# JAMES BAY RESOURCES LIMITED

# CONSOLIDATED FINANCIAL STATEMENTS

# FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

**JAMES BAY RESOURCES LIMITED**

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2011 AND 2010**

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# INDEPENDENT AUDITOR'S REPORT

To the Shareholders of James Bay Resources Limited

We have audited the accompanying consolidated financial statements of James Bay Resources Limited and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011, and December 31, 2010 and January 1, 2010, and the consolidated statements of comprehensive loss, the consolidated statements of cash flows and the consolidated statements of changes in equity for the years ended December 31, 2011 and 2010 and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of James Bay Resources Limited and its subsidiaries as at December 31, 2011, December 31, 2010 and January 1, 2010, and their financial performance and cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.

McGOVERN, HURLEY, CUNNINGHAM, LLP

McGovern, Hurley, Cunningham, LLP

Chartered Accountants
Licensed Public Accountants

TORONTO, Canada
April 24, 2012

# JAMES BAY RESOURCES LIMITED
## Consolidated Statements of Financial Position
Expressed in Canadian dollars

As at

| | December 31, 2011 $ | December 31, 2010 $ | January 1, 2010 $ |
|---|---|---|---|
| | | (Note 18) | (Note 18) |
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents (Note 7) | 4,791,243 | 6,310,432 | 7,847,068 |
| Restricted cash (Note 7) | 834,047 | - | - |
| Prepaid expenses (Note 7) | 74,248 | 12,202 | 12,431 |
| Amounts receivable (Note 7) | 25,156 | 747,244 | 1,972 |
| | 5,724,694 | 7,069,878 | 7,861,471 |
| Exploration and evaluation assets (Note 7) | 2,433,662 | 2,438,662 | 2,431,529 |
| Equipment | 339 | 521 | 702 |
| Investments (Note 8) | - | 407,500 | 190,000 |
| Loan receivable (Note 9) | - | 138,704 | - |
| | 8,158,695 | 10,055,265 | 10,483,702 |
| **LIABILITIES** | | | |
| **Current** | | | |
| Accounts payable and accrued liabilities | 104,765 | 144,029 | 41,386 |
| **EQUITY** | | | |
| Common shares (Note 10) | 9,261,904 | 9,261,904 | 9,261,904 |
| Share-based payments reserve (Note 11) | 1,294,394 | 1,294,394 | 1,538,626 |
| Warrant reserve (Note 12) | 1,403,372 | 1,329,372 | 1,217,372 |
| Deficit | (3,905,740) | (1,974,434) | (1,575,586) |
| | 8,053,930 | 9,911,236 | 10,442,316 |
| | 8,158,695 | 10,055,265 | 10,483,702 |

**COMMITMENTS AND CONTINGENCIES** (Note 17)

**APPROVED ON BEHALF OF THE BOARD:**

Signed "STEPHEN SHEFSKY", Director

Signed "MARK BRENNAN", Director

See accompanying notes to the consolidated financial statements

# JAMES BAY RESOURCES LIMITED
## Consolidated Statements of Comprehensive Loss
Expressed in Canadian dollars
For the years ended December 31,

| | 2011 | 2010 |
|---|---|---|
| **Expenses** | | |
| Share-based compensation | $ - | $ 182,447 |
| Management salaries and benefits | 300,238 | 286,819 |
| Professional fees (Note 15) | 116,742 | 89,505 |
| Office and general (Note 15) | 133,791 | 98,357 |
| Consulting fees | 42,993 | 23,417 |
| Due diligence on oil & gas property (Note 7) | 1,233,304 | - |
| Shareholder relations | 25,384 | 66,899 |
| Warrant extension valuation (Note 12) | 74,000 | 112,000 |
| Transfer agent and listing fees | 19,684 | 26,482 |
| Amortization | 182 | 181 |
| **Loss before the undernoted** | (1,946,318) | (886,107) |
| Foreign exchange gain (loss) | 18,735 | (51,422) |
| Loss on held-for-trading investments (Note 8) | (201,120) | (22,500) |
| Gain on loan | 132,871 | 37,764 |
| Interest income | 64,526 | 96,738 |
| **Net loss and comprehensive loss for the year** | $ (1,931,306) | $ (825,527) |
| **Loss per share** | | |
| Basic and diluted | $ (0.07) | $ (0.03) |
| Weighted average number of shares outstanding – basic and diluted | 28,040,350 | 28,040,350 |

See accompanying notes to the consolidated financial statements

## JAMES BAY RESOURCES LIMITED
**Consolidated Statements of Cash Flows**
Expressed in Canadian dollars
For the years ended December 31,

| | 2011 | 2010 |
|---|---|---|
| **Cash used in operating activities**: | | |
| Net loss for the year | $ (1,931,306) | $ (825,527) |
| Add (deduct) items not affecting cash: | | |
| Amortization | 182 | 181 |
| Share–based compensation | - | 182,447 |
| Foreign exchange (gain) loss | (24,742) | 47,000 |
| Warrant extension valuation | 74,000 | 112,000 |
| Gain on loan | (132,871) | (37,764) |
| Loss on held-for-trading investment | 230,000 | 22,500 |
| Gain on held-for-trading investment | (28,880) | - |
| Interest income | (13,898) | (28,440) |
| Net change in non-cash working capital | (213,269) | (637,400) |
| Net cash used in operating activities | (2,040,784) | (1,165,003) |
| **Cash used in investing activities:** | | |
| Sale of marketable securities | 206,380 | - |
| Exercise of investment in warrants | - | (85,000) |
| Due diligence fee received | - | 22,500 |
| Repayment (issuance) of loan | 285,473 | (250,000) |
| Interest in mineral properties | 5,000 | (12,133) |
| Net cash provided by (used in) investing activities | 496,853 | (324,633) |
| **Change in cash and cash equivalents during the year** | (1,543,931) | (1,489,636) |
| Effect of change in foreign exchange | 24,742 | (47,000) |
| Cash and cash equivalents at beginning of year | 6,310,432 | 7,847,068 |
| Cash and cash equivalents at end of year | $ 4,791,243 | $ 6,310,432 |
| **Cash and cash equivalents are as follows:** | | |
| Cash | $ 113,970 | $ 2,182,814 |
| Cash equivalents | 4,677,273 | 4,127,618 |
| Cash and cash equivalents | $ 4,791,243 | $ 6,310,432 |

See accompanying notes to the consolidated financial statements

# JAMES BAY RESOURCES LIMITED
## Consolidated Statements of Changes in Equity
Expressed in Canadian dollars

| | Common shares $ | Share-based Payments Reserve $ | Warrant Reserve $ | Accumulated Deficit $ | Total Equity $ |
|---|---|---|---|---|---|
| Balance, December 31, 2010 | 9,261,904 | 1,294,394 | 1,329,372 | (1,974,434) | 9,911,236 |
| Share-based compensation | - | - | 74,000 | - | 74,000 |
| Loss for the year | - | - | - | (1,931,306) | (1,931,306) |
| Balance, December 31, 2011 | 9,261,904 | 1,294,394 | 1,403,372 | (3,905,740) | 8,053,930 |

| | Common shares $ | Share-based Payments Reserve $ | Warrant Reserve $ | Accumulated Deficit $ | Total Equity $ |
|---|---|---|---|---|---|
| Balance, January 1, 2010 | 9,261,904 | 1,538,626 | 1,217,372 | (1,575,586) | 10,442,316 |
| Share-based compensation | - | 182,447 | 112,000 | - | 294,447 |
| Expiry of warrants and stock options | - | (426,679) | - | 426,679 | - |
| Loss for the year | - | - | - | (825,527) | (825,527) |
| Balance, December 31, 2010 | 9,261,904 | 1,294,394 | 1,329,372 | (1,974,434) | 9,911,236 |

