

Metallica Resources Inc.

(A development stage company)

**Consolidated Financial Statements
as at December 31, 2005 and 2004 and for the
years ended December 31, 2005, 2004 and 2003**

Management's Report

To the Board of Directors and Shareholders of Metallica Resources Inc.

Management is responsible for the preparation of the information contained in this annual report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in the report. The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada and necessarily include amounts based on estimates and judgments.

Management has established and maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that financial information is reliable and accurate. The Audit Committee of the Board of Directors, comprised of non-management directors, has reviewed the consolidated financial statements with management and the external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

The Company's independent auditors, PricewaterhouseCoopers LLP, are appointed by the shareholders and have conducted an audit in accordance with generally accepted auditing standards in Canada and the standards of the Public Company Accounting Oversight Board (United States). Their report follows.

"Richard J. Hall"
Richard J. Hall
President and Chief Executive Officer

"Bradley J. Blacketor"
Bradley J. Blacketor
Vice President, Chief Financial Officer and Secretary

February 6, 2006

Auditors' Report

To the Shareholders of Metallica Resources Inc.

We have audited the accompanying consolidated balance sheets of Metallica Resources Inc. as of December 31, 2005 and 2004, and the related consolidated statements of operations and deficit and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Canada and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Metallica Resources Inc. at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in accordance with accounting principles generally accepted in Canada.

"PricewaterhouseCoopers LLP"
Chartered Accountants
Vancouver, British Columbia

February 6, 2006, except for Note 1, which is as of February 8, 2006

Comments by Auditors for United States Readers on Canada-United States Reporting Difference

In the United States, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when there are changes in accounting principles that have a material effect on the comparability of the company's financial statements, such as the changes described in Note 2 to the financial statements. Our report to the shareholders dated February 6, 2006 except for Note 1, which is as of February 8, 2006 is expressed in accordance with Canadian reporting standards which do not require a reference to such a change in accounting principles in the auditors' report when the change is properly accounted for and adequately disclosed in the financial statements.

"PricewaterhouseCoopers LLP"
Chartered Accountants
Vancouver, British Columbia

February 6, 2006, except for Note 1, which is as of February 8, 2006

Consolidated Balance Sheets

December 31, 2005 and 2004
U.S. dollars

	2005	2004
Assets		
Current assets:		
Cash and cash equivalents (Note 11)	\$ 42,669,830	\$ 41,617,044
Value-added tax receivable and other current assets	969,947	640,244
	43,639,777	42,257,288
Mineral properties and deferred expenditures (Note 3)	55,530,251	47,355,378
Property, plant and equipment (Note 4)	503,585	416,464
Other assets (Note 10)	246,271	263,970
	99,919,884	90,293,100
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,383,006	\$ 738,384
Asset retirement obligation (Note 5)	343,164	203,818
Shareholders' equity:		
Share capital (83,301,676 common shares, 2004: 82,687,043) (Note 6(b))	108,158,077	107,661,917
Contributed surplus (Note 6(d))	1,484,554	--
Warrants (Note 6(d))	5,889,285	7,373,839
Stock options (Note 6(c))	1,431,014	1,043,156
Deficit	(18,769,216)	(26,728,014)
	98,193,714	89,350,898
Total liabilities and shareholders' equity	\$ 99,919,884	\$ 90,293,100
Contingencies (Notes 1 and 9)		
Commitments (Note 10)		

Approved by the Board:

"Craig J. Nelsen"
Craig J. Nelsen

"Ian A. Shaw"
Ian A. Shaw

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

Consolidated Statements of Operations and Deficit

For the years ended December 31, 2005, 2004 and 2003

U.S. dollars, except shares outstanding

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Interest income	\$ 1,036,850	\$ 925,180	\$ 158,087
Income from property payments (Notes 3(b and f))	<u>8,349,264</u>	<u>300,000</u>	<u>150,000</u>
	9,386,114	1,225,180	308,087
General and administrative expense	1,748,514	1,469,246	1,252,077
Exploration expense	232,252	192,627	212,366
Reclamation and property closure costs	--	22,368	17,421
Stock-based compensation expense	341,110	83,466	6,675
Write-down of mineral properties and deferred expenditures	2,518	81,469	703,536
Interest expense (Note 3(a))	--	40,260	446,851
Foreign exchange (gain)	<u>(1,045,359)</u>	<u>(2,169,257)</u>	<u>(609,547)</u>
Income (loss) before income taxes	8,107,079	1,505,001	(1,721,292)
Income tax provision (benefit) (Note 7)	<u>148,281</u>	<u>136,539</u>	<u>(5,745)</u>
Net income (loss)	7,958,798	1,368,462	(1,715,547)
Deficit at beginning of year as previously reported	(26,728,014)	(27,695,861)	(25,980,314)
Stock-based compensation expense (Note 6(c))	--	(400,615)	--
Deficit at beginning of year as restated	<u>(26,728,014)</u>	<u>(28,096,476)</u>	<u>(25,980,314)</u>
Deficit at end of year	<u>\$ (18,769,216)</u>	<u>\$ (26,728,014)</u>	<u>\$ (27,695,861)</u>
Basic net income (loss) per share	<u>\$ 0.10</u>	<u>\$ 0.02</u>	<u>\$ (0.04)</u>
Diluted net income (loss) per share	<u>\$ 0.10</u>	<u>\$ 0.01</u>	<u>\$ (0.04)</u>
Weighted average number of common shares outstanding	<u>82,952,717</u>	<u>82,405,035</u>	<u>42,865,141</u>

