

# KWG RESOURCES INC.

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## CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010

## **MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS**

All of the information in the accompanying financial statements of KWG Resources Inc. is the responsibility of management. The financial statements have been prepared by management in accordance with International Financial Reporting Standards. Where necessary, management had made judgments and estimates in preparing the financial statements and such statements have been prepared within acceptable limits of materiality.

Management maintains appropriate systems of internal control to give reasonable assurance that its assets are safeguarded and the financial records are properly maintained.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control and exercises this responsibility principally through the Audit Committee. The Audit Committee, which is comprised of Directors, none of whom are employees or officers of the Company, meets with management and the external auditors to review the auditor's report and the financial statements to satisfy itself that management is properly discharging its responsibilities to the Directors, who approve the financial statements.

A firm of independent Chartered Accountants, appointed by the shareholders, audits the financial statements in accordance with Canadian generally accepted auditing standards and provides an independent professional opinion thereon. The external auditors have free and full access to the Audit Committee with respect to their findings regarding the fairness of financial reporting and the adequacy of internal controls.

Frank C. Smeenk  
President & CEO

Thomas E. Masters  
Chief Financial Officer

April 30, 2012



April 30, 2012

## **Independent Auditor's Report**

**To the Shareholders of  
KWG Resources Inc.**

We have audited the accompanying consolidated financial statements of KWG Resources Inc., which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010 and the consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and the related notes, which include a summary of significant accounting policies.

### **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 as issued by the International Accounting Standards Board, 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 audits 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.

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\*PwC\* refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of KWG Resources Inc. as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

**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 KWG Resources Inc.'s ability to continue as a going concern.

*PricewaterhouseCoopers LLP*

**Chartered Accountants, Licensed Public Accountants**

**KWG RESOURCES INC.**  
(An exploration stage company)  
**Consolidated Balance Sheets**

		As at December 31, 2011	As at December 31, 2010	As at January 1, 2010
(in Canadian dollars)	Notes		(Note 27)	(Note 27)
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents	6	16,030,551	3,261,057	2,056,751
Receivables	7	1,072,320	392,110	216,486
Marketable securities	8	3,074,298	293,438	134,991
Prepaid expenses		31,058	28,079	25,022
<b>Total current assets</b>		<b>20,208,227</b>	<b>3,974,684</b>	<b>2,433,250</b>
<b>Non-current assets</b>				
Property and equipment	9	65,837	48,232	40,101
Mineral property interests	10	28,442,269	31,390,134	18,256,842
<b>Total non-current assets</b>		<b>28,508,106</b>	<b>31,438,366</b>	<b>18,296,943</b>
<b>Total assets</b>		<b>48,716,333</b>	<b>35,413,050</b>	<b>20,730,193</b>
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Trade and other payables	11	1,112,928	1,680,963	2,001,674
<b>Total current liabilities</b>		<b>1,112,928</b>	<b>1,680,963</b>	<b>2,001,674</b>
<b>Non-current liabilities</b>				
Warrant liability	12	1,096,584	2,492,772	2,302,100
<b>Total non-current liabilities</b>		<b>1,096,584</b>	<b>2,492,772</b>	<b>2,302,100</b>
<b>Equity attributable to the owners of the parent company</b>				
Share capital	14	21,308,113	28,685,901	14,870,467
Warrants	15	7,431,617	5,316,679	2,809,159
Contributed surplus		7,091,101	5,895,585	3,137,356
Accumulated other comprehensive income (loss)		283,674	15,238	(255,805)
Retained earnings (deficit)		10,392,316	(8,735,274)	(4,134,758)
		<b>46,506,821</b>	<b>31,178,129</b>	<b>16,426,419</b>
Non-controlling interests	13	-	61,186	-
<b>Total equity</b>		<b>46,506,821</b>	<b>31,239,315</b>	<b>16,426,419</b>
<b>Total liabilities and equity</b>		<b>48,716,333</b>	<b>35,413,050</b>	<b>20,730,193</b>

**Nature of operations and going concern (Note 1)**  
**Commitments (Note 23)**  
**Subsequent events (Note 28)**

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

**Approved by the Board of Directors**

René Galipeau  
Director

Frank Smeenk  
Director

**KWG RESOURCES INC.**

(An exploration stage company)

**Consolidated Statements of Operations and Statements of Comprehensive Income (Loss)**  
**For the years ended December 31, 2011 and 2010**

<b>(in Canadian dollars)</b>	<b>Notes</b>	<b>2011</b>	<b>2010</b>
General and administrative	17	(2,796,335)	(3,344,021)
Amortization of property and equipment	9	(30,151)	(24,350)
Stock compensation costs	16	(1,157,799)	(2,759,655)
Write-down of mineral property interests	10	(202,123)	(210,662)
Gain on foreign exchange		511,750	48,735
Gain on disposal of mineral property interests	10	14,259,115	-
<b>Operating profit (loss)</b>		<b>10,584,457</b>	<b>(6,289,953)</b>
<b>Other income (expenses)</b>			
Finance income	18	292,094	234,527
Other income		86,566	34,750
Termination fee	19	-	2,300,000
Gain (loss) on disposal of marketable securities	8	153,000	(65,096)
Gain (loss) on revaluation of warrant liability	12	1,396,188	(777,634)
		<b>1,927,848</b>	<b>1,726,547</b>
<b>Income (loss) from continuing operations</b>		<b>12,512,305</b>	<b>(4,563,406)</b>
<b>Loss from discontinued operations</b>	5	<b>(755,872)</b>	<b>(45,924)</b>
<b>Net income (loss) for the year</b>		<b>11,756,433</b>	<b>(4,609,330)</b>
Net loss attributable to non-controlling interest	13	250,243	8,814
<b>Net income (loss) attributable to equity holders of KWG Resources Inc.</b>		<b>12,006,676</b>	<b>(4,600,516)</b>
<b>Earnings (loss) per share (basic and diluted)</b>	21	<b>0.02</b>	<b>(0.01)</b>

**Consolidated Statements of Comprehensive income (loss)**

<b>(in Canadian dollars)</b>	<b>Notes</b>	<b>2011</b>	<b>2010</b>
Net income (loss) for the year		11,756,433	(4,609,330)
Other comprehensive Income ("OCI")			
Net change in fair value of AFS	8	268,436	271,043
<b>Total comprehensive income (loss) for the year</b>		<b>12,024,869</b>	<b>(4,338,287)</b>
Portion attributable to non-controlling interest		250,243	8,814
<b>Total comprehensive income (loss) attributable to equity holders of KWG Resources Inc.</b>		<b>12,275,112</b>	<b>(4,329,473)</b>

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

**KWG RESOURCES INC.**

(An exploration stage company)

**Consolidated Statements of Changes in Equity**  
**For the years ended December 31, 2011 and 2010**

(in Canadian dollars)	Notes	Share capital	Warrants	Contributed Surplus	Retained earnings (Deficit)	Accumulated Other Comprehensive Income	Non-controlling Interest	Total
<b>Balance, December 31, 2010</b>		<b>28,685,901</b>	<b>5,316,679</b>	<b>5,895,585</b>	<b>(8,735,274)</b>	<b>15,238</b>	<b>61,186</b>	<b>31,239,315</b>
Net income for the year		-	-	-	12,006,675	-	(250,243)	11,756,432
Other comprehensive income for the year		-	-	-	-	268,436	-	268,436
<b>Total comprehensive income for the year</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>12,006,675</b>	<b>268,436</b>	<b>(250,243)</b>	<b>12,024,868</b>
Private placements, net of share issuance costs	14	2,213,777	336,756	-	-	-	-	2,550,533
Settlement of liability	14	212,766	187,234	-	-	-	-	400,000
Issued for marketable securities	8	1,785,000	1,638,000	-	-	-	-	3,423,000
Exercise of warrants and stock options	14	39,335	(6,485)	(2,850)	-	-	-	30,000
Expired warrants	15	-	(40,567)	40,567	-	-	-	-
Stock based compensation	16	-	-	1,157,799	-	-	763,125	1,920,924
Normal course issuer bid	14	(500,000)	-	-	-	-	-	(500,000)
Non-controlling interest in Debut Diamonds Inc.	13	334,614	-	-	-	-	1,906,464	2,241,078
Distribution of Debut Diamonds Inc shares	5	(11,463,280)	-	-	7,120,915	-	(2,480,532)	(6,822,897)
<b>Balance, December 31, 2011</b>		<b>21,308,113</b>	<b>7,431,617</b>	<b>7,091,101</b>	<b>10,392,316</b>	<b>283,674</b>	<b>-</b>	<b>46,506,821</b>
<b>Balance, January 1, 2010</b>		<b>14,870,467</b>	<b>2,809,159</b>	<b>3,137,356</b>	<b>(4,134,758)</b>	<b>(255,805)</b>	<b>-</b>	<b>16,426,419</b>
Net loss for the year		-	-	-	(4,600,516)	-	(8,814)	(4,609,330)
Other comprehensive income for the year		-	-	-	-	271,043	-	271,043
<b>Total comprehensive loss for the year</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>(4,600,516)</b>	<b>271,043</b>	<b>(8,814)</b>	<b>(4,338,287)</b>
Private placements, net of share issuance costs	14	8,725,355	3,074,679	-	-	-	-	11,800,034
Exercise of warrants and compensation options	14	4,652,819	(530,325)	-	-	-	-	4,122,494
Exercise of stock options		437,260	-	(38,260)	-	-	-	399,000
Expired warrants	15	-	(36,834)	36,834	-	-	-	-
Stock based compensation	16	-	-	2,759,655	-	-	-	2,759,655
Non-controlling interest in Debut Diamonds Inc.	13	-	-	-	-	-	70,000	70,000
<b>Balance, December 31, 2010</b>		<b>28,685,901</b>	<b>5,316,679</b>	<b>5,895,585</b>	<b>(8,735,274)</b>	<b>15,238</b>	<b>61,186</b>	<b>31,239,315</b>

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

**KWG RESOURCES INC.**  
(An exploration stage company)  
**Consolidated Statements of Cash Flows**  
**For the years ended December 31, 2011 and 2010**

<b>(in Canadian dollars)</b>	<b>Notes</b>	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities</b>			
Net income (loss) for the year		11,756,433	(4,609,330)
Adjustments for			
Amortization of property and equipment	9	30,151	24,350
Stock based compensation costs	16	1,920,922	2,759,655
Write-off of mining assets	10	202,123	210,662
Gain (loss) on disposal of marketable securities	8	(153,000)	65,096
FV changes in marketable securities classified as FVTPL	8	65,117	-
Finance income excluding interest	18	(289,420)	(219,821)
Gain (loss) on revaluation of warrant liability	15	(1,396,188)	777,634
Gain on distribution of Debut Diamonds Inc.	5	(758,595)	-
Gain on disposal of mineral property interest	10	(14,259,115)	-
Net change in non-cash working capital balances		132,321	(1,373,597)
<b>Net cash used by operating activities</b>		<b>(2,749,251)</b>	<b>(2,365,351)</b>
<b>Cash flows from financing activities</b>			
Share capital issued	14	2,643,420	13,510,624
Warrants and compensation options issued	15	322,180	3,266,502
Share and warrant issue expenses		(118,497)	(593,681)
Shares repurchased through normal course issuer bid	14	(292,669)	-
<b>Net cash provided by financing activities</b>		<b>2,554,434</b>	<b>16,183,445</b>
<b>Cash flows from investing activities</b>			
Expenditures on exploration and evaluation projects	10	(4,313,972)	(12,628,074)
Proceeds from disposals of mineral property interests	10	16,759,117	-
Purchases of property and equipment	9	(47,756)	(36,382)
Proceeds from disposal of property and equipment	9	-	3,900
Purchase of marketable securities	8	(16,776)	-
Proceeds from disposal of marketable securities	8	-	47,500
Repayment of advances to related company	22	583,698	-
<b>Net cash used by investing activities</b>		<b>12,964,311</b>	<b>(12,613,056)</b>
Effect of exchange rate changes on cash		-	(732)
<b>Net change in cash and cash equivalents during the year</b>		<b>12,769,494</b>	<b>1,204,306</b>
Cash and cash equivalents – Beginning of the year		3,261,057	2,056,751
<b>Cash and cash equivalents – End of the year</b>		<b>16,030,551</b>	<b>3,261,057</b>
<b>Change in non-cash working capital balances comprises:</b>			
Receivables		(31,405)	(175,624)
Prepaid expenses		(2,979)	(3,057)
Trade and other payables		166,705	(1,194,916)
<b>Net change in non-cash working capital balances</b>		<b>132,321</b>	<b>(1,373,597)</b>
<b>Additional information - non-cash transactions</b>			
Issuance of shares/warrants for exploration and evaluation projects		-	70,000
Acquisition of marketable securities		2,838,965	-
Issuance of agent compensation options		35,250	24,378
Expired warrants included in contributed surplus		40,567	36,834
Additions to exploration and evaluation projects included in accounts payable		325,333	844,555
Financing charge included in accounts payable		-	50,000

The accompanying notes form an integral part of these financial statements.



