



CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE YEARS ENDED
DECEMBER 31, 2010 AND 2009**

All amounts in Canadian dollars unless otherwise specified

MANAGEMENTS' RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements and all of the data included in this report have been prepared by and are the responsibility of management of the Company. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect management's best estimates and judgments based on currently available information. The Company has developed and maintains systems of internal accounting control in order to assure, on a reasonable and cost-effective basis, the reliability of its financial information and that assets are safeguarded from loss.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, comprised of non-management directors, which meets with the external auditors to satisfy itself that management's responsibilities are properly discharged and to review the consolidated financial statements before they are presented to the Board of Directors for approval.

The consolidated financial statements as at and for the year ended December 31, 2010 have been audited by KPMG LLP, Chartered Accountants. Their report outlines the scope of their examination and opinion on the consolidated financial statements.



Robert Jackson
President and CEO



Frances Kwong
Vice President and CFO

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Vaalidam Mining Inc.

We have audited the accompanying consolidated financial statements of Vaaldiam Mining Inc., which comprise the consolidated balance sheet as at December 31, 2010, the consolidated statements of shareholders' equity and deficit, operations and comprehensive loss and deficit and cash flows for the year ended December 31, 2010, and notes, comprising 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 Canadian generally accepted accounting principles, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 our 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, we consider 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audit 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 consolidated financial position of Vaaldiam Mining Inc. as at December 31, 2010 and its consolidated results of operations and its consolidated cash flows for year ended December 31, 2010 in accordance with Canadian generally accepted accounting principles.

Other Matter

The consolidated financial statements of Vaaldiam Mining Inc. as at and for the year ended December 31, 2009 were audited by another auditor who expressed an unmodified opinion on those statements on March 9, 2010, except for note 25(a) as to which was dated March 15, 2010.

KPMG LLP

A handwritten signature in black ink that reads "KPMG LLP". The letters are slanted and connected in a cursive style. A horizontal line is drawn underneath the signature, starting from the left and extending to the right, ending under the second "P".

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

March 24, 2011

VAALDIAM MINING INC.
CONSOLIDATED BALANCE SHEETS
AS AT DECEMBER 31, 2010 AND 2009

(Expressed in thousands of Canadian dollars)	Notes	2010	2009
ASSETS			
Current Assets			
Cash and cash equivalents	4	\$ 8,347	\$ 1,262
Short-term investments	4	–	10,057
Sundry receivables and prepayments		327	238
Inventories	5	848	–
Brazilian taxes and contributions recoverable	6	116	–
Due from associated company	11	126	–
Current portion of long-term loan	7	802	71
Assets held for sale	9	–	6,679
		10,566	18,307
Long-term loan	7	–	681
Brazilian taxes and contributions recoverable	6	227	–
Plant and equipment	8	4,737	89
Mineral properties	9	4,691	–
Other assets		136	–
Investments	10	1,749	1,969
Investments in associated companies	11	3,346	1,673
		\$ 25,452	\$ 22,719

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities			
Accounts payable and accrued liabilities		\$ 2,947	\$ 571
		2,947	571
Long-term liabilities	13	472	–
Asset retirement obligations	14	903	–
Shareholders' Equity			
Common shares	15(a)	194,312	187,210
Contributed surplus	15(d)	3,707	3,702
Deficit		(176,087)	(167,985)
Accumulated other comprehensive loss	16	(802)	(779)
		21,130	22,148
		\$ 25,452	\$ 22,719

Commitments and contingencies (Note 23)

Subsequent events (Note 25)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



Jean-Charles Potvin
Chairman



Stephen Woodhead
Director

VAALDIAM MINING INC.

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Expressed in thousands of Canadian dollars)	Notes	2010	2009
Mine administration		\$ 877	\$ –
Corporate and general		4,184	4,477
Stock-based compensation	15(c)	708	26
General exploration		54	145
		5,823	4,648
Foreign exchange loss		556	277
Interest and other income		(871)	(647)
Interest expense		5	3
Amortization and depreciation		168	177
Other expenses	19	2,421	30,911
Net loss for the year		8,102	35,369
Deficit, beginning of year		167,985	132,616
Deficit, end of year		\$ 176,087	\$ 167,985
Basic and diluted loss per common share	21	\$ 0.12	\$ 0.74
Weighted average number of common shares outstanding	21	66,560,500	48,118,586
Net loss for the year		\$ 8,102	\$ 35,369
Loss on disposal of available-for-sale securities (net of tax of \$Nil)	10	(19)	–
Unrealized loss on available-for-sale securities (net of tax of \$Nil)	10	42	779
Comprehensive loss for the year		\$ 8,125	\$ 36,148

See accompanying notes to consolidated financial statements.

VAALDIAM MINING INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Expressed in thousands of Canadian dollars)	Notes	2010	2009
Common shares			
Balance at beginning of year		\$ 187,210	\$ 187,075
Issued on acquisition of Vaaldiam Resources Ltd.	3	6,346	–
Private placement		53	–
Issued through share bonus scheme		700	135
Cashless stock options		3	–
Balance at end of year	15(a)	194,312	187,210
Contributed surplus			
Balance at beginning of year		3,702	3,811
Issued through share bonus scheme		–	(84)
Stock option market price adjustment		5	(25)
Balance at end of year	15(d)	3,707	3,702
Deficit			
Balance at beginning of year		(167,985)	(132,616)
Net loss for the year		(8,102)	(35,369)
Balance at end of year		(176,087)	(167,985)
Accumulated other comprehensive loss			
Balance at beginning of year		(779)	–
Loss on disposal of available-for-sale securities (net of tax of \$Nil)	10	19	–
Unrealized loss on available-for-sale securities (net of tax of \$Nil)	10	(42)	(779)
Balance at end of year		(802)	(779)
Total shareholders' equity at end of year		\$ 21,130	\$ 22,148

See accompanying notes to consolidated financial statements.

VAALDIAM MINING INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31

(Expressed in thousands of Canadian dollars)	Notes	2010	2009
Operating Activities			
Net loss for the year		\$ (8,102)	\$ (35,369)
Amortization and depreciation		168	177
Stock-based compensation	15(c)	708	26
Unrealized foreign exchange loss		311	275
Other non-cash items	24	885	29,984
		(6,030)	(4,907)
Change in non-cash components of working capital	24	(3,556)	(1,450)
Cash used in operating activities		(9,586)	(6,357)
Investing Activities			
Purchase of plant and equipment		(745)	(2)
Proceeds on disposal of mineral properties	9	10,351	–
Proceeds on disposal of plant and equipment		1	–
Proceeds on disposal of investments	10	29	–
Investment in Flemish Gold Corp.	11	–	(1,574)
Deferred exploration and pre-production costs		(1,356)	–
Acquisition of Vaaldiam Resources Ltd.	3	(699)	–
Increase in other assets		(136)	–
Short-term investments		10,057	(10,057)
Cash provided by (used in) investing activities		17,502	(11,633)
Financing Activities			
Payment on line of credit	12	(718)	–
Payment on capital lease obligations		–	(36)
Cash used in financing activities		(718)	(36)
Effect of foreign exchange on cash		(113)	(12)
Net increase (decrease) in cash and cash equivalents during the year		7,085	(18,038)
Cash and cash equivalents, beginning of year		1,262	19,300
Cash and cash equivalents, end of year		\$ 8,347	\$ 1,262

See accompanying notes to consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009**

(in Canadian dollars unless otherwise specified)

1. NATURE OF OPERATIONS

Vaaldiam Mining Inc. (the “Company” or “Vaaldiam Mining”) (TSX: VAA), previously Tiomin Resources Inc. (“Tiomin”), is a publicly held company incorporated under the Canada Business Corporations Act listed on the Toronto Stock Exchange (“TSX”). The Company had been a development stage enterprise until March 23, 2010, when it acquired Vaaldiam Resources Ltd. (“Vaaldiam Resources” or “VRL”), a TSX-listed diamond producer and developer, and changed its name from Tiomin Resources Inc. to Vaaldiam Mining Inc. The Company is engaged in the investigation, acquisition, exploration and development of mineral properties. The Company’s Duas Barras mine in Brazil is currently in the pre-production phase and the Braúna diamond project in Brazil is currently in advanced exploration stage. Substantially all of the efforts of the Company are devoted to these business activities.

These consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As at December 31, 2010, the Company had working capital of \$7,619,000 but had incurred losses since inception resulting in an accumulated deficit of \$176,087,000. As at December 31, 2010, the Company had no consistent sources of cash and may require additional financing to fund the development of its properties and to continue operations in the future. There can be no assurances that the Company will be successful in this regard and, therefore, there is doubt regarding the Company’s ability to continue as a going concern and, accordingly, the use of accounting principles applicable to a going concern. These consolidated financial statements do not reflect adjustments that would be necessary if the “going concern” assumption were not appropriate. If the “going concern” assumption were not appropriate for these consolidated financial statements, then adjustments to the carrying values of the assets and liabilities, the reported expenses and the balance sheet classifications, which could be material, would be necessary.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**(a) Principles of Consolidation**

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“CGAAP”).

The consolidated financial statements include the accounts of the Company and its direct and indirect wholly-owned subsidiaries:

- Tiomin Minerals Ltd. (“TML”);
- Tiomin Kenya Ltd. (“TKL”);
- Tiomin China Ltd. (“TCL”);
- Vaaldiam Resources;
- Vaaldiam do Brasil Mineração Ltda. (“VBM”);
- Mineração Montes Claros Ltda. (“MMC”);
- Chapada Brasil Mineração Ltda. (“CBM”);
- Great Western Diamonds Corp. (“Great Western”);
- Oleander Financial Inc. (“Oleander”);
- Mineração Fortuna Ltda. (“Fortuna”); and
- RST Recursos Minerais Ltda. (“RST”).

All intercompany balances and transactions have been eliminated on consolidation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in Canadian dollars unless otherwise specified)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Use of Estimates

The preparation of financial statements in conformity with CGAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, particularly mineral properties, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the year. Significant areas that require the use of estimates include the assessment of valuation and impairment of long-lived assets, estimation of the asset retirement obligations, valuation of inventories, valuation of stock-based compensation and the determination of the existence and measurement of tax assets and related valuation allowances. Actual results could differ from those estimates.

(c) Foreign Currency Translation

The Company's foreign subsidiaries are operationally and financially dependent on the parent company and, as such, are considered to be integrated operations for accounting purposes and are translated using the temporal method. Under this method, monetary assets and liabilities are translated into Canadian dollars at the rates of exchange in effect at the consolidated balance sheet date and non-monetary assets and liabilities are translated at the historical rates of exchange. Revenues and expenses, other than depreciation and amortization, are translated into Canadian dollars at the average exchange rates prevailing on the date of the transaction. Foreign currency gains and losses are recognized in the consolidated statements of operations and deficit.

(d) Cash and Cash Equivalents

Cash and cash equivalents include all cash on hand, bank balances and all highly liquid short-term investments. The Company considers all highly liquid short-term investments with a maturity of three months or less at the date of purchase to be cash equivalents.

(e) Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined using the average cost method. The cost includes direct labour, other direct costs, related amortization and depreciation, and production overhead based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business, less applicable selling expenses.

(f) Plant and Equipment

Plant and equipment are recorded at cost and are amortized over the estimated useful lives of the assets as follows:

Plant and mining equipment	Units of production basis over indicated mineral resources
Exploration and other equipment	3 years, straight-line
Vehicles	3 years, straight-line
Computers and software	3 years, straight-line
Furniture and fixtures	5 years, straight-line
Leasehold improvements	5 years, straight-line

Assets under construction are recorded at cost and are transferred to property, plant and equipment together in the case of projects with any pre-production revenues at the commencement of production.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in Canadian dollars unless otherwise specified)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(g) Mineral Properties and Deferred Exploration Expenditures

The Company considers its exploration costs to have the characteristics of property, plant and equipment. As such, the Company defers all exploration costs including acquisition costs, field exploration and field supervisory costs relating to specific properties, until those properties are brought into production, at which time they will be amortized on a unit-of-production basis based on total indicated mineral resources, or until the properties are abandoned, sold or considered to be impaired in value, at which time, an appropriate charge would be made. Expenses incurred during the pre-production period are also deferred and any revenues realized during the pre-production period are recorded as a reduction in deferred expenditures.

The recoverability of the carrying value of exploration properties is dependent upon the discovery of economically recoverable resources, the ability of the Company to obtain financing or other means to complete development of the properties, and the future profitable production or proceeds from the disposition of the properties.

The amounts capitalized represent costs to be charged to operations in the future and do not necessarily reflect the present or future values of particular properties.

(h) Investments

Investments in marketable securities are classified as available-for-sale and are measured at fair value with revaluation gains and losses included in other comprehensive income (loss) ("OCI"), a component of shareholders' equity, until the investments are disposed of or permanently impaired. Where an active market does not exist, the investment is carried at cost.

Investments in companies through which the Company exerts significant influence over the investee are accounted for under the equity method. Under this method, the investment is initially recorded at cost and the carrying value is adjusted thereafter to include the following:

- The Company's pro-rata share of income or loss (including the Company's proportionate share of discontinued operations and extraordinary items) relating to the investee. Such amounts are included when determining the Company's net loss in the year being reported;
- The Company's proportionate share of a change in an accounting policy, a correction of an error relating to prior year financial statements and capital transactions (including amounts recognized in OCI) of the investee; and
- The Company's proportion of dividends paid by the investee.

(i) Impairment of Long-lived Assets

The carrying values of long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When indicators of impairment exist, and the carrying value is greater than the net recoverable value, an impairment loss is recognized to the extent that the fair value is below the carrying value. Mineral properties are written off when the property rights are allowed to lapse or when the property is intended to be abandoned.

(j) Financial Instruments

Cash and cash equivalents, and restricted cash are classified as held-for-trading and are carried at fair values on the consolidated balance sheets. Accounts receivable are designated as loans receivable, and accounts payable, accrued liabilities and line of credit are designated as other financial liabilities. The carrying amount of these items approximates fair value due to the short-term nature of these financial instruments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in Canadian dollars unless otherwise specified)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments in securities that the Company does not have significant influence over are classified as available-for-sale investments and are recorded on the consolidated balance sheets at fair value, to the extent that the equity investment has a quoted market price. Unrealized gains and losses are recorded in OCI. Realized gains and losses are recorded in the consolidated statements of operations, comprehensive loss and deficit when the investment is sold. An impairment loss is recorded in the consolidated statements of operations and deficit to the extent that any unrealized declines in fair value are judged to be other than temporary.

(k) Asset Retirement Obligations

The Company accrues the legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal operation of a long-lived asset. The fair value of a liability for an asset retirement obligation is recorded in the year in which it is incurred. When the liability is initially recorded, the cost is capitalized by increasing the carrying amount of the related long-lived asset. Upon settlement of the liability, a gain or loss is recorded to the extent that actual cost is more or less than the initial estimate.

(l) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income and mining tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax bases (temporary differences). Future income tax assets and liabilities are measured using the enacted tax rates and laws expected to be in effect when the temporary differences are likely to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the year in which the change is enacted or substantively enacted. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

(m) Revenue Recognition

Revenue from the sale of rough diamonds is recognized when title transfers and the rights and obligations of ownership pass to the purchaser, which generally occurs when the goods are received by the customer. It is at this point that the purchase price is agreed, delivery has occurred, and all significant acts have been completed. Revenue from the sale of gold produced is recognized as a separate revenue stream at the time the goods are received by the customer.

(n) Stock-based Compensation

The Company has a stock-based compensation plan, which is described in Note 15(c). The Company accounts for all stock-based awards to employees and non-employees using the fair value method.

