

KERNOW RESOURCES AND DEVELOPMENTS LTD.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2005

AUDITORS' REPORT

To the Shareholders of
Kernow Resources and Developments Ltd.

We have audited the consolidated balance sheets of Kernow Resources and Developments Ltd. as at December 31, 2005 and 2004 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"DAVIDSON & COMPANY LLP"

Vancouver, Canada

Chartered Accountants

March 6, 2006

A Member of *SC INTERNATIONAL*

KERNOW RESOURCES AND DEVELOPMENTS LTD.
CONSOLIDATED BALANCE SHEETS
AS AT DECEMBER 31

	2005	2004
ASSETS		
Current		
Cash	\$ 147,792	\$ 83,434
Receivables	126,818	20,657
Marketable securities (market value \$76,375; 2004 - \$17,575)	<u>76,375</u>	<u>17,575</u>
	350,985	121,666
Deposits (Note 3)	25,600	25,600
Investments (Note 4)	2,100	2,100
Mineral properties (Note 5)	<u>57,180</u>	<u>118,191</u>
	<u>\$ 435,865</u>	<u>\$ 267,557</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	<u>\$ 130,456</u>	<u>\$ 44,159</u>
Shareholders' equity		
Capital stock (Note 6)	2,846,469	2,826,819
Contributed surplus (Note 6)	56,452	-
Deficit	<u>(2,597,512)</u>	<u>(2,603,421)</u>
	<u>305,409</u>	<u>223,398</u>
	<u>\$ 435,865</u>	<u>\$ 267,557</u>

Nature and continuance of operations (Note 1)

Contingencies (Note 12)

On behalf of the Board:

(Signed) Alan F. Matthews	Director	(Signed) Robert F. Weicker	Director
Alan F. Matthews		Robert F. Weicker	

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

KERNOW RESOURCES AND DEVELOPMENTS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
YEAR ENDED DECEMBER 31

	2005	2004
EXPENSES		
Accounting, legal and audit	\$ 34,724	\$ 35,509
Bank charges and interest	3,399	2,571
Filing, listing and transfer agent fees	12,602	12,740
Foreign exchange loss (gain)	1,951	(228)
Management fees	13,612	10,400
Office, miscellaneous and shareholder costs	11,357	8,257
Property investigation	-	1,400
Stock-based compensation (Note 6)	56,452	-
Travel and related	5,855	10,176
Website design and maintenance	<u>1,075</u>	<u>-</u>
Loss before other items	<u>(141,027)</u>	<u>(80,825)</u>
OTHER ITEMS		
Interest income	709	344
Gain on disposal of marketable securities	27,645	335
Operator fees	73,938	23,679
Recovery of mineral property costs (Note 5)	43,144	-
Write-off of accounts payable	1,500	-
Write-down of marketable securities	<u>-</u>	<u>(4,650)</u>
	<u>146,936</u>	<u>19,708</u>
Net income (loss) for the year	5,909	(61,117)
Deficit, beginning of the year	<u>(2,603,421)</u>	<u>(2,542,304)</u>
Deficit, end of the year	<u>\$ (2,597,512)</u>	<u>\$ (2,603,421)</u>
Basic and fully diluted income (loss) per share	<u>\$ 0.01</u>	<u>\$ (0.01)</u>
Weighted average number of shares outstanding	<u>11,168,340</u>	<u>10,825,388</u>

