KLONDIKE SILVER CORP.

Consolidated Annual Financial Statements

Years Ended May 31, 2012 and 2011

(Expressed in Canadian Dollars)

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
Klondike Silver Corp.

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Klondike Silver Corp., which comprise the consolidated statements of financial position as at May 31, 2012, May 31, 2011 and June 1, 2010, and the consolidated statements of operations and comprehensive loss, statements of changes in equity, and statements of cash flows for the years ended May 31, 2012 and May 31, 2011, 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.

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 consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained 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 Klondike Silver Corp. as at May 31, 2012, May 31, 2011 and June 1, 2010, and its financial performance and its cash flows for the years ended May 31, 2012 and May 31, 2011 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 matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

Vancouver, Canada *"Morgan & Company"*

September 26, 2012 Chartered Accountants

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KLONDIKE SILVER CORP.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed In Canadian dollars)

	May 31 2012	May 31 2011 (Note 13)	June 1 2010 (Note 13)
ASSETS			
Current			
Cash	**$ -**	$ 131,637	$ -
Receivables	**88,644**	50,561	94,051
Prepaid expenses	**5,914**	2,023	8,134
Marketable securities	**197,250**	-	-
Total Current Assets	**291,808**	184,221	102,185
Deposits	**10,146**	9,900	-
Reclamation Bonds (Note 5)	**119,000**	119,000	119,000
Mill And Equipment (Note 6)	**658,833**	773,250	979,193
Exploration And Evaluation Assets (Note 7)	**9,324,544**	13,631,808	13,852,066
Total Assets	**$ 10,404,331**	$ 14,718,179	$ 15,052,444
LIABILITIES			
Current			
Bank overdraft	**$ 51,222**	$ -	$ 51,983
Accounts payable and accrued liabilities	**319,942**	182,277	267,417
Loan payable	**-**	301,450	-
Due to related parties (Note 9)	**40,421**	346,421	274,988
Total Current Liabilities	**411,585**	830,148	594,388
Deferred Income Taxes	**-**	-	16,000
Decommissioning Liability (Note 8)	**80,000**	78,400	76,800
Total Liabilities	**491,585**	908,548	687,188
EQUITY			
Share Capital (Note 10)	**28,549,189**	27,024,731	25,889,531
Share Subscriptions (Note 16)	**149,500**	-	-
Share-based Payments Reserve	**2,495,962**	2,495,962	2,299,462
Deficit	**(21,281,905)**	(15,711,062)	(13,823,737)
Total Equity	**9,912,746**	13,809,631	14,365,256
Total Liabilities And Equity	**$ 10,404,331**	$ 14,718,179	$ 15,052,444

Nature of Operations and Going Concern (Note 1)
Commitments (Note 16)

These consolidated financial statements were approved for issue by the Board of Directors on September 26, 2012. They are signed on the Company's behalf by:

"***Richard Hughes***"
Director

"***Alan Campbell***"
Director

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

KLONDIKE SILVER CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(Expressed In Canadian dollars)

	Years Ended May 31	
	2012	2011 (Note 13)
Expenses		
Amortization	**$ 4,700**	$ 7,943
Administration (Note 9)	**410,000**	86,000
Compensation and consulting (Note 9)	**487,150**	203,914
Investor relation and promotion	**35,828**	15,591
Interest and bank charges	**8,613**	183,683
Office and miscellaneous	**143,887**	71,344
Part XII.6 tax	**1,896**	4,268
Professional fees	**40,651**	95,121
Regulatory and stock transfer fees	**59,185**	90,952
Supplies and maintenance	**506**	-
Utilities and communication	**28,783**	1,335
Loss Before Other (Expenses)	**(1,221,199)**	(760,151)
Other Income (Expenses)		
Accretion	**(1,600)**	(1,600)
Loss on disposal of equipment	**-**	(11,056)
Foreign exchange gain	**-**	2,836
Exploration and evaluation assets written-off	**(2,973,682)**	(1,182,689)
Loss on disposal of exploration and evaluation asset	**(1,383,439)**	-
Interest earned	**77**	225
Recovery of prior year expenses	**-**	49,110
Unrealized gain on marketable securities	**9,000**	-
Loss Before Income Taxes	**(5,570,843)**	(1,903,325)
Deferred Income Tax Recovery	**-**	16,000
Net Loss And Comprehensive Loss	**$ (5,570,843)**	$ (1,887,326)
Loss Per Share – Basic and diluted	**$ (0.36)**	$ (0.19)
Weighted Average Number Of Shares Outstanding, Basic and diluted	**15,600,822**	10,154,243

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

KLONDIKE SILVER CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Expressed In Canadian dollars)

	SHARE CAPITAL					
	NUMBER OF SHARES	AMOUNT	SHARE SUBSCRIPTIONS	SHARE-BASED PAYMENTS RESERVE	DEFICIT	TOTAL
Balance, June 1, 2010	9,313,904	$ 25,889,531	$ -	$ 2,299,462	$ (13,823,737)	$ 14,365,256
Issue of shares for exploration and evaluation assets	5,000	4,000	-	-	-	4,000
Issue of shares for cash, private placements						
Flow-through shares	675,000	675,000	-	-	-	675,000
Non flow-through shares	1,335,000	543,000	-	-	-	543,000
Issue of shares for loan agreement	253,000	150,500	-	-	-	150,500
Share issue costs	-	(40,800)	-	-	-	(40,800)
Share issue costs - re-priced warrants	-	(196,500)	-	196,500	-	-
Adjustment due to fraction rounding	(12)	-	-	-	-	-
Net loss for the year	-	-	-	-	(1,887,325)	(1,887,325)
Balance, May 31 , 2011	11,581,892	27,024,731	-	2,495,962	(15,711,062)	13,809,631
Issue of shares for exploration and evaluation assets	115,714	25,458	-	-	-	25,458
Issue of shares for finder's fee	30,000	6,600	-	-	-	6,600
Issue of shares for cash, private placements						
Non flow-through shares	6,047,200	1,511,800	-	-	-	1,511,800
Share subscription received	-	-	149,500	-	-	149,500
Share issue costs	-	(19,400)	-	-	-	(19,400)
Net loss for the year	-	-	-	-	(5,570,843)	(5,570,843)
Balance, May 31 , 2012	**17,774,806**	**$ 28,549,189**	**$ 149,500**	**$ 2,495,962**	**$ (21,281,905)**	**$ 9,912,746**

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

KLONDIKE SILVER CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed In Canadian dollars)

	YEARS ENDED MAY 31 2012	2011 (Note 13)
Operating Activities		
Net loss for the year	**$ (5,570,843)**	$ (1,887,325)
Non-cash items:		
Accretion and amortization	**6,300**	9,543
Accrued loan interest	**-**	27,984
Exploration and evaluation assets written-off	**2,973,682**	1,182,689
Loan consideration	**-**	150,500
Loss on disposal of equipment	**-**	11,056
Sale of exploration and evaluation assets	**1,383,439**	-
Unrealized gain on marketable securities	**(9,000)**	-
Deferred income taxes recoverable	**-**	(16,000)
Changes in non-cash operating assets and liabilities:		
(Decrease) Increase in receivables	**(38.083)**	43,490
(Decrease) increase in prepaid expenses	**(3,891)**	6,111
Decrease (increase) in accounts payable and accrued liabilities	**216,667**	(54,188)
Due to related parties	**-**	(8,967)
Cash Used In Operating Activities	**(1,041,729)**	(535,107)
Investing Activities		
Equipment sales proceeds	**-**	11,550
Deposits	**(246)**	(9,900)
Mill and equipment purchases	**(20,749)**	-
Exploration and evaluation assets acquisition costs	**(57,408)**	-
Exploration and evaluation assets exploration costs	**(1,176,085)**	(1,195,436)
Exploration and evaluation assets ancillary income	**1,082,708**	381,447
Cash Used In Investing Activities	**(171,780)**	(812,339)
Financing Activities		
Proceeds from shares issuance	**1,508,000**	1,218,000
Share issue costs	**(19,400)**	(40,800)
Due to related parties	**(306,000)**	80,400
Loan proceeds	**-**	400,000
Loan repayments	**(301,450)**	(126,534)
Share subscriptions received	**149,500**	-
Cash Provided By Financing Activities	**1,030,650**	1,531,066
(Decrease) Increase In Cash During The Year	**(182,859)**	183,620
Cash (Bank Overdraft) – Beginning Of Year	**131,637**	(51,983)
(Bank Overdraft) Cash – End Of Year	**$ (51,222)**	131,637