Effective June 11, 2007, the Company amended its stock option plan whereby the value of the options at the time of exercise is settled by the surrendering of the options for substituted rights and the immediate conversion of these rights into common shares ("cashless settlement"). The number of substituted rights is determined based on the exercise price and the market price of the Company's common shares at the date of exercise.

For options granted prior to June 11, 2007, compensation expense was first measured at fair value at the grant date using the Black-Scholes option pricing model and recognized over the vesting period with a corresponding increase in contributed surplus. If, prior to the exercise of the options, the quoted market price of the common shares exceeds the total of the fair value of the options as determined at the grant date plus the exercise price, additional compensation expense will be recorded equal to the excess with ongoing remeasurement of the outstanding contributed surplus. At the time of exercise, capital stock is credited with the amount, if any, of the outstanding contributed surplus.

For options granted after June 11, 2007, compensation expense is calculated at the amount by which the quoted market price exceeds the exercise price with ongoing remeasurement of the outstanding contributed surplus. At the time of exercise, capital stock is credited with the amount, if any, of the outstanding contributed surplus.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009
(in Canadian dollars unless otherwise specified)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(o) Loss per Share

Basic loss per share is computed by dividing loss available to common shareholders by the weighted average number of common shares outstanding during the year. The treasury stock method is used to calculate diluted loss per share. Diluted loss per share is similar to basic loss per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding assuming that options and warrants, with average market prices for the year greater than their exercise prices, were exercised and the proceeds used to repurchase common shares. As the Company has a loss for each year presented, all stock options and warrants are considered to be anti-dilutive.

(p) Disposal of Long-lived Assets and Discontinued Operations

Long-lived assets are classified as assets held for sale in the year during which all of the required criteria of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3475, Disposal of Long-lived Assets and Discontinued Operations, have been met. Long-lived assets to be disposed of by sale are measured at the lower of their carrying amount or fair value less selling costs and are not amortized as long as they are classified as assets to be disposed of by sale.

Changes in Accounting Policies

Business Combinations, Consolidations and Non-Controlling Interests

In January 2009, the Accounting Standards Board ("AcSB") issued the following new standards: CICA Handbook Section 1582 – *Business Combinations*, Section 1601 – *Consolidations*, and Section 1602 – *Non-Controlling Interests*. These standards will be effective for fiscal years beginning on or after January 1, 2011, and early application is encouraged. Section 1582 replaces Section 1581 and establishes standards for the accounting for a business combination. It provides the Canadian equivalent of International Financial Reporting Standard ("IFRS") 3, Business Combinations. Sections 1601 and 1602 together replace Section 1600, *Consolidated Financial Statements*. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS-27, *Consolidated and Separate Financial Statements*. The Company has early adopted these new standards effective January 1, 2010 and has applied this to the business combination that occurred effective March 23, 2010. As a result of early adoption of these new standards, all costs associated with the March 23, 2010 business combination have been expensed as transaction costs and have not been capitalized. Early adoption of Sections 1601 and 1602 did not have any other impact on these consolidated financial statements.

3. ACQUISITIONS

Acquisitions are accounted for using the acquisition method, whereby identifiable assets and liabilities are recorded at their fair market values as of the date of acquisition.

Vaaldiam Resources

On December 11, 2009, the Company subscribed for 5,000,000 common shares of Vaaldiam Resources at a price of \$0.03 per share. On January 15, 2010, the Company further subscribed for 20,000,000 common shares of Vaaldiam Resources at a price of \$0.03 per share, and announced that it has entered into a definitive agreement to acquire, via a plan of arrangement, all of the outstanding common shares of Vaaldiam Resources that it did not already own in an all-share transaction ("Transaction") on the basis of 0.8 of a Tiomin common share for each Vaaldiam Resources common share.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in Canadian dollars unless otherwise specified)

3. ACQUISITIONS (CONTINUED)

On March 15, 2010, at the respective special meetings of shareholders held by Tiomin and Vaaldiam Resources, shareholders approved the Transaction. At the Tiomin shareholders' meeting, the shareholders also approved a name change to Vaaldiam Mining Inc. and a share consolidation (the "Consolidation") on the basis of one new Vaaldiam common share for ten existing common shares. All prior period information has been adjusted to reflect this consolidation. On March 18, 2010, the Company received final court approval from the Ontario Superior Court of Justice and the arrangement became effective on March 23, 2010. Vaaldiam Resources was delisted on March 26, 2010. On the same day, Vaaldiam Mining commenced trading on the TSX under the symbol VAA.

Vaaldiam Resources owned two properties that had been placed on care and maintenance due to the global economic conditions and the decline in diamond prices, as well as advanced stage exploration properties. The acquisition was made to derive value to the Company's shareholders by gaining access to these properties and to restart production at one of the mines.

The acquisition was accounted for as a business combination and the purchase price was calculated as follows:

(C\$ 000's)		
Common shares issued		
(211,532,258 pre-Consolidation common shares at a cost of \$0.03 per share)	\$	6,346
Fair value of 91,520 warrants and 713,724 options issued		–
Cash paid for 25,000,000 Vaaldiam Resources shares		750
Payments to dissenting shareholders and small lot holders		98
Purchase price	\$	7,194

The purchase price was allocated as follows:

(C\$ 000's)		
Non-cash working capital deficiency	\$	(5,243)
Property, plant and equipment		4,116
Mineral properties		8,076
Other non-current assets		1,327
Other non-current liabilities		(1,082)
Net identifiable assets	\$	7,194

During the year ended December 31, 2010, the Company expensed \$734,000 of transaction costs related to the acquisition of Vaaldiam Resources.

From the date of acquisition to December 31, 2010, Vaaldiam Resources has recorded a net loss of \$7,429,000 that is included in the consolidated statements of operations, comprehensive loss and deficit for the year ended December 31, 2010.

Had the acquisition of VRL occurred at January 1, 2010, the pro forma net loss for the year ended December 31, 2010 would have been \$9,714,000.

4. CASH AND CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

(\$000's)	2010		2009	
Cash and cash equivalents	\$	8,347	\$	1,262
Short-term investments		–		10,057
	\$	8,347	\$	11,319

Short-term investments represent investments in cashable GICs that are redeemable at any time without penalty.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009
(in Canadian dollars unless otherwise specified)

5. INVENTORIES

(\$000's)	2010		2009	
Rough diamonds	\$	634	\$	-
Work-in-progress		132		-
Supplies		82		-
	\$	848	\$	-

As at December 31, 2010, diamond inventories are carried at net realizable value.

6. BRAZILIAN TAXES AND CONTRIBUTIONS RECOVERABLE

Brazilian taxes and contributions recoverable consist of recoverable credits for ICMS, PIS and COFINS. ICMS is the State Value Added Tax imposed by the individual states in Brazil. PIS and COFINS are Federal Contributions for the purposes of social financing. An ICMS taxpayer may recover input tax charged on certain goods and services and PIS and COFINS taxpayers may recover input contributions charged on certain goods and services. The charges that are recoverable are in respect of purchases made for the purpose of manufacturing or production of supplies, and can be recovered, amongst other methods, as a deduction from output tax charged on the goods sold and, in the case of PIS and COFINS, can be set off against federal withholding taxes and income taxes. At December 31, 2010, a provision of \$1,075,000 (1,793,000 Brazilian Real) had been made against these taxes and contributions, as it is not certain that the full value of these credits will be recovered.

