

KERNOW RESOURCES & DEVELOPMENTS LTD.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2006

AUDITORS' REPORT

To the Shareholders of
Kernow Resources & Developments Ltd.

We have audited the consolidated balance sheets of Kernow Resources & Developments Ltd. as at December 31, 2006 and 2005 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, 2006 and 2005 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 12, 2007 (Except as to Note 13
which is as of March 23, 2007)

A Member of **SC INTERNATIONAL**

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

	2006	2005
ASSETS		
Current		
Cash	\$ 576,003	\$ 147,792
Receivables	48,071	126,818
Prepaid expenses	1,877	-
Marketable securities (market value \$87,524; 2005- \$76,375)	<u>84,314</u>	<u>76,375</u>
	710,265	350,985
Deposits (Note 3)	3,080	25,600
Investments (Note 4)	-	2,100
Mineral properties (Note 5)	<u>140,767</u>	<u>57,180</u>
	<u>\$ 854,112</u>	<u>\$ 435,865</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	<u>\$ 128,430</u>	<u>\$ 130,456</u>
Shareholders' equity		
Capital stock (Note 6)	3,444,896	2,846,469
Contributed surplus (Note 6)	56,452	56,452
Deficit	<u>(2,775,666)</u>	<u>(2,597,512)</u>
	<u>725,682</u>	<u>305,409</u>
	<u>\$ 854,112</u>	<u>\$ 435,865</u>

Nature and continuance of operations (Note 1)

Contingencies and commitments (Note 12)

Subsequent events (Note 13)

On behalf of the Board:

(signed) Alan F. Matthews Director (signed) Donn Burchill Director

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

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

	2006	2005
EXPENSES		
Accounting, legal and audit	\$ 82,095	\$ 34,724
Advertising and promotion	5,048	-
Bank charges and interest	3,168	3,399
Consulting	7,500	-
Filing, listing and transfer agent fees	14,525	12,602
Foreign exchange (gain) loss	(3,025)	1,951
Management fees	49,350	13,612
Office and miscellaneous	12,134	9,763
Property investigation	1,571	-
Shareholder costs	3,079	1,594
Stock-based compensation (Note 6)	-	56,452
Travel and related	21,110	5,855
Website design and maintenance	<u>2,624</u>	<u>1,075</u>
Loss before other items	<u>(199,179)</u>	<u>(141,027)</u>
OTHER ITEMS		
Interest income	3,792	709
Gain on disposal of marketable securities and investments	34,375	27,645
Operator fees (Note 5)	27,086	73,938
Recovery of mineral property costs (Note 5)	-	43,144
Write-off of mineral properties (Note 5)	(44,228)	-
Write-off of accounts payable	<u>-</u>	<u>1,500</u>
	<u>21,025</u>	<u>146,936</u>
Net income (loss) for the year	(178,154)	5,909
Deficit, beginning of the year	<u>(2,597,512)</u>	<u>(2,603,421)</u>
Deficit, end of the year	<u>\$ (2,775,666)</u>	<u>\$ (2,597,512)</u>
Basic and diluted income (loss) per share	<u>\$ (0.02)</u>	<u>\$ 0.01</u>
Weighted average basic number of shares outstanding	<u>11,689,698</u>	<u>11,168,340</u>
Weighted average diluted number of common shares outstanding	<u>11,689,698</u>	<u>11,405,807</u>

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

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

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss) for the year	\$ (178,154)	\$ 5,909
Items not affecting cash:		
Gain on disposal of marketable securities and investments	(34,375)	(27,645)
Stock-based compensation	-	56,452
Write-off of accounts payable	-	(1,500)
Recovery of mineral property costs	-	(43,144)
Write-off of mineral properties	44,228	-
Accrued interest income	(994)	-
Changes in non-cash working capital items:		
Decrease in receivables	9,169	5,856
Increase in prepaid expenses	(1,877)	-
Increase (decrease) in accounts payable and accrued liabilities	<u>47,355</u>	<u>(21,677)</u>
Net cash used in operating activities	<u>(114,648)</u>	<u>(25,749)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of capital stock	603,050	19,650
Share issue costs	<u>(14,873)</u>	<u>-</u>
Net cash provided by financing activities	<u>588,177</u>	<u>19,650</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Mineral property recoveries	330,861	948,814
Expenditures on mineral properties	(428,229)	(922,202)
Acquisition of marketable securities	(239,492)	-
Proceeds on sale of marketable securities and investments	269,022	43,845
Return of deposits	<u>22,520</u>	<u>-</u>
Net cash provided by (used in) investing activities	<u>(45,318)</u>	<u>70,457</u>
Increase in cash during the year	428,211	64,358
Cash, beginning of the year	<u>147,792</u>	<u>83,434</u>
Cash, end of the year	<u>\$ 576,003</u>	<u>\$ 147,792</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 & DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006

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.