Consolidated Statements of Cash Flows

For the years ended December 31, 2005, 2004 and 2003
U.S. dollars

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cash flows provided from (used for) operating activities			
Net income (loss)	\$ 7,958,798	\$ 1,368,462	\$ (1,715,547)
Non-cash items:			
Depreciation and amortization	11,542	12,865	10,564
Stock-based compensation expense	341,110	83,466	6,675
Restricted stock units	59,435	--	--
Interest expense	--	40,260	442,933
Common share contribution to retirement plan	19,449	23,060	21,735
Reclamation and property closure costs	--	--	17,421
Write-down of mineral properties and deferred expenditures	2,518	81,469	703,536
Foreign exchange (gain) on foreign cash held	(1,045,359)	(2,169,257)	(609,547)
Changes in non-cash working capital:			
Value-added tax and other current assets	(329,703)	(224,366)	(158,022)
Accounts payable and accrued liabilities	85,169	(21,884)	217,940
Reclamation and closure cost obligation	--	(29,796)	(137,625)
Other assets	17,500	(245,492)	(13,664)
	<u>7,120,459</u>	<u>(1,081,213)</u>	<u>(1,213,601)</u>
Cash flows provided from (used for) investing activities			
Acquisition of subsidiary, net of cash acquired	--	(5,000,000)	(1,921,933)
Mineral properties and deferred expenditures	(9,024,369)	(14,889,399)	(2,044,946)
Mineral properties and deferred expenditures applied to income from property payments	1,650,736	--	--
Payments to acquire property, plant and equipment	(169,136)	(254,405)	(105,504)
	<u>(7,542,769)</u>	<u>(20,143,804)</u>	<u>(4,072,383)</u>
Cash flows provided from (used for) financing activities			
Common shares and units issued for cash, net of issue costs	--	--	70,774,607
Proceeds from exercise of warrants	--	400,230	168,454
Proceeds from exercise of options	429,737	362,618	222,546
Repayment of acquisition debt	--	(6,000,000)	(5,000,000)
Repayment of note payable	--	(200,100)	--
Proceeds from repayment of loan to director	--	--	100,000
	<u>429,737</u>	<u>(5,437,252)</u>	<u>66,265,607</u>
Foreign exchange gain on foreign cash held	<u>1,045,359</u>	<u>2,169,257</u>	<u>609,547</u>
Increase (decrease) in cash and cash equivalents	1,052,786	(24,493,012)	61,589,170
Cash and cash equivalents, beginning of year	41,617,044	66,110,056	4,520,886
Cash and cash equivalents, end of year	<u>\$ 42,669,830</u>	<u>\$ 41,617,044</u>	<u>\$ 66,110,056</u>

Supplementary cash flow information (Note 11)

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

Notes to Consolidated Financial Statements

U.S. dollars

1. Nature of Operations

Metallica Resources Inc. (the "Company") is engaged in the exploration, development and acquisition of precious metal rich mineral properties located principally in North and South America.

The Company commenced construction of its 100%-owned Cerro San Pedro gold and silver project in Mexico in February 2004. In June 2004, construction of the mine was suspended pending resolution of various permitting and other issues involving the project as discussed in Note 3(a) and Note 9. The Company received notification from Secretaria de Defensa Nacional ("SEDENA") that the restriction on its explosives permit for the project that prohibited the use of explosives on land communally owned by the Ejido of Cerro de San Pedro was removed. The Company intends to recommence full scale mine construction during the first quarter of 2006. It is anticipated that mine construction will be completed by the end of 2006.

In June 2005, the Company received a Temporary Occupancy and Right of Way Authorization from the Federal Mining Bureau for its Cerro San Pedro project. This authorization provides the Company with federally mandated surface rights access to its mineral rights over the life of the mine, and overrides the various rulings and appeals in the Agrarian Court that challenged the Company's surface rights access.

The Company has been notified of various lawsuits and legal actions that have been filed by a group of project opponents against governmental agencies seeking nullification of various permits and licenses that have been granted to the Company with respect to its Cerro San Pedro project. Various lawsuits and legal actions have been filed by members of this group over the past three years, those that have had final rulings have all been resolved in favor of the various governmental agencies. In the event of an adverse ruling from any of the unresolved lawsuits, the Company could be forced to suspend or cease project construction or operating activities.

The Company is also advancing a copper-gold exploration project in Chile with Falconbridge Limited ("Falconbridge"), formerly Noranda Inc., (Note 3(b)) and is pursuing various other exploration projects in the Americas.

2. Summary of Significant Accounting Policies

These consolidated financial statements are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. The significant measurement differences between these principles and those that would be applied to the Company under United States GAAP are described in Note 13.

Consolidation

These consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries, after elimination of intercompany balances and transactions.

- Datawave Sciences Inc.
- De Re Holdings Inc.
- Desarrollos Metallica C.A.
- MMM Exploraciones, S.A. de C.V.
- Metallica (Barbados) Inc.
- Metallica Management Inc.
- Minera Metallica Limitada
- Minera San Xavier, S.A. de C.V.
- Raleigh Mining International Limited
- Servicios del Plata y Oro, S.A. de C.V.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amount of income and expenses during the reporting period. Significant estimates that involve highly subjective assumptions by management include the Company's estimated reclamation obligation for its Cerro San Pedro project in Mexico, its estimation of stock-based compensation amounts and its assessment of its mineral property carrying values for impairment. Actual results could differ from those reported.

Foreign Currency Translation

The Company considers the U.S. dollar to be the functional currency of all of its operations. The Company's subsidiaries are integrated foreign subsidiaries and, accordingly, foreign currency amounts are translated into U.S. dollars using the temporal method. Monetary balances are translated at the rate of exchange at the balance sheet date, nonmonetary balances at historic exchange rates and other revenue and expense items at average exchange rates. Foreign currency gains and losses are included in earnings for the period.

Cash and Cash Equivalents

Cash and cash equivalents include cash in demand deposits and short-term money market investments that, on acquisition, have a term to maturity of three months or less.

Mineral Properties and Deferred Expenditures

The costs of acquiring mineral property interests, and related exploration and development costs incurred thereafter, are capitalized until commercial production is established, the property is disposed of through sale or otherwise, or the carrying value is impaired. Expenditures related to generative exploration are expensed as incurred. If a project is put into commercial production, capitalized costs would be depleted on the unit-of-production basis.

Proceeds received from the partial sale or sale of any interest in a property are credited against the carrying cost of such property until the payments are in excess of the costs incurred, at which time they are then credited to income.

The costs deferred at any point in time do not necessarily reflect present or future values. The ultimate recovery of such amounts depends on the discovery of economically recoverable reserves, successful commercial development of the related properties, availability of financing, future profitable production, or proceeds from the disposition of the properties.