7. LONG-TERM LOAN

As at December 31, 2010, the fair value of the long-term loan receivable from Freegold Ventures Ltd. ("Freegold") was \$802,000 (2009 - \$752,000). The loan has a face value of \$855,000 and bears interest at an annual rate of 6% payable quarterly with a maturity date of September 30, 2011. The Company has collateral of a first priority pledge of the shares in Freegold's wholly-owned US subsidiaries and a general security agreement against the personal property of Freegold.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009
(in Canadian dollars unless otherwise specified)

8. PLANT AND EQUIPMENT

As at December 31, 2010 (\$'000's)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Plant and mining equipment	\$ 4,110	\$ -	\$ 4,110
Exploration and other equipment	504	209	295
Vehicles	204	26	178
Computers and software	318	255	63
Furniture and fixtures	93	16	77
Leasehold improvements	18	4	14
	\$ 5,247	\$ 510	\$ 4,737

As at December 31, 2009 (\$'000's)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Exploration and other equipment	\$ 218	\$ 173	\$ 45
Vehicles	157	152	5
Computers and software	280	260	20
Furniture and fixtures	101	82	19
	\$ 756	\$ 667	\$ 89

During the year ended December 31, 2010, the Company acquired plant and equipment totalling \$4,861,000, which included \$4,116,000 on the acquisition of Vaaldiam Resources. During the year ended December 31, 2010, the Company recorded amortization expense of \$168,000 and wrote-off or disposed of equipment totalling \$45,000, which resulted in a loss of \$44,000.

9. MINERAL PROPERTIES

(\$'000's)	January 1, 2010	Acquisition of VRL	Additions	Impairment	December 31, 2010
Production properties					
Brazil					
Duas Barras	\$ -	\$ 6,340	\$ 1,356	\$ (4,741)	\$ 2,955
Chapada	-	1,727	-	-	1,727
	-	8,067	1,356	(4,741)	4,682
Exploration properties					
Brazil					
Catalão	-	9	-	-	9
	-	9	-	-	9
Total Mineral Properties	\$ -	\$ 8,076	\$ 1,356	\$ (4,741)	\$ 4,691

In March 2010, following the acquisition of Vaaldiam Resources as described in note 3, the Company acquired two diamond mines and exploration properties in Brazil. As of the acquisition date, both mines had been placed on care and maintenance since 2008.

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9. MINERAL PROPERTIES (CONTINUED)

Duas Barras Mine, Minas Gerais, Brazil

The Duas Barras mine is an alluvial diamond deposit located about 150 kilometres north of the town of Diamantina in the state of Minas Gerais, Brazil. The Company, through its wholly owned subsidiary, MMC, owns a 100% interest in the deposit. A royalty of 6% of gross sales revenues is payable to the owner of the surface rights. Mining and processing operations had been suspended since October 2008 due to the weak diamond markets which were caused by the global economic crisis. During the year ended December 31, 2010, the Company completed the re-commissioning of the plant and started pre-production activities. At December 31, 2010, the Company determined that the mine value was less than its carrying value due mainly to lower than expected grades and higher costs experienced in the pre-production activities. As a result, an impairment loss of \$4,741,000 was recorded. In calculating the impairment loss, the Company compared the carrying costs to the fair value, estimated using a discounted cash flow model. The discounted cash flow model is based on management's best estimates of future cash flow based on expected diamond prices, gold prices, recovery rates, operating costs and other economic factors. However, actual cash flow may vary significantly from these estimates.

Chapada, Mato Grosso, Brazil

The Chapada mine is located about 80 kilometres northeast of the city of Cuiabá in the state of Mato Grosso, Brazil. Mining operations have been suspended since the end of June 2008, the end of the contract mining term, in order to finance and convert the mining operation from contract mining to a company owned mining operation. The Chapada mine stayed suspended and was placed on a care and maintenance basis due to the global economic crisis. During 2010, exploration work commenced to further delineate resources on the property.

Kwale, Kenya

The Kwale project is located about 40 kilometres south of Mombasa, approximately 10 kilometres inland from the Indian Ocean coastline. It consists of three large Aeolian dunes containing quantities of the heavy minerals ilmenite, rutile and zircon and is owned 100% by TKL, a wholly owned subsidiary of the Company.

The Company entered into a Memorandum of Understanding ("MOU") with the Jinchuan Group Ltd. ("Jinchuan") on July 28, 2008 and an Investment Agreement ("IA") on August 31, 2009 whereby Jinchuan was to acquire 70% of TKL by investing US\$25,000,000 into TKL and to procure all financing, on normal commercial terms, to develop the Kwale project. On October 27, 2009, before the transaction closed, Jinchuan terminated the IA, which resulted in an other than temporary impairment to the Kwale project. At December 31, 2009, the Company wrote off an amount of \$30,267,000, being all the costs associated with the Kwale project and also reversed amounts owing to Jinchuan and to the Canadian International Development Agency ("CIDA").

On February 24, 2010, Vaaldiam Mining and Base Resources Limited ("BRL") (ASX: BSE, formerly Base Iron Limited,) signed a binding heads of agreement ("HoA") for a transaction in which BRL would acquire the Kwale project, all the intellectual property associated with Vaaldiam Mining's mineral sands in Africa and an option to acquire 100% of TKL. Pursuant to the HoA, Vaaldiam Mining received US\$3,000,000 in cash at closing on July 31, 2010. If the project reaches commercial production, Vaaldiam Mining will receive a cash royalty of 1.5% of all product value and Pangea Goldfields, a 100% owned subsidiary of Barrick Gold Corporation, will receive a 0.5% cash royalty on the same terms and conditions as Vaaldiam Mining in exchange for waiving certain rights that it acquired in prior transactions with Vaaldiam Mining. During the year ended December 31, 2010, the Company recorded care and maintenance costs at the Kwale project of \$78,000 (2009 - \$818,000).

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9. MINERAL PROPERTIES (CONTINUED)

Pukaqaqa, Peru

The Pukaqaqa copper-gold deposit is located about 10 kilometres northwest of Huancavelica and 230 kilometres southeast of Lima, Peru. On October 2, 2004, the Company had entered into a heads of agreement (the "Milpo HOA") with Campaña Minera Milpo S.A.A. ("Milpo"), and pursuant to the agreement, the Company earned a 49% interest in the property.

On February 19, 2010, the Company entered into an agreement to sell its 49% interest in the Pukaqaqa project to Milpo at a price of US\$7,000,000. Under the terms of the agreement, the Company received cash consideration of US\$5,571,228 on closing and received a further US\$1,428,772 upon providing Milpo with a standard tax certificate from the Canada Revenue Agency.

If the project reaches commercial production, the Company will receive a further US\$4,000,000 in the first year of production and an additional US\$4,000,000 in the following year. The Company will also receive a Net Smelter Return royalty ("NSR") on all mineral production from the current property package and any properties subsequently acquired by Milpo within 15 kilometres of the boundaries of the existing property package on a sliding scale. The NSR will be 1% if the quarterly London Metals Exchange copper price averages US\$3/lb or less and 2% otherwise.

As a result of this, the total amounts expended on the project amounting to \$6,679,000 were reclassified to assets held for sale as at December 31, 2009. During the first quarter of 2010, a gain of \$572,000 was recorded on the sale of the project.

Tanzania

During 2006, the Company acquired a reconnaissance exploration license for mineral sands along the coastline of Tanzania. During the year ended December 31, 2009, the Company decided to abandon the project and wrote off the costs incurred to date of \$233,000.

10. INVESTMENTS

(C\$ 000's)	December 31, 2010		December 31, 2009	
	Carrying Value	Cost	Carrying Value	Cost
Freegold Ventures	\$ 1,469	\$ 2,156	\$ 1,559	\$ 2,203
Western Standard Metals Ltd.	280	395	260	395
Vaaldiam Resources	-	-	150	150
	\$ 1,749	\$ 2,551	\$ 1,969	\$ 2,748

Freegold

On January 15, 2009, the Company received 250,000 common shares of Freegold (TSX: FVL, Frankfurt: FR4N) as a commission for the extension of a bridge loan facility to Freegold. On July 15, 2009, as a commission for further extensions to the loan, the Company received 360,000 Freegold common shares. On October 1, 2009, the Company received 16,714,773 additional Freegold common shares on the conversion of debt advanced to Freegold.