## **KWG RESOURCES INC.**

(An exploration stage company)

### **Notes to the Consolidated Financial Statements(in Canadian dollars)**

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#### **1 NATURE OF OPERATIONS AND GOING CONCERN**

##### **Nature of Operations**

KWG Resources Inc. ("KWG" or the "Company") is an incorporated entity domiciled in Canada. The Company's registered office is located at 600 de Maisonneuve Boulevard West, Suite 2750, Montreal, Quebec, H3A 3J2. KWG is involved in the exploration and evaluation of base and precious metals and in the development of a transportation link to access the remote areas where these are located. It has interests in properties located in Canada. It was incorporated on August 21, 1937.

The Company is listed on the TSX Venture Exchange and on the Canadian National Stock Exchange under the symbol "KWG".

##### **Going Concern**

These financial statements have been prepared using International Financial Reporting Standards applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due for the foreseeable future.

The Company is in the process of exploring its mineral property interests and has not yet determined whether its mineral property interests contain mineral deposits that are economically recoverable. The Company will periodically have to find additional funds to continue its exploration activities and, while it has been successful in doing so in the past, there can be no assurance it will be able to do so in the future.

Until it is determined that properties contain mineral reserves or resources that can be economically mined, they are classified as exploration and evaluation properties. The recoverability of deferred exploration expenses is dependent upon: the discovery of economically recoverable reserves and resources; securing and maintaining title and beneficial interest in the properties; the ability to obtain necessary financing to complete exploration, development and construction of processing facilities; obtaining certain government approvals; and attaining profitable production.

For the year ended December 31, 2011, the Company had a cash outflow from operating activities of \$2,749,251 (\$2,365,351 for December 31, 2010). Cash and cash equivalents as at December 31, 2011 amounted to \$16,030,551 (\$3,261,057 as at December 31, 2010). Trade and other payables that will be settled in cash as at December 31, 2011 amounted to \$867,273 (\$1,412,459 as at December 31, 2010). In addition to ongoing working capital requirements, the Company must secure on an ongoing basis sufficient funds for its existing commitments for exploration, general and administration costs and future exploration activity in the Company's projects (notes 10 and 23).

The Company's current cash reserves are sufficient to provide for these working capital requirements and existing commitments in the short term. However, management will continue to pursue all financing alternatives available to fund its future obligations and exploration activities. There is no assurance that the Company will be successful in these actions. Should the Company not be able to obtain the necessary financing, the Company would not have the ability to meet its obligations as they come due. These circumstances may cast significant doubt as to the Company's ability to continue as a going concern and the ultimate appropriateness of the use of accounting principles applicable to a going concern. These consolidated financial statements do not reflect the adjustments to the carrying values

**KWG RESOURCES INC.**

(An exploration stage company)

**Notes to the Consolidated Financial Statements(in Canadian dollars)**

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of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary if the Company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

**2 BASIS OF PREPARATION AND ADOPTION OF IFRS**

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and to require publicly accountable enterprises to apply these standards effective for years beginning on or after January 1, 2011. Accordingly, these are the Company's first annual consolidated financial statements prepared in accordance with IFRS as issued by the IASB. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

The consolidated financial statements have been prepared in compliance with IFRS. Subject to certain transition elections and exceptions disclosed in Note 29, the company has consistently applied the accounting policies used in the preparation of its opening IFRS statement of financial position at January 1, 2010 throughout all periods presented, as if these policies had always been in effect. Note 29 discloses the impact of the transition to IFRS on the company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the company's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP.

These financial statements were approved by the board of directors for issue on April 30, 2012.

**3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

**Basis of Measurement**

The consolidated financial statements have been prepared under the historic cost convention, except for investments in equity securities and derivatives, including warrants, which are measured at fair value.

The methods used to measure fair values are discussed further in Note 25.

**Basis of Consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Canada Chrome Corporation (formerly ChromeCana Ltd.) which was incorporated in Ontario, Canada on February 20, 2009, SMD Mining Corporation, which was incorporated in Ontario, Canada on January 16, 2008, Canada Chrome Mining Corporation which was incorporated federally on June 4, 2010, 7207565 Canada Inc, which was incorporated Federally on July 15, 2009 and 6949541 Canada Inc, which was incorporated Federally on March 31, 2008. The latter four companies have been inactive since their inception and the latter two were disposed of during the year.

## **KWG RESOURCES INC.**

(An exploration stage company)

### **Notes to the Consolidated Financial Statements(in Canadian dollars)**

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The comparative figures for 2010 also include the accounts of Debut Diamonds Inc. ("DDI") which had been a majority-owned (96.81% as at December 31, 2010) subsidiary of the Company until December 15, 2011. On this date, the equity shares of DDI were distributed to the Company's shareholders as a return of capital (note 5).

#### **Distribution of Debut Diamonds Inc**

The Company accounted for the distribution of DDI as a return of capital to its shareholders. This distribution was recognized once it was appropriately authorized and no longer at the discretion of the Company. It was measured initially and subsequently at fair value using the market price of the DDI shares.

DDI was also classified as a discontinued operation and the results of the disposal group are classified as discontinued operations in the statement of operations and the comparative amounts restated for all periods presented.

#### **Foreign Currency**

*(i) Functional and presentation currency*

Items included in the financial statements of each consolidated entity in the KWG group are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The functional currency of KWG and all of its subsidiaries is the Canadian dollar.

*(ii) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates of monetary assets and liabilities denominated in currencies other than an entities' functional currency are recognized in the consolidated statements of operations in "gain(loss) on foreign exchange".

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less.

#### **Financial Instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

At initial recognition, the Company classifies its financial instruments in the following categories:

*(i) Financial assets and liabilities at fair value through profit or loss*

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term.

Derivatives are also included in this category unless they are designated as hedges. The Company has invested in and has issued warrants that qualify as derivatives. All derivatives have been classified as held-for-trading and are included on the balance sheet

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**Notes to the Consolidated Financial Statements(in Canadian dollars)**

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within marketable securities or warrant liabilities. Gains and losses on re-measurement of the fair value of warrants are included in the consolidated statements of operations in either finance income or gain (loss) on revaluation of warrant liability.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statements of operations. Gains and losses arising from changes in fair value are presented in the consolidated statements of operations in the period in which they arise. Non-derivative financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which are classified as long-term. Warrants are classified as current.

*(ii) Available-for-sale investments*

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company's available-for-sale assets comprise investments in equity securities included in the marketable securities in the balance sheet.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from remeasurement are recognized in other comprehensive income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of operations and are included in gain (loss) on marketable securities. Available-for-sale investments are classified as non-current, unless management expects to dispose of them within twelve months.

Dividends on available-for-sale equity instruments are recognized in the statement of operations as dividend income when the company's right to receive payment is established.

*(iii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise trade receivables, and cash and cash equivalents, and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less any provision for impairment.

*(iv) Financial liabilities at amortized cost*

Financial liabilities at amortized cost consist of trade and other payables. Trade and other payables are initially recognized at the amount required to be paid, less a discount to reduce the payables to fair value. Subsequently, trade and other payables are measured at amortized cost using the effective interest method. These are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

**Impairment of Financial Assets**

At each reporting date, the Company assesses whether there is objective evidence that a financial asset (other than a financial asset classified as fair value through profit or loss) is impaired. The criteria used to determine if objective evidence of an impairment loss include:

## KWG RESOURCES INC.

(An exploration stage company)

### Notes to the Consolidated Financial Statements(in Canadian dollars)

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- (i) significant financial difficulty of the obligor;
- (ii) delinquencies in interest or principal payments; and
- (iii) it becomes probable that the borrower will enter bankruptcy or other financial reorganization.

For equity securities, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired. If such evidence exists, the Company recognizes an impairment loss, as follows:

(i) *Financial assets carried at amortized cost*

The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount through the use of an allowance account.

(ii) *Available-for-sale financial assets*

The impairment loss is the difference between the acquisition cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of operations. This amount represents the loss in accumulated other comprehensive income that is reclassified to net income (loss).

Impairment losses on financial assets carried at amortized cost and available-for-sale debt instruments are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

### Property and Equipment

(i) *Recognition and measurement*

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes any expenditure that is directly attributable to the acquisition of the asset.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized net in the statement of operations.

(ii) *Amortization*

Amortization is calculated as a function of the depreciable amount, which is the cost of an asset less its residual value.

Amortization is recognized through operations as follows over the estimated useful lives of each part of an item of property and equipment.

Amortization is computed using the straight-line method based on the following number of periods:

Computer equipment	-	2 years
Automobiles	-	3 years
Office furniture	-	5 years

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Amortization methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

#### **Impairment of non-financial assets**

The carrying amounts of the Company's non-financial assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit ("CGU") (see definition below) is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets. Generally, a CGU is analogous to an individual project.

An impairment loss is recognized if the carrying amount of an asset or a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of operations.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that it does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized in prior periods.

#### **Mineral Property Interests**

##### *(i) Exploration & Evaluation expenditures*

Exploration & Evaluation ("E&E") expenditures relate to costs incurred on the exploration for and evaluation of potential mineral reserves and includes costs related to the following: acquisition of exploration rights; conducting geological studies; exploratory drilling and sampling and evaluating the technical feasibility and commercial viability of extracting a mineral resource.

E&E expenditures, including costs of acquiring licenses, are capitalized as Mineral Property Interest ("MPI") assets on an "area of interest basis" which generally is defined as a project. The Company considers a project to be an individual geological area whereby the presence of a mineral deposit is considered favourable or has been proved to exist and, in most cases, comprises of a single mine or deposit.

MPI assets are recognized if the rights to the project are current and either:

- the expenditures are expected to be recouped through successful development and exploitation of the project, or alternatively by its sale; or
- activities on the project have not, at the reporting date, reached a stage which permits a reasonable assessment of the existence of economically recoverable reserves and active and significant operations in, or in relation to, the project are continuing.

E&E expenditures are initially capitalized as MPI assets. Such E&E expenditures may include costs of licence acquisition, technical services and studies, seismic acquisition,

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exploration drilling and testing, materials and fuels used, rentals and payments made to contractors and consultants. To the extent that a tangible asset is consumed in developing an MPI asset, the amount reflecting that consumption is recorded as part of the cost of the intangible asset.

Once the technical feasibility and commercial viability of the extraction of mineral reserves in a project are demonstrable and permitted, MPI assets attributable to that project are first tested for impairment and then reclassified to *mine property and development projects*. Currently, the Company does not hold any assets classified as *mine property and development projects*.

#### (ii) *Impairment*

MPI assets are assessed for impairment when facts and circumstances suggest that the carrying amount of a MPI asset may exceed its recoverable amount and any impairment loss is recognized as "Write down of mineral property interests" through the consolidated statements of operations. The following facts and circumstances, among other things, indicate that E&E assets must be tested for impairment:

- the term of exploration license for the project has expired during the reporting 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 project area is neither budgeted nor planned;
- exploration for and evaluation of mineral resources in the project area have not led to the discovery of commercially viable quantities of mineral resources and the Company plans to discontinue activities in the specific area; or
- sufficient data exists to indicate that while development activity is likely to proceed, the carrying amount of the MPI asset is unlikely to be recovered in full through such activity.

MPI assets are tested for impairment at CGUs level which are on an individual project (area of interest) basis. As noted above, a project would also be tested for impairment before being transferred to "Mineral property interests" on the balance sheet.

#### **Borrowing Costs**

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as interest expense in the statement of operations in the period in which they are incurred.