See accompanying notes to the consolidated financial statements

## 1. NATURE OF OPERATIONS AND GOING CONCERN

James Bay Resources Limited (the "Company" or "James Bay") was incorporated on November 5, 2007. The Company currently has interests in resource properties in the Porcupine mining district of Ontario, Canada (the “Claims”) and during 2011, was involved in the evaluation of oil and gas related opportunities in Nigeria. The Company is in the process of exploring its resource properties for mineral resources and has not determined whether the properties contain economically recoverable reserves. The Company has not yet discovered any deposits, nor has it earned any income from the Claims.

The business of mining and exploring for minerals involves a high degree of risk and there can be no assurance that current exploration programs will result in profitable mining operations. The recoverability of the carrying value of exploration and evaluation assets and the Company's continued existence is dependent upon the preservation of its interests in the underlying properties, the discovery of economically recoverable reserves, the achievement of profitable operations, the ability of the Company to secure an interest in new properties or the ability of the Company to complete additional financings, if necessary, or alternatively upon the Company's ability to dispose of its interests on an advantageous basis. Changes in future conditions could require a material write-down of the carrying values.

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements, unregistered claims, aboriginal claims and non-compliance with regulatory and environmental requirements. The Company’s assets may also be subject to increases in taxes and royalties, renegotiation of contracts, currency exchange fluctuations and restrictions, and political uncertainty.

The Company has a need for equity capital and financing for working capital and acquisition exploration and development of its properties. Because of continuing operating losses, the Company's continuance as a going concern is dependent upon its ability to obtain adequate financing and to reach profitable levels of operation. Management believes it will be successful in rising the necessary funding to continue operations in the normal course of operations; however, there is no assurance that these funds will be available on terms acceptable to the Company or at all.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to a going concern. Accordingly, they do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and liquidate its liabilities and commitments in other than the normal course of business and at amounts different from those in the accompanying consolidated financial statements. Such adjustments could be material.

The Company’s shares are listed on the TSX Venture Exchange. The head office, principal address and records office of the Company are located at 20 Victoria Street, Suite 800, Toronto, Ontario, Canada, M5C 2N8. These consolidated financial statement of the Company for the years ended December 31, 2011 and 2010 were approved and authorized for issue by the board of directors on April 24, 2012.

## 2. BASIS OF PREPARATION

*(a) Conversion to IFRS*

These annual consolidated financial statements of the Company and its subsidiaries were prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). As these financial statements represent the Company's initial presentation of its results and financial position under IFRS, they were prepared in accordance with International Accounting Standard ("IAS") 1, Presentation of Financial Statements and by IFRS 1, First-time Adoption of IFRS. These annual consolidated financial statements have been prepared in accordance with accounting policies based on the IFRS standards and International Financial Reporting Interpretations Committee ("IFRIC") interpretations. The policies set out below were consistently applied to all the periods presented unless otherwise noted below.

The Company's consolidated financial statements were previously prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). Canadian GAAP differs in some areas from IFRS. The Company has consistently applied the same accounting policies throughout all periods presented, as if these policies had always been in effect. Note 18 discloses the impact of the transition to IFRS on the Company's consolidated statements of financial position as at January 1, 2010 and December 31, 2010 and the consolidated statements of comprehensive loss for the year ended December 31, 2010.

The preparation of financial statements in accordance with IAS 1 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies.

## 3. RECENT ACCOUNTING PRONOUNCEMENTS

Certain new accounting standards, amendments to standards and interpretations have been issued.

*IFRS 9, Financial Instruments ("IFRS 9")*
This amendment addresses the classification and measurement of financial assets. IFRS 9 is the first standard issued as part of a wider project to replace IAS 39. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply. This new standard is effective for the Company's and annual consolidated financial statements commencing January 1, 2015. The Company is assessing the impact of this new standard on its consolidated financial statements.

## 3. RECENT ACCOUNTING PRONOUNCEMENTS (continued)

*IFRS 10 Consolidated Financial Statements ("IFRS 10")*
IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are special purpose entities in the scope of SIC 12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 Consolidated and Separate Financial Statements. The Company intends to adopt IFRS 10 in its financial statements for the annual period beginning January 1, 2013. The Company has not yet determined the impact of the amendments to IFRS 10 on its consolidated financial statements.

*IFRS 11 Joint Arrangements ("IFRS 11")*
IFRS 11 replaces the guidance in IAS 31 Interests in Joint Ventures. Under IFRS 11, joint arrangements are classified as either joint operations or joint ventures. IFRS 11 essentially carves out of previously jointly controlled entities, those arrangements which although structured through a separate vehicle, such separation is ineffective and the parties to the arrangement have rights to the assets and obligations for liabilities and are accounted for as joint operations in a fashion consistent with jointly controlled assets/operations under IAS 31. In addition, under IFRS 11, joint ventures are stripped of the free choice of equity accounting or proportionate consolidation; these entities must now use the equity method.

Upon application of IFRS 11, entities which had previously accounted for joint ventures using proportionate consolidation shall collapse the proportionately consolidated net asset value (including any allocation of goodwill) into a single investment balance at the beginning of the earliest period presented. The investment's opening balance is tested for impairment in accordance with IAS 28 Investments in Associates and IAS 36 Impairments of Assets. Any impairment losses are recognized as an adjustment to opening retained earnings at the beginning of the earliest period presented. The Company intends to adopt IFRS 11 in its consolidated financial statements for the annual period beginning January 1, 2013. The Company has not yet determined the impact of the amendments to IFRS 11 on its consolidated financial statements.

*IFRS 13 Fair Value Measurement ("IFRS 13")*
IFRS 13 converges IFRS and US GAAP on how to measure fair value and the related fair value disclosures. The new standard creates a single source of guidance for fair value measurements, where fair value is required or permitted under IFRS, by not changing how fair value is used but how it is measured. The focus will be on an exit price. IFRS 13 is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. The Company has not yet determined the impact of the amendments to IFRS 13 on its consolidated financial statements.

## 4. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries. (Note 15)

*Subsidiaries*
Subsidiaries are entities over which the Company has control, where control is defined as the power to govern financial and operating policies of an entity so as to obtain benefit from its activities. Generally, the Company has a shareholding of more than one half of the voting rights in its subsidiaries. The effects of potential voting rights that are currently exercisable are considered when assessing whether control exists. Subsidiaries are fully consolidated from the date control is transferred to the Company, and are de-consolidated from the date control ceases. Intercompany transactions are eliminated on consolidation.