In May 2010, the Company sold 380,000 common shares of Freegold for proceeds of \$29,000, resulting in a realized loss of \$19,000 and the corresponding reversal of \$19,000 of unrealized loss that was previously recorded in Other Comprehensive Loss. On August 27, 2010, Freegold common shares were consolidated on a 6:1 basis. As at December 31, 2010, the Company held 2,824,128 common shares, which are considered an available-for-sale security, and has recognized a cumulative unrealized loss in the amount of \$687,000 (2009 - \$644,000) being recorded in OCI due to the change in market value (note 16).

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10. INVESTMENTS (CONTINUED)

Western Standard Metals Ltd. ("Western Standard")

On October 1, 2009, the Company received 1,000,000 common shares of Western Standard (TSX-V: WSM, Frankfurt: ND7A) as part of the Freegold transaction.

As at December 31, 2010, the Company held 1,000,000 common shares, which are considered an available-for-sale security, and has recognized a cumulative unrealized loss in the amount of \$115,000 (2009 - \$135,000) being recorded in Other Comprehensive Loss due to the change in market value (note 16).

Subsequent to December 31, 2010, Western Standard was acquired by Terraco Gold Corp. (see Note 25).

11. INVESTMENTS IN ASSOCIATED COMPANIES

(\$000's)	2010	2009
Flemish Gold Corp.	\$ 2,161	\$ 1,673
Lipari Mineração Ltda.	1,185	-
	\$ 3,346	\$ 1,673

Flemish Gold Corp. (formerly Kivu Gold Corp.)

Flemish Gold Corp. ("Flemish") is a private corporation incorporated under the Canada Business Corporations Act focusing on precious metals exploration in sub-Saharan Africa. On February 14, 2008, the Company acquired by way of a private placement, 4,000,000 common shares of Flemish ("Flemish shares") at \$0.50 per common share, representing approximately 16.9% of the then issued and outstanding common shares of Flemish and 4,000,000 Flemish share purchase warrants which have since expired unexercised. As there are common directors in both Flemish and the Company, non-related directors of the Company approved the investment based on their review and analysis, which included receiving an independent fairness opinion.

On February 20, 2009, by way of a private placement ("February 2009 Placement"), the Company increased its holding by 6,625,000 common shares at a price of \$0.215 per common share, thereby increasing its ownership to approximately 33.5% of the then outstanding Flemish shares. On completion of the February 2009 Placement, the Company determined that it has significant influence over Flemish and was required to adopt the equity method of accounting. In October 2009, the Company's ownership percentage in Flemish decreased to 30.81%.

During the year ended December 31, 2009, the Company recorded an equity loss of \$481,000 and \$130,000 as a write-down in the carrying value of the investment due to an other-than-temporary decline in value.

During 2010, Flemish issued 12,609,685 common shares at prices between \$0.215 and \$0.75 per share, which reduced the Company's ownership to 22.56%. This resulted in a dilution gain of \$1,611,000.

During the year ended December 31, 2010, the Company recorded an equity loss of \$1,123,000 on the investment in Flemish.

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11. INVESTMENTS IN ASSOCIATED COMPANIES (CONTINUED)

Lipari Mineração Ltda.

The Company holds a 20% interest in the Braúna diamond through its investment in Lipari Mineração Ltda. ("LML"), a Brazilian-registered company. The Braúna property is located in the state of Bahia near the town of Nordestina. The Company's investment in LML is accounted for as an equity investment.

The Company also holds 100% of the rights relating to the gold potential of the Braúna property, with the exception of any by-product gold produced as a result of diamond mining activities. During 2010, a bulk sampling program was completed on the Braúna diamond project and a preliminary economic assessment is underway.

During the year ended December 31, 2010, the Company recorded an equity loss of \$34,000 on the investment in LML. At December 31, 2010, the Company had a receivable from LML of \$126,000, representing expenses for the bulk sampling program incurred by the Company on behalf of LML.

Subsequent to December 31, 2010, the Company entered into an agreement to increase its ownership interest from 20% to 51% (see Note 25).

12. LINE OF CREDIT

As part of the acquisition of Vaaldiam Resources, the Company acquired an unsecured revolving line of credit of US\$2,500,000. Interest for this line of credit is payable quarterly and is determined based on the three-month US\$ LIBOR rate plus 2.75% on the date of each drawdown. Under the terms of the agreement, the creditor may demand repayment at any time by providing 90 days' written notice. After the acquisition of Vaaldiam Resources, the Company paid down the outstanding balance of \$718,000 (US\$700,000).

13. LONG-TERM LIABILITIES

Long-term liabilities consist of the long-term portion of Brazilian taxes payable and mineral license fees for which the Company has negotiated long-term payment plans with the Brazilian government.

14. ASSET RETIREMENT OBLIGATIONS

(\$000's)	2010	2009
Balance, January 1, 2010	\$ -	\$ -
Acquisition of Vaaldiam Resources	784	-
Accretion expense	80	-
Foreign exchange	39	-
Balance, December 31, 2010	\$ 903	\$ -

Any restoration, rehabilitation and environmental costs incurred at the Duas Barras and Chapada mines during the life of the mines are expensed immediately as rehabilitation is incurred on an ongoing basis. The asset retirement obligations relate to the closure and reclamation costs associated with the Duas Barras and Chapada mines and associated processing facilities. The Company has estimated the net present value of the obligations using a discount rate of 13.0%. The total undiscounted closure and reclamation costs are estimated at approximately \$1,389,000 (R\$2,435,000) to be incurred between 2013 and 2015. These closure and reclamation costs are based on management's internal estimates and are reviewed regularly to take into account any significant changes to the assumptions. However, actual costs may vary depending on market prices and other factors at the time they are actually incurred. Furthermore, the timing of these closure and reclamation costs may change depending on the future operations at the mines.

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15. SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares at no par value. On March 23, 2010, the shareholders approved the consolidation on the basis of one new Vaaldiam Mining common share for ten existing common shares. All prior period information has been adjusted to reflect this consolidation.

(a) Common Shares

	Notes	Number of Shares	Amount (\$000's)
Balance, January 1, 2009		47,661,380	\$ 187,075
Share bonus scheme	(i)	565,000	135
Balance, December 31, 2009		48,226,380	187,210
Share bonus scheme	(ii)	2,000,000	700
Cashless stock options	(iii)	8,571	3
Shares issued on acquisition of Vaaldiam Resources	(iv)	21,153,226	6,346
Private placement	(v)	238,636	53
Balance, December 31, 2010		71,626,813	\$ 194,312

- (i) On December 3, 2008, the Board of Directors of Vaaldiam Mining approved share bonuses totalling 675,000 common shares at a deemed price of \$0.20 per share. These shares may be issued up to February 28, 2009. At December 31, 2008, 235,000 common shares had been issued and during January 2009 another 420,000 common shares were issued with the balance of 20,000 being forfeited. On September 11, 2009, the Board of Directors approved share bonuses totalling 145,000 common shares at a deemed price of \$0.35 per share.
- (ii) On February 3, 2010, the Board of Directors approved share bonuses totalling 2,000,000 common shares at a deemed price of \$0.35 per share.
- (iii) On March 9, 2010, 8,571 cashless stock options were exercised with a deemed value of \$3,000.
- (iv) On March 23, 2010, pursuant to a plan of arrangement, 21,153,226 common shares were issued to shareholders of Vaaldiam Resources as described in Note 3.
- (v) On July 12, 2010, the Company issued 238,636 common shares in settlement of an outstanding payable acquired as part of the acquisition of Vaaldiam Resources.

(b) Common Share Purchase Warrants

The following is a summary of the unexercised outstanding warrants as at December 31, 2010:

Description	Number Outstanding	Exercise Price	Expiry Date
Jinchuan warrants	6,093,769	\$ 6.50	July 31, 2016

On January 1, 2010, 445,129 Radiant B warrants and 40,460 Radiant compensation warrants expired unexercised.

