per share	$ (0.07)	$ (0.08)	$ (0.02)	$ (0.03)
Weighted average number of shares outstanding	42,461,083	42,434,826	42,461,083	42,450,987

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

	June 30 2012	December 31 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,143,750	$ 6,238,514
Receivables	163,570	53,479
Prepaid expenses	389,547	394,450
Inventory (Note 4)	4,503,902	4,575,976
	6,200,769	11,262,419
Advances and deposits	251,433	76,688
Mine properties, plant and equipment (Note 5)	52,413,848	52,109,644
Exploration and evaluation properties (Note 6)	13,080,467	11,993,371
	$ 71,946,517	$ 75,442,122
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$ 3,724,454	$ 4,870,324
Provision for closure and restoration (Note 7)	1,295,687	1,270,746
	5,020,141	6,141,070
Shareholders' equity		
Capital stock (Note 8)	89,059,365	89,059,365
Contributed surplus (Note 8)	13,377,179	12,848,842
Deficit	(35,510,168)	(32,607,155)
	66,926,376	69,301,052
	$ 71,946,517	$ 75,442,122

Nature and continuance of operations (Note 1)

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

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

	Number of Shares	Share Capital	Retained Loss	Contributed Surplus	Other Comprehensive Income (Loss)	Total
Balance at January 1, 2012	42,461,083	$ 89,059,365	$ (32,607,155)	$ 12,848,841	$ -	$ 69,301,051
Issue of share capital, net	-	-	-	-	-	-
Net loss for the period	-	-	(2,903,013)	-	-	(2,903,013)
Other comprehensive income (loss)	-	-	-	-	-	-
Stock options exercised	-	-	-	-	-	-
Warrants exercised	-	-	-	-	-	-
Stock option and warrant conversion	-	-	-	-	-	-
Stock-based compensation (Note 8)	-	-	-	528,338	-	528,338
Balance at June 30, 2012	42,461,083	$ 89,059,365	$ (35,510,168)	$ 13,377,179	$ -	$ 66,926,376
Balance at January 1, 2011	42,068,583	$ 87,256,130	$ (22,502,684)	$ 8,512,920	$ (88,505)	$ 73,177,861
Issue of share capital, net	-	-	-	-	-	-
Net loss for the period	-	-	(3,363,091)	-	-	(3,363,091)
Other comprehensive income (loss)	-	-	-	-	-	-
Stock options exercised	392,500	811,994	-	-	-	811,994
Warrants exercised	-	-	-	-	-	-
Stock option and warrant conversion	-	438,669	-	(438,669)	-	-
Stock-based compensation (Note 8)	-	-	-	1,018,278	-	1,018,278
Balance at June 30, 2011	42,461,083	$ 88,506,793	$ (25,865,774)	$ 9,092,529	$ (88,505)	$ 71,645,043