Management regularly reviews the carrying value of each mineral property. Where information is available and conditions suggest impairment, estimated future net cash flows from each property are calculated using estimated future prices, proven and probable reserves and value beyond proven and probable reserves, and operating, capital and reclamation costs on an undiscounted basis. If it is determined that the future cash flows are less than the carrying value, a write-down to the estimated fair value is made with a charge to earnings. Where estimates of future net cash flows are not available and where other conditions suggest impairment, management assesses if the carrying value can be recovered.

Management's estimates of mineral prices, recoverable proven and probable reserves and value beyond proven and probable reserves, and operating, capital and reclamation costs are subject to certain risks and uncertainties that may affect the recoverability of mineral property costs. Although management has made its best estimate of these factors, it is possible that changes could occur in the near term that could adversely affect management's estimate of the net cash flow to be generated from its properties.

Although the Company has taken steps to verify title to mineral properties in which it has an interest, these procedures do not guarantee the Company's title. Such properties may be subject to prior undetected agreements or transfers and title may be affected by such defects.

Depreciation and Amortization

Property, plant and equipment assets are recorded at cost. Depreciation and amortization are provided on a straight-line basis over the estimated useful lives of the related assets. The following estimated useful lives are being used:

Equipment	3 to 17 years
Vehicles	4 years
Buildings and leasehold improvements	3 to 20 years
Furniture	3 to 10 years

Asset Retirement Obligations

On January 1, 2004, the Company adopted the new accounting standard for asset retirement obligations. The standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The adoption of this standard did not have any impact on the Company's financial position or results of operations in 2003 as the Company did not commence construction at its Cerro San Pedro project until February 2004.

Financial Instruments

At December 31, 2005, the carrying values of cash and cash equivalents, value-added tax and other current assets, and accounts payable and accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying value and tax basis of assets and liabilities. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of substantive enactment. Future tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is provided.

Stock-based Compensation

The Company's stock-based compensation plan is described in Note 6. Effective January 1, 2004, the Company retroactively adopted the revised Canadian Institute of Chartered Accountants ("CICA") Section 3870, "Stock-based Compensation and Other Stock-based Payments", which requires an expense to be recognized in the financial statements for all forms of employee stock-based compensation, including stock options. Any consideration paid upon the exercise of stock options, in addition to the fair value attributable to stock options granted after January 1, 2002, is credited to share capital. The fair value attributable to stock options that expire unexercised is credited to contributed surplus. The fair value attributable to stock options that are forfeited is credited to earnings.

The Company applied these provisions retroactively, without restatement of prior years, resulting in a cumulative increase to the deficit of \$400,615 and a corresponding increase to stock options on January 1, 2004, with respect to options granted in 2002 and 2003.

Per Share Amounts

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated based on the treasury-stock method, which assumes that any proceeds from the exercise of options and warrants would be used to purchase common shares at the average market price during the year. The weighted average number of common shares outstanding is adjusted for the net increase in the number of common shares issued upon exercise of the options and warrants. Stock options and warrants are included in the calculation of diluted per share amounts only to the extent that the average market price of the common shares during the year exceeds the exercise price of the options or warrants. During years when the Company has generated a loss, the potential shares to be issued from the assumed exercise of options and warrants are not included in the computation of diluted per share amounts since the result would be anti-dilutive.

Variable Interest Entities

Effective January 1, 2005, the Company adopted Accounting Guideline AcG-15, "Consolidation of Variable Interest Entities", which requires consolidation of entities in which the Company has a controlling financial interest. The Company has determined that it has no variable interest entities.

3. Mineral Properties and Deferred Expenditures

Mineral property costs and deferred expenditures are summarized as follows:

December 31, 2005	Mineral Property Costs	Deferred Expenditures	Total
Cerro San Pedro, Mexico (a):			
Balance at January 1, 2005	\$ 23,869,587	\$ 21,345,638	\$ 45,215,225
Additions	4,737	7,924,071	7,928,808
Balance at December 31, 2005	<u>23,874,324</u>	<u>29,269,709</u>	<u>53,144,033</u>
El Morro, Chile (b):			
Balance at January 1, 2005	690,000	949,589	1,639,589
Additions	--	31,522	31,522
Proceeds from property payment	(690,000)	(960,736)	(1,650,736)
Balance at December 31, 2005	<u>--</u>	<u>20,375</u>	<u>20,375</u>
Rio Figueroa, Chile (c):			
Balance at January 1, 2005	115,856	375,182	491,038
Additions	219,186	1,145,508	1,364,694
Balance at December 31, 2005	<u>335,042</u>	<u>1,520,690</u>	<u>1,855,732</u>
Other Projects, Chile (d):			
Balance at January 1, 2005	8,043	1,483	9,526
Additions	20,114	1,226	21,340
Write-offs	(2,518)	--	(2,518)
Balance at December 31, 2005	<u>25,639</u>	<u>2,709</u>	<u>28,348</u>
Southwest Alaska/Aleutian Islands, USA (e):			
Balance at January 1, 2005	--	--	--
Additions	310,208	171,555	481,763
Balance at December 31, 2005	<u>310,208</u>	<u>171,555</u>	<u>481,763</u>
	<u>\$ 24,545,213</u>	<u>\$ 30,985,038</u>	<u>\$ 55,530,251</u>
December 31, 2004			
Cerro San Pedro, Mexico (a):			
Balance at January 1, 2004	\$ 16,115,223	\$ 9,353,297	\$ 25,468,520
Acquisition of subsidiary	5,000,000	--	5,000,000
Additions	2,754,364	11,992,341	14,746,705
Balance at December 31, 2004	<u>23,869,587</u>	<u>21,345,638</u>	<u>45,215,225</u>
El Morro, Chile (b):			
Balance at January 1, 2004	90,000	949,589	1,039,589
Acquisition of royalty	600,000	--	600,000
Balance at December 31, 2004	<u>690,000</u>	<u>949,589</u>	<u>1,639,589</u>
Rio Figueroa, Chile (c):			
Balance at January 1, 2004	--	--	--

Additions	115,856	375,182	491,038
Balance at December 31, 2004	<u>115,856</u>	<u>375,182</u>	<u>491,038</u>
Other Projects, Chile (d):			
Balance at January 1, 2004	15,570	50,711	66,281
Additions	8,971	15,743	24,714
Write-offs	<u>(16,498)</u>	<u>(64,971)</u>	<u>(81,469)</u>
Balance at December 31, 2004	<u>8,043</u>	<u>1,483</u>	<u>9,526</u>
	<u>\$ 24,683,486</u>	<u>\$ 22,671,892</u>	<u>\$ 47,355,378</u>

a) Mexico – Cerro San Pedro Project

The Cerro San Pedro gold and silver project (the "Project") is located in the State of San Luis Potosi, Mexico and is 100%-owned by the Company's wholly owned subsidiary, Minera San Xavier, S.A. de C.V. ("MSX"). The feasibility study for the Project is based on an open-pit mining operation with heap-leach processing of ores.