#### **Short-term Employee Benefits**

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be reliably estimated.

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**Provisions**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be reliably estimated and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as a finance cost.

In accordance with the Company's environmental policy and applicable legal requirements, a provision for site restoration or decommissioning in respect of land restoration, and the related expense, is recognized when the land is contaminated and there is a legal obligation to restore the site. The Company presently has no decommissioning liabilities.

**Finance Income**

Finance income comprises interest income on marketable securities, FV gains of financial assets classified as FVTPL, and flow-through premium. Interest income is recognized as it accrues through operations, using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

**Income Taxes**

Income tax expense comprises current and deferred tax. Income tax expense is recognized through operations except to the extent that it relates to items recognized either in other comprehensive income ("OCI") or directly in equity, in which case it is recognized in OCI or in equity respectively.

Current income tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly-controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.



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#### **Share Capital**

##### *Common shares*

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

The Company has financed a portion of its exploration and evaluation activities through the issue of flow-through shares. Under the terms of these share issues, the tax attributes of the related expenditures are renounced to subscribers. Common shares issued on a flow-through basis typically include a premium because of the tax benefits associated therewith ("Flow-through Premium"). Flow-through shares may also be issued with a warrant feature. At the time of issue, the Company estimates the proportion of proceeds attributable to the Flow-through Premium, the common share and the warrant with reference to closing market prices and such techniques as the Black-Scholes option-pricing model. The Flow-through Premium and warrant are estimated as the excess of the subscription price over the market value of the share and is recorded as a separate liability which is included in trade and other payables on the consolidated balance sheets (Note 11). The proceeds attributable to the warrants issued in the Company's functional currency are also treated as equity and recorded in contributed surplus on the balance sheet until exercise, when the associated proportion is transferred to share capital along with the cash proceeds received on exercise. See note 12 for commentary for US Dollar denominated warrants.

The effect of renunciation of the tax benefits to holders of such shares is recognized pro-rata with the associated expenditures being incurred by the Company. This could occur either before or after the formal renunciation of expenditures to the tax authorities have been made. When the eligible expenditures are incurred, the tax value of the renunciation is recorded as a deferred tax liability and charged against operations as a deferred tax provision.

Furthermore, as eligible expenditures are incurred, the Company recognises a pro-rata amount of the Flow-through Premium through "Finance income" in the consolidated statements of operations with a decrement to the liability on the balance sheet. Flow through shares renunciation of expenditures are is subject to the significant judgment of management in determining the eligibility of the expenditures incurred and are potentially subject to challenge by income tax authorities based on the nature of the amounts incurred. Management has taken and will continue to take actions to mitigate the risk of challenge, if any occurs. To the extent these are disallowed, the Company would generate additional tax attributes to assess for recognition in the financial statements.

##### *Normal Course Issuer Bid*

On the date the Company's Board of Directors authorizes a repurchase of its shares, a liability is established for the maximum amount authorized to be expended under the plan as the Company appoints an agent to repurchase the shares on its behalf, creating a present obligation with a corresponding reduction in share capital. This liability is drawn down as the shares are repurchased. Any remaining balance in this account will be returned to share capital, if unspent, at the termination date as determined by the Board at the outset.

#### **Share-Based Payment Arrangements**

##### *Stock Option Plan*

The Company has a stock option plan (the "Stock Option Plan") which is described in Note 16. All stock-based awards made to employees and non-employees are recognized at the date of grant using a fair-value-based method to calculate compensation expense. Compensation

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expense is charged to operations over the vesting period of the options with a corresponding increase to contributed surplus. Stock options typically vest over an 18-month period. The fair values are determined at the grant date by applying the Black-Scholes option pricing model. Measurement inputs include share price on the measurement date, exercise prices, expected volatility based on available historical volatility of the Company's share price, expected life, expected dividends, expected forfeiture rate and the risk free interest rate. Under graded vesting the fair value of each tranche is recognized over its respective vesting period.

The amount recognized as an expense is adjusted to reflect the actual number of share options for which the related service and non-market vesting conditions are met.

Share-based payment arrangements in which the Company receives properties, goods or services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by KWG.

**Earnings per Share**

The Company presents basic and diluted earnings per share ("EPS") data for its common shares based on the treasury method. Basic EPS is calculated by dividing the results of operations attributable to ordinary shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the results of operations attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares, which comprise warrants and share options. Options and warrants have a dilutive effect only when the average market price of ordinary shares during the period exceeds the exercise price of the options or warrants.

**Accounting Standards and Amendments Issued but not yet Adopted**

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

- (i) IFRS 9, Financial Instruments, was issued in November 2009 and is effective for fiscal years commencing on or after January 1, 2015 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, Financial Instruments – Recognition and Measurement, except that fair value changes due to credit risk for

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liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

- (ii) IFRS 10, Consolidated Financial Statements, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, Consolidation—Special Purpose Entities and parts of IAS 27, Consolidated and Separate Financial Statements.
- (iii) IFRS 11, Joint Arrangements, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities—Non-monetary Contributions by Venturers.
- (iv) IFRS 12, Disclosure of Interests in Other Entities, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities.
- (v) IFRS 13, Fair Value Measurement, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.
- (vi) There have been amendments to existing standards, including IAS 27, Separate Financial Statements (IAS 27), and IAS 28, Investments in Associates and Joint Ventures (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.
- (vii) IAS 1, Presentation of Financial Statements, has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted.
- (viii) IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine, sets out the accounting for overburden waste removal (stripping) costs in the production phase of a mine. Stripping activity may create two types of benefit: i) inventory produced and ii) improved access to ore. Stripping costs associated with the former should be accounted

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for as a current production cost in accordance with IAS 2, Inventories. The latter should be accounted for as an addition to or enhancement of an existing asset.

- (ix) IFRS 7, Financial Instruments: Disclosures, has been amended to include additional disclosure requirements in the reporting of transfer transactions and risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitization of financial assets. The amendment is applicable for annual periods beginning on or after July 1, 2011, with earlier application permitted.

#### **4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

It is reasonably possible that, on the basis of existing knowledge, outcomes in the next financial year that are different from the assumptions used could require a material adjustment to the carrying amount of the asset or liability affected.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Management has made a number of significant estimates and valuation assumptions based on present conditions and management's planned course of action as well as assumptions about future business and economic conditions which include, but are not limited to, the following:

##### **Critical Judgements**

- (i) Measurement of the recoverable amount of exploration and evaluation projects (note 10);
- (ii) The fair value of share-based payments, including stock based compensation and warrants (notes 15 and 16);
- (iii) Qualifying Canadian exploration expenditures for purposes of renouncing these to flow-through shareholders (notes 3 and 23).
- (iv) Determination that Company does not have significant influence over GoldTrain Resources Inc.

##### **Critical Estimates**

- (i) The estimated useful life and property and equipment (note 2);
- (ii) The valuation of the distribution of Debut Diamonds Inc. (note 5);
- (iii) The valuation of financial assets at fair value through operations (note 25); and
- (iv) The valuation of financial assets at fair value through OCI (note 25).

#### **5 DISTRIBUTION OF DEBUT DIAMONDS INC.**

On December 28, 2011 the Company distributed, by way of a return of capital, all of its shares of DDI, which consisted of 38,210,934 common shares, to its shareholders on the basis of 6 shares of DDI for every 100 shares of KWG held. The transaction was recorded in these financial statements as a demerger of the business to the Company's existing shareholders. The record date was December 15, 2011 and the market value of DDI on this date was \$0.30 per share. At the date the distribution was authorized and at the date the dividend was paid,

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the fair value of the dividend payable as \$11,463,280 based on the market value of DDI of \$0.30 per share. The book value of DDI on this date was \$10,704,685. Therefore the Company recorded a gain on the divestiture in the amount of \$758,595. This amount is included in loss on discontinued operations shown on the consolidated statement of operations which consists of the following:

<b>Year ended December 31</b>	<b>2011</b>	<b>2010</b>
Expenses		
General and administrative	(312,065)	(45,924)
Stock compensation cost	(763,125)	-
Exploration expenses	(439,277)	-
Loss from operations	(1,514,467)	(45,924)
Gain on distribution of DDI shares	758,595	-
<b>Loss from discontinued operations</b>	<b>(755,872)</b>	<b>(45,924)</b>

The following table provides information on the cash flows affected by the divestiture:

<b>Year ended December 31</b>	<b>2011</b>	<b>2010</b>
Cash flows from operating activities	(751,342)	(45,924)

**6 CASH AND CASH EQUIVALENTS**

	<b>As at December 31, 2011</b>	<b>As at December 31, 2010</b>	<b>As at January 1, 2010</b>
Bank balances	2,065,186	276,548	2,056,751
Short-term deposits	13,965,365	2,984,509	-
<b>Cash and cash equivalents</b>	<b>16,030,551</b>	<b>3,261,057</b>	<b>2,056,751</b>

**7 RECEIVABLES**

	<b>As at December 31, 2011</b>	<b>As at December 31, 2010</b>	<b>As at January 1, 2010</b>
Trade receivables	22,374	12,826	-
Sales taxes receivable	210,607	373,871	211,073
Due from Debut Diamonds Inc (note 22)	783,772	-	-
Other receivables	55,567	5,413	5,413
<b>Receivables</b>	<b>1,072,320</b>	<b>392,110</b>	<b>216,486</b>

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**Notes to the Consolidated Financial Statements(in Canadian dollars)****8 MARKETABLE SECURITIES**

	As at December 31, 2011	As at December 31, 2010	As at January 1, 2010
AFS:			
Strike Minerals Inc. (i) 3,452,217 common shares	-	293,438	103,567
GoldTrain Resources Inc. ("GoldTrain") (i) 7,270,000 common shares	472,550	-	-
Eloro Resources Ltd. ("Eloro") (ii) 3,080,580 common shares	415,900	-	-
Spider Resources Inc. 250,000 common shares	-	-	13,750
Copper Mesa Mining Inc. 353,488 common shares	-	-	17,674
<b>Total AFS</b>	<b>888,450</b>	<b>293,438</b>	<b>134,991</b>
Financial assets at fair value through P&L (FVTPL):			
GoldTrain Resources Inc. (i) 7,000,000 warrants	196,000	-	-
Eloro Resources Ltd. (ii) 3,080,580 premium warrants	123,186	-	-
1,540,290 regular warrants	45,062	-	-
Debut Diamonds Inc. (iii) 9,702,666 warrants exercisable at \$0.10	960,600	-	-
7,000,000 warrants exercisable at \$0.40	861,000	-	-
<b>Total fair value of financial assets through P&amp;L</b>	<b>2,185,848</b>	<b>-</b>	<b>-</b>
<b>Marketable securities</b>	<b>3,074,298</b>	<b>293,438</b>	<b>134,991</b>

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## Summary of transactions:

Years ended December 31	2011	2010
AFS assets		
Fair value	293,439	134,991
Accumulated other comprehensive income (loss)	(15,238)	255,805
Cost base	278,201	390,796
Disposals		
Fair value	(293,438)	(31,424)
Reclassification of OCI to profit & loss	15,238	(81,172)
Proceeds of disposals	431,200	47,500
<b>Realized gain on disposal</b>	<b>153,000</b>	<b>(65,096)</b>
Additions for the year	604,776	-
Change in fair value during the year	283,674	-
<b>Accumulated other comprehensive income (loss), December 31</b>	<b>283,674</b>	<b>(15,238)</b>
<b>Fair value of AFS assets, December 31</b>	<b>888,450</b>	<b>293,438</b>
<b>FVTPL assets</b>		
Fair value	-	-
Additions during the year	2,250,965	-
Net changes in fair value (note 18)	(65,117)	-
<b>Fair value, December 31</b>	<b>2,185,848</b>	<b>-</b>
<b>Fair value of marketable securities, December 31</b>	<b>3,074,298</b>	<b>-</b>