On May 31, 2010, 83,200 LinQ Series 2 warrants and 8,320 LinQ Series 3 warrants expired unexercised. The LinQ warrants were issued on March 23, 2010 in replacement of Vaaldiam Resources warrants as part of the acquisition of Vaaldiam Resources.

On December 31, 2010, 3,750,000 Nederlandse Financierings Maatschappijvoor Ontwikkelingslanden N.V. warrants expired unexercised.

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15. SHARE CAPITAL (CONTINUED)

(c) Stock-based Compensation

	Number of Options	Weighted Average Exercise Price
Options outstanding as at January 1, 2009	4,476,400	\$ 1.10
Granted	939,158	0.34
Expired and forfeited	(1,170,420)	2.00
Options outstanding as at December 31, 2009	4,245,138	\$ 0.68
Granted	913,724	0.44
Exercised	(8,571)	0.25
Expired and forfeited	(343,752)	0.81
Outstanding and exercisable as at December 31, 2010	4,806,539	\$ 0.63

Stock options outstanding and exercisable as at December 31, 2010 are as follows:

Range of Exercise Prices	Number of Options	Weighted Average Life (Years)	Weighted Average Exercise Price
< \$0.30	724,500	3.41	\$ 0.257
\$0.31 – \$0.40	913,058	3.75	\$ 0.354
\$0.41 – \$0.50	620,000	3.16	\$ 0.500
\$0.51 – \$0.70	633,250	2.41	\$ 0.650
\$0.71 – \$0.80	694,333	1.99	\$ 0.750
\$0.81 – \$1.00	900,000	1.15	\$ 0.900
\$1.01 – \$4.00	301,398	1.39	\$ 1.250
> \$4.01	20,000	0.23	\$ 4.050
	4,806,539	2.54	\$ 0.628

Under the Company's Stock Option Plan (the "Plan"), the Company may grant to directors, officers, employees and consultants options to purchase common shares of the Company. The maximum number of common shares reserved for issuance is 10% of the number of issued and outstanding common shares of the Company at the time of any option grant being reserved. The total number of common shares which may be reserved for issuance to any one individual under the Plan shall not exceed 5% of the total number of issued and outstanding common shares (on a non-diluted basis) under the Plan. Options granted since 1995 have a five-year term and are priced at the closing price of the Company's common shares on the day immediately prior to the date of granting. Vesting provisions vary according to the terms of the individual granting.

The Company also has a Stock Incentive Plan, which includes a Share Bonus Plan and a Share Purchase Plan for the benefit of directors, officers, employees and consultants of the Company. The maximum number of common shares issuable under the Stock Incentive Plan is 7,138,817 common shares, with no more than 5,496,889 common shares being issued under the Share Bonus Plan and the number of common shares issuable to any one person shall not exceed 20% of the aggregate number reserved. The Share Purchase Plan would allow participants to contribute up to 10% of their base annual salary and the Company would match each participant's contribution and the aggregate funds would be used to purchase common shares of the Company.

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15. SHARE CAPITAL (CONTINUED)

During 2007, the shareholders approved the cashless settlement alternative and the addition of a provision whereby, if the expiry date of an option granted under the Plan would otherwise occur during or within 10 days following a Black-Out Period, the expiry date of such option shall be extended to the first business day which is at least 10 days after the end of the Black-Out Period. Under the cashless settlement option, the Company has the option to issue to the option holder substituted rights which are immediately converted into an equal number of common shares.

During the year ended December 31, 2010, the Company issued 713,724 options with respect to the acquisition of Vaaldiam Resources. The Company also issued 200,000 options to two new non-executive Directors of the Company. For the year ended December 31, 2010, the Company recorded \$708,000 of stock-based compensation expense, which included \$700,000 under the share bonus scheme, \$3,000 on the exercise of cashless stock options and \$5,000 on the change in the intrinsic value of the outstanding cashless stock options.

As at December 31, 2010, the remaining number of common shares available for issuance under the Stock Option Plan was 2,356,143.

(d) Contributed Surplus

For options granted after June 11, 2007, compensation expense is calculated as the amount by which the quoted market price exceeds the exercise price with ongoing remeasurement of the outstanding contributed surplus. At December 31, 2010, the quoted market price of \$0.26 exceeded the exercise price of 524,500 outstanding stock options, and resulted in an adjustment to contributed surplus of \$5,000 to bring the total balance related to the stock options to \$5,000. At December 31, 2009, the market price of \$0.25 did not exceed the exercise price of any outstanding stock options. At the time of exercise, capital stock will be credited with the amount, if any, of the outstanding contributed surplus.

16. ACCUMULATED OTHER COMPREHENSIVE LOSS

During the year ended December 31, 2010, an amount of \$42,000, net of tax of \$Nil (2009 - \$779,000, net of tax of \$Nil), was charged to accumulated other comprehensive loss in relation to the unrealized loss on investments (Note 10). In addition, an amount of \$19,000, net of tax of \$Nil, was transferred from other comprehensive loss to net loss as result of the sale of 380,000 common shares of Freegold. As at December 31, 2010, the accumulated other comprehensive losses for Freegold and Western Standard are \$687,000 and \$115,000, respectively, for a total of \$802,000 (2009 - \$779,000).

17. MANAGEMENT OF CAPITAL

The Company considers its capital to include all components of debt and shareholders' equity. Its objectives are to ensure that the Company continues to operate as a going concern, if possible, in order to pursue the operation of its mines and the development of its mineral properties, to sustain future development and growth as well as to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares, seek debt financing, or acquire or dispose of assets. The Company, upon approval from its Board of Directors, makes changes to its capital structure as deemed appropriate under the specific circumstances.

As at December 31, 2010, the capital structure of the Company consists of shareholders' equity totalling \$21,130,000 (December 31, 2009 - \$22,148,000).

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18. FINANCIAL INSTRUMENTS

Fair Value

CGAAP requires that the Company disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the consolidated balance sheet dates, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

The Company has designated its cash and cash equivalents as held-for-trading, which is measured at fair value. Amounts due from related parties and long-term loans 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.

Credit risk is the risk of unexpected financial loss to the Company if a customer or third party to a financial instrument fails to meet its contractual obligations.

When operating, the sales of the Company are predominantly through uptake agreements with two customers and the Company is exposed to the concentration of credit risk on the accounts receivable from its customers. However, the uptake agreements provide for a relatively short credit period and, thus, reduce any credit risk.

Categories of Financial Assets and Liabilities

Financial instruments are classified into one of the following five categories under CGAAP: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets, and other financial liabilities. The carrying value of the Company's financial instruments is classified into the following categories:

(\$000's)	2010	2009
Held-for-trading ⁽¹⁾	\$ 8,347	\$ 11,319
Available-for-sale ⁽²⁾	1,749	1,969
Loans and receivables ⁽³⁾	928	808
Other financial liabilities ⁽⁴⁾	3,419	571

⁽¹⁾ Includes cash and cash equivalents and short-term investments.

⁽²⁾ Includes the Company's investments in the common shares of Freegold and Western Standard. Included in the December 31, 2009 balance was the investment in Vaaldiam Resources.

⁽³⁾ Includes receivables (Freegold and other receivables), but excludes prepaid share issuance costs, other prepaid expenses and deferred interest.

⁽⁴⁾ Includes accounts payable and accrued liabilities and long-term liabilities.

CICA Handbook Section 3862, *Financial Instruments - Disclosures* ("Section 3862"), requires expanded disclosures about fair value measurements. The three levels of the fair value hierarchy under Section 3862 are as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – 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); and

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

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18. FINANCIAL INSTRUMENTS (CONTINUED)

The following table sets forth the Company's financial assets and liabilities measured at fair value within the fair value hierarchy.