## 5. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. These consolidated financial statements include estimates, which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and the revision affects both current and future periods. Such estimates and assumptions affect the carrying value of assets, the determination of impairment charges of non-current assets, impact decisions as to when exploration and evaluation costs should be capitalized or expensed, and affect estimates for asset retirement obligations and reclamation costs. Other significant estimates made by the Company include factors affecting valuations of share-based compensation, warrants, investments and income tax accounts. The Company regularly reviews its estimates and assumptions, however, actual results could differ from these estimates and these differences could be material.

*(a) Capitalization of exploration and evaluation assets*
Management has determined that exploration and evaluation costs incurred during the year may have future economic benefits. In making this judgement, management has assessed various sources of information including but not limited to the geologic and metallurgic information, proximity of other operating facilities and discoveries, operating management expertise and existing permits. See Note 7 for details of capitalized exploration and evaluation assets.

*(b) Impairment of exploration and evaluation assets*
While assessing whether any indications of impairment exist for mineral properties and deferred exploration expenditures, consideration is given to both external and internal sources of information. Information the Company considers includes changes in the market, economic and legal environment in which the Company operates that are not within its control that could affect the recoverable amount of mineral properties and deferred exploration expenditures. Internal sources of information include the manner in which mineral properties and deferred exploration expenditures are being used or are expected to be used and indications of expected economic performance of the assets. Estimates may include, but are not limited to estimates of the discounted future after-tax cash flows expected to be derived from the Company’s properties, costs to sell the properties and the appropriate discount rate.

Reductions in metal price forecasts, increases in estimated future costs of production, increases in estimated future capital costs, and/or adverse current economics can result in a write-down of the carrying amounts of the Company’s exploration and evaluation assets.

## 5. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

*(c) Income taxes and recoverability of potential deferred tax assets*
In assessing the probability of realizing income tax assets recognized, management makes estimates related to expectations of future taxable income, applicable tax planning opportunities, expected timing of reversals of existing temporary differences and the likelihood that tax positions taken will be sustained upon examination by applicable tax authorities. In making its assessments, management gives additional weight to positive and negative evidence that can be objectively verified. The Company considers whether relevant tax planning opportunities are within the Company's control, are feasible, and are within management's ability to implement. Examination by applicable tax authorities is supported based on individual facts and circumstances of the relevant tax position examined in light of all available evidence. Where applicable tax laws and regulations are either unclear or subject to ongoing varying interpretations, it is reasonably possible that changes in these estimates can occur that materially affect the amounts of income tax assets recognized. Also, future changes in tax laws could limit the Company from realizing the tax benefits from the deferred tax assets. The Company reassesses unrecognized income tax assets at each reporting period.

*(d) Share-based payments and Warrants*
Management determines costs for share-based payments using market-based valuation techniques. The fair value of the market-based and performance-based share awards are determined at the date of grant using generally accepted valuation techniques. Assumptions are made and judgment used in applying valuation techniques. These assumptions and judgments include estimating the future volatility of the stock price, expected dividend yield, future employee turnover rates and future employee stock option exercise behaviours and corporate performance. Such judgments and assumptions are inherently uncertain. Warrants are valued in a similar way. Changes in these assumptions affect the fair value estimates.

*(e) Contingencies*
Refer to Note 17

## 6. SIGNIFICANT ACCOUNTING POLICIES

*(a) Foreign Currencies*

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

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

*(b) Cash and cash equivalents*

Cash equivalents include money market instruments which are readily convertible into cash or have maturities at the date of purchase of less than ninety days.

**6. SIGNIFICANT ACCOUNTING POLICIES (continued)**

*(c) Share-based payments*

Equity-settled share-based payments to employees and others providing similar services are measured at the fair value of the equity instruments at the grant date. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in the share-based payment note.

The fair value is determined at the grant date of the equity-settled share-based payments and is recognized on a graded-vesting basis over the period during which the employee becomes unconditionally entitled to the equity instruments, based on the Company's estimate of equity instruments that will eventually vest. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the equity-settled employee benefits reserve.

Equity-settled share-based payment transactions with parties other than employees are measured at the fair value of the goods or services received, except where that fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders the service.

*(d) Income Tax*

Current tax
Income tax expense represents the sum of the tax currently payable and deferred tax. The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax
Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

## 6. SIGNIFICANT ACCOUNTING POLICIES (continued)

*(d) Income Tax (continued)*

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off deferred tax assets against deferred tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its deferred tax assets and liabilities on a net basis.

*(e) Exploration and evaluation assets*

Once a license to explore an area has been secured, expenditures on exploration and evaluation activities, net of government assistance received, are capitalized to exploration and evaluation assets. Deferred exploration expenditures relate to the initial search for deposits with economic potential and to detailed assessments of deposits or other projects that have been identified as having economic potential. The Company's due diligence costs related to its search for a suitable oil and gas property in Nigeria (Note 7) have been expensed directly to the Consolidated Statements of Comprehensive Loss as they relate to work performed in advance of the Company securing a license to explore any specific project.

The Company's property interests are in the exploration and evaluation stage and accordingly the Company follows the practice of capitalizing all costs relating to the acquisition of, exploration for and evaluation of mineral claims and crediting all revenues received against the cost of the related claims. Such costs include, but are not exclusive to, geological, geophysical studies, exploratory drilling and sampling. At such time as commercial production commences, these costs will be charged to operations on a unit-of-production method based on proven and probable reserves. The aggregate costs related to abandoned mineral claims are charged to operations at the time of any abandonment or when it has been determined that there is evidence of a permanent impairment. The recoverability of amounts shown for exploration and evaluation assets is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain financing to complete development of the properties, and on future production or proceeds of disposition. The Company recognizes in profit or loss costs recovered on exploration and evaluation assets when amounts received or receivable are in excess of the carrying amount. Upon transfer of "Exploration and evaluation assets" into "Mine Development", all subsequent expenditure on the construction, installation or completion of infrastructure facilities is capitalised within "Mine development". After production starts, all assets included in "Mine development" are transferred to "Producing Mines".

All capitalized exploration and evaluation expenditures are monitored for indications of impairment. Where a potential impairment is indicated, assessments are performed. To the extent that exploration expenditures are not expected to be recovered, they are charged to profit or loss.

**6. SIGNIFICANT ACCOUNTING POLICIES (continued)**

*(f) Equipment*

Equipment is carried at cost less accumulated amortization. Amortization is calculated over the estimated useful life of the assets at the following annual rates:

| | | |
|---|---|---|
| Office equipment | - | 20%, declining balance basis |
| Computer software | - | 100%, declining balance basis |

*(g) Impairment of non-financial assets*

The carrying values of capitalized exploration and evaluation assets and equipment are assessed for impairment when indicators of such impairment exist. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated. The recoverable amount is determined as the higher of the fair value less costs to sell for the asset and the asset's value in use. For exploration and evaluation assets, indicators of impairment would include: exploration of a right to explore, no budgeted or planned material expenditures in an area or a decision to discontinue exploration in a specific area.

If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the statement of comprehensive loss so as to reduce the carrying amount to its recoverable amount.