- (i) On June 9, 2011 KWG acquired 7,000,000 common shares and 7,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.10 on or before June 9, 2013) in GoldTrain Resources Inc. ("GoldTrain") in exchange for the settlement of a debt (debt settlement agreement between KWG and GoldTrain). Prior to the signing of this agreement, KWG sold its investment in 3,452,217 common shares of Strike Minerals Inc. to GoldTrain. GoldTrain subsequently sold these shares in a series of transactions. Both parties agreed to have this debt settled through the issuance of the GoldTrain shares and warrants. On June 9, 2011 the market value of the GoldTrain shares was \$280,000. The warrants were valued at \$151,200 using a valuation model based on the following assumptions: dividend yield of 0%, volatility of 144%, risk free interest rate of 1.21% and an expected life of 2 years. KWG's holdings represent approximately 14.36% of the issued and outstanding common shares of GoldTrain and approximately 24.84% of the outstanding warrants. The Company realized a gain on the disposal of the Strike Mineral Inc. shares in the amount of \$153,000, which is included in gain (loss) on marketable securities on the consolidated statements of operations. Subsequent to this transaction, the Company acquired an additional 270,000 common shares through purchases on the open market.
- (ii) On December 21, 2011 KWG acquired 3,080,580 common shares, 3,080,580 premium warrants and 1,540,290 regular warrants of Eloro Resources Ltd ("Eloro") in exchange for 100% of the issued and outstanding common shares of 6949541 Canada Inc ("6949541"), a wholly-owned subsidiary of KWG. Prior to the sale, KWG sold 11 claims in Louvicourt

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Township and \$200,000 in cash into 6949541 (note 10i). The premium warrants entitle the holder to purchase one common share for \$1.00 on or before November 18, 2016. If the closing price of the common shares is over \$1.50 for 20 consecutive trading days following the expiry of the 4 month hold period, the premium warrants must be exercised within 10 business days of Eloro providing written notice, or they will be cancelled. The premium warrants were valued at \$71,187 using a valuation model based on the following assumptions: fair value of shares at grant date of \$0.10, dividend yield of 0%, volatility of 83.93%, risk free interest rate of 1.417% and an expected life of 5 years. The regular warrants entitle the holder to purchase one common share for \$0.24 on or before May 18, 2013. If the closing price of the common shares is over \$0.60 for 20 consecutive days following the expiry of the 4 month hold period, the regular warrants must be exercised within 10 business days of Eloro providing written notice, or they will be cancelled. The regular warrants were valued at \$23,398 using a valuation model based on the following assumptions: fair value of shares at grant date of \$0.10, dividend yield of 0%, volatility of 86.76%, risk free interest rate of 1.02% and an expected life of 1.5 years.

- (iii) On August 29, 2011 KWG acquired 7,000,000 common shares and 7,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.40 on or before August 29, 2016) in DDI in exchange for 21,000,000 common shares and 21,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.10 on or before August 29, 2016) in KWG. The value attributed to the shares was based on KWG's market value on August 29, 2011, which was \$0.085 per share since there was no comparable information for DDI. The warrants were valued at \$1,638,000 using a valuation model based on the following assumptions: fair value of share at grant date \$0.255, dividend yield of 0%, volatility of 163%, risk free interest rate of 1.65% and an expected life of 5 years. The common shares of DDI were subsequently distributed to KWG's shareholders as a return of capital (note 5).

**Warrants**

The financial assets at fair value through P&L consist of warrants which are not publicly-traded. However, their valuation can be obtained through the use of a valuation model, the inputs for which are readily determinable. Any change in fair value after initial recognition, is recorded through the consolidated statements of operations as a finance income (loss). The fair value of the warrants decreased by \$65,117 during the year.

The following table summaries the inputs that were used to calculate the fair value of the warrants as at December 31, 2011:

	<b>GoldTrain</b>	<b>Eloro Premium</b>	<b>Eloro Regular</b>	<b>DDI \$0.10</b>	<b>DDI \$0.40</b>
Average dividend per share	Nil	Nil	Nil	Nil	Nil
Estimated volatility	120.00%	86.76%	86.76%	132.25%	132.25%
Risk-free interest rate	0.95%	1.439%	1.159%	0.95%	1.18%
Expected life of the options granted	525 days	1,802 days	524 days	1,701 days	380 days
Calculated value per warrant	\$0.028	\$0.04	\$0.029	\$0.099	\$0.123



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**Notes to the Consolidated Financial Statements(in Canadian dollars)****Sensitivity Analysis - Equity Price Risk**

All of the Company's financial assets classified as AFS are listed on public stock exchanges. For such investments, a 10% increase in the equity prices at the reporting date would have increased equity by \$89,000, (as at December 31, 2010 - an increase of \$29,000) an equal change in the opposite direction would have had the equal but opposite effect on the amounts shown above.

For financial assets classified at fair value through P&L, the impact on operations of a 10% increase in the market price of the common shares at the reporting date would have been \$228,000 (nil as at December 31, 2010).

The analyses were performed on the same basis for 2011 and 2010.

**9 PROPERTY AND EQUIPMENT**

	<b>Automobiles</b>	<b>Computer Equipment</b>	<b>Office Equipment</b>	<b>Totals</b>
Balance, January 1, 2010				
Cost	34,000	14,400	-	48,400
Accumulated amortization	(6,055)	(2,244)	-	(8,299)
<b>Net book value</b>	<b>27,945</b>	<b>12,156</b>	<b>-</b>	<b>40,101</b>
Additions	8,550	5,305	22,000	35,855
Disposals	(5,000)	(766)	-	(5,766)
Amortization	(9,488)	(8,803)	(3,667)	(21,958)
Balance, December 31, 2010				
Cost	37,550	18,939	22,000	78,489
Accumulated amortization	(15,543)	(11,047)	(3,667)	(30,257)
<b>Net book value</b>	<b>22,007</b>	<b>7,892</b>	<b>18,333</b>	<b>48,232</b>
Additions	41,140	5,741	875	47,756
Amortization	(15,945)	(9,777)	(4,429)	(30,151)
Balance, December 31, 2011				
Cost	78,690	24,680	22,875	126,245
Accumulated amortization	(31,488)	(20,824)	(8,096)	(60,408)
<b>Net book value</b>	<b>47,202</b>	<b>3,856</b>	<b>14,779</b>	<b>65,837</b>

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**Notes to the Consolidated Financial Statements(in Canadian dollars)****10 MINERAL PROPERTY INTERESTS**

Cumulative costs relating to the acquisition of mineral property interests and exploration and evaluation expenditures have been incurred on the following projects:

	Balance as at January 1, 2011	Current Expend- itures	Write Downs	Disposals	Balance as at December 31, 2011
Canada – Ontario					
Spider No. 1 / MacFadyen and Kyle (a)(b)(c)	2,516,896	(6,866)	-	(2,484,898)	25,132
Spider No. 3 / McFaulds Lake (a)	4,189,695	-	-	-	4,189,695
Wawa (a)(b)	156,944	-	-	(156,944)	-
Big Daddy (a)(d)	6,454,391	2,358,726	-	-	8,813,117
Diagnos (a)(b)	189,120	-	-	(11,106)	178,014
Pele Mountain (a)(b)	556,878	85,905	-	(642,783)	-
Uniform Surround (b)	7,950	15,835	-	(23,785)	-
East West option (e)	202,123	-	(202,123)	-	-
Railroute Corridor (f)	14,313,571	999,277	-	(76,537)	15,236,311
Smelter Royalty (g)	2,682,587	20,000	-	(2,702,587)	-
Victor West	119,979	78,018	-	(197,997)	-
Nakina project	-	570,855	-	(570,855)	-
	31,390,134	4,121,750	(202,123)	(6,867,492)	28,442,269
	Balance as at January 1, 2010	Current Expend- itures	Write Downs		Balance as at December 31, 2010
Canada – Ontario					
Spider No. 1 / MacFadyen and Kyle (a)(b)(c)	2,501,951	14,945	-		2,516,896
Spider No. 3 / McFaulds Lake (a)	4,189,695	-	-		4,189,695
Wawa (a)(b)	156,944	-	-		156,944
Big Daddy (a)(d)	4,760,372	1,694,019	-		6,454,391
Diagnos (a)(b)	97,865	91,255	-		189,120
Pele Mountain (a)(b)	479,278	77,600	-		556,878
Uniform Surround (b)	7,950	-	-		7,950
East West option (e)	404,246	-	(202,123)		202,123
Railroute Corridor (f)	2,897,437	11,416,134	-		14,313,571
Smelter Royalty (g)	2,632,587	50,000	-		2,682,587
Victor West	119,979	-	-		119,979
Other (h)	8,538	-	(8,538)		-
	18,256,842	13,343,953	(210,661)		31,390,134

- (a) On May 15, 2006, the Company and Cliffs Chromite Far North Inc. (“Cliffs”), formerly Spider Resources Inc., agreed to amend and revise their joint venture agreement. The companies agreed to treat each project in their joint venture as a separate joint venture, to enable each company to either increase or decrease its interest in a project based upon their respective strategic objectives. The Company and Cliffs agreed to have their respective interest established at 50% in all the current projects of the joint venture.

Each party’s interest is diluted by not contributing further to the other party’s exploration program until its interest has reached 33 1/3%. At that level, a party’s interest in a project may be maintained by contribution to subsequent programs, or suffer further dilution.

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When an interest has been reduced to less than 10%, it will be automatically converted to a 0.5% Net Smelter Royalty ("NSR") in base metals and a 1% NSR in precious metals and diamonds.

- (b) Ashton Mining Canada Ltd. holds a 25% claw back entitlement to any kimberlite property found or developed by KWG/Cliffs within the geographic limits of the Spider No. 1 project area, with the exception of Kyle Lake No. 1 where Ashton Mining relinquished its rights, which can be executed by paying KWG/Cliffs an amount equal to 300% of all exploration expenditures on said property.
- (c) The Kyle project is optioned to Renforth Resources Inc. ("Renforth") the operator and on October 18, 2010 Renforth had earned a 55% interest in the Kyle project by transferring a group of 39 adjacent claims and by incurring a total of \$6 million of exploration expenditures over a period of three years. Debut's interests have been reduced to 22.5% and may be further reduced to 15% by Cliffs incurring exploration expenditures equal to its prior capital in the joint project.
- (d) In December 2005, KWG/Cliffs entered into an agreement with Freewest Resources Canada Inc. ("Freewest") for the acquisition of a 25% interest in certain mining property claims contiguous to McFauld's Lake in Ontario. The contribution of the Company included a commitment to carry out exploration work in the amount of \$1,500,000 before October 13, 2009 of which at least \$200,000 was incurred before February 28, 2006; and accordingly, each of KWG and Cliffs has earned a 25% interest of the property.

On March 27, 2009, the Company negotiated an amendment to the Freewest Option Agreement whereby the option earn-in calls for a \$15,000,000, three-year commitment. As a result of this amendment, the Company is no longer required to prepare a bankable feasibility study within 18 months, as had been called for in the 2005 agreement. Under the amendment, KWG would have options for up to a \$7,500,000 commitment over the next three years, of which \$2,500,000 was required to be spent before March 31, 2010. In early 2010, Freewest was served with a notice that this first commitment had been met. A further \$2,500,000 was required to be spent before March 31, 2011. This requirement was satisfied through the direct payment to Freewest early in the second quarter of 2011. Each such option increases the Company's ownership by 1.5%. The final \$2,500,000 must be spent by March 31, 2012 in order increase the Company's ownership to a full 30%.

- (e) On July 23, 2008, the Company acquired an option to earn a 65% interest in a group of claims held by Rainy Mountain Royalty Corp. (formerly East West Resources Corporation). The Company issued 2,000,000 shares at a price of \$0.034 per share and paid \$50,000 for the option for a total of \$118,000. The Company was required to incur exploration expenditures of \$250,000 in each of 2008 and 2009 and an additional \$1,000,000 by August 2012 to earn 60%. An additional 5% may be earned in any mineral deposit discovered by the Company providing development and production financing. During both 2010 and 2011, the Company incurred no expenditures on these claims.

In early 2011 the Company received notice that, since it had not made an outstanding option payment on approximately one-half of these claims, the agreement was terminated for this portion of the claims. As a result, the Company recognized a write down during 2010 in the amount of \$202,123 on these properties. Later in 2011, the Company decided

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not to perform any further work on this property and, as a result, wrote off the remaining balance.

