

Pinnacle Mines Ltd.

Financial Statements

December 31, 2005 and 2004

Address: Suite 350, 885 Dunsmuir Street
Vancouver, BC
V6C 1N5

Contact: Andrew W. Bowering
President

Telephone number: (604) 688-7377

Fax number: (604) 688-7307

Email address: bowering@pinnaclemines.com

Website: www.pinnaclemines.com

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Management's Responsibility for Financial Reporting

To the Shareholders of
Pinnacle Mines Ltd.

The accompanying financial statements of Pinnacle Mines Ltd. have been prepared in accordance with Canadian generally accepted accounting principals consistent with previous quarters and years.

Management is responsible for the integrity of the financial statements. Systems of internal control are designed and maintained by management to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for financial reporting purposes. Our auditors have provided information regarding areas where our internal controls could be improved and we have undertaken to implement improvements where practicable.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee of the Board. This committee meets with management to satisfy itself that management's responsibilities are properly discharged and to review the financial statements before they are presented to the Board of Directors for approval.

"Andrew W. Bowering"
Andrew W. Bowering
Director

"Paul F. Saxton"
Paul F. Saxton
Director

Vancouver, Canada
April 12, 2006

Auditors' Report

To the Shareholders of
Pinnacle Mines Ltd.

We have audited the balance sheets of Pinnacle Mines Ltd. as at December 31, 2005 and 2004 and the 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 about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these 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 cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Grant Thornton LLP

Vancouver, Canada
April 12, 2006

Chartered Accountants

Pinnacle Mines Ltd.

Balance Sheets

	December 31 2005	December 31 2004
Assets		
Current		
Cash and cash equivalents	\$ 1,877,422	\$ 1,606,968
Marketable securities (Note 4)	24,500	-
Receivables	56,376	18,051
Prepays	40,949	5,619
	<u>1,999,247</u>	<u>1,630,638</u>
Project deposit (Note 5)	10,000	-
Due from director (Note 6)	4,000	4,000
Mineral property interests (Note 7)	3,374,115	1,199,785
Equipment (Note 8)	28,798	5,413
	<u>\$ 5,416,160</u>	<u>\$ 2,839,836</u>
Liabilities		
Current		
Payables and accruals	\$ <u>262,755</u>	\$ <u>138,832</u>
Shareholders' Equity		
Capital stock (Note 9)	16,978,870	13,783,369
Contributed surplus (Note 9)	767,234	273,252
Deficit	<u>(12,592,699)</u>	<u>(11,355,617)</u>
	<u>5,153,405</u>	<u>2,701,004</u>
	<u>\$ 5,416,160</u>	<u>\$ 2,839,836</u>

Continuance of operations (Note 1)
 Commitments (Note 11)
 Subsequent events (Note 16)

Approved on Behalf of the Board

"Andrew W. Bowering" Director
 Andrew W. Bowering

"Paul F. Saxton" Director
 Paul F. Saxton

See accompanying notes to the financial statements.

Pinnacle Mines Ltd.

Statements of Operations and Deficit

Years Ended December 31	2005	2004
General and administrative expenses		
Amortization	\$ 5,290	\$ 955
Consulting services (Note 12)	101,896	102,713
Management services (Note 12)	189,000	80,250
Investor relations	141,209	61,641
Professional fees		
Accounting and audit	43,804	38,775
Legal	40,016	68,182
Office (Note 12)	146,556	110,590
Rent (Note 12)	41,303	52,800
Salaries and benefits	77,127	15,458
Shareholder services	36,038	45,669
Stock-based compensation (Note 9)	518,969	102,155
Travel	67,613	110,064
	<u>1,408,821</u>	<u>789,252</u>
Other items		
Write-down of mineral property interests	-	(44,540)
Property investigations	(1,363)	(13,912)
Interest income	14,463	990
Other income	1,750	-
	<u>14,850</u>	<u>(57,462)</u>
Loss before income taxes	<u>(1,393,971)</u>	<u>(846,714)</u>
Future income tax recovery (Note 13)	<u>156,889</u>	<u>-</u>
Net loss	<u>\$ (1,237,082)</u>	<u>\$ (846,714)</u>
Loss per share, basic and diluted	<u>\$ (0.10)</u>	<u>\$ (0.15)</u>
Weighted average common shares outstanding	<u>12,322,743</u>	<u>5,822,883</u>
Deficit, beginning of year, as originally reported	\$ (11,355,617)	\$ (10,353,790)
Adjustment related to adoption of Handbook Section 3870 (Note 3)	<u>-</u>	<u>(155,113)</u>
Deficit, beginning of year, restated	\$ (11,355,617)	\$ (10,508,903)
Net loss	<u>(1,237,082)</u>	<u>(846,714)</u>
Deficit, end of year	<u>\$ (12,592,699)</u>	<u>\$ (11,355,617)</u>

See accompanying notes to the financial statements.

Pinnacle Mines Ltd.

