



Consolidated Financial Statements of

SCORPIO MINING CORPORATION

For the years ended

December 31, 2012 and 2011



MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Scorpio Mining Corporation (the "Company") are the responsibility of the Company's management. The consolidated financial statements are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and reflect Management's best estimates and judgement based on information currently available.

Management has developed and maintains a system of internal controls to ensure that the Company's assets are safeguarded, transactions are authorized and properly recorded, and financial information is reliable.

The Board of Directors is responsible for ensuring management fulfills its responsibilities. The Audit Committee reviews the results of the audit and the annual consolidated financial statements prior to their submission to the Board of Directors for approval.

The consolidated financial statements have been audited by Deloitte LLP and their report outlines the scope of their examination and gives their opinion on the financial statements.

"Peter J. Hawley"

Peter J. Hawley
Interim President & Chief Executive Officer
March 14, 2013

"Hemdat Sawh"

Hemdat Sawh, CA
Chief Financial Officer
March 14, 2013

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Scorpio Mining Corporation

We have audited the accompanying consolidated financial statements of Scorpio Mining Corporation, which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011 and the consolidated statements of operations, comprehensive income, changes in equity, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Scorpio Mining Corporation at December 31, 2012 and December 31, 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

The image shows the handwritten signature of Deloitte LLP in a cursive script.

Chartered Accountants
March 14, 2013
Vancouver, Canada

Scorpio Mining Corporation

Consolidated statements of financial position

As at December 31, 2012 and December 31, 2011

(In thousands of Canadian dollars)

	December 31, 2012	December 31, 2011
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	23,595	25,768
Trade and other receivables (Note 6)	8,791	4,191
Deposits	-	1,843
Inventories (Note 7)	7,014	5,009
Investment in Scorpio Gold (Note 8)	7,453	14,285
Total current assets	46,853	51,096
Property, plant and equipment (Note 9)	89,915	78,578
Deferred income tax assets (Note 17)	10,783	14,973
Total assets	147,551	144,647
Equity and liabilities		
Current liabilities		
Trade and other payables	2,190	2,177
Total current liabilities	2,190	2,177
Provision for environmental rehabilitation (Note 10)	1,657	1,137
Total liabilities	3,847	3,314
Equity		
Share capital (Note 11)	170,304	169,328
Equity reserve	25,590	24,553
Foreign currency translation reserve and other	(3,219)	(355)
Changes in available-for-sale investment in Scorpio Gold	(452)	3,416
Deficit	(48,529)	(55,619)
Equity attributable to shareholders of the Company	143,694	141,323
Non-controlling interest	10	10
Total equity	143,704	141,333
Total equity and liabilities	147,551	144,647
Contingencies (Note 22)		

APPROVED BY THE BOARD

"Ewan Mason" (Signed)
Director

"Jonathan A. Berg" (Signed)
Director

See accompanying notes to the consolidated financial statements

Scorpio Mining Corporation

Consolidated statements of changes in equity

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars)

	Share capital		Equity reserve	Foreign currency translation reserve	Changes in fair value of available-for-sale investment in Scorpio Gold	Deficit	Non-controlling interest	Total equity
	Shares (thousands)	Amount (\$)						
Balance at December 31, 2011	197,776	169,328	24,553	(355)	3,416	(55,619)	10	141,333
Net earnings for the year	-	-	-	-	-	7,090	-	7,090
Translation adjustment	-	-	-	(2,864)	-	-	-	(2,864)
Share-based payments	-	-	1,367	-	-	-	-	1,367
Exercise of stock options	613	976	(330)	-	-	-	-	646
Change in fair value of available-for-sale securities of Scorpio Gold	-	-	-	-	(3,868)	-	-	(3,868)
Balance at December 31, 2012	198,389	170,304	25,590	(3,219)	(452)	(48,529)	10	143,704

	Share Capital		Equity reserve	Equity component of convertible debentures	Foreign currency translation reserve and other	Changes in fair value of available-for-sale investment in Scorpio Gold	Deficit	Non-controlling interest	Total equity
	Shares (thousands)	Amount (\$)							
Balance at December 31, 2010	189,114	156,422	20,510	1,885	(3,206)	-	(68,196)	10	107,425
Net earnings for the year	-	-	-	-	-	-	12,577	-	12,577
Translation adjustment	-	-	-	-	2,851	-	-	-	2,851
Share-based payments ⁽¹⁾	750	915	4,780	-	-	-	-	-	5,695
Reclassification on repayment of convertible debentures	-	-	1,885	(1,885)	-	-	-	-	-
Exercise of stock options	4,945	7,491	(2,622)	-	-	-	-	-	4,869
Exercise of warrants	2,967	4,500	-	-	-	-	-	-	4,500
Change in fair value of available-for-sale securities of Scorpio Gold	-	-	-	-	-	3,416	-	-	3,416
Balance at December 31, 2011	197,776	169,328	24,553	-	(355)	3,416	(55,619)	10	141,333

⁽¹⁾ 750,000 bonus shares were granted to the then Chairman of the Board in 2011.