Supplemental cash flow information (Note 15)

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

1. NATURE OF OPERATIONS AND GOING CONCERN

Klondike Silver Corp. (the "Company") was incorporated on March 2, 2005 under the laws of the Province of British Columbia, Canada. The Company is a public company listed on the TSX Venture Exchange (the "TSX.V"), trading under the "KS" symbol. The address of the Company's corporate office and principal place of business is Suite 711, 675 West Hastings Street, Vancouver, British Columbia, Canada V6B 1N2.

The Company incurred a net loss of $(5,570,843) for the year ended May 31, 2012 (May 31, 2011 - $(1,887,325)) and had working capital (deficiency) at May 31, 2012 of $(119,777) (May 31, 2011 - $(645,927)) and a deficit of $21,281,905 (May 31, 2011 - $15,711,062). As at May 31, 2012 the Company did not have sufficient cash to meet minimum general and administration expenses for the year ending May 31, 2013. These statements have been prepared on a going concern basis, which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company's ability to continue as a going concern is dependent upon achieving profitable operations and upon obtaining additional financing. While the Company is expending its best efforts in this regard, the outcome of these matters cannot be predicted at this time.

The Company is in the process of acquiring, exploring and developing its exploration and evaluation assets and has not yet determined whether the properties contain ore reserves that are economically recoverable. The recoverability of the amounts shown for exploration and evaluation assets and related deferred exploration costs are dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves, and upon future profitable production. The operations of the Company have primarily been funded by the issuance of common shares and ancillary income. Continued operations of the Company are dependent on the Company's ability to complete equity financing or generate profitable operations in the future. Management's plan in this regard is to secure additional funds through future equity financings, which may not be available or may not be available on reasonable terms. These factors may cast significant doubt on the Company's ability to continue as a going concern. Accordingly, the financial statements do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and liquidate its liabilities, contingent obligations and commitments other than in the normal course of business and at amounts different from those in the financial statements.

2. BASIS OF PRESENTATION

a) Statement of Compliance

The financial statements of the Company for the year ended May 31, 2012 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), having previously prepared its financial statements in accordance with pre-changeover Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in Note 13.

2. BASIS OF PRESENTATION (Continued)

b) Basis of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned inactive subsidiary Slocan Silver S.A. de C.V. which was incorporated in Mexico in April 2008. All intercompany transactions and balances are eliminated on consolidation.

c) Basis of Measurement and Presentation

These consolidated financial statements have been prepared on a historical cost basis except for financial instruments that have been measured at fair value. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information. In the opinion of management, all adjustments (including normal recurring accruals), considered necessary for a fair presentation have been included.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

d) Foreign Currencies

The presentation currency of the Company and the functional currency of the Company and its subsidiary is the Canadian dollar.

Transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on the dates of the transactions. At each financial position reporting date, monetary assets and liabilities that are denominated in foreign currencies are translated at the rates prevailing at the date of the statement of financial position. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

e) Significant Accounting Judgments and Estimates

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. The consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised.

2. BASIS OF PRESENTATION (Continued)

e) Significant Accounting Judgments and Estimates (Continued)

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the statement of financial position date, that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

- the assessment of indications of impairment of the Company's exploration and evaluation assets and related determination of recoverable values and write-down of those assets where applicable;
- the useful lives of mill and equipment which are included in the consolidated statements of financial position and the related amortization included in the consolidated statement of comprehensive loss;
- the fair value estimation of share-based payments included in the consolidated statements of financial position;
- the accounting and recognition of income taxes which is included in the consolidation statement of net loss and comprehensive loss and composition of deferred income tax asset and liabilities included in the consolidated statement of financial position; and
- the inputs used in determining the net present value of the liability for decommissioning liabilities included in the consolidated statement of financial position.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been adopted for the year-ending May 31, 2012 and have been applied consistently to all periods presented in these consolidated financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Financial Instruments and Risk Management

Financial assets

The Company classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Fair value through profit or loss ("FVTPL") - This category comprises derivatives, or financial assets acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried in the statements of financial position at fair value with changes in fair value recognized in the statements of operations and comprehensive loss.

Loans and receivables - These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at amortized cost less any provision for impairment. Significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default.

Held-to-maturity investments - These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest rate 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 statements of operations and comprehensive loss.

Available-for-sale - Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized directly in other comprehensive income (loss). Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in the statements of operations and accumulated other comprehensive income (loss).

Transaction costs associated with fair value through profit or loss financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

All financial assets except for those at FVTPL are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, which are described above.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Financial Instruments and Risk Management (Continued)

Financial liabilities

The Company classifies its financial liabilities into one of two categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Fair value through profit or loss - This category comprises derivatives, or liabilities acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in the statement of operations and comprehensive loss.

Other financial liabilities - This category includes amounts due to related parties and accounts payables and accrued liabilities, all of which are recognized at amortized cost.

The Company has classified cash (bank overdraft), marketable securities, deposits and reclamation bonds as fair value through profit or loss financial assets. Accounts payable and accrued liabilities, loan payable and due to related parties are classified as other financial liabilities. Management did not identify any material embedded derivatives, which require separate recognition and measurement.

Disclosures about the inputs to financial instrument fair value measurements are made within a hierarchy that prioritizes the inputs to fair value measurement.

The three levels of the 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

Financial instruments are exposed to credit, liquidity and market risks. Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Liquidity risks is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. Market risk is that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of price risk: currency risk, interest rate risk and other price risk.

Liquidity risk is significant to the Company’s statement of financial position. The Company manages these risks by actively pursuing additional share capital issuances to settle its obligations in the normal course of its operating, investing and financing activities. The Company’s ability to raise share capital is indirectly related to changing metal prices and the price of gold, silver, zinc and lead in particular. To mitigate this market risk, management of the Company actively pursues a diversification strategy with property holdings focusing on base metals as well as precious metals.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Cash and Cash Equivalents

Cash consists of balances with banks and investments in financial instruments with maturities within three months held for the purpose of meeting short-term cash commitments rather than for investing or other purposes. The Company places its cash and cash investments with institutions of high-credit worthiness. The Company had no cash equivalents as at May 31, 2012, May 31, 2011 and June 1, 2010.

c) Mill and Equipment

The mill comprises a used ore processing plant, used buildings and related equipment stated at cost. Amortization on mill and equipment is provided on the straight line method over estimated useful lives ranging from three to eight years.

d) Exploration and Evaluation Assets

Exploration and evaluation expenditures include the costs of acquiring licenses, costs associated with exploration and evaluation activities, and the fair value (at acquisition date) of exploration and evaluation assets acquired in a business combination. Exploration and evaluation expenditures are capitalized as incurred. Costs incurred before the Company has obtained the legal rights to explore an area are recognized in profit or loss. Ancillary income received while the properties are in the exploration stage is credited to the carrying value of the mineral properties. Cost recoveries are credited against specific property costs, as received.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

Facts and circumstances as defined in *IFRS 6 exploration and evaluation assets* are as follows:

- the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed;

- substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned;

- exploration for and evaluation of mineral resources in the specific area have not let to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area;

- sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

In making the assessment, management is required to make judgments on the status of each project and the future plans towards finding commercial reserves. The nature of exploration and evaluation activity is such that only a proportion of projects are ultimately successful and some assets are likely to become impaired in future periods.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

d) Exploration and Evaluation Assets (Continued)

Once the technical feasibility and commercial viability of the extraction of mineral resources in an area of interest are demonstrable, which management has determined to be indicated by a feasibility study, exploration and evaluation assets attributable to that area of interest are first tested for impairment and then reclassified to mining property and development assets.