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

	For the Six Months Ended June 30 2012	For the Six Months Ended June 30 2011	For the Three Months Ended June 30 2012	For the Three Months Ended June 30 2011
CASH FLOWS FROM OPERATING ACTIVITIES				
Loss for the period	$ (2,903,013)	$ (3,363,091)	$ (1,013,407)	$ (1,472,404)
Items not affecting cash:				
Amortization and accretion	213,327	308,141	46,690	133,972
Stock-based compensation (Note 8)	528,338	996,602	92,957	377,290
Changes in non-cash working capital items:				
(Increase) decrease in receivables	(110,087)	(47,663)	(41,746)	(18,836)
(Increase) decrease in prepaid expenses	4,903	(11,844)	6,479	13,506
(Increase) decrease in inventory	617,277	1,456,899	489,733	2,818,424
Increase (decrease) in accounts payable	84,048	(579,050)	(387,175)	(241,998)
Net cash used in operating activities	(1,565,207)	(1,240,006)	(803,470)	1,609,954
CASH FLOWS FROM INVESTING ACTIVITIES				
Expenditures on exploration and evaluation properties	(1,087,096)	(921,269)	(57,973)	(87,339)
Exploration advances and deposits	(174,745)	(109,545)	(45,767)	8,302
Pre-commercial production revenue credited to mine properties, plant and equipment	16,043,075	20,770,154	8,148,878	13,780,642
Expenditures on mine properties, plant and equipment	(18,310,791)	(14,283,985)	(8,819,171)	(9,397,481)
Net cash recovered (used) in investing activities	(3,529,557)	5,455,355	(774,033)	4,304,124
CASH FLOWS FROM FINANCING ACTIVITIES				
Issuance of capital stock and units	-	833,670	-	105,324
Issuance costs	-	-	-	-
Net cash provided (used) by financing activities	-	833,670	-	105,324
Change in cash for the period	(5,094,764)	5,049,019	(1,577,503)	6,019,402
Cash, beginning of period	6,238,514	3,179,143	2,721,253	2,208,760
Cash, end of period	$ 1,143,750	$ 8,228,162	$ 1,143,750	$ 8,228,162
Cash paid during the period for interest	$ -	$ -	$ -	$ -
Cash paid during the period for income taxes	$ 1,665,234	$ -	$ 1,665,234	$ -

Supplemental disclosure with respect to cash flows (Note 10)

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

1. NATURE AND CONTINUANCE OF OPERATIONS

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

On April 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 mine properties, plant and equipment, exploration and evaluation properties and certain other capital assets and the Company's ability to exploit these properties.

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

These condensed interim consolidated financial statements have been prepared using International Financial Reporting Standards ("IFRS") applicable to a going concern, which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. As mentioned above, there are conditions and matters which indicate the existence of a material uncertainty that may cast significant doubt about the ability of the Company to continue as a going concern.

In the event the Company is unable to produce sufficient precious metals for sale in the future or secure additional working capital, from debt or equity financings or through the profitable sale of capital assets, these consolidated financial statements may require adjustments relating to the recoverability and classification of recorded assets and liabilities.

2. BASIS OF PRESENTATION

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

2. BASIS OF PRESENTATION (cont'd)

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of August 13, 2012, the date the Audit Committee approved the statements. Any subsequent changes to IFRS after this date could result in changes to the consolidated financial statements for the period ended June 30, 2012.

These consolidated financial statements have been prepared on a historical cost basis except for certain financial instruments which are measured at fair value.

The condensed interim consolidated financial statements do not contain all disclosures required under IFRS and should be read in conjunction with Company's audited annual consolidated financial statements and the notes thereto for the year ended December 31, 2011.

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

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

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

3. NEW ACCOUNTING STANDARDS AND INTERPRETATION

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

Expressed in United States dollars unless otherwise noted

4. INVENTORY

	June 30 2012	December 31 2011
Materials and supplies	$ 2,406,090	$ 1,859,963
Finished goods	2,097,812	2,716,013
	$ 4,503,902	$ 4,575,976

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

5. MINE PROPERTIES, PLANT AND EQUIPMENT

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

	Mines Under Construction	Plant and Equipment	Land and Buildings	Total
Cost				
Balance as at December 31, 2010	$ 26,694,463	$ 31,248,412	$ 3,292,747	$ 61,235,622
Additions	31,934,711	1,285,810	-	33,220,521
Disposals	-	(457,327)	-	(457,327)
Net-off of pre-commercial sales	(34,185,254)	-	-	(34,185,254)
Balance as at December 31, 2011	24,443,920	32,076,895	3,292,747	59,813,562
Additions	17,581,415	899,051	-	18,840,466
Disposals	-	-	-	-
Net-off of pre-commercial sales	(16,043,075)	-	-	(16,043,075)
Balance as at June 30, 2012	**$ 25,982,260**	**$ 32,975,946**	**$ 3,292,747**	**$ 62,250,953**
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	-	2,117,543	15,644	2,133,187
Disposals	-	-	-	-
Balance as at June 30, 2012	**$ -**	**$ 9,696,531**	**$ 140,574**	**$ 9,837,105**
Net book value				
At December 31, 2011	$ 24,443,920	$ 24,497,907	$ 3,167,817	$ 52,109,644
At June 30, 2012	$ 25,982,260	$ 23,279,414	$ 3,152,173	$ 52,413,848