See accompanying notes to the consolidated financial statements

Scorpio Mining Corporation

Consolidated statements of operations

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars, except for share and per share amounts)

	2012	2011
	\$	\$
Revenue (Note 13)	45,805	61,064
Cost of sales excluding depletion and amortization	26,758	24,240
Gross margin	19,047	36,824
Depletion and amortization	3,845	3,593
Mine operating earnings	15,202	33,231
Expenses (income)		
General and administrative (Note 14)	4,887	7,472
Finance (income) costs (Note 15)	(29)	721
Fair value change of derivative liability (Note 11(b))	-	1,466
(Gain) loss from investment in Scorpio Gold (Note 8)	(699)	1,314
	4,159	10,973
Earnings before income taxes	11,043	22,258
Income tax expense (Note 17)	3,953	9,681
Net earnings attributable to:		
Equity shareholders of the Company	7,090	12,577
Earnings per share		
Basic	0.04	0.07
Diluted	0.04	0.06
Weighted average number of shares outstanding (Note 12)		
Basic	198,154,955	193,152,266
Diluted	199,570,113	196,619,270

See accompanying notes to the consolidated financial statements

Scorpio Mining Corporation

Consolidated statements of comprehensive income

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars)

	2012	2011
	\$	\$
Net earnings for the year	7,090	12,577
Other comprehensive income		
Foreign currency reserve	(2,864)	2,851
Change in fair value of available-for-sale securities of Scorpio Gold (net of tax)	(3,868)	3,416
Comprehensive income	358	18,844
Comprehensive income attributable to:		
Equity shareholders of the Company	358	18,844

See accompanying notes to the consolidated financial statements

Scorpio Mining Corporation

Consolidated statements of cash flows

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars)

	2012	2011
	\$	\$
Operating activities		
Earnings for the year before income taxes	11,043	22,258
Adjustments for:		
Income taxes paid	(35)	(8)
Finance costs	78	337
Items not involving cash:		
Depletion and amortization	3,861	3,627
Loss on disposal of property, plant and equipment	-	70
Share-based payments	1,367	5,695
Fair value change in derivative liability (Note 11(b))	-	1,466
(Gain) loss from investment in Scorpio Gold (Note 8)	(699)	1,314
Operating cash flows before movements in working capital	15,615	34,759
(Increase) decrease in trade and other receivables	(4,600)	3,056
Decrease (increase) in deposits	1,843	(1,843)
Increase in inventories	(2,005)	(1,781)
Increase (decrease) in trade and other payables	(31)	(322)
Effect of foreign exchange rate changes on working capital	(221)	251
	10,601	34,120
Investing activities		
Expenditures on non-producing mining properties	(8,309)	(5,512)
Expenditures on mining interests	(8,469)	(10,030)
Proceeds from disposal of Scorpio Gold shares	3,663	8,074
Proceeds from disposal of property, plant and equipment	-	50
Cash received on lease receivable	-	517
	(13,115)	(6,901)
Financing activities		
Repayment of debt (Note 16)	-	(20,455)
Interest paid	-	(700)
Issue of common shares for cash	646	6,535
	646	(14,620)
Effect of foreign exchange rate changes on non-Canadian dollar denominated cash and cash equivalents		
	(305)	589
(Decrease) increase in cash and cash equivalents	(2,173)	13,188
Cash and cash equivalents, beginning of year	25,768	12,580
Cash and cash equivalents, end of year	23,595	25,768
Cash and cash equivalents consist of:		
Cash	11,013	25,768
Term deposits	12,582	-
	23,595	25,768

Supplementary cash flow information (Note 18)

See accompanying notes to the consolidated financial statements

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

1. Corporate information

Scorpio Mining Corporation (the "Company" or "Scorpio Mining") was incorporated under the Canada Business Corporations Act on May 12, 1998 and conducts mining exploration, development and production in Mexico. The address of the Company's registered office is 40 University Avenue, Suite 606, Toronto, Ontario, Canada, M5J 1T1.