Recoverability of the carrying amount of any exploration and evaluation assets is dependent on successful development and commercial exploitation, or alternatively, sale of the respective areas of interest.

It is management's judgement that none of the Company's exploration and evaluation assets have reached the development stage and as a result are all considered to be exploration and evaluation assets.

Although the Company has taken steps to verify title to exploration and evaluation assets in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property may be subject to unregistered prior agreements and non-compliance with regulatory requirements.

e) Impairment of Non-financial assets

Impairment tests on intangible assets with indefinite useful economic lives are undertaken annually at the financial year-end. Other non-financials assets, including exploration and evaluation assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the assets is written down accordingly.

Where it is possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets. The Company has one cash-generating unit for which impairment testing is performed.

An impairment loss is recognized in the statement of operations, except to the extent they reverse gains previously recognized in other comprehensive income or loss.

f) Decommissioning Liabilities

The Company is subject to various government laws and regulations relating to environmental disturbances caused by exploration and evaluation activities. The Company records the present value of the estimated costs of legal and constructive obligations required to restore the exploration sites in the period in which the obligation is incurred. The nature of the rehabilitation activities includes restoration, reclamation and re-vegetation of the affected exploration sites.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

f) Decommissioning Liabilities (Continued)

The rehabilitation provision generally arises when the environmental disturbance is subject to government laws and regulations. When the liability is recognized, the present value of the estimated costs is capitalized by increasing the carrying amount of the related mining assets. Over time, the discounted liability is increased for the changes in present value based on current market discount rates and liability specific risks.

Additional environmental disturbances or changes in rehabilitation costs will be recognized as additions to the corresponding assets and rehabilitation liability in the period in which they occur.

g) Share Capital

i) Non-monetary consideration

Agent's warrant issued as purchase consideration in non-monetary transactions is recorded at fair value determined by management using the Black-Scholes option pricing model. The fair value of the shares issued as consideration for exploration and evaluation assets is based on the trading price of those shares on the TSX.V on the date of the agreement to issue shares as determined by the Board of Directors. Proceeds from unit placements are allocated between shares and warrants issued using the residual method.

ii) Flow-through shares

The Company will from time to time, issue flow-through common shares to finance a significant portion of its exploration program. Pursuant to the terms of the flow-though share agreements, these shares transfer the tax deductibility of qualifying resource expenditures to investors. On issuance, the Company bifurcates the flow-through share into i) a flow-through share premium, equal to the estimated premium, if any, investors pay for the flow-through feature, which is recognized as a liability, and ii) share capital. Upon expenses being incurred, the Company derecognizes the liability and recognizes a deferred tax liability for the amount of tax reduction renounced to the shareholders. The premium is recognized as other income and the related deferred tax is recognized as a tax provision.

Proceeds received from the issuance of flow-through shares are restricted to be used only for Canadian resource property exploration expenditures within a two-year period

The Company may also be subject to a Part XII.6 tax on flow-through proceeds, renounced under the Look-back Rule, in accordance with Government of Canada flow-through regulations. When applicable, this tax is accrued as a financial expense until paid.

iii) Share-based payments

The share option plan allows Company employees and consultants to acquire shares of the Company. The fair value of options granted is recognized as an employee or consultant expense with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

g) Share Capital (Continued)

iii) Share-based payments (Continued)

The fair value is measured at grant date, and each tranche is recognized over the period during which the options vest. The fair value of the options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. At each financial position reporting date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

In situations where equity instruments are issued to non-employees and some or all of the goods or services received by the entity as consideration cannot be specifically identified, they are measured at the fair value of the share-based payment. Otherwise, share-based payments are measured at the fair value of goods or services received.

iv) Share issuance costs

Costs directly identifiable with the raising of share capital financing are charged against share capital. Share issuance costs incurred in advance of share subscriptions are recorded as non-current deferred assets. Share issuance costs related to uncompleted share subscriptions are charged to operations.

h) Income Taxes

Income tax expense comprises of current and deferred tax. Current tax and deferred tax are recognized in net income except to the extent that it relates to a business combination or items recognized directly in equity or in other comprehensive income or loss.

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting nor taxable profit or loss.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized. At the end of each reporting period the Company reassesses unrecognized deferred tax assets. Deferred income tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

i) Loss Per Share

Basic loss per share is calculated by dividing the loss for the period by the weighted average number of common shares issued and outstanding during the period. Diluted loss per share is calculated using the treasury stock method. Under the treasury stock method, the weighted average number of common shares outstanding used for the calculation of diluted loss per share assumes that the proceeds to be received on the exercise of dilutive stock options and warrants are used to repurchase common shares at the average market price during the period. Basic and diluted loss per share is equal as outstanding stock options and warrants were all anti-dilutive.

4. FUTURE ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED

The following standards and interpretations have not been in effect as they will only be applied for the first time in future periods. They may result in consequential changes to the accounting policies and other note disclosures. The Company has not yet assessed the impacts of the standards or determined whether it will adopt the standards early.

IFRS 9 – Financial Instruments
IFRS 9 establishes the requirements for recognizing and measuring financial assets and financial liabilities. This new standard is effective for the Company's fiscal year commencing with earlier application permitted.

IFRS 11 - Joint Arrangements
IFRS 11 establishes principles for financial reporting by parties to a joint arrangement and supersedes IAS 31: Interests in Joint Ventures and SIC 13: Jointly Controlled Entities - Non-Monetary Contributions by Venturers. This new standard is effective July 1, 2013 with earlier application permitted.

IFRS 12 - Disclosure of Interests in Other Entities
IFRS 12 applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an uncondensed Interim structured entity. This new standard is effective July 1, 2013 with earlier application permitted.

IAS 27 - Separate Financial Statements
IAS 27 contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. IAS 27 requires an entity preparing separate financial statements to account for those investments at cost or in accordance with IFRS 9. This new standard is effective July 1, 2013 with earlier application permitted.

IAS 28 - Investments in Associates and Joint Ventures
IAS 28 prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This amendment is effective July 1, 2013 with earlier application permitted.

(Expressed in Canadian dollars)

4. FUTURE ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED (Continued)

IFRS 13 – Fair Value Measurement
IFRS 13 is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, set out in a single IFRS framework for measuring fair value and new required disclosures about fair value measurements. Management anticipates that this standard will be adopted in the Company's financial statements for the fiscal year beginning July 1, 2013, and has not yet considered the potential impact of the adoption of IFRS 13.

5. RECLAMATION BONDS

The reclamation bonds at May 31, 2012 of $119,000 (May 31, 2011 - $119,000; June 1, 2010 - $119,000) are recorded at fair value and consist of deposits made by the Company for indemnification of site restoration costs for the Silvana Mine, Sandon Mill, and exploration sites located in BC. Reclamation bonds in the amount of $100,000 were held in trust for the Company by a company controlled by a common director.