- (f) During 2009, the Company commenced efforts to explore and develop a transportation link to the Company's properties in Northern Ontario in order to increase the economic viability of these properties. These operations entailed a detailed analysis of railroad route alternatives, preliminary soils analysis and claim staking. Concurrent with this activity the Company is performing exploration activities on these claims. This project and exploration activity was continued throughout 2010 and 2011. All costs related to this project have been capitalized.
- (g) On July 22, 2009, the Company completed the purchase of a 1% NSR in the Black Thor, Black Label and Big Daddy chrome discoveries in the James Bay lowlands for cash consideration of \$1,635,000 including \$635,000 payable at the closing of the transaction and a further \$1 million payable within one year, and the issuance of 15 million common shares and 15 million common share purchase warrants, with each share purchase warrant entitling the holder to purchase a common share at a price of 10 cents for a period of five years. The common shares have been valued at \$600,000 and the warrants at \$370,000 making the total cost of the purchase \$2,605,000. Additional ancillary costs of \$27,587 were also incurred and these have been capitalized. Under the original terms of the purchase the remaining purchase price of \$1,000,000 was to be paid in July 2010. An agreement was reached with the vendor prior to the required payment date whereby \$950,000 of this amount was deferred to October 2010. In October 2010 a further agreement was reached whereby the amount owing would be paid out as follows: \$50,000 in October 2010, \$450,000 in December 2010 and \$450,000 in February 2011. The balance owing was increased by a \$50,000 financing fee which is also due in February 2011. A final agreement was negotiated on February 24, 2011 for the remaining payment owing of \$500,000. The Company paid \$100,000 in cash (\$50,000 in February 2011 and \$50,000 in March 2011) and in satisfaction of the remaining \$400,000 KWG issued 4,000,000 treasury units (Note 14(iii)) to complete the transaction. Each unit is valued at \$0.10 and is comprised of one treasury share and one purchase warrant enabling its holder to acquire one further treasury share at any time within two years upon payment of \$0.15. Additional financing payments of \$20,000 were paid during the first six months of 2011 due to timing delays in issuing these shares. All financing payments have been capitalized in accordance with the Company's reporting policies.

On August 4, 2011, the Company completed the sale of this 1% NSR for total proceeds of US\$18 million. Half of the purchase price was paid in cash and the remaining 50% was received by an escrow agent to be held in escrow for a period not to exceed three months and was to be paid to KWG upon confirmation of warranties made to the purchaser in connection with the transaction. The amount held in escrow was received on November 3, 2011. The sale of the NSR was effected by way of the sale of shares of 7207565 Canada Inc., the KWG subsidiary that held the royalty. The resulting gain of \$14,056,530 on this transaction is shown as gain on sale of mineral property interests on the Consolidated Statement of Operations in these financial statements.

- (h) Other assets of \$8,538 were written off during 2010.
- (i) On December 21, 2011, the Company sold 11 claims in the Louvicourt Township to Eloro for consideration consisting of 3,080,580 common shares, 3,080,580 premium warrants and 1,540,290 regular warrants of Eloro (note 8). Prior to the sale, KWG had transferred

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these claims in Louvicourt Township and \$200,000 in cash into 6949541 Canada Inc and the transaction was accomplished through the sale of the shares of 6949541 Canada Inc. These claims had been written off by the Company a number of years ago. The resulting gain in the amount of \$202,585 is included in gain on sale of mineral property interests on the Consolidated Statement of Operations in these financial statements.

- (j) As a result of the distribution of the DDI shares (note 5), the Company divested itself of the following mineral property interests:

Property Description	Amount
Spider No. 1 / MacFadyen and Kyle	2,484,898
Wawa	156,944
Diagnos	11,106
Pele Mountain	642,783
Uniform Surround	23,785
Railway infrastructure	76,537
Victor West	197,997
Nakina project	570,855
	4,164,905

**11 TRADE AND OTHER PAYABLES**

	Notes	December 31, 2011	December 31, 2010	January 1, 2010
Trade payables				
Exploration and evaluation projects	10	325,428	951,250	1,502,796
Non-project related		147,493	146,868	92,088
Accrued liabilities				
Non-project related		187,020	314,341	366,612
Flow-through premium liability (see table below)		245,656	268,504	40,178
Share repurchase liability (re Normal Course Issuer Bid)	14(x)	207,331	-	-
		1,112,928	1,680,963	2,001,674

The following table shows the transactions and balances of the flow-through premium liability:

	Notes	December 31, 2011	December 31, 2010	January 1, 2010
Balance, as at beginning of period		268,504	40,178	86,500
Flow-through premium adj through finance income		-	(40,178)	(46,322)
Flow-through premium from financing – Mar 2010 (net of share issue costs of \$2,273)	14(viii)	-	25,927	-
Flow-through premium adj through finance income		-	(25,927)	-
Flow-through premium from financing – Apr 2010 (net of share issue costs of \$19,860)	14(vii)	-	91,840	-
Flow-through premium adj through finance income		-	(91,840)	-
Flow-through premium from financing – Dec 2010 (net of share issue costs of \$39,598)	14(v)	-	320,450	-
Flow-through premium adj through finance income		(268,504)	(51,946)	-
Flow-through premium from financing – Jan 2011	14(iv)	20,915	-	-
Flow-through premium adj through finance income		(20,915)	-	-
Flow-through premium from financing – Dec 2011 (net of share issue costs of \$16,845)	14(i)	245,655	-	-
Balance, as at end of period		245,655	268,504	40,178

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**Notes to the Consolidated Financial Statements(in Canadian dollars)**

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**12 WARRANT LIABILITY**

Included in the warrants listed in note 15 are 26,518,854 warrants issued in March and April of 2009 exercisable in United States dollars. The fair value of these warrants is recorded as a Warrant liability at the date of issuance. These warrants are revalued at each Balance Sheet date with the corresponding gain (loss) recorded gain (loss) on warrant revaluation through the Statement of Operations and Comprehensive income (loss). A gain on the revaluation of \$1,396,188 was recognized in 2011 (loss of \$777,634 in 2010). The fair value of these warrants was estimated using the Black-Scholes option pricing model based on the following assumptions:

	<b>Dec 31, 2011</b>	<b>Dec 31, 2010</b>
U.S. exchange rate	1.0170	0.0999
Market price of shares	\$0.085	\$0.085
Average dividend per share	Nil	Nil
Estimated volatility	94.37%	174.35%
Risk-free interest rate	0.95%	2.45%
Expected life of the warrants	27 months	39 months

A 10% increase in the market price of the common shares would result in an increase in the gain on revaluation in the amount of \$70,000. A reduction of 10% would have an equal effect in the opposite direction.

**13 NON-CONTROLLING INTEREST**

The amount shown for non-controlling interest on the balance sheet is in relation to a non-controlling interest ownership in the shares of DDI. The original investment, valued at \$70,000, was in the form of services rendered in relation to one of the Company's mineral properties and was accordingly recorded as an increase to the cost of this property. During the year DDI received additional funds in the amount of \$2,241,078, after deducting share issuance costs from non-related third party investors. Non-controlling interests' share of DDI expenses are reflected in the statement of operations (note 5) and are charged as a reduction to the balance sheet account non-controlling interests. This balance was eliminated as a result of the DDI distribution (note 5).

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**Notes to the Consolidated Financial Statements(in Canadian dollars)****14 SHARE CAPITAL**

## Authorized

An unlimited number of no par value common shares

## Issued

Changes in the Company's share capital were as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Issued	Number of shares	Number of shares
Balance – Beginning of period	623,458,941	477,863,510
Issued for Canadian exploration expenses (i)(iv)(v)(vii)(viii)	26,620,000	75,514,231
Issued in exchange for marketable securities (ii)	21,000,000	-
Issued (vi)(ix)	-	26,882,390
Issued for settlement of liability re acquisition of mining assets (iii)	4,000,000	-
Issued for agents' compensation (v)(vii)	-	1,488,128
Issued following exercise of warrants and compensation options	250,000	37,720,682
Issued following exercise of stock options	50,000	3,990,000
Cancelled following repurchase through normal course issuer bid (x)	(4,055,000)	-
<b>Balance – End of period</b>	<b>671,323,941</b>	<b>623,458,941</b>

- (i) On December 30, 2011, the Company completed a non-brokered private placement of 17,500,000 units for a total consideration of \$1,750,000. These units were issued at \$0.10 each and comprised one common share of the Company and one-half of a common share purchase warrant exercisable at a price of \$0.12 per warrant to acquire one common share for a period of thirty months. The Company allocated proceeds of \$262,500 to the flow-through premium (note 11).

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.085 per share, dividend yield of 0%, volatility of 110.46%, risk free interest rate of 0.95% and an expected life of thirty months. As a result, the fair value of the purchase warrants was estimated at \$322,180.

Finders' fees totalling \$75,000 in cash and 750,000 compensation units were paid to one qualified party in relation to this placement. Each compensation unit was comprised of one non flow-through common share purchase warrant exercisable at a price of \$0.12 per warrant to acquire one common share for a period of 30 months.

The fair value of the warrant portion of the agents' compensation units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.085 per share, dividend yield of 0%, volatility of 110.46%, risk free interest rate of 0.95% and an expected life of thirty months. As a result, the fair value of the purchase warrants was estimated at \$35,250.

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- (ii) On August 29, 2011, the Company issued 21,000,000 common shares and 21,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.15 on or before August 29, 2016) to Debut in exchange for 7,000,000 common shares and 7,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.40 on or before August 29, 2016) in Debut. The warrants were valued at \$1,638,000 using the Black-Scholes model based on the following assumptions: market value of \$0.085 per share, dividend yield of 0%, volatility of 163%, risk free interest rate of 1.65% and an expected life of 5 years.
- (iii) On February 24, 2011, the Company issued 4,000,000 treasury units valued at \$0.10 per unit in satisfaction of a debt owing in the amount of \$400,000. This debt related to the purchase of a 1-percent NSR (Note 10(g)). Each unit consists of one common share and 1 purchase warrant which entitles the holder to purchase one common share at a price of \$0.15 for a period of two years.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.12 per share, dividend yield of 0%, volatility of 165.43%, risk free interest rate of 1.35% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$187,234 after a pro-rata allocation of the fair value of the units' components.

- (iv) On January 31, 2011, the Company completed the final tranche of a non-brokered private placement of 9,120,000 "flow-through" shares for a total cash consideration of \$1,185,600. These shares were issued for \$0.13 each. The Company allocated proceeds of \$20,915 to the flow-through premium (note 11).
- (v) On December 31, 2010 the Company completed the first tranche of a non-brokered private placement of 13,956,923 "flow-through" shares for a total consideration of \$1,814,400. These shares were issued for \$0.13 each. Finders' fees consisting of 480,480 shares were paid to two qualified parties. The Company allocated proceeds of \$360,048 to the flow-through premium (note 11).
- (vi) On April 21, 2010 the Company completed a non-brokered private placement of 26,382,390 units for total consideration of \$3,297,799. These units were issued at \$0.125 each and comprised one common share of the Company and one-half of a common share purchase warrant exercisable at a price of \$0.15 per warrant to acquire one common share for a period of two years.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.12 per share, dividend yield of 0%, volatility of 205.55%, risk free interest rate of 1.3% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$977,177 after a pro-rata allocation of the fair value of the units' components.

- (vii) On April 16, 2010, the Company completed a non-brokered private placement of 22,467,308 "flow-through" units for total consideration of \$2,808,414. These units were issued at \$0.125 each and comprised one flow-through common share of the Company and one-half of a common share purchase warrant exercisable at a price of \$0.15 per warrant to acquire one common share for a period of two years. The Company allocated proceeds of \$111,700 to the flow-through premium (note 11).



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The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.12 per share, dividend yield of 0%, volatility of 205.58%, risk free interest rate of 1.08% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$832,902 after a pro-rata allocation of the fair value of the units' components.

Finders' fees totalling \$499,373 in cash and 1,007,648 compensation units were paid to eleven qualified parties in relation to this placement and the one on March 31, 2010 (note 14(viii)). Each compensation unit was comprised of one non flow-through share and one-half of a common share purchase warrant exercisable at a price of \$0.15 per warrant to acquire one common share for a period of two years.

The fair value of the warrant portion of the agents' compensation units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.12 per share, dividend yield of 0%, volatility of 205.58%, risk free interest rate of 1.08% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$37,355 after a pro-rata allocation of the fair value of the units' components.