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

KERNOW RESOURCES AND DEVELOPMENTS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEAR ENDED DECEMBER 31

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss) for the year	\$ 5,909	\$ (61,117)
Items not affecting cash:		
Gain on disposal of marketable securities	(27,645)	(335)
Stock-based compensation	56,452	-
Write-off of accounts payable	(1,500)	-
Write-down of marketable securities	-	4,650
Recovery of mineral property costs	(43,144)	-
Changes in non-cash working capital items:		
(Increase) decrease in receivables	5,856	(13,039)
Increase (decrease) in accounts payable and accrued liabilities	<u>(21,677)</u>	<u>(7,176)</u>
Net cash used in operating activities	<u>(25,749)</u>	<u>(77,017)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of capital stock	<u>19,650</u>	<u>80,000</u>
Net cash provided by financing activities	<u>19,650</u>	<u>80,000</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Mineral property recoveries	948,814	320,990
Expenditures on mineral properties	(922,202)	(311,636)
Proceeds on sale of marketable securities	<u>43,845</u>	<u>1,700</u>
Net cash provided by investing activities	<u>70,457</u>	<u>11,054</u>
Increase in cash during the year	64,358	14,037
Cash, beginning of the year	<u>83,434</u>	<u>69,397</u>
Cash, end of the year	<u>\$ 147,792</u>	<u>\$ 83,434</u>
Cash paid during the year for interest	<u>\$ -</u>	<u>\$ -</u>
Cash paid during the year for income taxes	<u>\$ -</u>	<u>\$ -</u>

Supplemental disclosure with respect to cash flows (Note 8)

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

KERNOW RESOURCES AND DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005

1. NATURE AND CONTINUANCE OF OPERATIONS

The Company is incorporated under the laws of the Province of British Columbia. The Company is in the process of exploring its mineral properties and has not yet determined whether these properties contain ore reserves that are economically recoverable. To date, the Company has not generated significant revenues and is considered to be in the development stage.

The recoverability of the amounts shown for mineral properties and related deferred exploration costs are dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves and upon future profitable production.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation. Continued operations of the Company are dependent upon its ability to receive continued financial support, complete public equity financings, or generate profitable operations in the future. These consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and liabilities that might be necessary, should the Company be unable to continue as a going concern.

	2005	2004
Working capital	\$ 220,529	\$ 77,507
Deficit	(2,597,512)	(2,603,421)

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated upon consolidation.

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results may differ from those estimates.

Foreign currency translation

The Company's foreign subsidiaries and activities are translated into Canadian dollars using the temporal method. Under this method, monetary items are translated at the exchange rate in effect at the balance sheet date, non-monetary items are translated at historical rates and revenue and expense items are translated at exchange rates prevailing when such items are recognized in the results of operations. Exchange gains or losses arising on translation of foreign currency items are included in the results of operations.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Investments and marketable securities

Marketable securities are carried at the lower of cost and net realizable value.

Long-term investments are recorded at cost. If it is determined that there is an other than temporary decline in the value of an investment, it will be written-down to its estimated net realizable value.

Mineral properties

The Company records its interests in mineral properties and areas of geological interest at cost. All direct and indirect costs relating to the acquisition, exploration and development of these interests are capitalized on the basis of specific claim blocks or areas of geological interest until the properties to which they relate are placed into production, sold, abandoned or management has determined there to be an impairment. These costs will be amortized on the basis of units produced in relation to the proven reserves available on the related property following commencement of production. Mineral properties which are sold before that property reaches the production stage will have all revenues from the sale of the property credited against the cost of the property. Properties which have reached the production stage will have a gain or loss calculated based on the portion of that property sold.

The recorded cost of mineral exploration interests is based on cash paid, the value of share consideration and exploration and development costs incurred, net of recoveries. The recorded amount may not reflect recoverable value as this will be dependant on the development program, the nature of the mineral deposit, commodity prices, adequate funding and the ability of the Company to bring its projects into production.

Asset retirement obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability.

Income taxes

Future income taxes are recorded using the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that substantive enactment or enactment occurs. To the extent that the Company does not consider it more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

KERNOW RESOURCES AND DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Loss per share

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the year. For the years presented, this calculation proved to be anti-dilutive.

Basic loss per share is calculated using the weighted average number of shares outstanding during the year.

Stock-based compensation

The Company accounts for the granting of stock options to employees and non-employees using the fair value method whereby all awards to employees and non-employees will be recorded at fair value on the date of grant. The Company estimates the fair value of each stock option at the date of grant using the Black-Scholes option pricing model. Any consideration paid by the option holders to purchase shares is credited to capital stock.