*(h) Financial instruments*

*Financial assets*

Financial assets within the scope of IAS 39 are classified as financial assets at FVTPL, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or derivatives. The Company determines the classification of its financial assets at initial recognition.

All financial assets are recognised initially at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognised on the trade date, (i.e., the date that the Company commits to purchase or sell the asset).

The Company's financial assets include cash and cash equivalents, restricted cash, amounts receivable, loan receivable and investments.

Subsequent measurement
The subsequent measurement of financial assets depends on their classification as follows:

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. This category includes derivative financial instruments entered into by the Company that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with changes in fair value recognised in finance income and finance costs in the statement of comprehensive loss.

## 6. SIGNIFICANT ACCOUNTING POLICIES (continued)

*(h) Financial instruments (continued)*

*Financial assets (continued)*

The Company has designated its cash equivalents and investments at fair value through profit or loss. The Company evaluates its financial assets at fair value through profit or loss to determine whether the intent to sell them in the near term is still appropriate. When the Company is unable to trade these financial assets due to inactive markets and management's intent to sell them in the foreseeable future significantly changes, the Company may elect, in rare circumstances, to reclassify these financial assets. The reclassification to loans and receivables, available-for-sale or held-to-maturity depends on the nature of the asset. This evaluation does not affect any financial assets designated at fair value through profit or loss using the fair value option at designation.

Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held for trading or designated at fair value though profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the statement of comprehensive loss. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Loans and receivables
The Company has designated its cash, restricted cash, and amounts receivable as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate method ("EIR"), less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the statement of comprehensive loss. The losses arising from impairment are recognised in the statement of comprehensive loss.

Derecognition
A financial asset (or, where applicable a part of a financial asset or part of a Company of similar financial assets) is derecognised when:

- The rights to receive cash flows from the asset have expired; and
- The Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either:
  (a) the Company has transferred substantially all the risks and rewards of the asset; or
  (b) the Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Impairment of financial assets
The Company assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

## 6. SIGNIFICANT ACCOUNTING POLICIES (continued)

*(h) Financial instruments (continued)*

*Financial assets (continued)*

For financial assets carried at amortised cost, the Company first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of comprehensive loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance income in the statement of comprehensive loss. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Company. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to finance costs in the statement of comprehensive loss.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

*Financial liabilities*

Initial recognition and measurement
Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Company's financial liabilities include accounts payable and accrued liabilities.

**6. SIGNIFICANT ACCOUNTING POLICIES (continued)**

Subsequent measurement
The measurement of financial liabilities depends on their classification as follows:

*(h) Financial instruments (continued)*

*Financial liabilities (continued)*

Financial liabilities at fair value through profit or loss
Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as fair value through profit or loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. This category includes derivative financial instruments entered into by the Company that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognized in the consolidated statement of operations. The Company has not designated any financial liabilities upon initial recognition as at fair value through profit or loss.

Other financial liabilities
After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest rate ("EIR") method. Gains and losses are recognized in the consolidated statement of operations when the liabilities are derecognized, as well as through the EIR amortization process. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortization is included in finance cost in the statement of operations.

Derecognition
A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

*Fair value of financial instruments*

The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

*(i) Loss per share*

Basic loss per share is calculated by dividing the loss available to common shareholders by the weighted average number of common shares outstanding in the period. For all periods presented, the loss available to common shareholders equals the reported loss. Diluted loss per share is calculated by assuming that the proceeds to be received on the exercise of dilutive share options and warrants are used to repurchase common shares at the average market price during the period. In the Company's case, diluted loss per share is the same as basic loss per share as the effects of including all outstanding options and warrants would be anti-dilutive. As at December 31, 2011 and 2010, all outstanding options and warrants were anti-dilutive.

Expressed in Canadian dollars

## 7. EXPLORATION AND EVALUATION ASSETS

### James Bay Property, Ontario Canada

The Company acquired, by staking, certain claims in Ontario, Canada.

| | |
|---|---|
| Balance, January 1, 2010 | $ 2,431,529 |
| Additions | 7,133 |
| Balance, December 31, 2010 | $ 2,438,662 |
| Recovery | (5,000) |
| Balance, December 31, 2011 | $ 2,433,662 |

### Nigeria Oil & Gas Property

On March 21, 2011, the Company signed a memorandum of understanding (the "MoU") to conduct due diligence, and if a suitable target is identified, to form a special purpose vehicle (the "SPV") with D&H Solution AS ("D&H") (a 50/50 partnership between Hemla of Norway and Korea's DSME (Daewoo Shipbuilding and Marine Engineering)) to further evaluate the identified oil & gas opportunities in Nigeria, and if suitable, negotiate an agreement to acquire and develop such assets.

Subsequent to December 31, 2011, a new agreement was signed with D&H. The new agreement calls for the transfer of all Nigerian agreements and the corporations that currently hold these agreements into a wholly owned Nigerian subsidiary of the Company. This subsidiary (James Bay Energy Nigeria Limited, "JBENL") was incorporated on February 27, 2012. In addition, the Company will retain certain senior management of D&H as senior management of JBENL. In consideration the Company has agreed to issue to D&H share based compensation in the form of units consisting of one common share and one half of one common share purchase warrant, each whole common share purchase warrant entitling the holder to acquire one common share at a price of $1.25 for a period of two years from issuance. The units are to be issued as follows:

- 3,000,000 units upon a definitive agreement being entered into with regards to an acquisition of an interest in an oil and gas project in Nigeria, and
- 3,000,000 units upon the Company reaching 1,500 barrels oil equivalent ("BOE") per day or a minimum recoverable estimate of 50 million BOE.

Simultaneously with each issuance of the units above, D&H will receive a further 300,000 stock options exercisable for a period of five years following the date of issue, with the exercise price set in the context of the market on the date of issue.

The Company also assumes D&H's agreement to acquire a 47% interest in certain oil and gas interest in Nigeria through the formation of a joint operation with the seller. As consideration for the transfer of the interest, the Company will be required to pay US$2,500,000. These payments are to commence only upon completion of due diligence by the Company and to occur over a period of time defined by the accomplishment of project landmarks, ending with the achievement of commercial production. In addition, on the commencement of commercial production the Company will pay a monthly management retainer of US$30,000 to the seller in return for the seller performing its ordinary legal and regulatory duties as marginal field license holder. The Company will also be required to pay up to US$500,000 in capital contribution to the project as required to finance the joint operation until the commencement of commercial production. Related to this agreement, the Company paid US$50,000 for the first installment in exclusivity, data purchase and administrative fees during the 2011 year. The second installment of US$50,000 was paid subsequent to year-end.

Expressed in Canadian dollars

## 7. EXPLORATION AND EVALUATION ASSETS (continued)

### Nigeria Oil & Gas Property

On March 9, 2011, James Bay entered into a letter of intent with a Nigerian oil & gas service provider, MAK MERA. Subsequent to December 31, 2011, a new agreement with MAK MERA was signed. The new consulting services agreement calls for the issuance of common shares of the Company to MAK MERA as follows:

- 3,500,000 common shares upon a definitive agreement being entered into with regards to an acquisition of an interest in an oil and gas project in Nigeria, and
- 3,000,000 common shares upon the Company reaching 1,500 BOE per day or a minimum recoverable estimate of 50 million BOE.