(\$000's)	Total	Level 1	Level 2	Level 3
Financial Assets				
Receivables	\$ 126	\$ 126	\$ -	\$ -
Available-for-sale securities	1,749	1,749	-	-
Loans receivable	802	-	802	-
	\$ 2,677	\$ 1,875	\$ 802	\$ -
Financial Liabilities				
Accounts payable and accrued liabilities	\$ 2,947	\$ 2,947	\$ -	\$ -
Long-term liabilities	472	-	472	-
	\$ 3,419	\$ 2,947	\$ 472	\$ -

The Company's financial instruments are exposed to certain financial risks, including credit risk, liquidity risk and market risk, which includes interest rate risk, foreign currency risk and price risk.

(a) Credit Risk

On October 1, 2009, the Company agreed to convert approximately US\$1,378,000 of the US\$2,329,000 short-term loan into 16,714,773 Freegold common shares, leaving an amount of \$855,000 secured by a first priority pledge of the shares in Freegold's wholly owned US subsidiaries and a general security agreement against the personal property of the Company. Without taking into account the fair value of any collateral, the amount that represents the maximum credit risk exposure for this loan is \$855,000 at December 31, 2010. The credit quality of the loan is considered adequate by management considering the collateral held.

(b) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when they become due. As at December 31, 2010, the Company had cash and cash equivalents of \$8,347,000 (2009 - \$1,262,000) and short-term investments of \$Nil (2009 - \$10,057,000) to settle current liabilities of \$2,947,000 (2009 - \$571,000). Most of the Company's accounts payable and accrued liabilities have contractual maturities of less than 30 days and are subject to normal trade terms.

(c) Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and diamond, gold and base metal prices.

(i) Interest Rate Risk

The Company is exposed to interest rate risk as bank accounts earn interest income at variable rates. The fair value of its portfolio is relatively unaffected by changes in short-term interest rates. The Company has cash balances as discussed above and no interest-bearing long-term debt. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by its banking institutions. The income earned on these bank accounts is subject to the movements in interest rates. Assuming the \$8,347,000 held in cash and cash equivalents and short-term investments at December 31, 2010 had a +/- 1% change in interest rates, this would have an effect on loss before income taxes of approximately +/- \$83,000. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. As at December 31, 2010, the Company had investments in investment-grade short-term deposit certificates.

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18. FINANCIAL INSTRUMENTS (CONTINUED)

(ii) Foreign Currency Risk

As at December 31, 2010, the Company holds its cash and cash equivalents in Canadian dollars, US dollars, Brazilian real and Kenyan shillings as discussed above, to settle the current liabilities. The Company's cash and cash equivalents, receivables, and accounts payable and accrued liabilities that are held in the various currencies are then translated into Canadian dollars. Foreign exchange fluctuations occur against the various currencies.

When the mines are operating, the Company's diamond sales are denominated in US dollars. The Company operates primarily in Brazil and a significant portion of the Company's operating costs and capital expenditures are denominated in the Brazilian real and Canadian dollar. A significant change in the currency exchange rates between the Brazilian real or the United States dollar relative to the Canadian dollar could have an effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

At December 31, 2010, a 10% change in the exchange rate between the Canadian dollar and the US dollar with all other variables held constant would result in a change of approximately \$300,000 in net loss. Similarly, a 10% change in the exchange rate between the Canadian dollar and the Brazilian real with all other variables held constant would result in a change of approximately \$200,000 in net loss.

(iii) Price Risk

The Company is exposed to price risk with respect to diamond, gold and base metal prices as well as input prices for fuel and electricity. Diamond, gold and base metal price risk is defined as the potential adverse impact on earnings and economic value due to gold and base metal price movements and volatilities. The Company closely monitors prices of diamonds, gold and other base metals to determine the appropriate course of action to be taken by the Company.

19. OTHER INCOME AND EXPENSES

Other income and expenses consist of the following:

(\$000's)	Notes	2010	2009
Provision for Brazilian taxes and contributions recoverable		\$ 190	\$ -
Severance costs		741	109
Transaction costs	3	734	-
Loss on disposal of investments	10	19	-
Gain on disposal of mineral properties	9	(3,673)	-
Loss on disposal of property, plant and equipment	8	44	35
Equity loss in associated company	11	1,158	481
Gain on dilution of associated company	11	(1,611)	-
Impairment of investment in associated company		-	130
Bad debt expense		-	394
Kwale project		78	818
Impairment of mineral properties	9	4,741	30,047
Write-off of long-term lease and land		-	797
Miscellaneous income		-	(849)
Forgiveness of long-term liabilities		-	(386)
Gain on extinguishment of loan		-	(665)
		\$ 2,421	\$ 30,911

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in Canadian dollars unless otherwise specified)

20. INCOME TAXES

The Company is subject to income taxes in Canada, Barbados, Brazil Kenya and Tanzania. The recovery of income taxes varies from the amounts that would be computed by applying the Canadian federal and provincial statutory rates of approximately 31.00% (2009 – 33.00%) to income before income taxes as follows:

	2010	2009
Expected income tax recovery using statutory income tax rates	\$ (2,512)	\$ (11,672)
Increase (decrease) in tax recovery resulting from:		
Adjustment for different tax rates	(622)	1,263
Stock based compensation	220	8
Foreign exchange loss on loans to subsidiaries	176	1,463
Amounts not taxable	260	(206)
Change in valuation allowance	2,478	9,144
Future income tax recovery	\$ –	\$ –

The tax effects of temporary differences that give rise to the future tax liabilities as at December 31, 2010 and 2009 are as follows:

	2010	2009
Canada		
Non-capital losses	\$ 11,904	\$ 6,546
Capital losses	24	-
Property, plant and equipment	360	311
Stock issuance costs	424	328
Investments	258	302
Mineral properties	5,557	2,771
Brazil		
Non-capital losses	14,048	-
Property, plant and equipment	1,119	-
Mineral properties	2,449	-
Gain on disposal of mineral properties	1,583	-
VAT recoverable	45	-
Other	(62)	-
Barbados		
Non-capital losses	217	-
	37,926	10,258
Valuation allowances	(37,926)	(10,258)
Net Future Tax Assets (Liabilities)	\$ –	\$ –

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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20. INCOME TAXES (CONTINUED)

Losses and Tax Reduction Amounts

Canada

The Company has non-capital losses for income tax purposes in Canada of approximately \$47,037,000, which may be carried forward to reduce taxable income of future years. No provision has been made in these consolidated financial statements for the potential income tax savings on the application of these losses. These losses, if unapplied, would expire in the future as follows:

2012	\$	82
2013		618
2014		5,321
2015		3,089
2024		37
2025		2,904
2026		11,665
2027		10,075
2028		6,772
2029		4,373
2030		2,101
	\$	47,037

The Company also has capital losses for income tax purposes in the amount of \$190,000, which may be carried forward indefinitely to reduce taxable capital gains of future years. No provision has been made in these consolidated financial statements for the potential income tax savings on the application of these losses.

The Canadian resource pools, which may be carried forward indefinitely, consist of the following amounts:

Cumulative Eligible Capital	\$	75
Earned depletion base		81
Cumulative Canadian Exploration Expenditures		11,782
Cumulative Canadian Development Expenditures		3,457
Foreign Exploration and Development Expenditures		6,390
	\$	21,785

Brazil

The Company has non-capital losses for income tax purposes in Brazil of approximately \$41,317,000, which may be carried forward to reduce taxable income of future years. The losses can be used to offset up to 34% of each year's fiscal profits and they can be carried forward indefinitely. The tax benefit of these losses has not been reflected in the consolidated financial statements.

Kenya

The Company has non-capital losses for income tax purposes in Kenya of approximately \$17,001,000, which may be carried forward indefinitely to reduce taxable income of future years. The tax benefit of these losses in the amount of \$5,100,000 has not been reflected in the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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20. INCOME TAXES (CONTINUED)

Barbados

The Company has non-capital losses for income tax purposes in Barbados of approximately \$8,681,000 which may be carried forward to reduce taxable income of future years. The tax benefit of these losses has not been reflected in the consolidated financial statements. These losses, if unapplied, would expire as follows:

2015	\$	8,284
2016		390
2019		7
	\$	8,681

21. LOSS PER SHARE

For the purpose of the determination of loss per share, the basic and diluted weighted average number of common shares outstanding for the year ended December 31, 2010 was 66,560,500 (2009 - 48,118,586). The determination of the weighted average number of common shares outstanding for the calculation of diluted loss per share does not include the effect of outstanding warrants and options since to do so would reduce the loss per share and would, therefore, be anti-dilutive.