- (viii) On March 31, 2010, the Company completed a non-brokered private placement of 39,090,000 "flow-through" units for total consideration of \$4,886,250. These units were issued at \$0.125 each and comprised one flow-through common share of the Company and one-half of a common share purchase warrant exercisable at a price of \$0.15 per warrant to acquire one common share for a period of two years. The Company allocated proceeds of \$28,200 to the flow-through premium (note 11).

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.12 per share, dividend yield of 0%, volatility of 205.84%, risk free interest rate of 0.96% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$1,449,504 after a pro-rata allocation of the fair value of the units' components.

- (ix) On February 23, 2010, the Company completed a private placement of 500,000 units at \$0.07 per unit for a total consideration of \$35,000. Each unit was comprised of one common share and one-half of a common share purchase warrant exercisable at a price of \$0.10 per warrant to acquire one common share for a period of one year.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.06 per share, dividend yield of 0%, volatility of 162.46%, risk free interest rate of 0.62% and an expected life of one year. As a result, the fair value of the purchase warrants was estimated at \$6,919 after a pro-rata allocation of the fair value of the units' components.

- (x) On October 5, 2011, the Company's Board of Directors authorized the purchase of up to 31,900,000 of its common shares by way of normal course purchases on the TSX Venture Exchange. This represented 5% of the common shares outstanding at the time. The estimated cap on these purchases is \$500,000 and the purchases will terminate within one year from the date of commencement. To December 31, 2011 the Company had purchased and cancelled 4,055,000 shares under this plan for a total consideration of \$292,669.

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**Notes to the Consolidated Financial Statements(in Canadian dollars)****15 WARRANTS AND COMPENSATION OPTIONS**

Changes in the Company's outstanding common share purchase warrants and compensation options were as follows:

Issued	Year ended December 31, 2011		Year ended December 31, 2010	
	Warrants	Compensation options	Warrants	Compensation options
Balance – Beginning of period	165,365,162	-	159,709,798	1,102,373
Issued as part of private placement of units (note 14(i)(vi)(ix))	8,750,000	-	44,219,849	-
Issued in exchange for marketable securities (note 14(ii))	21,000,000	-	-	-
Issued for settlement of debt re acquisition of mining assets (note 14(iii))	4,000,000	-	-	-
Issued for agents' compensation (note 14(i)(vii))	-	750,000	503,824	-
Exercised *	(250,000)	-	(36,618,309)	(1,102,373)
Expired	(2,416,269)	-	(2,450,000)	-
<b>Balance – End of period</b>	<b>196,448,893</b>	<b>750,000</b>	<b>165,365,162</b>	<b>-</b>

\* Exercise price was \$0.10 at date of exercise with a market share price of \$0.13.

Outstanding common share purchase warrants and compensation options entitle their holders to subscribe for an equivalent number of common shares.

A summary of the Company's outstanding warrants and compensation options as at December 31, 2011 is presented below:

Number of warrants	Number of compensation options	Exercise price	Expiry date
19,545,000	-	0.15	March 2012
24,928,673	-	0.15	April 2012
200,000	-	0.10	May 2012
1,300,000	-	0.10	June 2012
1,000,000	-	0.10	July 2012
1,000,000	-	0.10	August 2012
5,000,000	-	0.10	September 2012
21,911,540	-	0.10	October 2012
8,697,500	-	0.12	October 2012
4,135,000	-	0.15	December 2012
7,062,326	-	0.18	December 2012
4,000,000	-	0.15	February 2013
17,208,015	-	0.10 U.S.	March 2014
9,310,839	-	0.10 U.S.	April 2014
8,750,000	750,000	0.12	June 2014
15,000,000	-	0.10	July 2014
26,400,000	-	0.10	August 2014
21,000,000	-	0.15	August 2016
<b>196,448,893</b>	<b>750,000</b>	<b>0.12</b>	

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**Notes to the Consolidated Financial Statements(in Canadian dollars)****16 STOCK OPTION PLAN**

The Company maintains a stock option plan (the "Plan") whereby the Board of Directors may from time to time grant to employees, officers, directors and consultants of the Company or any subsidiary thereof options to acquire common shares in such numbers, for such terms and at such exercise prices as may be determined by the Board, provided that the exercise price may not be lower than the market price of the common shares at the time of the grant of the options.

On May 19, 2010, the shareholders of the Company approved the conversion of the Company's Employee Incentive Stock Option Plan into a rolling option plan pursuant to which a maximum of 10% of the number of issued and outstanding common shares of the Company from time to time may be reserved and allocated for the granting of stock options.

As at December 31, 2011, the Plan provides (i) that the maximum number of common shares that may be reserved for issuance under the Plan shall be equal to 10% of the number of issued and outstanding common shares; (ii) that the maximum number of common shares which may be reserved for issuance to any one optionee pursuant to a share option may not exceed 5% of the common shares outstanding at the time of the grant; and (iii) that the maximum number of common shares that may be reserved for issuance to insiders of the Company is limited to 10% of the common shares outstanding at the time of the grant.

Options vest over an 18-month period: 25% at the date of the grant and 12.5% in each of the following six quarters. Options granted must be exercised over a period no longer than five years after the date of grant, and they are not transferable.

A summary of changes in the Company's stock options outstanding is presented below:

**Options**

	Year ended December 31, 2011		Year ended December 31, 2010	
	Number of shares	Average exercise price	Number of shares	Average exercise price
Balance – Beginning of period	58,343,200	0.114	30,032,280	0.10
Granted	4,300,000	0.112	38,545,000	0.12
Exercised	(50,000)	0.10	(3,990,000)	0.10
Cancelled or expired	(2,000,000)	0.10	(6,244,080)	0.11
<b>Balance – End of period</b>	<b>60,593,200</b>	<b>0.114</b>	<b>58,343,200</b>	<b>0.114</b>

Information on exercised options is contained in the following table:

Date of exercise	Number Exercised	Exercise Price	Market Value
February 11, 2011	50,000	0.10	0.13
November 19, 2010	1,200,000	0.10	0.11
November 17, 2010	1,600,000	0.10	0.12
June 2, 2010	200,000	0.10	0.14
May 28, 2010	990,000	0.10	0.13

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The following table summarizes information about options outstanding and exercisable as at December 31, 2011:

		Outstanding options	Exercisable options
Exercise price	Number of options	Average contractual life (in years)	
0.10	25,138,200	2.99	21,788,200
0.115	3,500,000	4.23	2,187,500
0.12	5,410,000	0.91	5,410,000
0.125	24,545,000	3.35	21,476,875
0.14	1,500,000	3.50	1,312,500
0.15	500,000	0.81	500,000
<b>0.114</b>	<b>60,593,200</b>		<b>52,675,075</b>

Total stock compensation costs for the year ended December 31, 2011 amounted to \$1,157,799 (2010 – \$2,759,655).

The fair value of the options granted in 2011 and 2010 was estimated using the Black-Scholes option pricing model based on the following assumptions:

	Nov 2011	Mar 2011	May 2010	June 2010	Dec 2010
Average dividend per share	Nil	Nil	Nil	Nil	Nil
Estimated volatility	161.36%	164.85%	170.72%	172.55%	167.94%
Risk-free interest rate	1.46%	1.3%	0.98%	1.14%	1.37%
Expected life of the options granted	5 years	5 years	5 years	5 years	5 years
Weighted average of estimated fair value of each option granted	\$0.079	\$0.108	\$0.084	\$0.130	\$0.094

**17 GENERAL AND ADMINISTRATIVE EXPENSES**

The Company's general and administrative expenses consist of the following:

Years ending December 31	2011	2010
Advertising and promotion	97,058	17,218
Consultants' fees	562,647	856,612
Directors' fees and insurance	132,356	74,457
Filing fees	62,299	76,755
Investor relations fees	44,398	126,819
Professional fees	429,790	1,229,784
Office overheads	264,996	210,838
Salaries and benefits	1,371,484	767,663
Travel and accommodation	82,946	84,278
Administrative recovery	(251,639)	(100,403)
	<b>2,796,335</b>	<b>3,344,021</b>

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**Notes to the Consolidated Financial Statements(in Canadian dollars)****18 FINANCE INCOME / (LOSS)**

<b>Years ended December 31</b>	<b>2011</b>	<b>2010</b>
Interest income	67,791	14,706
Net change in fair value of financial assets through P&L	(65,117)	-
Premium on flow-through spending	289,420	219,821
Finance income / (loss)	292,094	234,527

**19 TERMINATION FEE**

On July 2, 2010, the Company announced that Spider Resources Inc. ("Spider") had terminated the Combination Agreement previously signed on June 14, 2010 among the Company, its wholly-owned subsidiary, 7569076 Canada Inc., and Spider. As a result of this termination Spider was required to pay a break-fee of \$2,300,000 to the Company. This amount was received on July 5, 2010. All costs related to this Agreement have been expensed in these financial statements.

**20 INCOME TAXES**

A reconciliation between tax expense and the product of accounting loss multiplied by the Corporation's domestic tax rate is as follows:

	<b>2011</b>	<b>2010</b>
Statutory tax rate	28.25%	31.00%
Income (loss) before income taxes	12,732,185	(3,995,361)
Tax (benefit) expense at statutory rate	3,596,842	(1,238,562)
Impact of rate changes	202,374	747,845
Effect of flow through renunciation	334,932	3,390,380
Expired tax losses	-	111,214
Stock based compensation	327,078	855,193
Effect of tax benefits not previously recognized	(4,377,680)	(3,819,380)
Other	(83,000)	(46,690)
Total tax expense	-	-

The 2011 statutory tax rate of 28.25% differs from the 2010 statutory tax rate of 31% because of the reduction in both federal and Ontario substantively enacted tax rates.

The Company offsets tax assets and liabilities if and only if it has a legally enforceable right to set off the current tax assets and current tax liabilities or deferred tax assets and liabilities and they relate to taxes levied by the same tax authority.

The tax benefit of the following unused tax losses and deductible temporary differences have not been recognized in the financial statements due to the unpredictability of future earnings.

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<b>Deductible Temporary Differences</b>	<b>Dec 31, 2011</b>	<b>Dec 31, 2010</b>	<b>Jan 1, 2010</b>
Mineral Property Interests	1,422,874	3,019,439	18,168,127
Non capital loss carry-forwards	-	8,678,342	7,645,684
Capital loss carry-forwards	84,202,192	84,355,192	84,236,930
Share issue costs	706,441	1,012,174	641,033
Marketable Securities	230,706	120,828	391,871
Property plant and Equipment	2,375,796	2,351,386	2,327,036
	88,938,009	99,537,361	113,410,681

At December 31, 2011, the Company has unclaimed non-capital losses of nil, (2010- \$8.7 million).

The Company's balance of capital losses at December 31, 2011 amounts to approximately \$84.2 million (2010-\$84.4 million), and can be carried forward indefinitely against capital gains.

**21 EARNINGS (LOSS) PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share:

<b>Years ended December 31</b>	<b>2011</b>	<b>2010</b>
Weighted average number of shares outstanding – basic	642,650,516	559,552,490
Effect of dilutive securities:		
Stock options	-	-
Warrants and compensation options	-	-
Weighted average number of shares and assumed Conversions – diluted	642,650,516	559,552,490
Income (loss) from continuing operations	12,512,305	(4,563,406)
Loss from discontinued operations	(505,629)	(37,110)
Net income (loss) for the year	12,006,676	(4,600,516)
Earnings (loss) per share from continuing operations:		
Basic and diluted	0.02	(0.01)
Earnings (loss) per share from discontinued operations:		
Basic and diluted	-	-
Earnings (loss) per share for the year		
Basic and diluted	0.02	(0.01)
Non-dilutive securities:		
Stock options	60,593,200	58,343,200
Warrants and compensation options	197,198,893	165,365,162

**22 RELATED PARTY TRANSACTIONS**

The Company defines its officers (CEO, CFO and corporate secretary) and directors as Key Management Personnel (“KMP”). During 2011, officers and companies controlled by officers charged consulting fees totalling \$280,103 (\$258,769 in 2010) of which \$18,305 remained payable at December 31, 2011 (\$16,767 in 2010) and directors of the Company were paid nil (\$241,267 in 2010) for professional consulting services. Directors’ fees paid for the year totalled \$147,060 (\$56,000 in 2010) and certain directors also received salaries and bonuses

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**Notes to the Consolidated Financial Statements(in Canadian dollars)**

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in the amount of \$667,916 in 2011 (\$328,000 in 2010). KMP received 1,500,000 stock options in 2011 (23,900,000 in 2010). In 2011 stock compensation expenses totalled \$1,126,482 for KMP (\$805,273 in 2010).