Statements of Cash Flows

Years Ended December 31	2005	2004
Cash derived from (used in)		
Operating activities		
Net loss	\$ (1,237,082)	\$ (846,714)
Amortization	5,290	955
Stock-based compensation	518,969	102,155
Future income taxes (Note 13)	(156,889)	-
Write-down of mineral properties	-	44,540
Change in non-cash operating working capital (Note 10)	(23,341)	29,750
	<u>(893,053)</u>	<u>(669,314)</u>
Financing activities		
Shares issued for cash	3,105,403	3,335,647
Share issue costs	-	(190,573)
Deposit on shares	100,000	-
	<u>3,205,403</u>	<u>3,145,074</u>
Investing activities		
Mineral property expenditures		
Project deposit	(10,000)	-
Exploration expenditures	(1,434,622)	(401,334)
Acquisition costs	(568,599)	(537,512)
Purchase of equipment	(28,675)	(6,368)
Due from director	-	(4,000)
	<u>(2,041,896)</u>	<u>(949,214)</u>
Net increase in cash	270,454	1,526,546
Cash		
Beginning of year	<u>1,606,968</u>	<u>80,422</u>
End of year	<u>\$ 1,877,422</u>	<u>\$ 1,606,968</u>
Cash comprises:		
Cash	\$ 227,422	\$ 356,973
Cashable guaranteed investment certificates	<u>1,650,000</u>	<u>1,249,995</u>
	<u>\$ 1,877,422</u>	<u>\$ 1,606,968</u>
Non-cash investing and financing transactions not included in cash flows:		
Marketable securities received as option proceeds	\$ 24,500	\$ -
Shares issued for acquisition of mineral property	\$ 122,000	\$ 46,200

See accompanying notes to the financial statements.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

1. Nature of operations and going concern

Pinnacle Mines Ltd. (the company) is incorporated under the laws of the Province of British Columbia. The company's shares are traded on the TSX Venture Exchange ("TSXV"). The company's business is to acquire, explore and develop interests in mining projects.

In 2004, the company incorporated a subsidiary in Hong Kong under the Companies Ordinance. This subsidiary (Pinnacle Mines (Asia) Ltd.) was inactive since its inception and was wound up during 2005.

These financial statements have been prepared on the going concern basis, which assumes that the company will continue operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. The company has a net loss of \$1,237,082 for the year ended December 31, 2005 and accumulated deficit of \$12,592,699 at December 31, 2005. The recoverability of the amounts shown for mineral property interests in the company's balance sheet are dependent upon the existence of economically recoverable reserves, the ability of the company to arrange appropriate financing to complete the development of its properties, the receipt of necessary permitting and upon achieving future profitable production or receiving proceeds from the disposition of the properties. The timing of such events occurring, if at all, is not yet determinable.

These financial statements do not reflect the adjustments to the carrying values of assets and liabilities that would be necessary if the company is unable to continue operations or does not receive continued financial support from its shareholders.

2. Summary of significant accounting policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts 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 reporting period. Actual results could differ from these estimates. Significant areas requiring the use of management estimates relate to the determination of impairment of mineral property interests and the determination of fair value for stock based transactions. Where estimates have been used financial results as determined by actual events could differ from those estimates.

Marketable securities

Marketable securities consist of shares in listed mineral exploration companies and are carried at the lower of cost and market value.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

2. Summary of significant accounting policies (Continued)

Mineral property interests

Mineral interests represent acquisition and holding costs, and deferred exploration costs, less amounts written-off or written-down to date. Costs are reduced by amounts received from joint ventures or received as option payments related to each property. A gain is recognized on a property by property basis only when option payments received exceed costs. If production is attained, these costs will be amortized using the unit-of-production method based on estimated reserves. Costs related to properties which are abandoned or considered uneconomic in the foreseeable future are written-off. Management considers some indicators that properties are uneconomic in the foreseeable future to be when no work was performed on the property for several years, when contiguous properties are abandoned or where it is determined that commercial quantities of minerals are unlikely to be found.

When properties are acquired under agreements requiring future acquisition payments to be made at the sole discretion of the company, those future payments, whether in cash or shares, are recorded only when the company has made or becomes obliged to make the payment or to issue the shares.

The amounts shown for mineral properties and related costs represent acquisition, holding and exploration costs and do not necessarily represent present or future recoverable values. The recoverability of these amounts is dependent upon the confirmation of economically recoverable reserves, the ability of the company to obtain the necessary financing to successfully complete their development and to meet the requirements from time to time, of investors or lenders who are providing this financing, and upon future profitable production.

Although the company has taken steps to verify the title to mineral properties in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the company's title. Property title may be subject to unregistered prior agreements or transfers and title may be affected by undetected defects.

Asset retirement obligations

The company recognizes the fair value of liabilities for asset retirement obligations in the period in which a reasonable estimate of such costs can be made. The asset retirement obligation is recorded as a liability with a corresponding increase to the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost is allocated to expenses using a systematic and rational method and is also adjusted to reflect period-to-period changes in the liability resulting from passage of time and revisions to either timing or the amount of the original estimate of the undiscounted cash flow. As at December 31, 2005, the company did not have any asset retirement obligations.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand deposits and short term, highly liquid investments that are readily convertible to known amounts of cash within ninety days of purchase.