If a target is identified through this process, completion of an acquisition could represent a Change of Business under the TSX Venture Exchange policies. As a result, any such transaction would be subject to a number of conditions, including TSX Venture Exchange acceptance and if required shareholder approval.

As of December 31, 2011, approximately US$1,180,000 of the US$2 million placed in an escrow account was drawn down for the purpose of conducting the initial due diligence to identify and secure the acquisition of oil & gas property targets in Nigeria. The expenses incurred in relation to the due diligence were approximately US$1,069,000 ($1,089,676). US$11,000 ($11,000) remained payable from the escrow account related to these expenses as at December 31, 2011. As at December 31, 2011, the restricted cash balance of $834,047 (US$820,000) represented the unspent funds in the escrow account.

Included in cash and cash equivalents is approximately $60,000 funds held by the Company's solicitor for payment of the second installment in connection with the acquisition of oil & gas interest in Nigeria. Included in prepaid expenses is approximately $58,000 in prepaid office rent in Nigeria.

## 8. INVESTMENTS

As at December 31, 2011, the Company's marketable securities consisted of the following:

| | Note | Security Description | Fair value December 31, 2011 $ |
|---|---|---|---|
| Hendricks Resources Limited | (iii) | 1,000,000 warrants | - |

As at December 31, 2010, the Company's marketable securities consisted of the following:

| | Note | Security Description | Fair value December 31, 2010 $ |
|---|---|---|---|
| Royal Coal Corp. | (i) | 1,000,000 warrants | 140,000 |
| Largo Resources Ltd. | (iv) | 500,000 common shares | 177,500 |
| Morumbi Oil & Gas Inc. | (ii) | 500,000 warrants | 90,000 |
| | | | 407,500 |

Expressed in Canadian dollars

## 8. INVESTMENTS (continued)

As at January 1, 2010, the Company's marketable securities consisted of the following:

| | Note | Security Description | Fair value January 1, 2010 $ |
|---|---|---|---|
| Royal Coal Corp. | (i) | 1,000,000 warrants | 190,000 |

### (i) Royal Coal Corp. (Formerly CDR Minerals Inc.)

On June 29, 2009, the Company entered into a letter of agreement with CDR Minerals Inc. ("CDR"), regarding a proposed business combination. As part of the agreement, the Company provided a loan of US$500,000 ($576,500) to CDR. The loan bore interest at 7.5% and was due upon closing of the business combination with a provision that if the business combination was not completed, the interest rate would increase to 15%. The loan was also convertible at the option of the Company at any time prior to the due date at a rate of $0.50 per share. The business combination was not completed and the loan and accrued interest were repaid in full prior to December 31, 2009. The Company received 1,000,000 CDR warrants on October 21, 2009, exercisable at a price of $0.50 for a period of two years following the date of issue. In addition, CDR agreed to pay a corporate finance fee of $200,000 to the Company in the event that the warrants are exercised.

The fair value of these warrants was originally estimated at $190,000 using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 100%; risk free interest rate of 1.5% and expected life of 2 years. The estimated fair value of these warrants has been recorded as gain on termination of letter of agreement in the statement of comprehensive loss for the year ended December 31, 2009.

During 2010, CDR completed an amalgamation with Amalfi Capital Corporation, a public company which trades on the TSX Venture Exchange. The amalgamated company then changed its name to Royal Coal Corp. All warrants of CDR were exchanged for warrants of Royal Coal Corp. on a one-for-one basis, having the same terms as the original CDR warrants.

The fair value of these warrants as at December 31, 2010 was estimated at $140,000 using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 146%; risk free interest rate of 1.5% and expected life of 0.81 years. The unrealized loss of $50,000 has been recorded as part of the net gain on fair value through profit or loss investments in the statement of comprehensive loss for the year ended December 31, 2010.

These warrants expired during the year ended December 31, 2011. Accordingly a loss of $140,000 has been recorded as part of the net loss on held-for-trading investments in the statement of comprehensive loss for the year ended December 31, 2011.

### (ii) Morumbi Oil & Gas Inc.

See Note 9. The fair value of these warrants as at December 31, 2010 was estimated at $90,000 using the Black-Scholes option pricing model with the following assumptions: expected dividend yield – 0%; expected volatility – 112%; risk-free interest rate – 1.74%; expected life – 2.6 years.

As Morumbi repaid the loan in full prior to the first anniversary date of the loan agreement, the policies of the TSX Venture Exchange required the immediate termination of the Morumbi warrants held by the Company. During the year ended December 31, 2011, the Company realized a loss of $90,000 related to the termination of the Morumbi Warrants.

## 8. INVESTMENTS (continued)

### (iii) Hendricks Resource Limited

On September 2, 2010, the Company entered into an agreement to acquire certain coal assets. The completion of the transaction was subject to the signing of a definitive purchase and sale agreement, among other conditions. A definitive purchase and sale agreement was not signed and the transaction was not completed. Subsequent to December 31, 2010, the Company was reimbursed for due diligence costs incurred totaling $733,496. This amount is included in amounts receivable on the balance sheet as at December 31, 2010. The Company also received 1,000,000 warrants in Hendricks Resources Limited, a private corporation, subsequent to December 31, 2010. The warrants are exercisable into 1,000,000 shares of Hendricks Resources Limited at USD$1.20 per share until January 31, 2013.

As the fair value for these warrants could not be reasonably assessed by the Company, the Company was precluded by IAS 39 from valuing these warrants at fair value. The warrants are thus being carried at their original cost of Nil.

### (iv) Largo Resources Ltd.

On August 30, 2010**,** the Company entered into a short term bridge loan agreement with Largo Resources Ltd. (“Largo”). As part of the agreement, the Company provided a loan of $750,000 to Largo. The loan bore interest at 12%, was to mature on August 31, 2011 and was secured against all the assets of Largo and its subsidiaries. The Company had the right at any time up to August 31, 2011 to convert up to 50% of the outstanding loan balance into units of Largo at a conversion price of $0.17 per unit. Each unit would be comprised of one common share of Largo and one half of one common share purchase warrant with each whole warrant exercisable into a common share of Largo for $0.25 for a period of twelve months from August 30, 2010. In addition, as consideration for the loan, the Company received 500,000 share purchase warrants of Largo. Each warrant is exercisable for one common share of Largo at an exercise price of $0.17 for a period of one year following the date of issue. A director of the Company is also a director of Largo.

The fair value of these warrants upon receipt was estimated at $25,000 using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 70%; risk free interest rate of 1.22% and expected life of 1 year. The value of these warrants was applied against the carrying value of the loan receivable and was to be recognized as income over the term of the loan.

The conversion option was valued at $88,000. The fair value of the conversion option was estimated using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 94%; risk-free interest rate of 0.94%; and expected life of three months. This amount was recorded as an asset on the balance sheet and was also applied against the carrying value of the loan receivable. The conversion option was available until November 30, 2010.