On February 12, 2003, the Company acquired Glamis Gold Ltd.'s ("Glamis") 50% equity interest in MSX for \$18 million, less 50% of MSX's working capital deficit at closing of \$58,328. The purchase price was paid as follows:

- i) \$2 million paid at closing.
- ii) 50% of MSX's working capital deficit at closing of \$58,328, paid to the Company subsequent to closing.
- iii) \$5 million paid on August 12, 2003.
- iv) \$6 million paid on February 10, 2004.
- v) \$5 million paid on March 24, 2004.

The \$5 million payment that was made on March 24, 2004 was initially due and payable upon commencement of commercial production (\$2.5 million) and one year from commencement of commercial production (\$2.5 million). These amounts initially represented contingent consideration and were not recognized as acquisition costs until March 2004.

The acquisition of Glamis' 50% equity interest in MSX was a business combination accounted for as a purchase transaction. As of December 31, 2003, the fair value of the consideration of \$13 million (\$18 million less \$5 million of contingent payments) less 50% of MSX's working capital deficit of \$58,328, was allocated to the fair value of the net assets acquired as follows:

Cash	\$	19,739
Other current assets		72,376
Property, plant and equipment		75,708
Mineral properties		<u>12,461,971</u>
		12,629,794
Current liabilities and other		(71,265)
Note payable		<u>(100,050)</u>
Fair value of net assets acquired	\$	<u>12,458,479</u>
Consideration:		
Cash at closing, less working capital deficit	\$	1,941,672
Present value of future cash payments, discounted at 6%		<u>10,516,807</u>
	\$	<u>12,458,479</u>

Initial acquisition debt of \$10.5 million represented the estimated present value of future cash payments of \$11.0 million, discounted at 6%. Interest accretion for the years ended December 31, 2004 and 2003 was \$40,260 and \$442,933, respectively. The acquisition debt was paid off in February 2004.

On March 24, 2004, the Company acquired a sliding scale net returns royalty that Glamis had retained as part of the sale of its 50% equity interest in MSX to the Company in February 2003, and prepaid the remaining \$5 million of contingent consideration owed to Glamis, for \$7.25 million. The \$7.25 million payment was allocated to mineral properties.

In December 2003, the Company awarded a contract to Washington Group International ("WGI") to provide the Company with contract mining and related construction services over the pre-production period and estimated mine life totaling approximately ten years. The contract has a remaining estimated gross value, exclusive of fuel costs, of approximately \$112 million. The contract also provides that the Company, and in certain circumstances WGI, may terminate the contract at any time prior to the end of the ten-year term, but the Company would be required to pay early termination fees and equipment demobilization costs to WGI as follows:

Termination Period	Demobilization and Termination Fees
Pre-production	\$11,560,000
Year 1	\$10,160,000
Year 2	\$7,460,000
Year 3	\$4,760,000
Year 4	\$2,960,000
Year 5	\$2,360,000
Year 6	\$2,060,000
Year 7	\$1,660,000
Year 8	\$1,360,000
Year 9	--

In the event that the contract is terminated as a result of force majeure, the Company is only obligated to pay WGI equipment demobilization and termination fees totaling approximately \$2.0 million.

Project construction commenced in February 2004, but was suspended in June 2004 pending resolution of various permitting and other issues (Notes 1 and 9). In May 2004, the Company entered into a standby agreement, and subsequent extensions, with WGI in order to retain the construction equipment at the Project site. In November 2005, the Company executed a limited notice to proceed with WGI to allow for certain construction activities at hourly rates during the standby period. Through December 31, 2005, the Company has deferred costs totaling \$2.7 million under the standby agreement and \$0.3 million under the limited notice to proceed.

The Project is subject to a 1.95% royalty on the gross value of metals and minerals contained in production in all mineral concessions presently owned or optioned by the Company. In addition, the Company has entered into an agreement with a former owner of certain mining concessions that provides for a 2.5% net smelter returns ("NSR") royalty on any production that occurs on the those properties or \$50,000 per year beginning April 2003, whichever is greater, subject to a maximum of \$1.0 million. The Company has made minimum royalty payments totaling \$150,000 under the agreement.

b) Chile – El Morro Project

The Company's activities in Chile are concentrated on precious metal rich exploration targets. The El Morro copper-gold project consists of the La Fortuna and El Morro areas. The Company's interest in the El Morro area, which is approximately five kilometers from the La Fortuna area, was acquired by staking in 1998.

In September 1999, the Company entered into an exploration agreement with Falconbridge that provided for Falconbridge to earn a 70% interest in the El Morro copper-gold project by making, among other requirements, minimum exploration and property acquisition expenditures on the project of \$10.0 million and by making a \$10.0 million payment to the Company by September 14, 2005. On August 31, 2005, the Company received a \$10.0 million payment from Falconbridge which resulted in Falconbridge earning a 70% interest in the El Morro project and the Company recording \$8.35 million of income from property payments:

Falconbridge El Morro earn-in payment	\$	10,000,000
Carrying value at August 31, 2005		1,650,736
Income from property payment	\$	<u>8,349,264</u>

It is anticipated that the taxable gain attributable to the \$10.0 million payment will be offset by tax loss carryforwards not previously recognized.

In December 2004, the Company and Falconbridge acquired a 2% NSR royalty on certain mining concessions at the La Fortuna area, that were formerly owned by BHP Minerals Ltd., for \$2.0 million. The Company acquired a 30% interest in the royalty for \$0.6 million and Falconbridge acquired the remaining 70% interest for \$1.4 million.