6. MILL AND EQUIPMENT

	Costs			
	Mill	**Equipment**	**Land**	**Total**
Balance June 1, 2010	$ 314,800	$ 1,293,202	$ 62,773	$ 1,670,775
Disposal	-	(28,591)	-	(28,591)
Balance May 31, 2011	314,800	1,264,611	62,773	1,642,184
Additions	-	20,749	-	20,749
Balance May 31, 2012	**$ 314,800**	**$ 1,285,360**	**$ 62,773**	**$ 1,662,933**

	Accumulated Depreciation			
	Mill	**Equipment**	**Land**	**Total**
Balance June 1, 2010	$ 34,670	$ 656,912	$ -	$ 691,582
Additions	34,670	142,682	-	177,352
Balance May 31, 2011	69,340	799,594	-	868,934
Additions	34,670	100,496	-	135,166
Balance May 31, 2012	**$ 104,010**	**$ 900,090**	**$ -**	**$ 1,004,100**

	Net Carrying Amount			
	Mill	**Equipment**	**Land**	**Total**
Balance June 1, 2010	$ 280,130	$ 636,290	$ 62,773	$ 979,193
Balance May 31, 2011	$ 245,460	$ 465,017	$ 62,773	$ 773,250
Balance May 31, 2012	**$ 210,790**	**$ 385,270**	**$ 62,773**	**$ 658,833**

KLONDIKE SILVER CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2012 AND 2011
(Expressed in Canadian dollars)

7. EXPLORATION AND EVALUATION ASSETS

For the year ended May 31, 2012:

	Slocan and Sandon BC	Stump Yukon	Hart Yukon	Haultain Ontario	Milner Ontario	Total
Acquisition Costs						
Opening balance-acquisition	$ 577,764	$ 140,577	$ 12,445	$ 302,213	$ 106,506	$ 1,139,505
Staking costs	308	-	-	-	-	308
Option payments cash	57,100	-	-	-	-	57,100
Option payments shares	32,058	-	-	-	-	32,058
Property write-off	-	(70,288)	(12,445)	(302,212)	(106,505)	(491,450)
	667,230	70,289	-	1	1	737,521
Opening balance-exploration	8,301,886	329,655	28,426	1,543,524	717,122	10,920,613
Amortization	130,466	-	-	-	-	130,466
Consulting	12,450	-	-	2,900	-	15,350
Equipment repairs and rental	57,574	-	-	-	-	57,574
Fuel	153,168	-	-	-	-	153,168
Geological	19,084	-	-	1,718	600	21,402
Labour and benefits	521,370	-	-	-	-	521,370
Mapping and sampling	34,884	-	-	-	-	34,884
Site administration	27,123	-	-	-	-	27,123
Supplies and maintenance	187,685	-	-	-	-	187,685
Utilities and communications	59,212	-	-	410	410	60,032
Ancillary income	(1,082,706)	-	-	-	-	(1,082,706)
Property write-off	-	(164,828)	(28,426)	(1,548,552)	(718,132)	(2,459,938)
	8,422,196	164,827	-	-	-	8,587,023
Balance, May 31 , 2012	$ 9,089,426	$ 235,116	$ -	$ 1	$ 1	$ 9,324,544

KLONDIKE SILVER CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2012 AND 2011
(Expressed in Canadian dollars)

7. EXPLORATION AND EVALUATION ASSETS

For the year ended May 31, 2011:

	Slocan and Sandon BC	Connaught Yukon	Stump Yukon	Hart Yukon	Espiritu Mexico	Haultain Ontario	Milner Ontario
Acquisition Costs							
Opening balance-acquisition	$ 697,764	$ 245,497	$ 140,577	$ 12,145	$ 109,430	$ 302,213	$ 106,506
Staking costs	-	921	-	300	-	-	-
Option payments cash	-	-	-	-	-	-	-
Option payments shares	-	-	-	-	4,000	-	-
Option income	(120,000)	-	-	-	-	-	-
Property write off	-	-	-	-	(113,430)	-	-
	577,764	246,418	140,577	12,445	-	302,213	106,506
Opening balance-exploration	7,276,866	1,289,154	328,511	4,286	544,530	1,542,111	716,372
Opening balance-advance	12,500	-	-	-	-	-	-
Exploration advance	(12,500)	-	-	-	-	-	-
Amortization	175,394	-	-	-	-	-	-
Consulting	18,450	688	-	275	-	-	-
Drilling	73,280	(24,300)	-	-	-	-	-
Equipment repairs and rental rentals	215,770	940	-	85	-	-	-
Fuel	66,782	-	-	-	-	-	-
Geological	101,828	32,447	1,144	13,051	-	1,413	750
Labour and benefits	447,485	-	-	-	-	-	-
Line cutting	30,479	-	-	-	-	-	-
Mapping and sampling	74,643	22,240	-	10,111	-	-	-
Site administration	2,681	4,102	-	618	-	-	-
Supplies and maintenance	121,778	-	-	-	-	-	-
Surveying	24,952	-	-	-	-	-	-
Utilities and communications	52,947	-	-	-	-	-	-
Ancillary income	(381,447)	-	-	-	-	-	-
Property write off	-	-	-	-	(544,530)	-	-
	8,301,888	1,325,271	329,655	28,426	-	1,543,524	717,122
Balance, May 31, 2011	$ 8,879,652	$ 1,571,689	$ 470,232	$ 40,871	$	$ 1,845,737	$ 823,628

KLONDIKE SILVER CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2012 AND 2011
(Expressed in Canadian dollars)

7. EXPLORATION AND EVALUATION ASSETS

For the year ended May 31, 2011:

	Lawson Ontario	South Bay Ontario	Clagor Ontario	Maralgo Ontario	Cleaver Central Ontario	Reeves Lake Ontario	Beemer Ontario	
Opening balance-	$ 3,960	$ 54,250	$ 26,600	$ 87,625	$ 17,500	$ 30,000	$ 46,776	$ 1,880,843
Staking costs	-	-	-	-	-	-	-	1,221
Option payments cash	-	-	-	-	-	-	-	-
Option payments shares	-	-	-	-	-	-	-	4,000
Option income	-	-	-	-	-	-	-	(120,000)
Property write off	(3,960)	(54,250)	(26,600)	(87,625)	(17,500)	(30,000)	(46,776)	(380,141)
	-	-	-	-	-	-	-	1,385,923
Opening balance	158,225	668	12,539	13,561	-	-	71,901	11,958,724
Amortization	-	-	-	-	-	-	-	175,394
Consulting	-	-	-	-	-	-	-	19,413
Drilling	-	-	-	-	-	-	-	48,980
Equipment repairs	-	-	-	-	-	-	-	216,795
Fuel	-	-	-	-	-	-	-	66,782
Geological	1,125	-	-	-	-	-	-	151,758
Labour and benefits	-	-	-	-	-	-	-	447,485
Line cutting	-	-	-	-	-	-	-	30,479
Mapping and sampling	-	-	-	-	-	-	-	106,994
Site administration	-	-	-	-	-	-	-	7,401
Supplies and	-	-	-	-	-	-	-	121,778
Surveying	-	-	-	-	-	-	-	24,952
Utilities and	-	-	-	-	-	-	-	52,947
Incidental revenue	-	-	-	-	-	-	-	(381,447)
Property write off	(159,350)	(668)	(12,539)	(13,561)	-	-	(71,901)	(802,549)
	-	-	-	-	-	-	-	12,245,886
Balance, May 31, 2011	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$13,631,809

7. EXPLORATION AND EVALUATION ASSETS (Continued)

British Columbia Properties

a) Slocan and Sandon Group, British Columbia

The Slocan and Sandon Group covers an area of approximately 100 square kilometers. The claims include legacy claims, crown-granted claims and recently acquired or converted mineral claims. Not all claims are contiguous. One claim group is located approximately 7 km northeast of the Sandon Mill and another claim group is 7 km to the southeast.