During 2010, the Company received $776,677 from Largo which consisted of $750,000 principal repayment, $22,500 of due diligence fees and $4,177 of interest income. The carrying values of the loan and conversion option asset totaled $712,236 at the time of repayment. The difference between this and the $750,000 face value of the loan has been recorded as a gain on loan in the statement of comprehensive loss for the year ended December 31, 2010.

On October 17, 2010, the Company exercised the 500,000 share purchase warrants of Largo at an exercise price of $0.17. The Company realized a gain of $96,380 on the disposition of the 500,000 share purchase warrants.

On January 17, 2011, the Company disposed of its full shareholdings in Largo, realizing an additional gain of $28,880 during 2011.

Expressed in Canadian dollars

## 9. LOAN RECEIVABLE

On August 13, 2010, the Company entered into a loan agreement with Morumbi Oil & Gas Inc. ("Morumbi") to extend a net amount of $250,000 which requires Morumbi to repay an aggregate of $275,000 plus interest on or before August 13, 2013. The loan bears an interest rate of 5% for the first year and 9% for the following two years and is secured against the assets of Morumbi. As consideration for the loan, the Company received a total of 500,000 warrants of Morumbi. Each warrant entitles the Company to acquire one common share of Morumbi at a price of $0.25 for a period of three years. Certain directors and officers of the Company are also directors and officers of Morumbi. The loan was repaid in full during the year ended December 31, 2011 (Note 8(ii)).

## 10. SHARE CAPITAL

**(a)** **Authorized** - Unlimited common shares

**(b)** **Issued** - 28,040,350 common shares

| | # | $ |
|---|---|---|
| Balance at January 1, 2010, December 31, 2010 and December 31, 2011 | 28,040,350 | 9,261,904 |

## 11. SHARE-BASED PAYMENTS

The Company has an incentive stock option plan (the “Plan") whereby the Company can grant to directors, officers, employees and consultants options to purchase shares of the Company. The Plan provides for the issuance of stock options to acquire up to 10% of the Company's issued and outstanding capital at the time of granting of options for a maximum term of five years. The Plan is a rolling plan as the number of shares reserved for issuance pursuant to the grant of stock options will increase as the Company's issued and outstanding share capital increases. In no case (calculated at the time of grant) shall the Plan result in:

- The number of options granted in a 12-month period to any one consultant exceeding 2% of the issued shares of the Company;
- The aggregate number of options granted in a 12-month period to any one individual exceeding 5% of the outstanding shares of the Company;
- The number of options granted in any 12-month period to employees or consultants undertaking investor relations activities exceeding in aggregate 2% of the issued shares of the Company;
- The aggregate number of common shares reserved for issuance to any one individual upon the exercise of options granted under the Plan or any previously established and outstanding stock option plans or grants exceeding 5% of the issued shares of the Company in any 12-month period.

On June 11, 2010, the Company granted a total of 200,000 stock options. The options vested immediately. Each option allows the holder to purchase one share of the Company at an exercise price of $0.75 for a period of five years from the date of grant. The estimated grant date fair value of these options was estimated at $0.49 each using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 105%; risk free interest rate of 2.7%; and expected life of five years. Expected volatility is estimated by considering historic average share price volatility.

Expressed in Canadian dollars

## 11. SHARE-BASED PAYMENTS (continued)

The following reconciles the share options outstanding during the year:

| | From January 1, 2011 to December 31, 2011 | | From January 1, 2010 to December 31, 2010 | |
|---|---|---|---|---|
| | Number of options # | Weighted average exercise price $ | Number of options # | Weighted average exercise price $ |
| Balance, beginning of year | 2,765,000 | 0.75 | 3,201,835 | 0.85 |
| Granted | - | - | 200,000 | 0.75 |
| Expired | - | - | (636,835) | (0.85) |
| Balance, end of year | 2,765,000 | 0.75 | 2,765,000 | 0.75 |

The Company has the following share options and compensation options outstanding at December 31, 2011:

| Estimated Grant Date Fair Value $ | Outstanding Options # | Options Exercisable # | Exercise Price $ | Expiry Date |
|---|---|---|---|---|
| 768,944 | 1,350,000 | 1,350,000 | 0.75 | April 2, 2013 |
| 5,700 | 10,000 | 10,000 | 0.75 | April 16, 2013 |
| 421,750 | 1,205,000 | 1,205,000 | 0.75 | September 17, 2013 |
| 98,000 | 200,000 | 200,000 | 0.75 | June 11, 2015 |
| 1,294,394 | 2,765,000 | 2,765,000 | | |

The weighted average exercise price of options exercisable at December 31, 2011 is $0.75 (December 31, 2010 - $0.75).

The weighted average contractual life of options outstanding at December 31, 2011 is 1.6 years (December 31, 2010 – 2.6 years).

## 12. WARRANTS

The following table reflects the continuity of warrants:

| | Number # | Amount $ |
|---|---|---|
| Balance at December 31, 2009 | 3,723,925 | 1,217,372 |
| Revaluation of warrants – extended term (i) | - | 112,000 |
| Balance at December 31, 2010 | 3,723,925 | 1,329,372 |
| Revaluation of warrants – extended term (ii) | - | 74,000 |
| Balance December 31, 2011 | 3,723,925 | 1,403,372 |

(i) On June 7, 2010, the Company extended the expiry date of common share purchase warrants issued by the Company in connection with the initial public offering (the “IPO”) financing that closed on July 24, 2008. The expiry date for all these warrants was extended until July 24, 2011. The incremental fair value of the warrants created by the extension of the expiry date of $112,000 was estimated using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 78%; risk free interest rate of 3.12%; expected life of 1.12 years. These warrants have an exercise price of $2.00. Expected volatility is estimated by considering historic average share price volatility.

Expressed in Canadian dollars

## 12. WARRANTS (continued)

(ii) On June 20, 2011, the Company extended the expiry date of common share purchase warrants issued by the Company in connection with the IPO financing that closed on July 24, 2008. The expiry date for all these warrants was extended until July 24, 2012. The incremental fair value of the warrants created by the extension of the expiry date of $74,000 was estimated using the Black-Scholes option pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 84%; risk free interest rate of 1.49%; expected life of 1.09 years. These warrants have an exercise price of $2.00. Expected volatility is estimated by considering historic average share price volatility.

As of December 31, 2011, the following warrants were outstanding:

| Estimated Grant Date Fair Value $ | Outstanding Warrants # | Exercise Price $ | Expiry Date |
|---|---|---|---|
| 1,403,372 | 3,723,925 | 2.00 | July 24, 2012 |

Subsequent to December 31, 2011, the Company extended the expiry date of common share purchase warrants issued by the Company in connection with the initial public offering (the “IPO”) financing that closed on July 24, 2008. The expiry date for these warrants has now been extended until July 24, 2013. The exercise price of these warrants has been reduced from $2.00 to $1.25 per warrant.

## 13. CAPITAL MANAGEMENT

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of mineral properties. The capital structure of the Company at December 31, 2011 consists of equity attributable to common shareholders comprised of common share-based payments reserve, warrant reserve and deficit. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The properties in which the Company currently has an interest are in the exploration stage; as such the Company is dependent on external financing to fund its activities. In order to carry out the planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed.