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.

The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

	2006	2005
Working capital	\$ 581,835	\$ 220,529
Deficit	(2,775,666)	(2,597,512)

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

All costs related to the acquisition, exploration and development of mineral properties are capitalized by property. If economically recoverable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the unit of production method. When a property is abandoned, all related costs are written off to operations. If, after management review, it is determined that the carrying amount of a mineral property is impaired, that property is written down to its estimated net realizable value. A mineral property is reviewed for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

The amounts shown for mineral properties do not necessarily represent present or future values. Their recoverability is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing and permitting to complete the development and future profitable production or proceeds from the disposition thereof.

Mineral property option agreements

From time to time, the Company acquires or disposes of properties pursuant to the terms of option agreements. Options are exercisable entirely at the discretion of the optionee and, accordingly, are recorded as mineral property costs or recoveries when payments are made or received. Option payments received in excess of costs deferred are included in the results of operations.

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.

Changes in the liability for an asset retirement obligation due to the passage of time will be measured by applying an interest method of allocation. The amount will be recognized as an increase in the liability and an accretion expense in the statement of operations. Changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows are recognized as an increase or a decrease to the carrying amount of the liability and the related long-lived asset.

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

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.

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 fair value of stock options granted is determined using the Black-Scholes option pricing model and recorded as stock-based compensation expense over the vesting period of the stock options.

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 \$3,080 (€2,000) (2005 - \$25,600 (€16,000)) as security with the Millennium BCP (Banco Commercial Portugal) to support performance guarantees written by the bank to the Portuguese Government relating to the exploration of the mineral properties in Portugal (Note 12).

4. INVESTMENTS

	2006	2005
Bannockburn Resources Limited	\$ -	\$ 2,100

The Company owned 29,666 common shares of Bannockburn Resources Limited. ("Bannockburn") with a value of \$2,100. During the year ended December 31, 2006, the Company sold all of the common shares of Bannockburn for a gain of \$14,490.

KERNOW RESOURCES & DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006

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

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. 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. The Jales property consists of an exploration license granted by the Government of Portugal. This license expired June 16, 2006. The Company has applied for an experimental mining license with the Government of Portugal. A draft contract has been received and is expected to be finalized in May 2007.

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 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 \$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 year ended December 31, 2006, the Company recovered \$261,283 (2005 - \$1,035,831) in exploration costs and received \$Nil (2005 - \$100,000) in option payments consisting of \$Nil (2005 - \$25,000) in cash and Nil (2005 - 300,000) common shares valued at \$Nil (2005 - \$75,000). The Company also earned \$27,086 (2005 - \$73,938) as an operator fee.

The Company is required to incur a further €45,000 (approximately \$73,300) of exploration work prior to October 2007.

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 was initially for two years and was renewed for a further year expiring in October 2008. The Company completed its commitment to incur €45,000 (approximately \$73,300) of exploration work on the property in the first two years. The Company is required to incur a further €45,000 (approximately \$73,300) of exploration work prior to October, 2007.

In addition to the 3% royalty payable to the Government of Portugal, the Company must pay an additional €50,000 (approximately \$81,400) per year for 5 years in the event of production.

Alandroal and Barrancos Properties, Portugal

During the current year, the Company entered into option agreements with Rio Narcea Gold Mines Ltd. to acquire an initial 60% interest with the right to earn the remaining 40% in the Alandroal and Barrancos properties in Southern Portugal.

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

Alandroal and Barrancos Properties, Portugal (cont'd...)