Comparative figures

Certain comparative figures have been reclassified to conform with the current year's presentation.

3. DEPOSITS

The Company posted refundable term deposits totaling \$25,600 (€16,000) as security with the Bank of Portugal to support a performance guarantee written by the bank to the Portuguese Government relating to the exploration of mineral properties in Portugal (Note 5).

4. INVESTMENTS

	2005	2004
Bannockburn Resources, Inc.	\$ 2,100	\$ 2,100

The Company owns 29,666 common shares of Bannockburn Resources, Inc. ("Bannockburn") which were written down by \$29,425 to a carrying value of \$2,100 in the 2002 fiscal year. The president and director of the Company became a director of Bannockburn during the 2003 fiscal year and resigned during the year ended December 31, 2005.

5. MINERAL PROPERTIES

Title to mineral properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties are in good standing.

KERNOW RESOURCES AND DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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5. MINERAL PROPERTIES (cont'd...)

2005	Jales	Boticas	Joutel	Orvilliers	Voisey's Bay	Shawnee	Dyke Hot Springs	Total
Balance, beginning of year	\$ 69,637	\$ 11,761	\$ 5,460	\$ 6,150	\$ 4,761	\$ 10,573	\$ 9,849	\$ 118,191
Additions:								
Administration	15,267	-	-	-	-	-	-	15,267
Assays	40,256	1,830	-	-	-	-	-	42,086
Claim fees	8,952	(169)	-	-	-	1,610	1,289	11,682
Core storage	4,193	-	-	-	-	358	-	4,551
Drilling and sampling	767,352	-	-	-	-	-	-	767,352
Field accommodations	19,447	-	-	-	-	-	-	19,447
Field supplies	19,144	-	-	-	-	-	-	19,144
Labour	20,160	-	-	-	-	-	-	20,160
Technical and professional	107,229	3,648	-	-	-	-	-	110,877
Travel and transport	21,050	60	-	-	-	-	-	21,110
	1,023,050	5,369	-	-	-	1,968	1,289	1,031,676
Recoveries and option payments	(1,135,831)	-	-	-	-	-	-	(1,135,831)
	(112,781)	5,369	-	-	-	1,968	1,289	(104,155)
Net recovery recognized as income	43,144	-	-	-	-	-	-	43,144
	(69,637)	5,369	-	-	-	1,968	1,289	(61,011)
Balance, end of year	\$ -	\$ 17,130	\$ 5,460	\$ 6,150	\$ 4,761	\$ 12,541	\$ 11,138	\$ 57,180

KERNOW RESOURCES AND DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005

5. MINERAL PROPERTIES (cont'd...)

2004	Jales	Boticas	Joutel	Orvilliers	Voisey's Bay	Shawnee	Dyke Hot Springs	Total
Balance, beginning of year	\$ 118,949	\$ -	\$ 5,000	\$ 5,000	\$ 161	\$ 7,996	\$ 8,439	\$ 145,545
Additions:								
Acquisition	-	8,525	-	-	-	-	-	8,525
Administration	18,609	-	-	-	-	-	-	18,609
Assays	19,091	-	-	-	-	-	-	19,091
Claim fees	10,514	-	460	1,150	4,600	1,761	1,410	19,895
Core storage	3,561	-	-	-	-	816	-	4,377
Drilling and sampling	82,736	-	-	-	-	-	-	82,736
Field accommodations	13,001	-	-	-	-	-	-	13,001
Field supplies	6,061	-	-	-	-	-	-	6,061
Labour	21,997	-	-	-	-	-	-	21,997
Technical and professional	87,098	3,236	-	-	-	-	-	90,334
Travel and transport	27,010	-	-	-	-	-	-	27,010
	289,678	11,761	460	1,150	4,600	2,577	1,410	311,636
Recoveries	(338,990)	-	-	-	-	-	-	(338,990)
	(49,312)	11,761	460	1,150	4,600	2,577	1,410	(27,354)
Balance, end of year	\$ 69,637	\$ 11,761	\$ 5,460	\$ 6,150	\$ 4,761	\$ 10,573	\$ 9,849	\$ 118,191

5. MINERAL PROPERTIES (cont'd...)

Jales, Portugal

In October 2001, the Company entered into an agreement to acquire a 100% interest in the Jales gold property from Target Europe Corp. The Jales property consists of an exploration license granted by the Government of Portugal. The license has been renewed to June 16, 2006. As consideration, the Company issued 800,000 common shares at a value of \$73,430 and will issue a further 750,000 common shares upon the property reaching commercial production. There is a 3% royalty payable to the Government of Portugal on all minerals produced from the property.