The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the years ended December 31, 2011 and 2010. Neither the Company nor its subsidiaries are subject to externally imposed capital requirements.

## 14. FINANCIAL INSTRUMENTS

The Company has designated its cash equivalents and investments as fair value through profit or loss, measured at fair value. Cash, restricted cash, amounts receivable and loan receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below. There have been no significant changes in the risks, objectives, policies and procedures from the previous period.

Credit risk
The Company's credit risk is primarily attributable to guaranteed investment certificates and amounts receivable. The Company has no significant concentration of credit risk arising from operations. Guaranteed investment certificates have been invested with reputable financial institutions, from which management believes the risk of loss to be remote. Financial instruments included in amounts receivable at December 31, 2011 and 2010 consist of sales tax due from the Federal Government of Canada. Management believes that the credit risk concentration with respect to these financial instruments is remote.

Liquidity risk
The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. At December 31, 2011, the Company had cash and cash equivalents (including restricted cash) of $5,625,290 (December 31, 2010 - $6,310,432; January 1, 2010 - $7,847,068) to settle current liabilities of $104,765 (December 31, 2010 - $144,029; January 1, 2010 - $41,386). The Company's financial liabilities generally have contractual maturities of less than 30 days and are subject to normal trade terms.

Market risk
(a) Interest rate risk
The Company has cash balances and no interest-bearing debt. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by its banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. The loan receivable bears interest at a fixed rate and therefore does not give rise to interest rate risk.

(b) Price risk
The ability of the Company to develop its property and the future profitability of the Company is directly related to the market price of certain minerals. The Company is also exposed to market risk in trading its investments and unfavourable market conditions could result in dispositions of investments at less than favourable prices.

(c) Foreign currency risk
The Company is subject to foreign exchange risk as the Company has certain assets and liabilities, and makes certain expenditures, in US dollars. The Company is therefore subject to gains and losses due to fluctuations in the US dollar relative to the Canadian dollar. The Company does not hedge its foreign exchange risk.

Sensitivity analysis
Based on management's knowledge and experience of the financial markets, the Company believes the following movements are reasonably possible over a year ended: The Company’s cash equivalents as at December 31, 2011 are held at a fixed interest rate of 1.2% and are therefore not subject to fluctuations in interest rates. A change in interest rates of 1% will result in a corresponding change in net loss of approximately $46,500 based on the cash balance at December 31, 2011.

## 14. FINANCIAL INSTRUMENTS (continued)

Sensitivity analysis (continued)
As at December 31, 2011, the Company has US cash and cash equivalents of approximately $834,000 (US $820,000). A 10% change in the value of the Canadian dollar relative to the US dollar would result in a corresponding change in net loss of approximately $83,000 based on the balance of these assets held in US dollars at December 31, 2011.

Fair Value
The carrying value of cash and cash equivalents, restricted cash, investments, amounts receivable and accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of the financial instruments. The fair value of the loan receivable approximates its carrying value given the short amount of time passed since its inception.

Fair Value hierarchy and liquidity risk disclosure
Fair value measurements are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels: (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices) (Level 2); and (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). As at December 31, 2011, December 31, 2010 and January 1, 2010, cash equivalents were Level 2. As at December 31, 2010 and January 1, 2010, investments consisting of common shares were level 1 and investments consisting of warrants were Level 2.

## 15. RELATED PARTY DISCLOSURES

These consolidated financial statements include balances and transactions with directors and officers of the Company and/or corporations related to them. During the year ended December 31, 2011 and 2010 the Company entered into the following transactions involving related parties:

The Company rents office space from a corporation controlled by a director of the Company. During the year ended December 31, 2011, approximately $60,955 (December 31, 2010 - $42,742) was charged by this corporation. The amount is included in office and general expense on the statement of comprehensive loss. In March 2011, the Company renewed the sublease agreement for another 18 months, resulting in a lease commitment of approximately $38,800 as at December 31, 2011.

Expressed in Canadian dollars

## 15. RELATED PARTY DISCLOSURES (continued)

The Company incurred legal fees of approximately $29,200 (December 31, 2010 - $39,700) paid to a law firm of which a partner is a director of the Company. This amount is included in professional fees on the statement of comprehensive loss.

The consolidated financial statements include the financial statements of the Company and its subsidiaries and their respective ownership listed in the following table:

| | |
|---|---|
| James Bay Coal Co., USA | 100% |
| 2255431 Ontario Limited, Canada | 100% |

The remuneration of directors and other members of key management personnel during the year ended December 31, 2011 and 2010 were as follows:

| | 2011<br>$ | 2010<br>$ |
|---|---|---|
| Management salaries | 284,738 | 312,319 |
| Share-based payments | - | 98,000 |
| | 284,738 | 410,319 |

## 16. INCOME TAXES

a) Provision for Income Taxes

Major items causing the Company's income tax rate to differ from the federal statutory rate of 28% (2010 - 31%) were as follows:

| | **2011**<br>**$** | **2010**<br>**$** |
|---|---|---|
| (Loss) before income taxes | (1,931,306) | (825,527) |
| Expected income tax recovery based on statutory rate | (546,000) | (256,000) |
| Adjustment to expected income tax benefit: | | |
| Warrant extension | 21,000 | - |
| Share-based compensation | - | 91,000 |
| Taxable gain on sale of marketable securities | (9,000) | - |
| Gain on loan | - | (13,000) |
| Change in tax rates | 65,000 | (20,000) |
| Other | 28,000 | 16,000 |
| Tax benefits not recognized | 441,000 | 182,000 |
| Deferred income tax provision | - | - |

Expressed in Canadian dollars

## 16. INCOME TAXES (continued)

b) Deferred tax assets have not been recognized in respect of the following items:

| | 2011<br>$ | 2010<br>$ |
|---|---|---|
| Non-capital loss carry-forwards | 750,000 | 246,000 |
| Loan receivable | - | 34,000 |
| Marketable securities | - | (44,000) |
| Share issue costs | 68,000 | 141,000 |
| Exploration and evaluation assets | 193,000 | 193,000 |
| Equipment | 2,000 | 2,000 |
| | 1,013,000 | 572,000 |

c) Tax Loss Carry-Forwards

As at December 31, 2011, the Company had approximately $3,205,000 (2010 - $3,210,000) of Canadian exploration and development expenditures, which under certain circumstances, may be utilized to reduce taxable income of future years.

As at December 31, 2011, the Company had approximately $3,016,000 (2010 - $1,028,000) of non-capital losses in Canada, which can be used to reduce taxable income in future years. The losses expire as follows:

| Year of Expiry | Amount $ |
|---|---|
| 2027 | 7,000 |
| 2028 | 107,000 |
| 2029 | 102,000 |
| 2030 | 812,000 |
| 2031 | 1,988,000 |
| | 3,016,000 |

## 17. COMMITMENTS AND CONTINGENCIES

The Company is party to certain management contracts. These contracts contain clauses requiring additional payments of up to $504,000 be made upon the occurrence of certain events such as a change of control. As the likelihood of these events taking place is not determinable, the contingent payments have not been reflected in these financial statements. Additional minimum management contract commitments remaining under these contracts are approximately $508,000.