On July 7, 2009 the Company entered into a property option agreement to earn a 100% interest in the Goldsmith property. There is a 2% NSR payable. In order to earn its 100% interest, the Company must:

i) Pay $5,000 (paid) and issue 2,500 shares (issued) upon regulatory approval.
ii) On or before August 24, 2010, pay $10,000 (paid), and issue 2,500 shares (outstanding).
iii) On or before August 24, 2011 pay $15,000 (paid), and issue 2,500 shares (outstanding).
iv) On or before August 24, 2012 pay $20,000 (outstanding), and issue 2,500 shares (outstanding).
v) On or before August 24, 2013 pay $30,000.
vi) Pay $20,000 in each of the following six years from 2014 to 2019.

On June 8, 2010, the Company entered into an option agreement with Gold Jubilee Capital Corp. (TSX.V) ("Jubilee") pursuant to which Jubilee can acquire a 51% right, title and interest in the Hewitt-Van Roi property for $320,000 ($120,000 received), a total of 300,000 common shares of Jubilee, and incurring at least $1,500,000 in exploration expenses. All payments are due in staged payments through October 28, 2013. Jubilee has not issued the 100,000 shares to the Company which were due October 31, 2011. The Company has terminated the option agreement with Jubilee as at May 31, 2012.

On August 2, 2011, the Company entered into a property option agreement to earn a 100% interest in the Bakus property. In order to earn 100% interest, the Company must:

i) On or before August 2, 2011 pay $15,000 (Paid).
ii) Issue common shares valued at $15,000 (issued) upon regulatory approval.
iii) On or before October 31, 2012 pay $15,000, and issue common shares valued at $15,000.

On August 3, 2011 the Company entered into a property option agreement to earn a 100% interest in the Cody Creek property. In order to earn its 100% interest, the Company must:

i) Pay $15,000 (paid) and issue 30,000 shares (issued) upon regulatory approval.
ii) On or before November 24, 2012, pay $25,000, and issue 30,000 shares.
iii) On or before November 24, 2013 pay $30,000, and issue 40,000 shares.
iv) On or before November 24, 2014 pay $40,000, and issue 50,000 shares.

There is a 1% NSR payable

7. EXPLORATION AND EVALUATION ASSETS (Continued)

Ontario Properties

b) Haultain, Ontario
On May 5, 2006, and as amended on May 13, 2009, the Company entered into a property option agreement to earn a 100% interest in a mineral property located in the Haultain Mining Division in Ontario. The agreement provides for a 2% net smelter royalty ("NSR") of which half may be purchased for $1,000,000. In order to earn its 100% interest, the Company must:

i) Pay $80,000 (paid) and issue 15,000 shares (issued).
ii) On or before June 5, 2010, pay $15,000, and issue 3,750 shares.

As at May 31, 2012, the Company has not paid the $15,000 or issued 3,750 shares as required under the terms of the option agreement. The option agreement has not been officially terminated as at May 31, 2012, but the Company considers the option agreement to not be in good standing. Therefore, the mineral property related to the property has been written down by $1,850,764, to a value of $1.

c) Milner Silver, Ontario
On February 5, 2007, and as amended May 13, 2009, the Company entered into two property option agreements to earn a 100% interest in a mineral property located in Milner Township, Ontario. There is a 2% NSR payable, of which half may be purchased for $1,000,000. The Company has earned its 100% interest. One agreement was completed on February 25, 2010. The second requires payment of $7,000 on or before July 6, 2010.

As at May 31, 2012, the Company has not made the $7,000 payment which was due July 6, 2010, as required under the terms of the agreement. The option agreement has not been officially terminated as at May 31, 2012, but the Company considers the option agreement to not be in good standing. Therefore, the mineral property related to the property has been written down by $824,637, to a value of $1.

Yukon Properties

d) Connaught Property, Yukon
On May 31, 2006 the Company entered into a property option agreement to earn a 50% interest in a mineral property located in the Dawson Mining District in Yukon Territory. The Company has earned its 50% interest. Effective May 28, 2012, the 50% was re-purchased by ATAC Resources Ltd. ("ATAC") in exchange for 75,000 common shares of ATAC at $2.51 per share for total consideration of $188,250 resulting in the termination of the joint exploration agreement.

e) Stump Property, Yukon
On May 28, 2006, the Company entered into a property option agreement to earn a 100% interest in a mineral property located in the Watson Lake Mining District in Yukon Territory. There is a NSR that could range from 2% to 5% depending upon the amount of processing the ores receive prior to smelting. The Company paid a NSR of $17,077 in February 2010. The Company has earned its 100% interest in the Stump Property. As at May 31, 2012, a 50% write-down of $235,116 was recorded to reflect management's assessment of recoverable amounts.

(Expressed in Canadian dollars)

7. EXPLORATION AND EVALUATION ASSETS (Continued)

Yukon Properties (Continued)

f) Hart Property, Yukon
This property lies five kilometers east of the Connaught Joint Venture claims and was acquired by staking in the year ended May 31, 2011. As at May 31, 2012, the Company has written off all costs.

8. RESTORATION PROVISION

The Company has calculated the fair value of the restoration provision as at May 31, 2012 using a pre-tax discount rate of 2.00% (May 31, 2011 – 2.00%). The estimated total future undiscounted cash flows to settle the restoration provision at May 31, 2012 is $85,000 (May 31, 2011 - $85,000). The Company has estimated that the payments will be made in 2015.

	Year Ended May 31, 2012	Year Ended May 31, 2011
Balance, beginning of the year	**$ 78,400**	$ 76,800
Accretion	**1,600**	1,600
Balance, end of the year	**$ 80,000**	$ 78,400

The Company may be contingently liable for other decommissioning liabilities. However, such obligations are not recognized since the fair value cannot be reasonably estimated due to the uncertainty of the extent of reclamation and remediation work and the settlement dates.

9. RELATED PARTY BALANCES AND TRANSACTIONS

Related party balances consisted of the following:

	May 31 2012	May 31 2011	June 1 2010
Due to director, officer and companies with directors in common	**$ 40,421**	$ 346,421	$ 274,988

Other Related Party Transactions

The Company entered into the following transactions and had the following balances payable with related parties. All related party transactions were measured at the amount of consideration established and agreed to by the related parties.

(Expressed in Canadian dollars)

9. RELATED PARTY BALANCES AND TRANSACTIONS (Continued)

Other Related Party Transactions (Continued)

a) Under an annual renewable agreement for services and cost recovery, the Company was charged by a private company controlled by a director;

	Year Ended May 31, 2012	2011
Administration fees	**$ 410,000**	$ 86,000
Automobile rental	**55,000**	96,250
Core storage facilities	**-**	7,000
Related party loan *	**75,500**	-
Private placement participation	**(122,600)**	-

* The related party loan was repaid before May 31, 2012.

The automobile rental charges were capitalized to exploration and evaluation assets. The services to the Company included supervision and administration of the financial requirements of the Company's business, producing quarterly accounts in accordance with public reporting requirements; communicating with various regulatory authorities to ensure compliance with all applicable laws, professional analysis and planning of materials and other documents required to be disseminated, responding to any requests for information and questions; providing secretarial services and legal consultation; office space, office furniture, boardroom facilities, photocopier, fax and such other amenities associated with office needs; and providing such other additional instructions and directions as required. The agreement can be terminated by either party with 30 days' notice.

b) Consulting fees in the aggregate of $194,770 (2011 - $103,650) were paid to directors, an officer, and a former director.

c) Office administration fees in aggregate of $Nil (2011 - $24,500) were paid to a private company controlled by a former officer.