Equipment

Equipment is recorded at cost less accumulated amortization. Amortization is calculated using the declining balance method at rates ranging from 20% to 30%.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

2. Summary of significant accounting policies (Continued)

Future income taxes

The company follows the liability method of accounting for income taxes. Under the liability method, future income tax assets and liabilities are computed based on differences between the carrying amount of assets and liabilities on the balance sheet and their corresponding tax values, using substantively enacted income tax rates at each balance sheet date. Future income tax assets also include the benefit that may be derived from unused loss carry forwards and unclaimed other deductions. The valuation of future income tax assets is reviewed annually and adjusted, if necessary, by use of a valuation allowance to reflect the estimated realizable amount.

Stock-based compensation

The company has a stock option plan which is disclosed in Note 9. The company accounts for its grants under that plan using the fair value based method of accounting for stock-based compensation. Accordingly, the fair value of the options at the date of grant is accrued and charged to operations, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised or expire, the applicable amounts are transferred to capital stock.

Capital stock issued for other than cash

Capital stock issued for other than cash is valued at the price at which the stock traded on the principal stock exchange on which the stock trades at the time the agreement to issue the stock is made or, if such issuance is at the option of the company, at the time the company determines to issue such stock. Where capital stock is issued for other than cash and the number of shares is sufficiently large that the quoted market value per share may not represent an appropriate value to be assigned to such issue, the issued shares are valued at an amount equal to the fair market value of the consideration received for such issuance.

Flow-through shares

The company has financed a portion of its exploration activities through the issue of flow-through shares, which transfer the tax deductibility of exploration expenditures to the investor. The proceeds received on the issue of such shares have been credited to capital stock and the related exploration costs have been charged to mineral property interests. Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. When these expenditures are renounced, temporary taxable differences created by the renunciation will reduce share capital.

Loss per share

Loss per common share is calculated using the weighted average number of common shares outstanding during each period. Diluted earnings per common share are calculated using the treasury stock method, which assumes that stock options are only exercised when the exercise price is below the average market price during the period, and that the company will use the proceeds to purchase its common shares at their average market price during the period.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

2. Summary of significant accounting policies (Continued)

Foreign currency translation

The Canadian dollar is the functional currency of the company. Foreign currency transactions are translated by the temporal method whereby monetary assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; non-monetary assets are translated at rates prevailing when acquired; and, revenue and expenses are translated at average rates of exchange for the year. Translation gains and losses are included in the results of operations for the year.

Comparative figures

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted for the current year.

3. Change in accounting policy

Effective January 1, 2004 the company adopted the new accounting recommendations of The Canadian Institute of Chartered Accountants (the "CICA") with respect to the fair value based method of accounting for stock-based compensation, as described in Note 2. This change has been applied retroactively; however, financial statement amounts for 2003 and prior years have not been restated. Prior to January 1, 2004, the company presented the fair value expense of stock options under supplementary pro forma information.

The effect of this change was to increase the deficit and contributed surplus as at December 31, 2003 by \$155,113 to account for the stock option expense that would have been charged to operations in 2003 with respect to all options granted since January 1, 2002, and to increase the net loss for the year ended December 31, 2004 by \$102,155 (\$0.02 per share). When options are exercised, the proceeds received by the company, together with the amount in contributed surplus are credited to capital stock.

4. Marketable securities

	<u>Shares</u>	<u>Cost</u>	<u>Market Value</u>	<u>Carrying Value</u>
Mountain Boy Resources Ltd. - traded on the TSX Venture Exchange	98,000	\$ 24,500	\$ 54,880	\$ 24,500

5. Project deposits

The project deposit represents a term deposit pledged in favour of regulatory authorities as security for performance of site restoration for the Silver Coin property. This deposit will be released to the company on satisfactory reclamation of the property.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

6. Due from director

The amount due from a director bears interest at 5% per annum and has no set terms or repayment. This amount relates to a loan provided in 2004.

7. Mineral property interests

The company's mineral property interests are comprised of properties located in British Columbia, Canada and China.

	Canada	China	Total
Balance, December 31, 2003	\$ 178,239	\$ -	\$ 178,239
Acquisition costs	71,700	512,011	583,711
Exploration expenditures			
Assays	32,490	-	32,490
Drilling and metallurgical testing	117,652	-	117,652
Geological and geophysical consulting	214,292	-	214,292
Helicopter and camp	12,998	-	12,998
Labour	21,695	-	21,695
Maintenance	12,490	-	12,490
Supplies	21,823	-	21,823
Shipping	7,147	-	7,147
Travel and accommodation	27,640	-	27,640
Other	14,148	-	14,148
Properties written-down	(44,540)	-	(44,540)
Balance, December 31, 2004	\$ 687,774	\$ 512,011	\$ 1,199,785
Acquisition costs	122,000	568,599	690,599
Exploration expenditures			
Geochemistry	10,116	-	10,116
Drilling and metallurgical	842,585	-	842,585
Geological & engineering	301,165	-	301,165
Helicopter	25,801	-	25,801
General administration	4,442	-	4,442
Geologic mapping	23,182	-	23,182
Maintenance	15,426	-	15,426
Field supplies	128,182	-	128,182
Resource estimation	2,046	-	2,046
Shipping	26,577	-	26,577
Travel and accommodation	91,149	-	91,149
Trenching & underground	37,560	-	37,560
Options proceeds	(24,500)	-	(24,500)
Balance, December 31, 2005	\$ 2,293,505	\$ 1,080,610	\$ 3,374,115