The Company and Falconbridge are required to make payments to the former owners of certain mining concessions totaling \$400,000, in accordance with their respective ownership interests, within two years of commencement of mining on these concessions.

Certain mining concessions at the La Fortuna area, that were formerly owned by S.L.M. Cantarito and S.L.M. Tronquito, are subject to a 2% NSR royalty.

c) Chile – Rio Figueroa Project

In September 2004, the Company entered into an option agreement with Sociedad Contractual Minera Los Potrillos ("Potrillos") to acquire a 100% interest in a copper-gold exploration project referred to as the Rio Figueroa project. In order to exercise the option, the Company must make annual option payments over a five-year period beginning September 2004 totaling \$3.5 million, of which \$0.3 million has been paid to date. The Company must also incur qualifying aggregate exploration expenditures over a three-year period beginning September 2004 of \$1.5 million, of which approximately \$1.3 million has been incurred to date.

d) Chile – Other Projects

Other projects consist of copper-gold exploration concessions that the Company acquired by staking and are contiguous to the El Morro project. The Company has incurred property acquisition costs and deferred expenditures on these concessions totaling \$28,348 at December 31, 2005.

e) USA - Southwest Alaska/Aleutian Islands

In September 2005, the Company entered into an option agreement that allows the Company to earn a 65% interest in precious metal rich exploration properties located in southwest Alaska and the Aleutian Islands by making qualifying aggregate expenditures totaling \$4.75 million over a five-year period beginning September 2005. The Company may increase its interest in individual properties to 70% by completing a pre-feasibility study, and it may further increase its interest in individual properties to 80% by completing a feasibility study. The Company has incurred qualifying expenditures as of December 31, 2005 totaling approximately \$0.48 million.

f) Brazil – Mara Rosa Project

At December 31, 2001, the Company elected not to proceed with further exploration on its Mara Rosa gold project and wrote off the project carrying value. In November 2003, the Company entered into an option agreement to sell its 100% interest in the Mara Rosa gold project for \$0.45 million. The Company received \$0.15 million pursuant to the agreement in 2003, and the remaining \$0.3 million in 2004. These amounts were recognized as income from option payments in the year in which the payments were received.

4. Property, Plant and Equipment

Property, plant and equipment consist of the following at December 31, 2005 and 2004:

December 31,	Cost	Accumulated Depreciation and Amortization	Net Book Value
	2005	2005	2005
Equipment	\$ 339,736	\$ 172,279	\$ 167,457
Vehicles	183,076	90,789	92,287
Building and leasehold improvements	269,021	40,877	228,144
Furniture	44,757	29,060	15,697
	<u>\$ 836,590</u>	<u>\$ 333,005</u>	<u>\$ 503,585</u>

December 31,	Cost	Accumulated Depreciation and Amortization	Net Book Value
	2004	2004	2004
Equipment	\$ 310,579	\$ 126,821	\$ 183,758
Vehicles	119,996	73,087	46,909
Building and leasehold improvements	196,057	27,850	168,207
Furniture	43,690	26,100	17,590
	<u>\$ 670,322</u>	<u>\$ 253,858</u>	<u>\$ 416,464</u>

5. Asset Retirement Obligation

The Company's environmental permit for its Cerro San Pedro project requires that it reclaim any land that it disturbs during mine construction and mine operations. The Company has estimated the present value of its future reclamation obligation to be \$343,164 at December 31, 2005, of which \$30,583 represents capitalized interest accretion. The present value of the future reclamation obligation assumes a credit-adjusted risk-free rate of 9% and commencement of reclamation activities in 2016. The total reclamation obligation for the Cerro San Pedro project per the Company's September 2003 feasibility study is estimated to be \$4.3 million. The Company has agreed to fund this obligation during mining operations; however, negotiations with the relevant Mexican governmental agency to determine the interim funding requirements have not yet been finalized.

6. Share Capital

a) Authorized

Unlimited number of common and preferred shares without par value.

b) Common Shares Issued and Outstanding

Year Ended December 31,	2005		2004		2003	
	Shares	Amount	Shares	Amount	Shares	Amount
Outstanding, beginning of year	82,687,043	\$ 107,661,917	81,763,885	\$106,786,049	32,449,167	\$ 43,068,285
Shares issued in public offering (Note 6(d))	--	--	--	--	38,700,000	55,416,199
Shares issued in private placement (Note 6(d))	--	--	--	--	10,100,000	7,847,925
Exercise of warrants (Note 6(d))	--	--	354,500	400,229	151,500	168,454
Fair value of warrants exercised (Note 6(d))	--	--	--	95,739	--	40,905
Exercise of stock options (Note 6(c))	598,833	429,737	555,000	362,619	344,333	222,546
Fair value of stock options						

exercised (Note 6c)	--	46,051	--	--	--
Shares issued for retirement plan (Note 8)	15,800	20,372	13,658	17,281	18,885
Outstanding, end of year	<u>83,301,676</u>	<u>\$ 108,158,077</u>	82,687,043	\$ 107,661,917	81,763,885
					<u>\$ 106,786,049</u>

c) Options

The Company's stock-based compensation plan provides that the exercise price per share is equal to the five-day weighted average market price as quoted on the Toronto Stock Exchange for the five days preceding the date of grant. Each option allows for the purchase of one share and expires not later than five years from the date it was granted. Options generally vest over a period of up to two years from the date of grant. The stock option plan was amended to provide for a maximum of 5.0 million common shares that may be issued after April 29, 2003. As of December 31, 2005, 1,498,166 common shares had been issued pursuant to the plan subsequent to April 29, 2003.