10. SHARE CAPITAL

a) Authorized: Unlimited common shares without par value.

b) During the year ended May 31 , 2012, the following private placements were completed:

i) In July 2011, the Company closed a private placement for 1,000,000 non flow-through units at a price of $0.25 per unit for total proceeds of $250,000. All units consisted of one common share and one share purchase warrant entitling the holder to purchase one additional common share for four years at a price of $0.30 per share. The Company paid commission of $17,500 on this private placement.

(Expressed in Canadian dollars)

10. SHARE CAPITAL (Continued)

ii) In September 2011, the Company closed a private placement for 1,634,200 non flow-through units at a price of $0.25 per unit for total proceeds of $408,550. All units consisted of one common share and one share purchase warrant entitling the holder to purchase one additional common share for four years at a price of $0.30 per share. The Company paid a commission of $1,900 on this private placement.

iii) In November 2011, the Company closed a private placement for 3,413,000 non flow-through units at a price of $0.25 per unit for total proceeds of $853,250. All units consisted of one common share and one share purchase warrant entitling the holder to purchase one additional common share for four years at a price of $0.30 per share.

c) During the year ended May 31, 2011 the following private placements were completed:

i) In May 2011, the Company closed a private placement for 1,200,000 non flow through units at a price of $0.34 per unit for total proceeds of $408,000. All units consisted of one common share and one share purchase warrant entitling the holder to purchase one additional common share for five years at a price of $0.45 per share.

ii) In July 2010, the Company closed a private placement for 675,000 flow-through units and 135,000 non-flow-through units at a price of $1.00 per unit for total proceeds of $810,000. Each flow-through unit consisted of one flow-through common share and one non-flow-through share purchase warrant entitling the holder to purchase one additional common share for two years at a price of $2.00 per share. Each non-flow- through unit consisted of one non-flow-through common share and one non-flow- through share purchase warrant entitling the holder to purchase one additional common share for five years at a price of $2.00 per share in years one and two, $3.00 per share in year three, and $4.00 per share in years four and five. The Company paid commissions of $40,800 on this private placement.

d) A summary of the changes in warrants follows:

	NUMBER OF WARRANTS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE
Balance, June 1, 2010	**5,796,712**	**$ 2.05**
Issued	2,010,000	0.93
Expired/Cancelled	(909,625)	3.52
Balance, May 31, 2011	**6,897,087**	**1.60**
Issued	6,047,200	0.30
Expired/Cancelled	(2,552,815)	1.14
Balance, May 31 , 2012	**10,391,472**	**$ 0.91**

(Expressed in Canadian dollars)

10. SHARE CAPITAL (Continued)

d) A summary of the changes in warrants follows (Continued)

As at May 31, 2012 the following share purchase warrants were outstanding:

TOTAL NUMBER OF WARRANTS	EXERCISE PRICES	EXPIRY DATES
447,367	$ 0.40	May 21, 2014
500,000	$ 2.00	June 3, 2012 *
15,000	$ 2.00	June 9, 2012 *
160,000	$ 2.00	July 14, 2012 *
258,915	$ 2.00	December 3, 2012
305,750	$ 3.00/4.00	July 6, 2012/2013
232,500	$ 3.00/4.00	July 22, 2012/2013
125,000	$ 3.00	November 10, 2014
650,615	$ 3.00	December 9, 2014
75,000	$ 3.00/4.00	December 21, 2012/2014
239,125	$ 3.00/4.00	January 31, 2013/2015
10,000	$ 2.00/3.00/4.00	June 9, 2012/2013/2015
125,000	$ 2.00/3.00/4.00	July 14, 2012/2013/2015
1,000,000	$ 0.30	July 20, 2015
1,634,200	$ 0.30	September 12, 2015
3,413,000	$ 0.30	November 8, 2015
1,200,000	$ 0.45	May 23, 2016
10,391,472		

* Subsequently, 675,000 warrants were expired unexercised.

As at May 31, 2012 the weighted average remaining contractual life of the share purse warrants was 2.86 years (2011 – 1.88 years)

e) Stock Options

The Company has a stock option plan that provides for the issuance of options to its directors, officers, employees and consultants. The maximum number of outstanding options must be no more than 10% of the issued and outstanding shares at any point in time. All options have been granted with a term of five or seven years and were fully vested on the grant date.

The following is a summary of the changes in stock options:

	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding and exercisable at June 1, 2010	767,825	$ 2.00
Options cancelled/expired	(420,175)	2.00
Outstanding and exercisable at May 31, 2011	347,650	2.00
Options cancelled/expired	(347,650)	2.00
Outstanding and exercisable at May 31, 2012	-	$ -

(Expressed in Canadian dollars)

11. MANAGEMENT OF CAPITAL

The Company manages its cash, common shares, stock options and warrants as capital. The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the development of its exploration and evaluation assets and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk. The Board of Directors does not establish a quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management team to sustain the future development of the business.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents.

In order to facilitate the management of its capital requirements, the Company prepares expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. In order to maximize ongoing exploration efforts, the Company does not pay out dividends. The Company's investment policy is to keep its cash treasury on deposit in an interest bearing Canadian chartered bank account.

There were no changes in the Company's approach to capital management during the year ended May 31, 2012. Neither the Company nor its subsidiary is subject to externally imposed capital requirements.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial assets and financial liabilities are measured on an ongoing basis at fair value or amortized cost. The disclosures in the notes to these financial statements describe how the categories of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognized.

As at May 31, 2012, the classification of the financial instruments, as well as their carrying values and fair values, are shown in the table below:

	FVTPL	LOANS AND RECEIVABLES/ AMORTIZED COST	TOTAL CARRYING VALUE	FAIR VALUE
Financial assets				
Cash	$ -	$ -	$ -	$ -
Deposits	10,146	-	10,146	10,146
Reclamation bonds	119,000	-	119,000	119,000
Accounts receivable (a)	-	45,789	45,789	45,789
Marketable securities	197,250	-	197,250	197,250
	$ 326,396	$ 45,789	$ 372,185	$ 372,185
Financial liabilities				
Accounts payable and accrued liabilities (a)	$ -	$ (277,087)	$ (277,087)	$ (277,087)
Due to related parties (a)	-	(40,421)	(40,421)	(40,421)
	$ -	$ (317,508)	$ (317,508)	$ (317,508)

(a) Fair value approximates the carrying amounts due to the short-term nature.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

At May 31, 2012 and May 31, 2011, the Company's financial instruments which are measured at fair value on a recurring basis are cash and marketable securities which are classified as Level 1.

The carrying values of the Company's financial liabilities were a reasonable approximation of fair value.

The Company is exposed to potential loss from various risks including commodity price risk, interest rate risk, currency risk, credit risk and liquidity risk. Based on the Company's operations the liquidity risk and commodity price risk are considered the most significant.

a) Commodity Price Risk

The Company's ability to raise capital to fund exploration or development activities is subject to risk associated with fluctuations in the market prices of base and precious metals including gold, silver, zinc and lead, and the outlook for these metals. The Company does not have any hedging or other derivative contracts respecting its operations.

Market prices for metals historically have fluctuated widely and are affected by numerous factors outside of the Company's control, including, but not limited to, levels of worldwide production, short-term changes in supply and demand, industrial and retail demand, central bank lending, and forward sales by producers and speculators. The Company has elected not to actively manage its commodity price risk, as the nature of Company's business is in exploration.

b) Liquidity Risk

The liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity risk through careful management of its financial obligations in relation to its cash position. Using budgeting processes the Company manages its liquidity requirements based on expected cash flow to ensure there are adequate funds to meet the short term obligations during the year.

During the past year the Company has been able to maintain its liquidity position through private placements. However, the variable market conditions make it uncertain whether the Company can continue to raise adequate funds to meet its financial obligations.