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

7. Mineral property interests (Continued)

Canada

	<u>Silver Coin</u>	<u>Surprise Creek</u>	<u>Kansas</u>	<u>Other</u>	<u>Total</u>
Balance, December 31, 2003	\$ -	\$ 133,299	\$ -	\$ 44,940	\$ 178,239
Acquisition costs	-	-	71,700	-	71,700
Exploration expenditures					
Assays	28,364	4,015	-	111	32,490
Drilling and metallurgical	117,652	-	-	-	117,652
Geological	171,613	42,679	-	-	214,292
Helicopter and camp	-	3,894	-	9,104	12,998
Labour	17,471	4,224	-	-	21,695
Maintenance	4,730	7,760	-	-	12,490
Supplies	21,823	-	-	-	21,823
Shipping	7,147	-	-	-	7,147
Travel and accommodation	27,152	488	-	-	27,640
Other	9,467	2,500	-	2,181	14,148
Properties written-down	-	-	-	(44,540)	(44,540)
Balance, December 31, 2004	\$ 405,419	\$ 198,859	\$ 71,700	\$ 11,796	\$ 687,774
Acquisition costs	-	122,000	-	-	122,000
Exploration expenditures					
Geochemistry	-	10,116	-	-	10,116
Drilling and metallurgical	842,585	-	-	-	842,585
Geological & engineering	279,664	21,501	-	-	301,165
Helicopter	17,302	8,499	-	-	25,801
General administration	3,713	129	-	600	4,442
Geologic mapping	17,035	6,147	-	-	23,182
Maintenance	11	15,415	-	-	15,426
Field supplies	125,253	1,785	-	1,144	128,182
Resource estimation	2,046	-	-	-	2,046
Shipping	26,164	413	-	-	26,577
Travel and accommodation	87,999	3,150	-	-	91,149
Trenching & underground	37,560	-	-	-	37,560
Options proceeds	-	-	(24,500)	-	(24,500)
Balance, December 31, 2005	\$ 1,844,751	\$ 388,014	\$ 47,200	\$ 13,540	\$ 2,293,505

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

7. Mineral property interests (Continued)

(a) Silver Coin Property

On August 4, 2004 the company entered into an option agreement with Mountain Boy Minerals Ltd. whereby the company can earn 51% of Mountain Boy's interest in its 100% owned Silver Coin and 55% owned Dauntless projects as well as the 100% owned FR claims by spending \$1.75 million on exploration on the Silver Coin Property over a three year period as follows:

	<u>Exploration Expenditures</u>	
by Oct 15, 2004	\$ 250,000	(incurred)
by Oct 15, 2005	500,000	(incurred)
by Oct 15, 2006	<u>1,000,000</u>	(incurred)
	<u>\$ 1,750,000</u>	

In addition, Pinnacle has the right to earn an additional 9% in the projects by bringing one of the projects to production.

(b) Surprise Creek Property

On April 14, 2005 the company optioned the Surprise Creek property to Pallaum Minerals Ltd., whereby Pallaum can earn up to a 50% interest in the Surprise Creek property by spending \$1,025,000 on exploration and issuing 400,000 common shares over a four year period.

Pallum Resources Ltd. did not make the required exploration expenditures by August 9, 2005 and the option agreement was terminated.

On July 30, 2005 the company entered into an agreement to acquire a 100% interest in three more mineral claims in the Surprise Creek property area by issuing 200,000 shares valued at \$0.61 per share which was the trading price of the company's shares at the time this agreement was entered into.

(c) Kansas Property

On October 13, 2004 the company entered into an option agreement with Tenajon Resources Corp. whereby the company can earn up to a 60% interest of Tenajon's 100% owned Kansas property by making a cash payment of \$50,000 (\$25,500 of which was paid by the company and \$24,500 of which was paid by the joint venture partner Mountain Boy) on signing and issuing 77,000 common shares (issued) and by spending \$1.0 million on exploration and development over a 4 year period as follows:

	<u>Exploration Expenditures</u>	
by Oct 13, 2005	\$ 100,000	(incurred)
by Oct 13, 2006	200,000	(incurred)
by Oct 13, 2007	300,000	(incurred)
by Oct 13, 2008	<u>400,000</u>	
	<u>\$ 1,000,000</u>	

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

7. Mineral property interests (Continued)

(c) Kansas Property (Continued)

In addition, the company has the right to earn an additional 10% in Kansas property by bringing it through a positive feasibility study within 4 years of earning its 60% interest.