During 2001, the Company also entered into an agreement with Bannockburn whereby Bannockburn assigned its option agreement to earn a 100% interest in the Jales property to the Company in exchange for a promissory note in the amount of \$49,100 (USD\$30,729). During the fiscal year ended December 31, 2004, the Company issued 421,949 common shares at a price of \$0.10 per share to settle the promissory note and accrued interest totalling \$42,195.

During 2002, the Company entered into an option agreement with St. Elias Mines Ltd. ("St. Elias"), a company related by a common director at the time, whereby St. Elias can earn a 51% interest in the property in exchange for cash payments totalling \$50,000 (received), incurring cumulative exploration expenditures of \$1,500,000 (completed) on the property and issuing a total of 500,000 common shares (received) at a value of \$106,000 (2004 – 200,000 shares at a value of \$31,000) to the Company over a three year period. St. Elias has earned a 51% interest in the property and elected in 2005 to earn a further 24% interest in exchange for additional cash payments totalling \$100,000 (\$25,000 received), incurring additional exploration expenditures of not less than \$2,500,000 and issuing an additional 1,000,000 common shares over a three year period.

The Company also entered into a Technical Services Contract with St. Elias whereby St. Elias will reimburse the Company, as operator, for exploration costs incurred plus an 8% operator fee based on exploration costs incurred on the property. During the current year, the Company recovered \$1,035,831 (2004 - \$295,990) in exploration costs and received \$100,000 (2004 - \$43,000) in option payments consisting of \$25,000 (2004 - \$Nil) cash and 300,000 (2004 – 100,000) common shares valued at \$75,000 (2004 - \$18,000).

Poco das Freitas Property (Boticas), Portugal

During the year ended December 31, 2004, the Company entered into a contract of exploration with the government of Portugal to explore the Poco das Freitas property located in northeast Portugal. The contract is initially for two years and thereafter can be renewed annually for further one year terms. The Company has committed to complete €45,000 of exploration work on the property in the first two years. The Company was required to provide a guarantee in the amount of €10,000 related to the property (Note 12).

In addition to the 3% royalty payable to the Government of Portugal, the Company must pay an additional €50,000 per year for 5 years in the event of production.

5. MINERAL PROPERTIES (cont'd...)

Joutel, Quebec, Canada

The Company owns a 100% interest in certain mining claims in northwestern Quebec. The claims are subject to a 1% net smelter returns royalty, to a maximum of \$2,000,000.

During the 2003 fiscal year, the Company wrote-down the carrying value of the Joutel property by \$245,440 to a nominal value of \$5,000.

Orvilliers, Quebec, Canada

The Company owns a 100% interest in certain claims in the Orvilliers Township in Quebec.

During the 2003 fiscal year, the Company wrote-down the carrying value of the Orvilliers property by \$86,870 to a nominal value of \$5,000.

Voisey's Bay – Claim I (Sachem Bay), Labrador, Canada

The Company owns a 100% interest in certain mining claims in Labrador, Canada.

The Company entered into an agreement with Pathfinder Resources Ltd. ("Pathfinder") whereby it granted an option to Pathfinder to earn a 100% interest in its Voisey's Bay property. During the 2003 fiscal year, the Company received \$10,000 cash, and 50,000 shares of Pathfinder valued at \$6,500. During the 2004 fiscal year, the agreement was terminated.

Shawnee, Nevada, U.S.A.

The Shawnee property consists of a 100% interest in certain mining claims in north central Nevada, U.S.A.