The consolidated financial statements of the Company for the year ended December 31, 2012 were authorized for issuance by the Board of Directors of the Company on March 14, 2013.

2. Basis of preparation

These consolidated financial statements have been prepared in accordance with accounting policies in full compliance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and the IFRS Interpretations Committee ("IFRIC").

These consolidated financial statements have been prepared under the historical cost basis except for financial instruments classified as available-for-sale which are stated at their fair value.

3. Summary of significant accounting policies

The significant accounting policies used in the preparation of these consolidated financial statements are as follows:

(a) Basis of consolidation

These consolidated financial statements incorporate the financial statements of the Company and the entities controlled by the Company (its subsidiaries, including special purpose entities). Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. All intercompany transactions and balances, income and expenses have been eliminated.

These consolidated financial statements include the accounts of the Company and its 100% owned subsidiaries, Scorpio Holding One Limited, Scorpio Holding Two Limited, Minera Cosala S.A. de C.V., Platte River Gold Inc. and its 100% owned subsidiaries, Platte River Gold (US) Inc., Minera Platte River Gold S. de R.L. de C.V. and Minera Cayeros S. de R. L. de C.V. Scorpio Gold Corporation ("Scorpio Gold") ceased being a subsidiary of the Company on March 10, 2010 and was accounted for as an investment in associate until June 15, 2011. Subsequently, it has been accounted for as an available-for-sale financial instrument (Note 8).

Non-controlling interest in the net assets of consolidated subsidiaries are identified separately from the Company's equity. Non-controlling interest consists of the non-controlling interest at the date of the original business combination plus the non-controlling interest's share of changes in equity since the date of acquisition.

Special Purpose Entities ("SPE's") as defined by the IASB in SIC 12 *Consolidation-Special Purpose Entities* are entities which are created to accomplish a narrow and well-defined objective (e.g. to provide services to the operating entity). SPE's are subject to consolidation when there is an indication that the other entity controls the SPE. The Company has determined that it controls certain SPE's relating to service companies at its Mexican operations (4246136 Canada Inc., Servicios Especializados en Minas S.A. de C.V., Triturados Mineros del Noroeste S.A. de C.V. and Servicios Generales en Minería S.A. de C.V.) and the accounts of those SPE's are consolidated with those of the Company.

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

(b) *Presentation currency and functional currency*

The Company's presentation currency is the Canadian dollar ("CAD"). The functional currency of the Company is the Canadian dollar and the functional currency of its Mexican subsidiaries and SPE's as well as its US and British Virgin Island's subsidiaries is the U.S. dollar ("USD"). The financial statements of these subsidiaries are translated into the presentation currency. Assets and liabilities have been translated using the exchange rate at period end, and income, expenses and cash flow items are translated using the rate that approximates the exchange rates at the dates of the transactions (the average rate for the period). All resulting exchange differences are recorded in the foreign currency translation reserve.

(c) *Foreign currency transactions*

The Company's foreign subsidiaries and SPE's in Mexico operate in an environment where the USD is the functional currency and the operations are considered to be financially and operationally independent of the reporting entity.

Transactions in foreign currencies are translated into the entities' functional currency at the exchange rate at the date of the transactions. Monetary assets and liabilities of the Company's operations denominated in a currency other than the functional currency are translated at the rate in effect at the statement of financial position date, and non-monetary items at historic exchange rates at each transaction date. Revenue and expense items are translated at average exchange rates of the reporting period. Gains and losses on translation are charged to the statement of operations.

(d) *Significant accounting judgements and estimates*

The preparation of financial statements in conformity with IFRS requires management to make judgements and estimates that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The areas which require management to make significant judgements, estimates and assumptions in determining carrying values include, but are not limited to:

(i) Reserves

Proven and probable reserves are the economically mineable parts of the Company's measured and indicated mineral resources demonstrated by at least a preliminary feasibility study. The Company estimates its proven and probable reserves and measured and indicated and inferred mineral resources based on information compiled by appropriately qualified persons. The information relating to the geological data on the size, depth and shape of the ore body requires complex geological judgements to interpret the data. The estimation of future cash flows related to proven and probable reserves is based upon factors such as estimates of foreign exchange rates, commodity prices, future capital requirements and production costs along with geological assumptions and judgements made in estimating the size and grade of the ore body.

Changes in the proven and probable reserves or measured, indicated and inferred mineral resources estimates may impact the carrying value of mining properties and equipment, depletion and amortization, impairment assessments and the timing of provisions for environmental rehabilitation.

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

(ii) Depletion and amortization

Mining properties are depleted using the unit-of-production method over a period not to exceed the estimated life of the ore body based on estimated recoverable reserves.