The Kansas property is a crown grant claim, 19.5 hectares in size, and is surrounded by the Silver Coin project. The expenditures incurred on the Kansas property are included in the Silver Coin property expenditures and are eligible for the expenditures required for that property. Pursuant to an option agreement dated July 29, 2004 Mountain Boy will be participating in the Kansas property and is entitled to a 49% interest of the company's interest. This carried interest was acquired by making a cash payment of \$24,500 upon the signing of the agreement and issuing to the company 98,000 shares of Mountain Boy stock (received). If Pinnacle elects to put Kansas or any adjoining property into production, Mountain Boy would be reduced to owning 40% of the company's interest.

China

Yang Wen Chong

(i) Initial Purchase Contract and Amendments

On May 8, 2004, the company executed a formal Purchase Contract with Yunnan Geology and Mineral Resources Co., Ltd. ("YGM") to acquire a 100% interest in the Yang Wen Chong ("YWC") gold property, located in the southeast region of Yunnan Province, PRC. The YWC property is a 51.2 square kilometre mineral exploration license located in Funing County, Yunnan Province, PRC.

As consideration for YWC, the company initially agreed to pay YGM 27,000,000 RMB (\$4,437,000) as follows:

On signing the Purchase Contract	RMB 270,000	\$ 44,370
On the latter of four months from the signing of the Purchase Contract (September 8, 2004) or on receipt of regulatory approval	13,230,000	2,174,130
Within twelve months of the second payment	5,400,000	887,400
By November 18, 2005	8,100,000	1,331,100
	<u>27,000,000</u>	<u>\$ 4,437,000</u>

YGM agreed to transfer title to YWC upon completion of 70% of the required payments. In addition, the company agreed to pay YGM 500,000 RMB for every tonne of gold in excess of 11 tonnes, if such resources were established prior to the company obtaining the property title. In connection with the purchase of YWC, Pinnacle has agreed to pay a finder's fee of up to 700,000 shares to a unrelated person upon approval by the TSX Venture Exchange.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

7. Mineral property interests (Continued)

Yang Wen Chong (Continued)

On September 27, 2004 the payment schedule agreed to in the Purchase Contract was modified to the following:

September 23, 2004 (paid)	3,000,000 RMB	\$467,641
November 8, 2004 (Subsequently modified to December 30, 2004 and never paid)	10,230,000 RMB	\$1,591,788

Letter Agreement

On January 27, 2005, the Purchase Contract was terminated and replaced by a Letter of Agreement that provided the company with the option to pay an additional 3,730,000 RMB (\$568,599) on or before January 31, 2005 (paid), to own 25% of a joint venture with YGM.

The company can earn an additional 45% of the joint venture by spending 12,600,000 RMB (\$1,960,560) on exploration and development of YWC within five years and can earn an additional 1% for each additional 280,000 RMB (\$43,568) spent on exploration on YWC. The maximum interest that the company can earn in this property is 90%.

Under the Letter Agreement, YGM agrees that if the Chinese authorities do not grant a business license by December 23, 2006 to the joint venture, or do not approve the transfer of title and exploration license to the joint venture, YGM will refund the January 28, 2005 payment of 3,730,000 RMB less expenses incurred (estimated by the company's management at \$50,000).

The net effect of the foregoing agreements and amendments is as follows:

In order for the company to earn a 25% interest in the YWC gold property, the company agreed to make the following payments:

	RMB	
On signing the May 8, 2004 Purchase Contract (paid)	270,000	\$ 44,370
On September 23, 2004 (paid)	3,000,000	467,641
Paid at December 31, 2004	3,270,000	512,011
January 28, 2005	3,730,000	568,599
	7,000,000	\$ 1,080,610
Exploration and development expenditures required to earn an additional 45% interest in the YWC property. To be spent over 5 years after joint venture approval given by the Chinese government.	12,600,000	1,960,560

On June 23, 2005, the company completed a resigning of the joint venture agreement with YGM on the YWC property in Yunnan Province. The Articles of Association governing the operation of the property were also signed.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

8. Equipment

	December 31, 2005		
	Cost	Accumulated Depreciation	Net Book Value
Computer equipment	\$ 22,335	\$ 4,974	\$ 17,361
Other equipment	12,708	1,271	11,437
	<u>\$ 35,043</u>	<u>\$ 6,245</u>	<u>\$ 28,798</u>
	December 31, 2004		
	Cost	Accumulated Depreciation	Net Book Value
Computer equipment	\$ 4,796	\$ 719	\$ 4,077
Other equipment	1,572	236	1,336
	<u>\$ 6,368</u>	<u>\$ 955</u>	<u>\$ 5,413</u>

9. Capital stock and contributed surplus

Capital Stock

Common Shares

Authorized:

Unlimited number of common shares without par value

Issued:

	Number	Amount
Balance, December 31, 2003	3,572,034	\$ 10,554,045
Private placement, net of share issue costs of \$13,960	1,770,100	646,040
Private placement, net of share issue costs of \$23,984	701,680	416,716
Private placement, net of share issue costs of \$25,000	1,040,000	599,000
Private placement, net of share issue costs of \$127,629	2,684,952	1,432,371
Issued for mineral properties	77,000	46,200
Return of escrow shares	(1,402)	(1,950)
Exercise of warrants	<u>321,097</u>	<u>90,947</u>
Balance, December 31, 2004	10,165,461	13,783,369
Future income tax relating to renounced exploration expenditures applicable to flow-through shares		(156,889)
Exercise of warrants	2,353,423	1,072,103
Private placement	93,000	55,800
Private placement	3,000,000	1,950,000
Private placement (Note 16)	117,647	100,000
Issued for mineral properties (Note 6)	200,000	122,000
Exercise of options	55,000	27,500
Fair value of options exercised	<u>-</u>	<u>24,987</u>
Balance, December 31, 2005	<u>15,984,531</u>	<u>\$ 16,978,870</u>

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

9. Capital stock and contributed surplus (Continued)

Private placements

During the third quarter of 2005 the company completed a private placement. The private placement consisted of 3,000,000 units at a price of \$0.65 per unit for net proceeds of \$1,950,000. Each unit consisted of one common share and one-half share purchase warrant with one whole warrant being exercisable into one additional common share for a period of two years at a price of \$0.83 per share.

During the second quarter of 2005 the company completed a private placement. The private placement consisted of 93,000 units at a price of \$0.60 per unit for net proceeds of \$55,800. Each unit consisted of one common share and one share purchase warrant, every two warrants being exercisable into one additional common share for a period of two years at a price of \$0.60 per share in the first year and \$0.75 per share in the second year.

On January 29, 2004 the company closed a private placement of 1,650,000 units for cash consideration of \$660,000. Each unit consisted of one common share and one share purchase warrant. Each two warrants entitle the holder to purchase one common share at a price of \$0.50 per share on or before February 5, 2005. Finders' fees of \$13,960 and 120,100 units were paid.

On September 23, 2004 the company completed a flow through financing of 678,000 units at \$0.65 per unit for gross proceeds of \$440,700. Each unit consisted of one common flow-through share and one share purchase warrant. Two of these warrants entitle the holder to purchase one non-flow-through share at a price of \$0.75 per share on or before September 23, 2005. Finders' fee of \$23,984 and 23,680 units were paid. Eligible mineral exploration expenditures were made during 2004 and renounced to investors in March 2005.

On November 8, 2004 the company closed a private placement of 1,040,000 units at \$0.60 per unit for gross proceeds of \$624,000. Each unit consisted of one common share and one share purchase warrant, with two share purchase warrants entitling the holder to acquire an additional share for a period of two years from the date of the offering at a price of \$0.75 per share in the first year and \$0.85 in the second year. The cost of this offering was \$25,000.

On November 30, 2004 the company closed a private placement of 2,600,000 units at \$0.60 per unit for gross proceeds of \$1,560,000. Each unit consisted of one common share and one-half share purchase warrant, with a whole share purchase warrant entitling the holder to acquire an additional share for a period of two years from the date of the offering at a price of \$0.75 per share in the first year and \$0.85 in the second year. The agent in the private placement received a cash commission of \$109,829 as well as Agents' Warrants to acquire that number of common shares equal to 15% of the number of units sold under the offering, the Agents' Warrants having the same terms as the share purchase warrants. Canaccord also received a corporate finance fee of 60,000 units and 30,000 warrants. In addition to the \$109,829 paid to the agent the company incurred other fees of \$17,800.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

9. Capital stock and contributed surplus (Continued)

Stock options

During 1997 the company established a share option plan (the "1997 Plan") whereby the board of directors may from time to time grant to directors, officers, employees or consultants stock options. The maximum number of shares subject to the plan, in the aggregate, may not exceed 20% of the company's issued shares. The maximum term of any option will be ten years, but generally options are granted for five years or less. The exercise price of an option is not less than the greater of \$0.15 per share or the minimum price permitted under the policies of the TSX Venture Exchange. Options vest over a two year period.

This plan was revised on May 16, 2003. The maximum number of shares subject to the plan, in the aggregate, may not exceed 10% of the Company's issued shares. The maximum term of any option will be five years if the company is a "Tier 2" company and ten years if the company is a "Tier 1" company. The vesting is at the direction of the company. However, options granted to consultants performing "investor relations' activities" must at a minimum vest in stages over a period of not less than twelve months, with no more than ¼ of the options vesting in any three month period. The exercise price shall be not less than the greater of \$0.10 per share and the last closing price of the company's shares.