During the year ended December 31, 2002, the Company wrote-down the carrying value of the Shawnee property by \$249,861 to a nominal value of \$5,000.

Dyke Hot Springs, Nevada, U.S.A.

The Company owns a 100% interest in certain mining claims in northwestern Nevada, U.S.A.

KERNOW RESOURCES AND DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005

6. CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Number of Shares	Amount	Contributed Surplus
Authorized			
Unlimited common shares without par value			
Issued			
Balance, December 31, 2003	9,914,540	\$ 2,704,624	\$ -
Shares for debt	421,949	42,195	-
Private placement	<u>800,000</u>	<u>80,000</u>	<u>-</u>
Balance, December 31, 2004	11,136,489	2,826,819	-
Exercise of stock options	46,500	4,650	-
Exercise of warrants	100,000	15,000	-
Stock-based compensation	<u>-</u>	<u>-</u>	<u>56,452</u>
Balance, December 31, 2005	<u>11,282,989</u>	<u>\$ 2,846,469</u>	<u>\$ 56,452</u>

During the year ended December 31, 2005, the Company altered its authorized share capital to unlimited from 50,000,000 common shares.

During the year ended December 31, 2004 the Company:

- 1) Issued 421,949 common shares at a price of \$0.10 per share to settle a promissory note and accrued interest totalling \$42,195.
- 2) Completed a private placement of 800,000 units at a price of \$0.10 per unit for gross proceeds of \$80,000. Each unit consisted of one common share and one half of one share purchase warrant. Each whole warrant was exercisable at a price of \$0.15 per share expiring on April 20, 2006.

Stock options

The Company has established an incentive stock option plan whereby the Board of Directors may grant options to directors, officers, employees or consultants for up to 10% of the issued and outstanding capital stock of the Company. The exercise price of the options cannot be less than the greater of \$0.10 per share or the closing trading price of the Company's shares on the day before the grant. Any options granted will have a term up to 5 years with vesting provisions determined by the board of directors.

As at December 31, 2005, the following stock options are outstanding:

Number of Shares	Exercise Price	Expiry Date
153,500	\$ 0.10	June 7, 2007
450,000	0.135	June 20, 2010

KERNOW RESOURCES AND DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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6. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

Stock options (cont'd...)

Stock option transactions are summarized as follows:

	Number of Shares		Weighted Average Exercise Price
Balance, December 31, 2003 and 2004	500,000	\$	0.13
Options exercised	(46,500)		0.10
Options expired	(300,000)		0.15
Options granted	<u>450,000</u>		0.135
Balance, December 31, 2005	603,500	\$	0.126
Number of options currently exercisable	603,500	\$	0.126

Stock-based compensation

During the year ended December 31, 2005, the Company granted 450,000 stock options to directors, officers and consultants. The estimated fair value of these options is \$56,452, or \$0.13 per option. This amount has been expensed as stock-based compensation in the statement of operations with a corresponding amount recorded as contributed surplus in shareholders' equity.

The following weighted average assumptions were used for the Black-Scholes valuation of stock options granted during the year:

	2005	2004
Risk-free interest rate	2.92%	-
Expected life of options	5.0 years	-
Annualized volatility	158.60%	-
Dividend rate	0.00%	-

Warrants

As at December 31, 2005, the following share purchase warrants are outstanding:

Number of Shares	Exercise Price	Expiry Date
300,000	\$ 0.15	April 20, 2006

The only share purchase warrant activity during the 2005 and 2004 fiscal years was the exercise of 100,000 warrants at \$0.15 per share during 2005.

7. RELATED PARTY TRANSACTIONS

Included in accounts payable is \$7,562 (2004 - \$16,966) due to a director of the Company and \$Nil (2004 - \$1,500) due to a company with a common director.

Included in receivables is \$124,071 (2004 - \$17,475) due from a company with a former common director.