13. FIRST TIME ADOPTION OF IFRS

The effect of the Company's transition to IFRS, described in Note 2 is summarized in this note as follows:

a) Mandatory Exemptions and Optional Transition Date Elections

IFRS 1, which governs the first-time adoption of IFRS, generally requires accounting policies to be applied retrospectively to determine the opening statement of financial position on the Company's transition date of June 1, 2010 (the "Transition Date"), with the application of certain mandatory exemptions and also allows certain optional transition elections upon adoption of IFRS. The mandatory exemptions applicable to and the transition elections the Company has chosen, respectively, are as follows:

(i) **Mandatory Exemptions** - Under IFRS 1, there are four mandatory exemptions from full retrospective application of IFRS. Of these, the only applicable election relates to estimates. An entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's IFRS estimates as at June 1, 2010 are consistent with its previous estimates under Canadian GAAP for the same date.

(ii) **Business Combinations** – IFRS 1 provides the option to apply IFRS 3R, *Business Combinations*, retrospectively or prospectively from the Transition Date. The retrospective basis would require the restatement of prior acquisitions that meet the definition of a business combination under IFRS 3R. The Company has elected to not restate previous business combinations that occurred before June 1, 2010.

(iii) **Share-based Payments** – IFRS 1 provides the option to not apply IFRS 2, *Share-based Payments*, to equity instruments granted after November 7, 2002 and vested before the Transition Date. The Company has elected not to apply IFRS 2 to awards that vested prior to Transition Date.

(iv) **Decommissioning Liabilities included in the cost of property, plant and equipment** – IFRS 1 provides the option to measure restoration provisions at the Transition Date in accordance with the requirements under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, and estimate the amount to be included in the cost of the related asset by discounting the liability to the date at which the liability first arose using the best estimate of historical risk-free discount rates.

(v) **Financial Instruments** – IFRS 1 provides the option to designate its cash and cash equivalents as FVPL upon initial recognition. The Company did this in accordance with their instrument strategy to evaluate performance on a fair value basis. The designation had no impact on the results and financial position of the Company.

13. FIRST TIME ADOPTION OF IFRS (Continued)

b) Reconciliation of Previously Reported Financial Statements

Reconciliations of the IFRS adjustments on transition are included in these following Statements of Financial Position and Statements of Loss and Comprehensive Loss for the dates noted below.

- Transitional Consolidated Statement of Financial Position Reconciliation – As at June 1, 2010;
- Consolidated Statement of Financial Position Reconciliation – As at May 31, 2011;
- Consolidated Statement of Loss and Comprehensive Loss Reconciliation – Year Ended May 31, 2011;
- Consolidated Statement of Cash Flows – Year Ended May 31, 2011

Explanation of Reconciling Differences

a) Flow-Through Shares

Under IFRS, the Company bifurcates the flow-through share into i) a flow-through share premium, equal to the estimated premium, if any, investors pay for the flow-though feature, which is recognized as a liability, and ii) share capital. Upon expenses being incurred, the Company recognizes a deferred tax liability for the amount of the tax deduction renounced to the shareholders and the premium liability is reversed. The reversal of the premium liability and the deferred tax liability are recognized as tax recoveries to the extent that suitable deferred tax assets are available. Under Canadian GAAP, the Company recorded the tax cost of expenditures renounced to subscribers on the date the deductions were renounced to the subscribers. Share capital was reduced and future income tax liabilities were increased by the tax cost of expenditures renounced to the subscribers, except that the amount was recognized as a tax recovery to the extent that suitable future tax assets were available.

As a result, for issuances of flow-through shares for which expenditures have been incurred, share capital was increased by $4,189,256 at the date of transition (May 31, 2011 - $4,403,926) and deficit was increased by $4,213,369 on the date of transition (May 31, 2011 - $4,400,403). The effect on net loss for the year ended May 31, 2011 was an increase of $242,308.

b) Reclassification Within Equity

IFRS requires an entity to present for each component of equity, reconciliation between the carrying amount at the beginning and end of the period, separately disclosing each change. The Company examined its “Contributed Surplus” account and concluded that as at the Transition Date, the balance of $2,299,462 (May 31, 2011 - $2,495,962) relates to “Share-based Payments Reserve”. The amounts in “Contributed Surplus” have been reclassified to “Share-based Payments Reserve” in the statement of financial position. The “Share-based Payments Reserve” is separately disclosed on the statement of changes in equity.

13. FIRST TIME ADOPTION OF IFRS (Continued)

c) Provisions, Contingent Liabilities and Contingent Assets

Under Canadian GAAP, asset retirement obligations are measured at fair value, incorporating market assumptions and discount rates based on the Company's credit-adjusted risk-free rate. Adjustments are made to asset retirement obligations for changes in the timing or amount of the cash flows and the unwinding of the discount.

Under IFRS, restoration provisions are measured at the inflation adjusted present value of the expected expenditures required to settle the obligation using a pre-tax discount rate reflecting the time value of money and risks specific to the liability.

The Company elected to apply the exemption from full retrospective application of IFRIC 1, Changes in Existing Decommissioning, Restoration and Similar Liabilities ("IFRIC 1") to the Company's decommissioning liabilities included in the cost of property, plant and equipment. In accordance with the IFRS 1 optional exemption, decommissioning and restoration liabilities of the Company are measured as at the date of transition to IFRS in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets. To the extent that the liability is within the scope of IFRIC 1, the amount that would have been included in the cost of the related asset when the liability first arose is determined by discounting the liability to that date using the best estimate of the historical risk free discount rates(s) that would have applied for that liability of the intervening period. Depreciation charges based on the adjusted cost is applied prospectively from June 1, 2010.

The Company has recalculated the revised asset retirement obligation by applying the revised discount rate applicable to the project liability. The impact on the previously reported amounts is as follows: As at June 1, 2010 and May 31, 2011: increase in Mill & Equipment $37,439; increase to the asset retirement obligation at June 1, 2010 $22,117 and $18,385 at May 31, 2011. The corresponding income statement impact with respect to accretion expense charge at June 1, 2010 $15,322 and $19,054 at May 31, 2011

The increase in the provision from June 1, 2010 to May 31, 2011 is primarily due to a change in the estimated cash flows and a change in the discount rate used to calculate the restoration provision from a credit-adjusted discount rate of 9.75% used under Canadian GAAP compared to the risk-free discount rate of 2.00% used under IAS 37.

In addition, under Canadian GAAP, the unwinding of the discount was disclosed as amortization and accretion expense within the loss from operations in the statement of loss and comprehensive loss and has now been reclassified under accretion expenses in the statement of loss and comprehensive loss as accretion on restoration provision in accordance with IFRS.

(Expressed in Canadian dollars)

13. FIRST TIME ADOPTION OF IFRS (Continued)

Reconciliation of Statements of Financial Position

		JUNE 1, 2010			May 31, 2011		
	NOTE	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS
ASSETS							
Current							
Cash		$ -	$ -	$ -	$ 131,637	$ -	$ 131,637
Accounts receivable		94,051	-	94,051	50,561	-	50,561
Prepaid expenses		8,134	-	8,134	2,023	-	2,023
		102,185	-	102,185	184,221	-	184,221
Deposit		-	-	-	9,900	-	9,900
Reclamation Bond		119,000	-	119,000	119,000	-	119,000
Mill And Equipment	c	941,754	37,439	979,193	735,811	37,439	773,250
Exploration And Evaluation Assets		13,852,066	-	13,852,066	13,631,808	-	13,631,808
TOTAL ASSETS		$ 15,015,005	$ 37,439	$ 15,052,444	$ 14,680,740	$ 37,439	$ 14,718,179
LIABILITIES							
Current liabilities							
Bank indebtedness		$ 51,983	$ -	$ 51,983	$ -	$ -	$ -
Accounts payable and accrued liabilities		267,417	-	267,417	182,277	-	182,277
Loan payable		-	-	-	301,450	-	301,450
Due to related parties		274,988	-	274,988	346,421	-	346,421
		594,388	-	594,388	830,148	-	830,148
Deferred Income Taxes		16,000	-	16,000	-	-	-
Asset Retirement Obligation	c	54,683	22,117	76,800	60,015	18,385	78,400
		665,071	22,117	687,188	890,163	18,385	908,548
SHAREHOLDERS' EQUITY							
Share Capital	a	21,700,275	4,189,256	25,889,531	22,620,805	4,403,926	27,024,731
Contributed surplus	b	2,299,462	(2,299,462)	-	2,495,962	(2,495,962)	-
Share-based payment reserves	b	-	2,299,462	2,299,462	-	2,495,962	2,495,962
Deficit	a	(9,649,803)	(4,173,934)	(13,823,737)	(11,326,190)	(4,384,872)	(15,711,062)
		14,349,934	(15,322)	14,365,256	13,790,577	19,054	13,809,631
TOTAL LIABILITIES AND EQUITY		$ 15,015,005	$ 37,439	$ 15,052,444	$ 14,680,740	$ 37,439	$ 14,718,179