22. RELATED PARTY TRANSACTIONS

Transactions with related parties, all of which are recorded at the exchange amount which is the amount of consideration agreed upon by the related parties, are as follows:

- (a) The Company holds a 22.56% ownership interest in Flemish. Certain directors, officers and employees of the Company currently hold 14,155,001 (30.06%) common shares of Flemish. The main holders of the common shares are Jean-Charles Potvin, the non-executive Chairman of Vaaldiam Mining, and his family, who hold 11,000,001 common shares, Roland Bertin, a non-executive director, and a company controlled by him, who hold 1,750,000 common shares, and Robert Jackson, the President and CEO of Vaaldiam Mining, who holds 1,300,000 common shares. Mr. Potvin, as Chairman and CEO of Flemish, received an annual salary of \$125,000 from Flemish, which was increased to \$250,000 effective October 1, 2010. During October 2010, Mr. Potvin received a bonus of \$50,000 and a retrospective salary adjustment of \$100,000 for years in which no salary was paid. Mr. Jackson is also a director of Flemish and receives no compensation from Flemish. At December 31, 2010, Mr. Potvin and Mr. Jackson also held 980,000 and 480,000 stock options, respectively, at exercise prices of between \$0.50 and \$0.75 per option.
- (b) The Company charges Flemish for office space rental and related expenses. During the year ended December 31, 2010, the Company charged Flemish \$22,940 for office space rental and expenses. No other services are provided and charged for by the Company. As at December 31, 2010, there were no amounts outstanding from Flemish.
- (c) In October 2009, Vaaldiam Mining entered into an agreement with Flemish whereby Flemish would pay to Vaaldiam Mining a share of the settlement costs and legal expenses in relation to the settlement of a legal action brought forth by Jaguar Financial Corp. against Flemish, Freegold and Vaaldiam Mining. Under the terms of the agreement, the payment to Vaaldiam Mining would be conditional on the ability of Flemish to raise additional financing. In July 2010, Flemish completed a financing of approximately \$6,555,000 and paid \$506,000 to Vaaldiam Mining in accordance with the agreement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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23. COMMITMENTS AND CONTINGENCIES

Lease Commitments

Under the terms of the Company's operating lease agreements, the Company is committed to pay the following minimum amounts in Brazil, Kenya and Canada:

**Twelve months ending
(\$000's)**

December 31, 2011	\$	188
December 31, 2012		135
December 31, 2013		117
December 31, 2014		117
Thereafter		–
Total	\$	557

Contingencies for Lawsuits and Tax Assessments

Subsidiaries of the Company have been served claims by former employees in Brazil in relation to wrongful dismissal, lost wages, overtime and reimbursement of expenses. In addition, certain subsidiaries of the Company have outstanding assessments from the Brazilian tax authorities with respect to prior period filings and outstanding balances. Some of these claims and assessments are still subject to court judgment, while others are in the process of being appealed.

When the Company assesses loss contingencies related to legal proceedings or tax assessment that are pending against the Company or unasserted claims that may result in such proceedings or assessments, the Company and its legal counsel evaluate the perceived merits of any legal proceedings, assessments or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought.

If a contingent loss is probable based on the assessment and the amount can be reasonably estimated, then a loss is recorded. If a contingent loss is not probable based on the assessment but is reasonably possible, or is probable but the amount of the loss cannot be reasonably estimated, then the details of the contingent loss are disclosed. If the contingent loss is considered remote, it is generally not disclosed unless it involves guarantees, in which case the nature of the guarantee is disclosed. Legal fees incurred in connection with pending legal proceedings are expensed as incurred.

In the opinion of management and on advice of legal counsel, these matters are without merit; however, based on the expected outcome of these claims, a provision of \$217,000 (R\$362,000) has been made for the claims in the consolidated financial statements. In addition, a lien was made by a former employee on an asset of the subsidiary to the amount of approximately \$265,000, which will be lifted in 2011, when the last installment of a negotiated settlement is due to be paid.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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24. SUPPLEMENTAL CASH FLOW INFORMATION

Other non-cash items consist of the following:

(\$000's)	Notes	2010	2009
Accretion of asset retirement obligation	14	\$ 80	\$ -
Provision for Brazilian taxes and contributions recoverable		190	-
Freegold share valuation adjustment		-	(466)
Accretion interest on Freegold loan		(63)	-
Gain on disposal of mineral properties	9	(3,673)	-
Loss on disposal of property, plant and equipment	8	44	35
Loss on disposal of investments	10	19	-
Impairment of mineral properties	9	4,741	30,047
Equity loss of associated company	11	1,158	481
Gain on dilution of investments in associated company	11	(1,611)	-
Write-off of long-term lease and land		-	797
Forgiveness of long-term liabilities		-	(386)
Gain on extinguishment of loan		-	(665)
Leasehold expenses written off		-	11
Impairment of investments in associated company		-	130
		\$ 885	\$ 29,984

Change in non-cash working capital consists of the following:

(\$000's)	2010	2009
Decrease in sundry receivables and prepayments	\$ 147	\$ 555
Increase in Brazilian taxes and contributions recoverable	(350)	-
Increase in inventories	(751)	-
Decrease in accounts payable and accrued liabilities	(2,602)	(1,741)
Decrease in due to related party	-	(264)
	\$ (3,556)	\$ (1,450)

Supplemental cash flow information:

(\$000's)	2010	2009
Interest paid	\$ 5	\$ 3

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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(in Canadian dollars unless otherwise specified)

25. SUBSEQUENT EVENTS

Lipari Mineração Ltda.

On March 4, 2011, an agreement was signed whereby Vaaldiam Mining increased its interest in the Braúna project from 20% to 51% for a transaction consideration of approximately US\$6,500,000. A payment of US\$917,000 was made on signing with US\$1,500,000 to be paid on August 4, 2011 and the balance of approximately US\$4,100,000 to be paid on June 4, 2012. Pursuant to the agreement, Vaaldiam Mining will act as operator for the project and will be responsible for the financing of a feasibility study and, if proven to be economically feasible, will finance the building and development of a mine. Various milestones have been agreed to between Vaaldiam Mining and the existing partners, and when the mine is built, Vaaldiam Mining's project development cost will be repaid in full from the project's profits before distribution of the profits to the joint venture partners. Should Vaaldiam Mining not meet the payment schedule or certain milestones by pre-determined deadlines, where the reason for such failure was within the reasonable control of Vaaldiam Mining, the partners have a right to buy back the 31% interest for the amount of the transaction consideration paid up to the buy-back date, and under certain circumstances, the right to purchase Vaaldiam Mining's remaining 20% interest at fair value as determined by an independent third party. Should this happen, Vaaldiam Mining would cease to be operator and if the project is successfully developed other than by Vaaldiam Mining, Vaaldiam Mining's contribution to the project development cost will be repaid out of the project's profits.

Western Standard Metals Ltd.

On November 1, 2010, Terraco Gold Corp. ("Terraco") (TSX-V: TEN) and Western Standard announced that they had entered into a binding letter agreement providing for Terraco to acquire all of the outstanding securities of Western Standard in an all share transaction, by way of a plan of arrangement. During January 2011, the plan of arrangement was approved by the shareholders of Western Standard and became effective on January 25, 2011. Pursuant to the plan of arrangement, Western Standard's shareholders received 0.75 common shares of Terraco for each Western Standard common shares held. As a result of the transaction, Vaaldiam now holds 750,000 common shares of Terraco.

26. COMPARATIVE FIGURES

Certain 2009 comparative figures have been reclassified to conform to the presentation adopted in the current year.