The Company entered into the following transactions with related parties during the year ended December 31, 2005:

- a) Paid or accrued management fees of \$13,612 (2004 - \$10,400) to a director of the Company.
- b) Paid or accrued accounting fees of \$4,160 (2004 - \$4,255) to an officer of the Company.
- c) Paid or accrued technical and professional fees of \$43,310 (2004 - \$29,617) to a director which were charged to the Jales property.
- d) Recovered \$1,035,831 (2004 - \$295,990) in mineral property expenditures and \$100,000 (2004 - \$43,000) in option payments from a company with a former common director.
- e) Settled a promissory note and accrued interest totalling \$42,195 in 2004 with a company having common directors at the time by issuing 421,949 common shares.

These transactions were in the normal course of operations and were measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

8. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Significant non-cash transactions for the year ended December 31, 2005 consisted of:

- a) Receiving marketable securities consisting of 300,000 shares of St. Elias at a value of \$75,000 as an option payment on mineral properties.
- b) Recognizing mineral property cost recoveries of \$112,017 through receivables.
- c) Incurring mineral property costs of \$109,474 through accounts payable.

Significant non-cash transactions for the year ended December 31, 2004 consisted of:

- a) Issuing of 421,949 common shares to settle a promissory note and accrued interest totaling \$42,195.
- b) Receiving marketable securities consisting of 100,000 shares of St. Elias at a value of \$18,000 as an option payment on mineral properties.

KERNOW RESOURCES AND DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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9. INCOME TAXES

A reconciliation of income taxes at statutory rates with the reported taxes is as follows:

	2005	2004
Income (loss) for the year	\$ 5,909	\$ (61,117)
Expected income tax recovery (expense)	\$ (2,060)	\$ 21,757
Difference in foreign tax rate	1,744	(639)
Non-deductible and other items	(18,354)	(6,251)
Recognized (unrecognized) benefit of non-capital losses	<u>18,670</u>	<u>(14,867)</u>
Net income tax recovery (expense)	\$ -	\$ -

The significant components of the Company's future income tax assets are as follows:

	2005	2004
Future income tax assets:		
Non-capital and operating loss carryforwards	\$ 128,000	\$ 153,000
Resource properties	<u>526,000</u>	<u>558,000</u>
	654,000	711,000
Valuation allowance	<u>(654,000)</u>	<u>(711,000)</u>
Net future income tax assets	\$ -	\$ -

The Company has non-capital losses of approximately \$348,300 available to offset against taxable income of future years. These losses, if not utilized, will expire through to 2015. The Company also has approximately \$28,000 of U.S. Federal operating loss carryforwards available to apply against U.S. source income that expires through to 2022. Subject to certain restrictions, the Company also has approximately \$1,318,000 of resource expenditures available to reduce taxable income in Canada in future years. Future tax benefits which may arise as a result of these non-capital and operating losses and resource expenditures have been offset by a valuation allowance and have not been recognized in these consolidated financial statements.

KERNOW RESOURCES AND DEVELOPMENTS LTD.
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10. SEGMENTED INFORMATION

The Company operates in one business segment, the exploration of mineral properties. Geographic information is as follows:

	2005	2004
Net income (loss) for the year		
Canada	\$ (17,756)	\$ (76,900)
Portugal	<u>23,665</u>	<u>15,783</u>
	<u>\$ 5,909</u>	<u>\$ (61,117)</u>
Identifiable assets		
Canada	\$ 242,183	\$ 118,024
United States	23,679	20,422
Portugal	<u>170,003</u>	<u>129,111</u>
	<u>\$ 435,865</u>	<u>\$ 267,557</u>

11. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, receivables, marketable securities, deposits, investments and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying values, unless otherwise noted.

At December 31, 2005, approximately 84% (2004 – 36%) of the Company's accounts payable and accrued liabilities are denominated in Euro's. The Company does not use derivative instruments or foreign exchange contracts to hedge against gains or losses arising from foreign exchange fluctuations.

12. CONTINGENCIES

The Company has provided letters of guarantee to the Government of Portugal for its exploration contracts on the mineral properties in Portugal totalling €24,965, €16,000 of which was secured by term deposits in 2004 (Note 3).