**Debut Diamonds Inc.**

The Company shares management, administrative assistance and facilities and other technical personnel with DDI. This is not covered by a written agreement. The costs charged to DDI are equal to the costs incurred by the Company. During 2011, the Company charged DDI for overhead and personnel charges in the amount of \$58,570 (\$nil in 2010) and for project costs in the amount of \$60,870 (\$nil in 2010) and it also advanced funds in the form of loans to DDI in the amount of \$664,332.

**23 COMMITMENTS AND CONTINGENCIES**

Pursuant to flow-through financing agreements closed during the year ended December 31, 2011 the Company must incur \$1,750,000 in exploration expenses by December 31, 2012.

The Company has incurred approximately \$8 million of expenditures which have been passed through to shareholders as eligible expenditures for their purposes under flow through agreements. As noted in Note 3 to these financial statements, there is a risk that some or all of these claims may be disallowed. No provision has been made for potential cost to the Company, if any, of such disallowance. To the extent that the costs are disallowed as deductions to shareholders, additional tax attributes would be created for the Company which would be considered for recognition at that time.

Certain conditions may exist at the date the financial statements are issued which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company does not record any liability for such future events until such time as the events are probable and reasonably determinable.

**24 FINANCIAL INSTRUMENTS AND FAIR VALUES****Overview**

The Company has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk; and

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

**Risk Management Framework**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board fulfils its responsibility through the Audit Committee, which is responsible for overseeing the Company's risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management practices are reviewed regularly to reflect changes in market conditions and the Company's activities. The Company has an established code of

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**Notes to the Consolidated Financial Statements(in Canadian dollars)**

conduct which sets out the control environment within which framework all directors' and employees' roles and obligations are outlined.

The Company's risk and control framework is facilitated by the small-sized and hands-on executive team.

**Credit Risk**

Credit risk is the risk of an unexpected financial loss to the Company if a customer or third party to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's cash and cash equivalents, receivables and marketable securities.

**Cash and Cash Equivalents**

The Company's cash and cash equivalents are held through large Canadian financial institutions. The Company has a corporate policy of investing its available cash in Canadian government instruments and certificates of deposit or other direct obligations of major Canadian banks, unless otherwise specifically approved by the Board. The Company does not own asset-backed commercial paper.

**Receivables**

The Company's receivables consist primarily of trade receivables and amounts due from related parties, both of which are settled on a regular basis.

When necessary, the Company establishes an allowance for impairment that represents its estimate of incurred losses in respect of receivables.

Furthermore, when the Company engages in corporate transactions it seeks to manage its exposure by ensuring that appropriate recourse is included in such agreements upon the counterparty's failure to meet contractual obligations.

**Marketable Securities**

The Company invests only in securities of companies listed on public stock exchanges and warrants of those companies. There is no active market for these warrants. Such strategic investments are approved by the Board of Directors of the Company. Management actively monitors changes in the markets and management does not expect any counterparty to fail to meet its obligations. The Company's investments are generally in the junior natural resources sector and these companies are subject to similar areas of risk as the Company itself.

**Guarantees**

The Company's policy is to provide financial guarantees only to wholly-owned subsidiaries or under business arrangements where the benefit of the guarantee will enure to the Company. At December 31, 2011, the Company had \$nil in guarantees outstanding (2010 - \$nil).

The Company's maximum exposure to credit risk at the reporting date was:

	Notes	December 31, 2011	December 31, 2010	January 1, 2010
Carrying amount				
Cash and cash equivalents	6	16,030,551	3,261,057	2,056,751
Receivables	7	861,713	18,401	6,736
Financial assets classified as AFS	8	888,450	293,438	134,991
Financial assets classified at FVTPL	8	2,284,000	-	-
		20,064,714	3,572,896	2,198,478



## **KWG RESOURCES INC.**

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### **Notes to the Consolidated Financial Statements(in Canadian dollars)**

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#### **Liquidity Risk (note 1)**

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking undue damage to the Company's reputation.

The Company's objective is to maintain sufficient capital in order to meet short-term business requirements after taking into account cash flows from operations and the Company's holdings of cash and cash equivalents and marketable securities. This is accomplished by budgets and forecasts which are updated on a periodic basis to understand future cash needs and sources. Spending plans are adjusted accordingly when possible to provide for liquidity.

The Company manages its liquidity risk through the mechanisms described above and as described in Capital Management Disclosures below. The Company has historically relied on issuances of shares to develop projects and to finance day-to-day operations and may do so again in the future. These circumstances may cast significant doubt as to the Company's ability to continue as a going concern and the ultimate appropriateness of the use of the accounting principles applicable to a going concern.

The Company has no significant long-term liabilities. All other contractually obligated cash flows are payable within the next fiscal year.

#### **Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, commodity prices and equity prices will affect the Company's income, the value of its E&E properties or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters while optimizing the return.

#### **Foreign Currency Risk**

The Company is exposed to foreign currency risk on purchases and other payables that are denominated in a currency other than the functional currency of the Company; the Canadian dollar. The currencies in which these transactions are denominated, when they occur, are the United States dollars (US\$). The Company does not actively hedge its foreign currency exposure. A 10% strengthening or weakening of the Canadian dollar would not have a material impact on the Company's equity or results of operations.

#### **Interest Rate Risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's cash equivalents earn interest at variable short-term rates. The estimated effect of a 50bps change in interest rate would not have a material effect on the Company's results of operations. None of the Company's other financial instruments are interest-bearing. Consequently, the Company is not exposed to any significant interest rate risk which could be caused by a sudden change in market interest rates.

#### **Other Market Price Risk**

The Company's marketable securities and strategic investments are subject to equity price risk. The values of these investments will fluctuate as a result of changes in market prices, the price of metals or other factors affecting the value of the investments.

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Commodity price risk is the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The value of the Company's mineral resource properties is related to the price of, and outlook for, base and precious metals. Historically, such prices have fluctuated and are affected by numerous factors outside of the Company's control, including, but not limited to: industrial and retail demand, central bank lending, forward sales by producers and speculators, levels of worldwide production, short-term changes in supply and demand because of speculative hedging activities and other factors such as significant mine closures. The Company does not have any hedging or other commodity-based risks respecting its operations. The value of the Company's strategic investments is also related to the price of, and outlook for, base and precious metals and other minerals.

**25 DETERMINATION OF FAIR VALUES****Measurement Categories**

As explained in Note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statement of operations or comprehensive income (loss). Those categories are: fair value through profit or loss; loans and receivables; available for sale assets; and, for liabilities, amortized cost. The following table shows the carrying values of financial assets and liabilities for each of these categories at the reporting date.

	Notes	December 31, 2011	December 31, 2010	January 1, 2010
<b>Assets</b>				
Loans and receivables				
Cash and cash equivalents	6	16,030,551	3,261,057	2,056,751
Receivables	7	861,713	18,401	6,736
Available for sale				
Marketable securities	8	888,450	293,438	134,991
Fair value through profit and loss				
Marketable securities	8	2,284,000	-	-
<b>Liabilities</b>				
Amortized cost				
Trade and other payables	11	1,112,929	1,680,963	2,001,674
Fair value through profit and loss				
Warrant liability	12	1,096,584	2,492,772	2,302,100

A number of the Company's accounting policies and disclosures require the determination of fair value for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the methods described below. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

**(a) Marketable securities**

The fair value of marketable securities included in financial assets at fair value through operations or OCI is determined by reference to their quoted closing bid price at the reporting date.

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**Notes to the Consolidated Financial Statements(in Canadian dollars)***Fair Value Hierarchy*

The different levels of valuation are defined as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3: Inputs for the asset or liability are not based on observable market data (unobservable inputs).

The table below analyzes financial instruments carried at fair value by valuation method:

	Level 1	Level 2	Level 3	Total
<b>As at December 31, 2011</b>				
<b>Assets</b>				
Marketable securities classified as AFS	888,450	-	-	888,450
Marketable securities classified as FVTPL	-	2,284,000	-	2,284,000
<b>Total assets</b>	<b>888,450</b>	<b>2,284,000</b>	<b>-</b>	<b>3,172,450</b>
<b>Liabilities</b>				
Warrant liability classified as FVTPL	-	1,096,584	-	1,096,584
<b>Total liabilities</b>	<b>-</b>	<b>1,096,584</b>	<b>-</b>	<b>1,096,584</b>
<b>As at December 31, 2010</b>				
<b>Assets</b>				
Marketable securities classified as AFS	293,438	-	-	293,438
<b>Total assets</b>	<b>293,438</b>	<b>-</b>	<b>-</b>	<b>293,438</b>
<b>Liabilities</b>				
Warrant liability classified as FVTPL	-	2,492,772	-	2,492,772
<b>Total liabilities</b>	<b>-</b>	<b>2,492,772</b>	<b>-</b>	<b>2,492,772</b>
<b>As at January 1, 2010</b>				
<b>Assets</b>				
Marketable securities classified as AFS	134,991	-	-	134,991
<b>Total assets</b>	<b>134,991</b>	<b>-</b>	<b>-</b>	<b>134,991</b>
<b>Liabilities</b>				
Warrant liability classified as FVTPL	-	2,302,100	-	2,302,100
<b>Total liabilities</b>	<b>-</b>	<b>2,302,100</b>	<b>-</b>	<b>2,302,100</b>

**(b) Warrants and Warrant Liability**

The fair values of equity warrants and the warrant liability are based upon the Black-Scholes option-pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historic experience and general option-holder behaviour), expected dividends and the risk-free interest rate (based on government bonds). Notes 8 and 12 contain details of these inputs.

**(c) Receivables**

The fair value of receivables is estimated at their book value due to their short term nature.

**(d) Non-derivative Financial Liabilities**

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

**26 CAPITAL MANAGEMENT DISCLOSURES**

The Company's objective when managing capital is to safeguard its accumulated capital in order to provide an adequate return to shareholders by maintaining a sufficient level of funds

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**Notes to the Consolidated Financial Statements(in Canadian dollars)**

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to support continued project development and corporate activities. Capital is defined by the Company as the aggregate of its shareholders' equity. Shareholders' equity totalled \$46,506,820 at December 31, 2011, \$31,329,315 at December 31, 2010 and \$16,426,419 at January 1, 2010.

The Company manages its capital structure and makes adjustments to it based on the level of funds available to the Company to manage its operations. In order to maintain or adjust the capital structure, the Company expects that it will be able to obtain equity, long-term debt, equipment-based financing and/or project-based financing sufficient to maintain and expand its operations. There are no assurances that these initiatives will be successful. In order to achieve these objectives, the Company invests its unexpended cash in highly-liquid, rated financial instruments. There were no changes in the Company's approach to capital management during the year. The Company is not subject to externally imposed capital requirements.

**27 SEGMENTED INFORMATION**

Operating segments are reported in a manner consistent with the way in which the Company's executive officers review business performance on a quarterly basis. The Company's operations comprise a single reporting operating segment engaged in mineral exploration in Canada. As the operations comprise a single reporting segment, amounts disclosed in the consolidated financial statements also represent segment amounts.

**28 SUBSEQUENT EVENTS**

(a) On February 29, 2012 the Company signed an agreement to acquire 49 unpatented claims from INV Metals Inc. in consideration for 3,000,000 treasury units each comprised of one share and one warrant exercisable at \$0.12 for a period of 5 years. The claims are located south of McFaulds Lake and the Ring of Fire and complete an important section of the railway corridor staked by the Company's subsidiary Canada Chrome Corporation.

(b) On March 29, 2012 the Company granted stock options to its directors to purchase a total of 7,100,000 shares at a price of \$0.10 each expiring on March 29, 2017.

**29 EXPLANATION OF TRANSITION TO IFRS**

As stated in Note 2, these are KWG's first consolidated financial statements prepared in accordance with IFRS.

The accounting policies set out in Note 3 have been applied in preparing the consolidated financial statements for the year ended December 31, 2011, the comparative information presented in these financial statements for the year ended December 31, 2010 and the opening IFRS balance sheet as at January 1, 2010 (date of transition).