The terms of the option agreements are as follows:

i) Alandroal Property

The Company can earn a 60% interest by incurring exploration expenditures of €350,000 (approximately \$539,000) and issuing an aggregate of 150,000 common shares (25,000 issued at a value of \$5,125) over a three year period. In addition, the Company can elect to earn a further 15% interest in the property by solely funding a bankable feasibility study and issuing 1,000,000 common shares. The Company has the right to acquire the remaining 25% undivided interest by issuing 3,000,000 common shares within 30 days of attaining commercial production.

ii) Barrancos Property

The Company can earn a 60% interest by incurring exploration expenditures of €25,000 (approximately \$808,000) and issuing an aggregate of 250,000 common shares (25,000 issued at a value of \$5,125) over a four year period. In addition, the Company can elect to earn a further 15% interest in the property by solely funding a bankable feasibility study and issuing 1,000,000 common shares. The Company has the right to acquire the remaining 25% undivided interest in the property by issuing 3,000,000 common shares within 30 days of attaining commercial production.

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 current year, management of the Company determined that it would not proceed with the development of the property and accordingly, all related costs were written-down to \$1.

Orvilliers, Quebec, Canada

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

During the current year, management of the Company determined that it would not proceed with the development of the property and accordingly, all related costs were written-down to \$1.

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

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

During the current year, management of the Company determined that it would not proceed with the development of the property and accordingly, all related costs were written- down to \$1.

KERNOW RESOURCES & DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006

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

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 current year, management of the Company determined that it would not proceed for the time being with the development of the property and accordingly, all related costs were written-down to \$1.

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

The Company owns a 100% interest in certain mining claims in northwestern Nevada, U.S.A. The mining claims were renewed for a further year in August 2006.

During the current year, management of the Company determined that it would not proceed with the development of the property for the time being and accordingly, all related costs were written- down to \$1.

6. CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Number of Shares	Amount	Contributed Surplus
Authorized			
Unlimited common shares without par value			
Issued			
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	-	-	56,452
	<u>11,282,989</u>	<u>2,846,469</u>	<u>56,452</u>
Balance, December 31, 2005	11,282,989	2,846,469	56,452
Private placement	3,244,570	567,800	-
Exercise of warrants	235,000	35,250	-
Issued for mineral properties	50,000	10,250	-
Share issue costs	-	(14,873)	-
	<u>14,812,559</u>	<u>\$ 3,444,896</u>	<u>\$ 56,452</u>
Balance, December 31, 2006	14,812,559	\$ 3,444,896	\$ 56,452

During the year ended December 31, 2006, the Company:

- i) Completed a 3,244,570 unit private placement at \$0.175 per unit for gross proceeds of \$567,800. Each unit consisted of one common share and one-half of a share purchase warrant exercisable at \$0.27 per share until December 5, 2007 and \$0.35 per share until December 5, 2008. If, after the expiry of four months, the closing trading price of the Company's shares is more that \$0.40 per share for 20 consecutive trading days the Company may give the warrant holders notice and accelerate the expiry date of the warrants to 30 days from such notice.

KERNOW RESOURCES & DEVELOPMENTS LTD.
 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
 DECEMBER 31, 2006

6. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

- ii) Issued 50,000 common shares valued at \$10,250 pursuant to a mineral property option agreement with Rio Narcea Gold Mines Ltd.

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, 2006, 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 17, 2010

Stock option transactions are summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Balance, December 31, 2004	500,000	\$ 0.13
Exercised	(46,500)	0.10
Expired	(300,000)	0.15
Granted	<u>450,000</u>	0.135
Balance, December 31, 2005 and 2006	<u>603,500</u>	<u>\$ 0.13</u>
Number of options currently exercisable	<u>603,500</u>	<u>\$ 0.13</u>

Stock-based compensation

During the year ended December 31, 2006, the Company granted Nil (2005 - 450,000) stock options to directors, officers and consultants. The estimated fair value of these options was \$Nil (2005 - \$56,452) or \$Nil (2005 - \$0.13) per option. This amount has been recorded as stock-based compensation in the statement of operations with a corresponding amount recorded as contributed surplus in shareholders' equity.

KERNOW RESOURCES & DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006

6. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

Stock-based compensation (cont'd...)