In March 2011, the Company renewed the sublease agreement for another 18 months, resulting in a lease commitment of approximately $38,800 as at December 31, 2011.

The Company's mining and exploration activities are subject to various federal and provincial laws and regulations governing the protection of the environment. These laws and regulations are continually changing and generally becoming more restrictive. The Company believes its operations are materially in compliance with all applicable laws and regulations. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations.

## 18. TRANSITION TO IFRS

The Company's financial statements for the year ending December 31, 2011 are the first annual financial statements that comply with IFRS and these consolidated financial statements were prepared as described in note 2, including the application of IFRS 1.

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which the Company has applied IFRS was January 1, 2010 (the "Transition Date"). IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

**Initial elections upon adoption**
Set forth below are the IFRS 1 applicable exemptions and exceptions applied in the conversion from Canadian GAAP to IFRS.

**IFRS Exemption Options**

1. *Share-based payments* - IFRS 2, Share-based Payments, encourages application of its provisions to equity instruments granted on or before November 7, 2002, but permits the application only to equity instruments granted after November 7, 2002 that had not vested by the Transition Date. The Company elected to avail itself of the exemption provided under IFRS 1 and applied IFRS 2 for all equity instruments granted after November 7, 2002 that had not vested by its Transition Date.

2. *Changes in Existing Decommissioning, Restoration and Similar Liabilities – IFRIC 1.* The Company did not apply the recognition and measurement principles of IFRIC 1 prior to January 1, 2010.

**IFRS Mandatory Exceptions**

**Estimates** - Hindsight is not used to create or revise estimates. The estimates previously made by the Company under Canadian GAAP were not revised for application of IFRS except where necessary to reflect any difference in accounting policies.

**Adjustments on transition to IFRS**

On transition to IFRS, the Company elected to change its accounting policy for the treatment of share-based payments whereby amounts recorded for expired unexercised share options and warrants are transferred to deficit. Previously, the Company's Canadian GAAP policy was to leave such amounts in contributed surplus. The impact of the change was a decrease to deficit and a decrease to share-based payments reserve of $670,254 at December 31, 2010 (January 1, 2010 - $243,575)

**Reconciliations of Canadian GAAP to IFRS**

IFRS 1 requires an entity to reconcile equity, comprehensive loss and cash flows for prior periods. The changes made to the consolidated statements of financial position and consolidated statements of comprehensive loss have resulted in reclassifications of various amounts on the consolidated statements of cash flows, however as there have been no changes to the net cash flows, no reconciliations have been presented.

Expressed in Canadian dollars

**18. TRANSITION TO IFRS (continued)**

**Reconciliation of consolidated statement of financial position as of January 1, 2010**

| | | Previous Canadian GAAP | Effect of transition to IFRS | IFRS |
|---|---|---|---|---|
| | | $ | $ | $ |
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | | 7,847,068 | - | 7,847,068 |
| Prepaid expenses | | 12,431 | - | 12,431 |
| Amounts receivable | | 1,972 | - | 1,972 |
| Total current assets | | 7,861,471 | - | 7,861,471 |
| Exploration and evaluation assets | | 2,431,529 | - | 2,431,529 |
| Equipment | | 702 | - | 702 |
| Investments | | 190,000 | - | 190,000 |
| **Total assets** | | 10,483,702 | - | 10,483,702 |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Accounts payable and accrued liabilities | | 41,386 | - | 41,386 |
| **EQUITY** | | | | |
| Common shares | | 9,261,904 | - | 9,261,904 |
| Share-based payments reserve | (a) | 1,782,201 | (243,575) | 1,538,626 |
| Warrant reserve | | 1,217,372 | - | 1,217,372 |
| Deficit | (a) | (1,819,161) | 243,575 | (1,575,586) |
| Total equity | | 10,442,316 | - | 10,442,316 |
| Total liabilities and equity | | 10,483,702 | - | 10,483,702 |

Expressed in Canadian dollars

## 18. TRANSITION TO IFRS (continued)

**Reconciliation of consolidated statement of financial position as of December 31, 2010**

| | | Previous Canadian GAAP | Effect of transition to IFRS | IFRS |
|---|---|---|---|---|
| | | $ | $ | $ |
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | | 6,310,432 | - | 6,310,432 |
| Prepaid expenses | | 12,202 | - | 12,202 |
| Amounts receivable | | 747,244 | - | 747,244 |
| Total current assets | | 7,069,878 | - | 7,069,878 |
| Exploration and evaluation assets | | 2,438,662 | - | 2,438,662 |
| Equipment | | 521 | - | 521 |
| Investments | | 407,500 | - | 407,500 |
| Loan receivable | | 138,704 | - | 138,704 |
| Total assets | | 10,055,265 | - | 10,055,265 |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Accounts payable and accrued liabilities | | 144,029 | - | 144,029 |
| **EQUITY** | | | | |
| Common shares | | 9,261,904 | - | 9,261,904 |
| Share-based payments reserve | (a) | 1,964,648 | (670,254) | 1,294,394 |
| Warrant reserve | | 1,329,372 | - | 1,329,372 |
| Deficit | (a) | (2,644,688) | 670,254 | (1,974,434) |
| Total equity | | 9,911,236 | - | 9,911,236 |
| Total liabilities and equity | | 10,055,265 | - | 10,055,265 |

Expressed in Canadian dollars

**18. TRANSITION TO IFRS (continued)**

**Reconciliation of consolidated statement of comprehensive loss for the year ended December 31, 2010**

| | Previous Canadian GAAP | Effect of transition to IFRS | IFRS |
|---|---|---|---|
| | $ | $ | $ |
| **Expenses** | | | |
| Share-based compensation | 182,447 | - | 182,447 |
| Management salaries and benefits | 286,819 | - | 286,819 |
| Professional fees | 89,505 | - | 89,505 |
| Office and general | 98,357 | - | 98,357 |
| Consulting fees | 23,417 | - | 23,417 |
| Shareholder relations | 66,899 | - | 66,899 |
| Warrant extension valuation | 112,000 | - | 112,000 |
| Transfer agent and listing fees | 26,482 | - | 26,482 |
| Amortization | 181 | - | 181 |
| **Loss before the undernoted** | 886,107 | - | 886,107 |
| Foreign exchange loss | 51,422 | - | 51,422 |
| Net loss on fair value through profit or loss investments | 22,500 | - | 22,500 |
| Gain on loan | (37,764) | - | (37,764) |
| Interest income | (96,738) | - | (96,738) |
| **Comprehensive loss for the year** | 825,527 | - | 825,527 |
| **Loss per share** | | | |
| Basic and diluted | (0.03) | - | (0.03) |
| Weighted average number of shares outstanding – basic and diluted | 28,040,350 | - | 28,040,350 |

**Note**

(a) On transition to IFRS, the Company elected to change its accounting policy for the treatment of share-based payments whereby amounts recorded for expired unexercised share options and warrants are transferred to deficit. Previously, the Company's Canadian GAAP policy was to leave such amounts in contributed surplus. The impact of the change was a decrease to deficit and a decrease to share-based payments reserve of $670,254 at December 31, 2010 (January 1, 2010 - $243,575).