Effective January 1, 2004, the Company adopted revised CICA Section 3870, "Stock-based Compensation and Other Stock-based Payments", which requires an expense to be recognized in the financial statements for all forms of employee stock-based compensation, including stock options. Previously, the Company did not record any compensation expense on the granting of stock options to employees and directors as the exercise price was equal to or greater than the market price on the date of grants. Under the new requirement, stock-based compensation expense would have been increased by \$339,367 and \$61,248 for the years ended December 31, 2003 and 2002, respectively. The Company elected to adopt this new requirement retroactively without restatement of prior years. This has resulted in a cumulative increase of \$400,615 to the deficit and to stock options at January 1, 2004. The pro forma effect on loss for the year, and basic and diluted loss per share, for the year ended December 31, 2003, had the Company followed the fair value method of accounting for stock-based compensation for options granted after January 1, 2002, is as follows:

Year Ended December 31,		2003
Loss for the year		\$ 1,715,547
Compensation expense		<u>339,367</u>
Pro forma loss for the year		<u>\$ 2,054,914</u>
Basic and diluted loss per share:		
As reported		\$ <u>(0.04)</u>
Pro forma		\$ <u>(0.05)</u>

The fair value of stock options used to calculate compensation expense has been estimated using the Black-Scholes Option Pricing Model with the following assumptions:

	2005	2004	2003
Risk free interest rate (Canada)	3.2 to 3.7%	3.3 to 3.5%	3.6 to 4.4%
Expected dividend yield	0.0%	0.0%	0.0%
Expected price volatility of the Company's common shares	65 to 66%	70 to 71%	75 to 87%
Expected life of option	5 years	5 years	5 years

Option pricing models require the input of highly subjective assumptions including the expected price volatility of the Company's common shares. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

The following is a summary of options granted under the Company's stock-based compensation plan:

Year Ended December 31,	Stock Options			Weighted Average Exercise Price (Canadian Dollars)		
	2005	2004	2003	2005	2004	2003
Outstanding, beginning of year	2,535,500	2,800,250	2,107,083	\$ 1.36	\$ 1.12	\$ 0.99
Granted	880,000	400,000	1,112,500	1.62	2.39	1.35
Exercised	(598,833)	(555,000)	(344,333)	0.86	0.86	0.88
Forfeited	(186,667)	(109,750)	--	1.79	1.48	--
Expired	(75,000)	--	(75,000)	2.87	--	2.24
Outstanding, end of year	<u>2,555,000</u>	<u>2,535,500</u>	<u>2,800,250</u>	<u>\$ 1.49</u>	<u>\$ 1.36</u>	<u>\$ 1.12</u>
Exercisable, end of year	<u>1,858,333</u>	<u>1,914,666</u>	<u>1,957,750</u>	<u>\$ 1.39</u>	<u>\$ 1.22</u>	<u>\$ 1.02</u>

The aggregate fair value of options granted in 2005, 2004 and 2003 was \$625,881, \$435,624 and \$714,447, respectively. The weighted average fair value per option granted in 2005, 2004 and 2003 was \$0.71, \$1.09 and \$0.64, respectively. The fair value attributable to stock options granted after January 1, 2002 and exercised during 2005 of \$46,051 has been allocated to share capital.

The following table summarizes selected information relating to stock options outstanding at December 31, 2005:

Range of Exercise Prices (Canadian Dollars)	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price (Canadian Dollars)
\$0.83	360,000	0.4 years	\$0.83
\$1.20 to \$1.64	1,815,000	3.0 years	\$1.44
\$2.07 to \$2.44	380,000	3.0 years	\$2.35
\$0.83 to \$2.44	<u>2,555,000</u>	<u>2.6 years</u>	<u>\$1.49</u>

d) Warrants

Year Ended December 31,	2005		2004		2003	
	Warrants	Amount	Warrants	Amount	Warrants	Amount
Outstanding, beginning of year	24,399,000	\$ 7,373,839	24,753,500	\$ 7,469,578	1,950,000	\$ --
Warrants issued in public offering	--	--	--	--	19,350,000	5,889,285
Warrants issued in private placement	--	--	--	--	5,555,000	1,621,198
Exercise of warrants	--	--	(354,500)	(95,739)	(151,500)	(40,905)
Expiration of warrants	(5,049,000)	(1,484,554)	--	--	(1,950,000)	--
Outstanding, end of year	<u>19,350,000</u>	<u>\$ 5,889,285</u>	<u>24,399,000</u>	<u>\$ 7,373,839</u>	<u>24,753,500</u>	<u>\$ 7,469,578</u>

On December 11, 2003, the Company issued 38.7 million units in a public offering at a price of Cdn\$2.20 per unit for gross proceeds of Cdn\$85.1 million (US\$61.3 million, net of issue costs). Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole common share purchase warrant entitles the holder to purchase one common share at an exercise price of Cdn\$3.10 for a period of five years to December 11, 2008. As of December 31, 2005, 19,350,000 warrants were outstanding.

On March 11, 2003, the Company closed a private placement for 10.1 million units at a price of Cdn\$1.50 per unit for gross proceeds of Cdn\$15.2 million (US\$9.5 million, net of issue costs). Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole common share purchase warrant entitles the holder to purchase one common share at an exercise price of Cdn\$2.00 for a period of two years to March 11, 2005. Warrants to purchase 1,000 shares were exercised in 2004. The remaining 5,049,000 warrants expired unexercised on March 11, 2005. The value attributable to the expired warrants of \$1,484,554 was

charged to contributed surplus. The Company also granted the underwriters 505,000 compensation warrants. Each compensation warrant was exercisable at a price of Cdn\$1.50 per share for a period of one year to March 11, 2004. Compensation warrants totaling 151,500 were exercised in 2003, and the remaining 353,500 compensation warrants were exercised in 2004.

e) Restricted Stock Units

In November 2005, the directors adopted a restricted stock unit ("RSU") plan with an effective date of March 1, 2005. The plan provides for the Compensation Committee of the Board of Directors to grant, at its sole discretion, RSU's to employees pursuant to vesting and other conditions as determined by the Compensation Committee; however, the vesting period may not exceed three years from the award date and may be accelerated at the sole discretion of the Compensation Committee. The settlement value of RSU's will be made in cash and is calculated as the average closing price of the Company's common shares on the Toronto Stock Exchange for the five trading days preceding the date of settlement. As of December 31, 2005, the Company had awarded 120,000 RSU's with a vesting date of March 1, 2008. The fair value of outstanding RSU's at December 31, 2005 was \$59,144.