Expressed in United States dollars unless otherwise noted

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

Mines under construction

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

Plant and equipment

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

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

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

Land and building

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

6. EXPLORATION AND EVALUATION PROPERTIES

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

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

6. EXPLORATION AND EVALUATION PROPERTIES (cont'd)

	Dynasty Project	Jerusalem Project	Other Projects	Total
Balance, December 31, 2011	$ 10,286,036	$ 1,537,166	$ 170,169	$ 11,993,371
Costs				
Camp supplies and field costs	15,655	679	-	16,334
Geological consulting	32,093	-	-	32,093
Laboratory fees	-	-	-	-
Mineral concession rights	958,413	6,670	-	965,083
Project administration	34,491	21,480	-	55,971
Travel and related costs	17,566	49	-	17,615
Additions for the period	1,058,218	28,878	-	1,087,096
Balance, June 30, 2012	$ 11,344,254	$ 1,566,044	$ 170,169	$ 13,080,467

7. PROVISION FOR CLOSURE AND RESTORATION

The Company's environmental permit at the Zaruma Gold Project requires that it reclaim any land it disturbs during the mine and plant construction and operations. Although the timing and the amount of the actual expenditures are uncertain, the Company has estimated the present value of the future reclamation obligation arising from its activities to June 30, 2012 to be $1,295,687 (December 31, 2011 - $1,270,746). The present value of the future reclamation obligation assumes an inflation rate of 2.5% and a discount rate of 4.0%, an undiscounted amount to settle the obligation of $1,324,000 and the commencement of reclamation activities after the life of the mine, which is estimated at 15 years.

	June 30 2012	December 31 2011
Balance, beginning of year	$ 1,270,746	$ 1,222,781
Accretion expense	24,941	47,965
Balance, end of year	$ 1,295,687	$ 1,270,746

8. CAPITAL STOCK AND CONTRIBUTED SURPLUS

Authorized and issued shares

At June 30, 2012, the Company had unlimited authorized common shares and 42,461,083 shares outstanding (December 31, 2011 – 42,461,083). All per share amounts below are in Canadian dollars (CAD) which, at June 30, 2012, is equivalent to 0.9727 US dollars.

Expressed in United States dollars unless otherwise noted

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

Stock options

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

The Company uses a fair value method of accounting for all stock-based payments. Under this method, the Company recorded a stock-based compensation expense of $528,338 and $92,957 for the six and three months ended June 30, 2012, respectively ($996,602 and $377,290 for the six and three months ended June 30, 2011, respectively) with a corresponding credit to contributed surplus. The fair value of the stock options granted during the six months ended June 30 is estimated as at the date of the grant using the Black-Scholes pricing model assuming the following weighted average assumptions:

	2012	2011
Risk-free interest rate	1.10%	1.10%
Expected life	3.24 years	3.20 years
Annualized volatility	76.96%	84.35%
Pre-vest forfeiture rate	10.00%	10.00%
Dividend rate	0.00%	0.00%

During the six months ended June 30, 2012, the Company granted 245,000 (2011 – 179,000) options with a fair value of $334,016 (2011 - $294,993), which is being recognized over the vesting periods of the options. The continuity of incentive stock options and warrants issued and outstanding is as follows:

	Warrants		**Stock options**	
	Number	**Weighted Average Exercise Price (CAD$)**	**Number**	**Weighted Average Exercise Price (CAD$)**
Balance, December 31, 2010	2,100,000	$ 4.92	4,250,600	$ 4.41
Granted	-	-	1,688,000	3.13
Exercised	-	-	(392,500)	2.09
Forfeited	-	-	(955,750)	4.20
Expired	(2,100,000)	4.92	(50,000)	3.48
Balance, December 31, 2011	-	-	4,540,350	4.19
Granted	-	-	245,000	3.00
Expired	-	4.92	(244,050)	4.72
Balance, June 30, 2012	-	$ -	4,541,300	$ 4.10

Expressed in United States dollars unless otherwise noted

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

Stock options (cont'd)

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

	Options outstanding			Options exercisable	
Exercise price range	**Number of stock options outstanding**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price CAD$**	**Number of stock options exercisable**	**Weighted average exercise price CAD$**
$2.00 - $3.35	1,964,000	3.99	2.93	1,725,750	2.91
$3.36 - $4.55	587,300	2.72	3.93	482,400	3.96
$4.56 - $5.45	1,898,000	2.06	5.23	1,886,250	5.23
$5.46 - $6.63	100,000	0.00	6.63	100,000	6.63
	4,541,300	2.93	4.09	4,194,400	4.18

The weighted average fair value per stock option granted during six months ended June 30, 2012 was $1.56 (2011 - $2.05) per option.

As at June 30, 2012, the non-vested stock-based compensation expense not yet recognized was $307,271 which is to be recognized over the next 17.6 months.

9. RELATED PARTY TRANSACTIONS

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

a) paid or accrued professional fees of 101,966 (2011 - $52,399) to a law firm in Ecuador with which a director of the Company is affiliated;

b) paid or accrued professional fees of $161,310 (2011 - $104,989) to a director of the Company; and

c) paid or accrued management fees of $210,000 (2011 - $150,000) to a company controlled by the President and Chief Executive Officer of the Company of which $157,500 (2011 - $112,500) were capitalized and included in either mineral properties, plant and equipment and exploration and evaluation properties.

Included in accounts payable at June 30, 2012 is $62,067 (December 31, 2011 - $51,352) due to a law firm with which a current director is affiliated and $19,000 (December 31, 2011 - $44,655) due to directors and companies controlled by directors of the Company.

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

10. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

a) During the six months ended June 30, 2012, the Company acquired inventory at a cost of $1,025,836, acquired land at a cost of $80,000, incurred plant construction expenditures of $148,171 and incurred mine development expenditures of $1,937,783 through accounts payable. In addition, the Company capitalized $803,005 and $1,049,042 of amortization on mining equipment and the plant, respectively to mine development costs.

b) During the six months ended June 30, 2011, the Company acquired inventory at a cost of $526,983, acquired land at a cost of $80,000, incurred plant construction expenditures of $416,798 and incurred mine development expenditures of $2,192,517 through accounts payable. In addition, the Company capitalized 560,243 and $919,612 of amortization on mining equipment and the plant, respectively to mine development costs.

11. CAPITAL DISCLOSURE

The Company's capital currently consists of common shares and options. As the Company is in the early stage production phase for the six months ended June 310, 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 six months ended June 30, 2012.

12. FINANCIAL INSTRUMENTS

Financial assets and liabilities

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

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

Credit Risk

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

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

12. **FINANCIAL INSTRUMENTS** (cont'd)

Currency Risk

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

At June 30, 2012, a significant portion of the Company's cash and cash equivalents were held in Canadian dollars and were therefore subject to fluctuation against the US dollar. Based on the balances as at June 30, 2012, if the Canadian dollar had weakened (strengthened) against the US dollar, with all other variables held constant, by 1%, net loss would have increased (decreased) by approximately $1,000. There would be no effect in other comprehensive loss. Additionally, a portion of the Company's receivables and accounts payable and accruals are denominated in the Canadian dollar and are therefore subject to fluctuation in exchange rates, however these balances are not large enough to expose the Company to significant foreign exchange risk.

Interest Rate Risk

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

Liquidity risk

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

Price risk

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