In preparing its opening IFRS balance sheet, KWG has adjusted amounts reported previously in financial statements prepared in accordance with predecessor Canadian GAAP in effect for the Company prior to the transition date ("pre-transition Canadian GAAP"). An explanation of how the transition from pre-transition Canadian GAAP to IFRS has affected KWG's financial position, financial performance and cash flows as well as any IFRS exceptions or exemptions elected by the Company is set out in the following tables and the notes that accompany the tables.

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The January 1, 2010 Canadian GAAP consolidated balance sheet has been reconciled to IFRS as follows:

		January 1, 2010		
	Notes	Pre-transition Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		2,056,751	-	2,056,751
Receivables		216,486	-	216,486
Marketable securities		134,991	-	134,991
Prepaid expenses		25,022	-	25,022
<b>Total current assets</b>		<b>2,433,250</b>	<b>-</b>	<b>2,433,250</b>
<b>Non-current assets</b>				
Property and equipment		40,101	-	40,101
Mineral property interests	(b),	18,256,842	-	18,256,842
<b>Total non-current assets</b>		<b>18,296,943</b>	<b>-</b>	<b>18,296,943</b>
<b>Total assets</b>		<b>20,730,193</b>	<b>-</b>	<b>20,730,193</b>
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Trade and other payables	(c)	1,961,496	40,178	2,001,674
<b>Total current liabilities</b>		<b>1,961,496</b>	<b>40,178</b>	<b>2,001,674</b>
<b>Non-current liabilities</b>				
Warrant liabilities	(d)	-	2,302,100	2,302,100
<b>Total non-current liabilities</b>		<b>-</b>	<b>2,302,100</b>	<b>2,302,100</b>
<b>Equity</b>				
Share capital	(c)	17,039,499	(2,169,032)	14,870,467
Warrants	(c)(d)	4,031,086	(1,221,927)	2,809,159
Contributed surplus	(e)	3,258,431	(121,075)	3,137,356
Accumulated other comprehensive income		(255,805)	-	(255,805)
Deficit	(g)	(5,304,514)	1,169,756	(4,134,758)
<b>Total equity</b>		<b>18,768,697</b>	<b>(2,342,278)</b>	<b>16,426,419</b>
<b>Total liabilities and equity</b>		<b>20,730,193</b>	<b>-</b>	<b>20,730,193</b>

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**Notes to the Consolidated Financial Statements(in Canadian dollars)**

The December 31, 2010 Canadian GAAP consolidated balance sheet has been reconciled to IFRS as follows:

		December 31, 2010		
	Notes	Pre-transition Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents		3,261,057	-	3,261,057
Receivables		392,110	-	392,110
Marketable securities		293,438	-	293,438
Prepaid expenses		28,079	-	28,079
<b>Total current assets</b>		<b>3,974,684</b>	<b>-</b>	<b>3,974,684</b>
<b>Non-current assets</b>				
Property and equipment		48,232	-	48,232
Mineral property interests	(b),	31,340,134	50,000	31,390,134
<b>Total non-current assets</b>		<b>31,388,366</b>	<b>50,000</b>	<b>31,438,366</b>
<b>Total assets</b>		<b>35,363,050</b>	<b>50,000</b>	<b>35,413,050</b>
<b>LIABILITIES AND EQUITY</b>				
<b>Current liabilities</b>				
Trade and other payables	(c)	1,412,459	268,504	1,680,963
<b>Total current liabilities</b>		<b>1,412,459</b>	<b>268,504</b>	<b>1,680,963</b>
<b>Non-current liabilities</b>				
Warrant liabilities	(d)	-	2,492,772	2,492,772
<b>Total non-current liabilities</b>		<b>-</b>	<b>2,492,772</b>	<b>2,492,772</b>
Non-controlling interests		61,186	(61,186)	-
<b>Equity attributable to owners of the parent</b>				
Share capital	(c)	31,369,877	(2,683,976)	28,685,901
Warrants	(c)(d)	6,628,687	(1,312,008)	5,316,679
Contributed surplus	(e)	6,054,920	(159,335)	5,895,585
Accumulated other comprehensive income		15,238	-	15,238
Deficit	(g)	(10,179,317)	1,444,043	(8,735,274)
		<b>33,889,405</b>	<b>(2,711,276)</b>	<b>31,178,129</b>
Non-controlling interests	(h)	-	61,186	61,186
<b>Total equity</b>		<b>33,889,405</b>	<b>(2,650,090)</b>	<b>31,239,315</b>
<b>Total liabilities and equity</b>		<b>35,363,050</b>	<b>50,000</b>	<b>35,413,050</b>

**KWG RESOURCES INC.**

(An exploration stage company)

**Notes to the Consolidated Financial Statements(in Canadian dollars)**

The Canadian GAAP consolidated statement of operations and comprehensive income for the year ended December 31, 2010 has been reconciled to IFRS as follows:

		For the year ended December 31, 2010		
	Notes	Pre-transition Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>Expenses</b>				
General and administrative		(3,344,021)	-	(3,344,021)
Amortization of property and equipment		(24,350)	-	(24,350)
Stock compensation costs	(e)	(2,759,655)	-	(2,759,655)
Write-down and write-off of mining assets		(210,662)	-	(210,662)
Gain on foreign exchange		48,735	-	48,735
<b>Operating loss</b>		<b>(6,289,953)</b>	<b>-</b>	<b>(6,289,953)</b>
<b>Other income (expenses)</b>				
Finance income	(f)	14,706	219,821	234,527
Interest and other income		34,750	-	34,750
Termination fee		2,300,000	-	2,300,000
Finance costs	(b)	(50,000)	50,000	-
Loss on disposal of marketable securities		(65,096)	-	(65,096)
Loss on revaluation of warrant liability	(d)	-	(777,634)	(777,634)
		<b>2,234,360</b>	<b>(507,813)</b>	<b>1,726,547</b>
<b>Profit (loss) for the year before income tax</b>		<b>(4,055,593)</b>	<b>(507,813)</b>	<b>(4,563,406)</b>
Deferred Income tax recovery		1,022,000	(1,022,000)	-
<b>Loss from continuing operations</b>		<b>(3,033,593)</b>	<b>(1,529,813)</b>	<b>(4,563,406)</b>
Loss from discontinued operations		<b>(45,924)</b>	<b>-</b>	<b>(45,924)</b>
<b>Net loss for the year</b>		<b>(3,079,517)</b>	<b>(1,529,813)</b>	<b>(4,609,330)</b>
Less: portion attributable to non-controlling interest in earnings of subsidiary	(h)	<b>8,814</b>	<b>-</b>	<b>8,814</b>
<b>Net loss attributable to equity holders of KWG Resources Inc.</b>		<b>(3,070,703)</b>	<b>(1,529,813)</b>	<b>(4,600,516)</b>
Deficit – Beginning of the year	(g)	(5,304,514)	1,169,756	(4,134,758)
Share and warrant issue expenses	(c)	(1,804,100)	1,804,100	-
<b>Deficit – End of the year</b>		<b>(10,179,317)</b>	<b>1,444,043</b>	<b>(8,735,274)</b>
<b>Loss per share (basic and diluted)</b>		<b>(0.01)</b>		<b>(0.01)</b>

**KWG RESOURCES INC.**

(An exploration stage company)

**Notes to the Consolidated Financial Statements(in Canadian dollars)****Consolidated Statements of Comprehensive Income (loss)**

		For the year ended December 31, 2010		
(in Canadian dollars)	Notes	Pre-transition Canadian GAAP	Effect of Transition to IFRS	IFRS
Net loss for the year		(3,079,517)	(1,529,813)	(4,609,330)
Other Comprehensive Income ("OCI")				
Net change in fair value of AFS		271,043	-	271,043
<b>Total Comprehensive Loss for the Year</b>		<b>(2,808,474)</b>	<b>(1,529,813)</b>	<b>(4,338,287)</b>
Portion attributable to non-controlling interest	(h)	8,814	-	8,814
<b>Total Comprehensive Loss attributable to equity holders of KWG Resources Inc.</b>		<b>(2,799,660)</b>	<b>(1,529,813)</b>	<b>(4,329,473)</b>

**a) Adjustments to the Statement of Cash Flows for 2010**

There are no material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under pre-transition Canadian GAAP.

**b) Mineral property interests**

Previously the Company had expensed financing charges related to one of its projects. Under IFRS such charges are required to be capitalized. An adjustment has been made in order to conform with the new standard. This applied to the 2010 fiscal year only. Prior to that the Company had not incurred any financing charges related to its mineral property interests.

**c) Flow-through share financing**

Under pre-transition Canadian GAAP, the Company accounted for the tax effects of renouncing expenditures in favour of its investors upon formal renunciation to the Canada Revenue Agency ("CRA") on its deadline of February 28 in each year. Furthermore, the Company recorded the entire amount of financing received as equity in share capital with an appropriate apportionment of proceeds to any warrants issued. Under IFRS, the Company's selected accounting treatment requires recognition of the tax effects of renunciation upon incurring expenditures related to the flow-through shares, as well as an identification of the premium associated with the tax benefits passed on to the subscribers of the flow-through shares and amortization thereof to operations upon incurring expenditures related to the flow-through shares. Flow-through expenditures are sometimes made in different reporting periods than the one in which formal renunciation to the CRA takes place. Furthermore, under IFRS, share issuance costs which were previously charged directly to deficit must be allocated against the equity accounts pro-rata with the recording of the original investment receipts.

The accounting policy determined by the Company is reflected in Note 3.

The impact arising from the change is summarized as follows:

Effect on Balance sheets	December 31, 2010	January 1, 2010
Decrease to share capital	3,303,449	2,135,777
Decrease to warrants	672,441	443,263
Set up deferred liability for flow-through premium	701,250	86,500
Decrease to flow-through premium upon incurring of renounced expenses	293,150	46,322
Decrease to deficit	3,567,790	2,538,862



**KWG RESOURCES INC.**

(An exploration stage company)

**Notes to the Consolidated Financial Statements(in Canadian dollars)****d) Warrant liability**

Under IAS 32, a foreign currency warrant will be classified as equity only if the instrument can be settled by delivery of a fixed number of equity shares in exchange for a fixed amount of cash. If an instrument fails this test it is treated as the issuance of a derivative financial liability. The Company has a number of outstanding warrants with an exercise price denominated in United States dollars while the Company's functional currency is the Canadian dollar. These warrants are now shown on the Balance Sheet as Warrant Liability. Under pre-transition Canadian GAAP these warrants were included in equity. The liability account will be drawn down as the warrants are exercised or upon their expiration date. Furthermore, this liability will be re-valued at each financial statement date and any corresponding change will be recorded on the Statement of Operations as Gain(loss) on revaluation of warrant liability.

**e) Share-based payments**

The Company has elected under IFRS 1 not to adopt retroactive application of fair value accounting on options issued and fully vested before the transition date. At the date of transition, the Company reviewed all unvested stock options and determined that no adjustments were necessary since the Company does not provide for forfeitures in its calculations of the fair value of the stock options due to the fact it has experienced only very minimal forfeitures in the past.

Accordingly, there are no differences arising from the transition to IFRS.

**f) Finance income and finance costs**

Under IFRS there are several reclassifications required to report components of net finance income. The reclassifications are summarized as follows:

Statement of Operations	Year ended December 31, 2010
<b>Finance Income</b>	
Premium on flow-through spending	219,821
	<b>219,821</b>

**g) Deficit**

The impact arising from the matters discussed above, have the following effects on the Company's deficit:

Balance Sheets	December 31, 2010	January 1, 2010
Effect of flow-through financings	3,540,783	2,538,862
Capitalization of interest	50,000	-
Gain (loss) on revaluation of warrant liability	(2,146,740)	(1,369,106)
	<b>1,444,043</b>	<b>1,169,756</b>

**h) Non-controlling interest**

Under IFRS, non-controlling interests in the Company's subsidiary are classified as a separate component of equity. On initial recognition, non-controlling interest was measured at their proportionate share of the identifiable book value of net assets of the subsidiary. Subsequent to acquisition date, adjustments are made to the carrying amount of non-controlling interest for the non-controlling interests' share of changes to the subsidiary's equity.

For the year ended December 31, 2010 the net effect was a re-classification of the non-controlling interest from between liabilities and equity to an equity component.