7. Income Taxes

The difference between the amount of reported consolidated income tax provision and the amount computed by multiplying income (loss) before income taxes by the Company's combined applicable Canadian federal and provincial tax rate of 36.12% (36.12% in 2004 and 36.62% in 2003) is reconciled as follows:

Year Ended December 31,	2005	2004	2003
Income tax provision (benefit) computed using the applicable tax rate	\$ 2,928,277	\$ 543,606	\$ (630,337)
Expenses not deductible for tax purposes	1,153,729	96,542	419,837
Tax deductions not expensed	(542,516)	(600,387)	--
Net foreign earnings taxed at more (less) than applicable rate	(138,711)	14,229	58,210
Unrealized foreign exchange gain	(377,632)	(783,536)	(223,130)
Foreign withholding tax on interest income	--	85,585	--
Benefit of tax loss carryforwards recognized	(3,066,783)	--	--
Benefit of current tax losses not recognized	191,917	780,500	369,675
	<u>\$ 148,281</u>	<u>\$ 136,539</u>	<u>\$ (5,745)</u>
Income tax provision (benefit)	<u>\$ 148,281</u>	<u>\$ 136,539</u>	<u>\$ (5,745)</u>

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and liabilities at December 31, 2005 and 2004 are as follows:

	2005	2004
Future income tax assets:		
Canada:		
Net operating loss carryforwards	\$ 352,000	\$ 3,651,000
Deferred financing costs	829,000	1,169,000
Other	--	200,000
Mexico:		
Net operating loss carryforwards	12,459,000	10,789,000
Other	100,000	126,000
Other countries:		
Net operating loss carryforwards	352,000	220,000
Other	9,000	10,000
Total future income tax assets	<u>14,101,000</u>	<u>16,165,000</u>
Less valuation allowance	<u>(4,189,000)</u>	<u>(9,212,000)</u>
Future income tax assets, net of valuation allowance	<u>9,912,000</u>	<u>6,953,000</u>

Future income tax liabilities:

Mexico:		
Mineral properties and deferred exploration expenditures	9,900,000	6,948,000
Other	12,000	5,000
Total future income tax liabilities	<u>9,912,000</u>	<u>6,953,000</u>
Net future income tax assets	<u>\$ --</u>	<u>\$ --</u>

At December 31, 2005, the Company and its subsidiaries have available tax loss carryforwards in various tax jurisdictions as follows:

Tax Jurisdiction	Expiry Dates	Tax Loss Carryforward
Mexico	2006	\$7.3 million
	2007	4.0 million
	2008	8.8 million
	2009	6.8 million
	2010	2.7 million
	2011	1.2 million
	2012	0.6 million
	2013	2.1 million
	2014	6.2 million
	2015	4.8 million
Total		<u>\$44.5 million</u>
Chile	None	\$3.3 million
Canada	2007 through 2012	\$1.0 million
United States	2018 through 2020	\$0.9 million
Barbados	2006 through 2012	\$0.7 million

8. Pension Plan

The Company has a qualified defined contribution savings plan that covers all U.S. employees. Subject to certain employee eligibility requirements and statutory limitations on employee elective deferrals, the Company matches 50% of the employee's elective deferral up to a maximum matching contribution of 5% of the employee's compensation, as defined under the plan. The employee has the option of receiving the matching contribution in common shares of the Company or in cash. Employees vest 100% in the employer matching contribution after three years of service. The Company's matching contributions were \$22,053, \$25,627, and \$26,773 for the years ended December 31, 2005, 2004 and 2003, respectively.

9. Contingencies

- a) The Company's activities are subject to various governmental laws and regulations relating to the protection of the environment. Although the Company believes that it is currently in full compliance with its permits, and although its permits have been renewed by governmental and regulatory authorities in the past, there are no assurances that the applicable governmental and regulatory authorities will renew the permits as they expire, or that pending or future permit applications will be granted.
- b) In August 2004, the Company received notification that a Federal Court nullified the Company's Manifestacion de Impacto Ambiental ("MIA") for its Cerro San Pedro project. The MIA is the Mexican equivalent of an Environmental Impact Statement or mining permit in the United States. The Federal Court concluded that the MIA had violated various environmental and other laws. In August 2005, an Appeals Court revoked the August 2004 MIA nullification ruling and sent the case to an Administrative and Fiscal Court for further review. In December 2005, the Administrative and Fiscal Court ruled that the government agency that issued the MIA must issue the Company an amended MIA within four months that conforms to current environmental and other laws.

10. Commitments

a) The Company leases certain surface rights, facilities and equipment under long-term operating lease agreements. As of December 31, 2005, lease commitments for the next five years and thereafter are as follows:

2006	\$	86,263
2007	\$	60,409
2008	\$	52,846
2009	\$	51,650
2010	\$	51,650
Thereafter	\$	51,650

b) In September 2003, the Company entered into an agreement with a Mexican governmental agency to provide approximately \$360,000 for reforestation of land in the area surrounding the proposed Cerro San Pedro mine that is not owned or leased by the Company. Although the timing of funding of this commitment has not been finalized, it is anticipated that the \$360,000 will be funded by the Company over a period of approximately twelve years.

c) The Company's Land Use License with the State of San Luis Potosí requires that it structurally stabilize a church in the village of Cerro de San Pedro prior to commencing mine operations. The Company has deposited \$237,000 in a bank trust account to cover the estimated cost of stabilizing the church. The \$237,000 deposit is included with other assets on the balance sheet.