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

	2006	2005
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, 2006, the following share purchase warrants are outstanding:

Number of Shares	Exercise Price	Expiry Date
1,622,285	\$ 0.27 if not, then at \$0.35	December 5, 2007 December 5, 2008

Warrant transactions are summarized as follows:

	Number of Warrants	Weighted Average Exercise Price
Outstanding, December 31, 2004	400,000	\$ 0.15
Exercised	<u>(100,000)</u>	0.15
Outstanding, December 31, 2005	300,000	0.15
Issued	1,622,285	0.27
Exercised	(235,000)	0.15
Expired	<u>(65,000)</u>	0.15
Outstanding, December 31, 2006	1,622,285	\$ 0.27

7. RELATED PARTY TRANSACTIONS

Included in accounts payable at December 31, 2006 is \$20,000 (2005 - \$7,562) due to a director of the Company.

The Company entered into the following transactions with related parties during the year ended December 31, 2006:

- a) Paid or accrued management fees of \$49,350 (2005 - \$13,612) to a director of the Company.
- b) Paid or accrued accounting fees of \$4,620 (2005 - \$4,160) to an officer of the Company.
- c) Paid or accrued technical and professional fees of \$27,922 (2005 - \$43,310) to a director which were charged to the Jales property.
- d) Recovered \$261,283 (2005 - \$1,035,831) in mineral property expenditures and \$Nil (2005 - \$100,000) in option payments from a company with a former common director.

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, 2006 consisted of:

- a) Issuing of 50,000 common shares valued at \$10,250 pursuant to mineral property option agreements with Rio Narcea Gold Miners Ltd.
- b) Recognizing mineral property cost recoveries of \$42,439 through receivables.
- c) Incurring mineral property costs of \$60,093 through accounts payable.

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.

KERNOW RESOURCES & DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006

9. INCOME TAXES

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

	2006	2005
Income (loss) for the year	\$ (178,154)	\$ 5,909
Expected income tax recovery (expense)	\$ 62,417	\$ (2,060)
Difference in foreign tax rate	1,932	1,744
Non-deductible items	(4,686)	(18,354)
Recognized (unrecognized) benefit of non-capital losses	<u>(59,663)</u>	<u>18,670</u>
Net income tax recovery (expense)	\$ -	\$ -

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

	2006	2005
Future income tax assets:		
Non-capital and operating loss carryforwards	\$ 123,000	\$ 128,000
Resource properties	409,000	526,000
Other items	<u>3,850</u>	<u>-</u>
	535,850	654,000
Valuation allowance	<u>(535,850)</u>	<u>(654,000)</u>
Net future income tax assets	\$ -	\$ -

The Company has non-capital losses of approximately \$365,000 available to offset against taxable income of future years. These losses, if not utilized, will expire through to 2026. The Company also has approximately \$28,000 of U.S. Federal operating loss carryforwards available to apply against U.S. source income that expires beginning in 2008. 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 & DEVELOPMENTS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006

10. SEGMENTED INFORMATION

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

	2006	2005
Capital assets		
Canada	\$ -	\$ 16,371
United States	-	23,679
Portugal	<u>140,767</u>	<u>17,130</u>
	<u>\$ 140,767</u>	<u>\$ 57,180</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, currency 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, 2006, approximately 53% (2005 – 84%) of the Company's accounts payable and accrued liabilities are denominated in Euros. The Company does not use derivative instruments or foreign exchange contracts to hedge against gains or losses arising from foreign exchange fluctuations.

12. CONTINGENCIES AND COMMITMENTS

The Company has provided letters of guarantee to the Government of Portugal for its exploration contracts on the mineral properties in Portugal totalling €12,000 (2005 - €24,965) (Note 3).

The Company entered into a consulting agreement effective September 1, 2006 with the president of the Company for management services, expiring September 1, 2008. The Company agreed to pay \$10,000 per month and to pay a severance of \$240,000 in the event of a change of control of the Company, and 200% of any compensation due over the remaining term of the contract in the event of termination other than due to a change of control or for other than just cause. The Company also agreed to grant not less than 1,000,000 stock options to the president. The agreement may be extended for a further two years.

13. SUBSEQUENT EVENTS

Subsequent to December 31, 2006, the Company:

- a) Granted stock options to purchase 175,000 common shares to a director and consultants at \$0.225 per share until February 5, 2012.
- b) Received conditional approval from the TSX Venture Exchange for a proposed private placement of 3,500,000 units at a price of \$0.25 per unit. Each unit is to consist of one common share and one share purchase warrant exercisable at \$0.40 per share for a period of two years.
- c) Issued 50,000 common shares at \$0.10 per share pursuant to the exercise of stock options to a director and consultants.