Stock option activity for the respective periods is as follows:

	2005	2004
Options outstanding, beginning of year	530,000	350,000
Granted	825,000	180,000
Exercised	<u>(55,000)</u>	<u>-</u>
Options outstanding, end of year	<u>1,300,000</u>	<u>530,000</u>

Stock options outstanding and exercisable at December 31, 2005:

Description	Year of Grant	Expiry Date	Outstanding and Exercisable		
			Number of Shares	Exercise Price Per Share	Average Remaining Contractual Life (Years)
Directors' options	2003	November 23, 2008	350,000	\$ 0.40	2.90
Directors' options	2004	March 16, 2009	90,000	0.70	3.21
Employee's option	2004	June 23, 2009	15,000	0.50	3.48
Consultant's option	2004	June 23, 2009	20,000	0.50	3.48
Consultant's option	2004	June 27, 2007	50,000	0.50	1.49
Consultant's option	2005	April 11, 2010	40,000	0.50	4.28
Employee's option	2005	April 11, 2010	35,000	0.50	4.28
Directors' options	2005	April 11, 2010	400,000	0.50	4.28
Directors' options	2005	December 6, 2010	260,000	0.95	4.93
Consultant's option	2005	December 6, 2010	30,000	0.95	4.93
Employee's option	2005	December 6, 2010	<u>10,000</u>	0.95	4.93
			<u>1,300,000</u>	<u>\$ 0.59</u>	<u>3.86</u>

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

9. Capital stock and contributed surplus (Continued)

Stock options

During 2005, the Company recorded \$518,969 (2004 - \$102,155) of compensation expense. This represents a portion of the options granted last year that vested during the year ended December 31, 2005 plus 825,000 options granted to the directors, consultants and employees during the year ended December 31, 2005. The company used the Black-Scholes option pricing model to estimate the fair value of the options at each grant date using the following weighted average assumptions:

	<u>2005</u>	<u>2004</u>
Risk-free interest rate	3.87%	4.00%
Dividend yield	0.00%	0.00%
Expected volatility	173%	146%
Expected option life	5 years	4.39 years
Weighted average fair value of stock options issued during the year	\$0.59	\$0.47

Warrants

Full share equivalent warrant activity for the respective years is as follows:

	December 31, 2005	December 31, 2004
Warrants outstanding, beginning of year	4,347,269	1,180,000
Issued	1,546,500	3,488,366
Exercised	(2,353,423)	(321,097)
Expired	(62,496)	-
Warrants outstanding, end of year	<u>3,477,850</u>	<u>4,347,269</u>

Full share equivalent warrants outstanding and exercisable at December 31, 2005:

<u>Description</u>	<u>Number of Full Share Equivalent Warrants</u>	<u>Price Per Share</u>	<u>Expiry Date</u>	<u>Year of Grant</u>	<u>Average Remaining Contractual Life (Years)</u>
Warrants	520,000	0.75	November 8, 2006	2004	0.85
Warrants	1,411,350	0.75	November 30, 2006	2004	0.92
Warrants	46,500	0.60	April 20, 2007	2005	1.30
Warrants	<u>1,500,000</u>	0.83	September 25, 2007	2005	1.73
	<u>3,477,850</u> \$	<u>0.78</u>			<u>1.35</u>

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

9. Capital stock and contributed surplus (Continued)

The weighted average grant date fair value per option granted during the year ended December 31, 2005 was \$0.60. Details of weighted average exercise price and weighted average fair value per option are as follows:

	Weighted Average Exercise Price	Weighted Average Fair Value per Option
Options granted with exercise price greater than market price on grant date	\$ 0.95	\$ 0.89
Options granted with exercise price equal to market price on grant date	\$ 0.50	\$ 0.44
Contributed surplus	2005	2004
Balance, beginning of year	\$ 273,252	\$ 169,147
Stock-based compensation	518,969	102,155
Return of escrow shares		1,950
Fair value of of options exercised	<u>(24,987)</u>	<u>-</u>
Balance, end of period	<u>\$ 767,234</u>	<u>\$ 273,252</u>

10. Change in non-cash operating working capital

	2005	2004
Receivables	\$ (38,325)	\$ (16,451)
Prepays	(35,330)	(5,619)
Payables and accruals	<u>50,314</u>	<u>51,820</u>
	<u>\$ (23,341)</u>	<u>\$ 29,750</u>

11. Commitments

(a) The company entered into a five year lease agreement with a company with directors in common for its office space commencing March 1, 2005 and ending February 28, 2010. The company is committed to making lease payments in 2006 of \$85,914, in 2007 \$89,363, in 2008 and 2009 \$92,812 each year and in 2010 \$15,469.

(b) During the third quarter of 2005, the company entered into a Cooperation Agreement with Gold Mountain (H.K.) International Mining Co. Ltd. ("Gold Mountain") a Hong Kong based subsidiary of Zijin Mining Group Co. Ltd. ("Zijin"), a gold and copper producer in China.

This Cooperation Agreement was entered as part of Gold Mountain's investment of \$1,950,000 in the Company (Note 9).

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

11. Commitments (Continued)

Under the Cooperation Agreement, Gold Mountain and Zijin agree to offer and select as yet indeterminable projects in China to the company for joint venture. Also under the Cooperative Agreement, the company agrees to offer Zijin a right of first refusal to participate in any projects held at the time of the Cooperative Agreement. Zijin may also arrange to have suitable professionals join the company's project team at the company's cost.