11. Supplementary Cash Flow Information

Cash and cash equivalents included in the cash flow statement comprise the following balance sheet amounts at December 31, as follows:

	2005	2004	2003
Cash on hand and balances with bank	\$ 489,913	\$ 639,841	\$ 642,637
Short-term investments	42,179,917	40,977,203	65,467,419
	<u>\$ 42,669,830</u>	<u>\$ 41,617,044</u>	<u>\$ 66,110,056</u>

The Company paid interest and income taxes for the three years ended December 31, as follows:

	2005	2004	2003
Income taxes	\$ 139,970	\$ 171,591	\$ --
Interest	\$ --	\$ --	\$ 25,929

In addition to the Company's acquisition of 50% of MSX as described in Note 3(a), the Company incurred non-cash investing and financing activities for the three years ended December 31, as follows:

	2005	2004	2003
Non-cash investing activities:			
Stock-based compensation allocated to deferred expenditures	\$ 92,800	\$ 552,400	\$ --

12. Segment Information

The Company's operations are limited to a single industry segment being the exploration and development of precious metal rich mineral properties for economically recoverable reserves. Segment assets by geographic location are as follows:

December 31, 2005	Mexico		Chile		United States		Total
Mineral properties and deferred expenditures	\$	53,144,033	\$	1,904,455	\$	481,763	\$ 55,530,251
Property, plant and equipment, net		488,960		--		14,625	503,585
	\$	53,632,993	\$	1,904,455	\$	496,388	\$ 56,033,836

December 31, 2004	Mexico		Chile		United States		Total
Mineral properties and deferred expenditures	\$	45,215,225	\$	2,140,153	\$	--	\$ 47,355,378
Property, plant and equipment, net		398,473		--		17,991	416,464
	\$	45,613,698	\$	2,140,153	\$	17,991	\$ 47,771,842

13. Reconciliation to United States Generally Accepted Accounting Principles

The consolidated financial statements have been prepared in accordance with Canadian GAAP which differs in certain respects from those principles that the Company would have followed had its consolidated financial statements been prepared in accordance with United States GAAP. Significant measurement differences that materially affect these consolidated financial statements are as follows:

- As described in Note 2, Canadian GAAP allows for the deferral of exploration expenditures. Under United States GAAP, the Company expenses, as incurred, costs relating to unproven mineral properties. When proven and probable reserves are determined for a property and a feasibility study has been prepared, then subsequent development costs of the property would be capitalized. The capitalized cost is then assessed periodically for recoverability of carrying values under Statement of Financial Accounting Standard ("SFAS") 144.
- For United States GAAP purposes, the Company will adopt SFAS 123R, "Accounting for Stock-based Compensation" effective January 1, 2006. SFAS 123R requires the use of the fair value method of accounting for stock-based compensation. This standard is consistent with the revised provisions of CICA Section 3870, which was adopted by the Company for Canadian GAAP effective January 1, 2004 (Note 6(c)). For United States GAAP, the Company has not yet determined which acceptable method of adoption it will apply.

Had the Company followed United States GAAP, certain items in the statements of operations and deficit and balance sheets would have been reported as follows:

Statements of Operations and Deficit

Year Ended December 31,	2005		2004		2003	
Net income (loss) under Canadian GAAP	\$	7,958,798	\$	1,368,462	\$	(1,715,547)
Exploration expenditures expensed		(1,899,978)		(570,327)		(206,855)
Net effect of write-down of mineral properties and deferred expenditures		2,518		81,469		703,536
Income from property payments		1,050,736		--		--
Stock based compensation expense		341,110		74,834		--
Net income (loss) under U.S. GAAP	\$	7,453,184	\$	954,438	\$	(1,218,866)
Basic net income (loss) per share under U.S. GAAP	\$	0.09	\$	0.01	\$	(0.03)
Diluted net income (loss) per share under U.S. GAAP	\$	0.09	\$	0.01	\$	(0.03)

Balance Sheets

December 31,	2005		2004	
	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
Mineral properties and deferred expenditures	\$ <u>55,530,251</u>	\$ <u>45,003,387</u>	\$ <u>47,355,378</u>	\$ <u>37,768,037</u>
Shareholders' equity	\$ <u>98,193,714</u>	\$ <u>87,666,850</u>	\$ <u>89,350,898</u>	\$ <u>79,763,557</u>

Statements of Cash Flows

Year Ended December 31,	2005	2004	2003
Cash flows provided from (used for) operating activities, Canadian GAAP	\$ 7,120,459	\$ (849,271)	\$ (1,213,601)
Mineral properties and deferred expenditures	<u>(849,242)</u>	<u>(570,327)</u>	<u>(206,855)</u>
Cash flows provided from (used for) operating activities, U.S. GAAP	\$ <u>6,271,217</u>	\$ <u>(1,419,598)</u>	\$ <u>(1,420,456)</u>
Cash flows used for investing activities, Canadian GAAP	\$ (7,542,769)	\$ (20,143,804)	\$ (4,072,383)
Mineral properties and deferred expenditures	<u>849,242</u>	<u>570,327</u>	<u>206,855</u>
Cash flows used for investing activities, U.S. GAAP	\$ <u>(6,693,527)</u>	\$ <u>(19,573,477)</u>	\$ <u>(3,865,528)</u>

Recent Canadian Accounting Pronouncements a) Non-monetary Transactions

CICA Handbook Section 3831, "Non-Monetary Transactions" will be applicable to the Company commencing with the 2006 financial year.

b) Derivative Instruments

In January 2005, CICA issued three new standards relating to financial instruments. These standards are applicable for fiscal years beginning on or after October 1, 2006. The Company is currently reviewing the impact of these new standards. These standards are as follows:

Financial Instruments – Recognition and Measurement, Section 3855

This standard prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and whether fair value or cost-based measures are used. It also specifies how financial instrument gains and losses are to be presented.

Hedges, Section 6865

This standard is applicable when a company chooses to designate a hedging relationship for accounting purposes. It builds on the existing Accounting Guideline AcG-13, "Hedging Relationships", and Section 1650, "Foreign Currency Translation", by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

Comprehensive Income, Section 1530

This standard introduces new rules for the reporting and display of comprehensive income. Comprehensive income, which is currently reported under United States GAAP, is the change in shareholders' equity (net assets) of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. These items include holding gains and losses on certain investments, gains and losses on certain derivative instruments and foreign currency gains and losses related to self-sustaining foreign operations (cumulative translation adjustment).

Recent U.S. Accounting Pronouncement

During June 2005, the FASB issued SFAS No. 154, "Accounting for Changes in Accounting Principles and Error Corrections". The new standard requires that entities which make a voluntary change in accounting principle apply that change retroactively to prior period financial statements, unless this would be impracticable. For changes in methods of depreciation, amortization or depletion for long-lived assets, the change must be accounted for prospectively, as a change in estimate. SFAS No. 154 is effective for the Company's 2006 financial statements and is not expected to impact earnings.