(Expressed in Canadian dollars)

13. FIRST TIME ADOPTION OF IFRS (Continued)

Reconciliation of Statements of Net Loss and Comprehensive Loss

	Year Ended May 31, 2011		
	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS
Expenses			
Amortization	$ 7,943	**$** -	$ 7,943
Administration	86,000	-	86,000
Consulting fees	91,500	-	91,500
Investor relations, travel and promotion	15,591	-	15,591
Labour and benefits	112,414	-	112,414
Loan consideration, interest and bank charges	183,683	-	183,683
Office	71,344	-	71,344
Part XII.6 tax	4,268	-	4,268
Professional fees	95,121	-	95,121
Regulatory and stock transfer fees	90,952	-	90,952
Utilities and communication	1,335	-	1,335
Loss Before Income Taxes	(760,151)	-	(760,151)
Other Income (Expenses)			
Accretion	(5,332)	3,732	(1,600)
Foreign exchange gain	2,836	-	2,836
Interest earned	225	-	225
Exploration and evaluation assets write-down	(1,182,689)	-	(1,182,689)
Loss on disposal of fixed assets	(11,056)	-	(11,056)
Recovery of prior period expenses	49,110	-	49,110
	(1,146,906)	3,732	(1,143,174)
Loss Before Income Taxes	(1,907,057)	-	(1,903,325)
Deferred Income Taxes	230,670	(214,670)	16,000
Net Loss And Comprehensive Loss For The Year	$ (1,676,387)	$ (210,938)	$ (1,887,325)

(Expressed in Canadian dollars)

13. FIRST TIME ADOPTION OF IFRS (Continued)

Reconciliation of Cash Flows

	Year Ended May 31, 2011		
	CANADIAN GAAP	EFFECT OF TRANSITION TO IFRS	IFRS
Operating Activities			
Net Loss for the year	$ (1,676,387)	$ (210,938)	$ (1,887,325)
Non-cash items:			
Accretion and amortization	13,275	(3,732)	9,543
Accrued loan interest	27,984	-	27,984
Exploration and evaluation assets write-down	1,182,689	-	1,182,689
Loan consideration	150,500	-	150,500
Loss on disposal of fixed assets	11,056	-	11,056
Deferred income taxes recovered	(230,670)	214,670	(16,000)
Changes in non-cash operating assets and liabilities			
Accounts receivable	43,490	-	43,490
Prepaid expenses	6,111	-	6,111
Accounts payable and accrued liabilities	(54,188)	-	(54,188)
Due to related parties	(8,967)	-	(8,967)
Cash Used In Operating Activities	(535,107)	-	(535,107)
Investing Activities			
Equipment sales proceeds	11,550	-	11,550
Security deposit	(9,900)	-	(9,900)
Exploration and evaluation assets expenditures, net	(813,989)	-	(813,989)
Cash Used In Investing Activities	(812,339)	-	(812,339)
Financing Activities			
Shares issued	1,218,000	-	1,218,000
Share issuance costs	(40,800)	-	(40,800)
Due from related parties	80,400	-	80,400
Loan proceeds	400,000	-	400,000
Loan repayments	(126,534)	-	(126,534)
Net Cash Provided By Financing Activities	1,531,066	-	1,531,066
Net Increase In Cash	183,620	-	183,620
		-	
(Bank Overdraft), Beginning of Year	(51,983)	-	(51,983)
Cash, End of Year	$ 131,637	$ -	$ 131,637

(Expressed in Canadian dollars)

14. DEFERRED INCOME TAX

a) Provision for Income Taxes

The Company's provision for income taxes for the years ended May 31, 2012 and 2011 differs from the amounts computed by applying the statutory income tax rates to the loss before income taxes as a result of the following:

	2012	2011
Statutory combined federal and provincial rate	**26%**	28%
Computed recovery of income taxes at statutory rates	**$ (1,444,000)**	$ (527,000)
Non-deductible permanent differences	**33,000**	45,000
Share issuance costs	**(5,000)**	(10,000)
Other	**143,000**	341,000
Valuation allowance and other	**1,273,000**	167,000
	$ -	$ 16,000

b) Deferred Income Tax Assets and Liabilities

The estimated tax effect of the significant components within the Company's deferred tax liability was as follows:

	MAY 31 2012	MAY 31 2011	JUNE 1 2010
Mineral properties	**$ (616,000)**	$ (1,815,000)	$ (1,872,000)
Non-capital losses carried forward	**1,867,000**	1,794,000	1,694,000
Cumulative eligible capital deductions	**3,000**	3,000	3,000
Capital assets	**230,000**	196,000	148,000
Share issue costs	**44,000**	77,000	115,000
Valuation allowance	**(1,528,000)**	(255,000)	(88,000)
Net deferred income tax liabilities	**$ -**	$ -	$ -

The Company's non-capital losses in the amount of $7,458,000 begin to expire in 2026

c) Flow-through Resource Expenditures

The Company is permitted, under Canadian income tax legislation, to renounce flow-through related resource expenditures to investors in advance of the Company incurring the expenditure. In accordance with this legislation, the Company has twelve months following the effective date of renunciation to incur the expenditures. The Company begins incurring interest charges for unspent funds after one month and fees for unspent funds at the end of the calendar year following the effective date of renunciation, and until such time as funds are fully expended.

(Expressed in Canadian dollars)

15. SUPPLEMENTAL CASH FLOW INFORMATION

		2012		2011
Cash Paid during the year for:				
Interest	**$**	**-**	$	-
Income Tax	**$**	**-**	$	-
Non-cash financing and investing activities:				
Shares issued for exploration and evaluation assets	**$**	**25,458**	$	4,000
Shares issued for finder's fee	**$**	**6,600**	$	-
Exploration costs included in accounts payable	**$**	**191,453**	$	93,957
Accounts payable previously recorded to write-off	**$**	**22,294**	$	-
Shares issued for accounts payable	**$**	**3,800**	$	-
Shares issued for loan payable	**$**	**-**	$	150,500
Fair value of warrants re-priced	**$**	**-**	$	196,500
Marketable securities received from sale of Connaught	**$**	**188,250**	$	-

16. COMMITMENT

In May 23, 2012, the Company announced a private placement for up to 4,000,000 flow-through and non flow-through units at a price of $0.20 and $0.15 per unit respectively. Each unit consisted of either one flow-through or one non flow-through common share and one non flow-through, non-transferable share purchase warrant entitling the holder to purchase one additional common share for a period of four years at a price of $0.25 per share in the case of flow-through units and $0.20 in the case of non-flow-through units. As of May 31, 2012, the Company had received share subscriptions in the amount of $149,500.