12. Related party transactions

During 2005, the company incurred fees of \$189,000 (2004 - \$80,250) with directors for management consulting services. This amount has been included in management services expense on the statement of operations and deficit.

During 2005, the company incurred consulting fees of \$30,411 (2004 - \$43,296) with a director for geological and mining engineering services. This amount has been included in consulting services expense on the statement of operations and deficit.

Included in payables is an amount of \$586 owed to a director of the company and \$29,500 owed to Gold Mountain. The \$29,500 payable to Gold Mountain arose from consulting services provided by Gold Mountain.

The company shares office space with Doublestar Resources Ltd. and Lincoln Gold Corp. Starting March 2005 Doublestar and Lincoln reimburse each month to Pinnacle a portion of the rent and office expenses. Doublestar, Lincoln and Pinnacle have one director in common.

All related party transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed to between the parties. The exchange amount was negotiated and established and agreed to by the related parties as if they were dealing at arm's length.

13. Income taxes

The income tax provision (recovery) shown on the statements of operations differs from the amounts obtained by applying statutory rates to the net loss before taxes as follows:

	2005	2004
Loss before income taxes	\$ <u>(1,237,082)</u>	\$ <u>(846,714)</u>
Effective tax rate	<u>34.9%</u>	<u>35.6%</u>
Expected tax (recovery) provision	\$ (431,000)	\$ (301,000)
Renunciation of mineral property expenditures	(156,889)	-
Other non-deductible items	-	(6,000)
Stock-based compensation	185,000	37,000
Change in valuation allowance	<u>246,000</u>	<u>270,000</u>
	\$ <u>(156,889)</u>	\$ <u>-</u>

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

13. Income taxes (Continued)

Future income tax assets are calculated as follows:

	2005	2004
Future income tax assets relate to:		
Loss carryforwards	\$ 648,000	\$ 458,000
Accumulated mineral property expenditures	177,000	105,000
Capital assets	2,000	-
Financing costs	<u>70,000</u>	<u>88,000</u>
	897,000	651,000
Valuation allowance	<u>(897,000)</u>	<u>(651,000)</u>
	\$ <u>-</u>	\$ <u>-</u>

As at December 31, 2005, the company has non-capital loss carry forwards of \$1,900,000 (2004: \$1,287,000) available to reduce income otherwise taxable in future years. These losses if not used will expire as follows:

December 31, 2006	\$ 81,000
December 31, 2007	231,000
December 31, 2008	37,000
December 31, 2010	14,000
December 31, 2011	190,500
December 31, 2014	571,500
December 31, 2015	<u>775,000</u>
	\$ <u>1,900,000</u>

The potential tax benefits related to the loss carry forwards and other timing differences, the application of which may be restricted, have not been recognized in these financial statements as management does not consider it likely that such assets will be realized in the carry forward period. Also, the availability of the above deductions for income tax purposes have been restricted due to previous changes in control of companies in the group and may be further restricted if there are future changes in control.

14. Financial instruments

(a) Fair value

The company's financial instruments consist of cash, marketable securities, receivables, due from directors and payable and accruals. The company limits its exposure to credit loss by placing its cash and cash equivalents with high credit quality financial institutions. The fair value of the company's financial instruments approximates their carrying values.

Pinnacle Mines Ltd.

Notes to the Financial Statements

For the Years Ended December 31, 2005 and 2004

14. Financial instruments (Continued)

(b) Foreign exchange risk

The company's operations in China expose the company to foreign exchange risk. The company does not enter into derivative financial instruments to mitigate this risk.

15. Segmented disclosure

The company has one operating segment which is mineral exploration and all capital assets of the company are located in Canada except for certain of its mineral properties located in China as disclosed in Note 7.

The company operates in two geographical segments: Canada and China. Corporate administrative activities are conducted from Canada. The income and expenses for the years ended December 31, 2005 and December 31, 2004 and the assets at the end of those years identifiable to these segments are as follows:

	<u>Canada</u>		<u>China</u>		<u>Corporate</u>		<u>Total</u>
Assets							
December 31, 2005	\$ 2,293,505	\$	1,080,610	\$	2,042,045	\$	5,416,160
December 31, 2004	687,774		512,011		1,640,051		2,839,836
Net loss							
Year ended							
December 31, 2005	-		-		1,237,082		1,237,082
Year ended							
December 31, 2004	44,540		-		802,174		846,714

16. Subsequent events

On February 1, 2006, the company closed a private placement consisting of 353,117 units at a price of \$0.85 per unit for net proceeds of \$300,149 of which \$100,000 was received in 2005. Each unit consisted of one common share and one share purchase warrant, every two warrants being exercisable into one additional common share for a period of two years at a price of \$1.00 per share in the first year and \$1.20 per share in the second year. A 5% finder's fee of \$12,500 was paid.

On March 1, 2006 the company received written confirmation from Mountain Boy that \$1,750,000 exploration expenditures was achieved during the year ended December 31, 2005 and that the company has earned a 51% interest in the Silver Coin property.