Property, plant and equipment are depreciated, net of residual value over the useful life of the equipment but do not exceed the related estimated life of the mine based on estimated recoverable mineral reserves.

The calculation of the units of production rate, and therefore the annual depletion and amortization expense, could be materially affected by changes in the underlying estimates. Changes in estimates can be the result of actual future production differing from current forecasts of future production and expansion of mineral reserves through exploration activities.

Significant judgement is involved in the determination of useful life and residual values for the computation of depletion and amortization and no assurance can be given that actual useful lives and residual values will not differ significantly from current assumptions.

(iii) Provision for environmental rehabilitation

The Company assesses its provision for environmental rehabilitation on an annual basis or when new material information becomes available. Mining and exploration activities are subject to various laws and regulations governing the protection of the environment. In general, these laws and regulations are continually changing and the Company has made, and intends to make in the future, expenditures to comply with such laws and regulations. Accounting for environmental rehabilitation requires management to make estimates of the future costs the Company will incur to complete the rehabilitation work required to comply with existing laws and regulations at each mining operation. Also, future changes to environmental laws and regulations could increase the extent of rehabilitation work required to be performed by the Company. Increases in future costs could materially impact the amounts charged to operations for environmental rehabilitation. The provision represents management's best estimate of the present value of the future provision for environmental rehabilitation. The actual future expenditures may differ from the amounts currently provided.

(iv) Share-based payments

The Company follows accounting guidelines in determining the fair value of share-based compensation. The computed amount is not based on historical cost, but is derived based on subjective assumptions input into an option pricing model. The model requires that management make forecasts as to future events, including estimates of the average future period of issued stock options before exercise, expiry or cancellation; future volatility of the Company's share price in the life of the option (using historical volatility as a reference); and the appropriate risk-free rate of interest. Share-based compensation also incorporates an expected forfeiture rate. The expected forfeiture rate is estimated annually based on historical forfeiture rates and expectations of future forfeiture rates.

The resulting value calculated is not necessarily the value that the holder of the option could receive in an arm's length transaction, given that there is no market for the options and they are not transferable. It is management's view that the value derived is highly subjective and dependent entirely upon the input assumptions made.

(v) Income taxes

Preparation of the consolidated financial statements requires an estimate of income taxes in each of the jurisdictions in which the Company operates. The process involves an estimate of the Company's

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

current tax exposure and an assessment of temporary differences resulting from differing treatment of items, such as depletion and amortization, for tax and accounting purposes.

These differences result in deferred tax assets and liabilities that are included in the Company's consolidated statements of financial position.

An assessment is also made to determine the likelihood that the Company's future tax assets will be recovered from future taxable income. To the extent that recovery is not considered likely, the related tax benefits are not recognized.

Judgement is required to continually assess changing tax interpretations, regulations and legislation, to ensure liabilities are complete and to ensure assets, net of valuation allowances, are realizable. The impact of different interpretations and applications could be material.

(vi) Revenue recognition

The Company fixes metal prices under provisional pricing arrangements with independent purchasers of its concentrates for specific sales for which concentrates have been delivered. In a period of unusual price volatility, the effect of mark-to-market price adjustments related to final settlement prices in subsequent periods with these purchasers could be significant.

(vii) Impairment of mining interests

The Company's management reviews the carrying values of its mining interests on a regular basis to determine whether any write-downs are necessary. The recovery of amounts recorded for mining interests depends on confirmation of the Company's interest in the underlying mineral claims, the ability of the Company to obtain the necessary financing to complete the development, and future profitable production or proceeds from the disposition thereof. Management relies on the life-of-mine plans in its assessments of economic recoverability and probability of future economic benefit. Life-of-mine plans provide an economic model to support the economic extraction of reserves and resources. A long-term life-of-mine plan and supporting geological model identifies the drilling and related development work required to expand or further define the existing ore body.

(viii) Exploration and evaluation expenditures

Judgement is required in determining whether the respective costs are eligible for capitalization where applicable, and whether they are likely to be recoverable by future exploitation, which may be based on assumptions about future events and circumstances. Estimates and assumptions may change if new information becomes available.

(e) Revenue recognition

The following specific conditions must all be met before revenue is recognized:

- the title, specific risks and rewards of ownership have been transferred to the purchaser;
- the Company does not retain continuing managerial involvement to the degree usually associated with ownership or effective control over the concentrate sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Company; and
- the costs incurred or to be incurred in respect of the sale can be measured reliably.

The Company's sales of concentrates are made under provisional pricing arrangements where the final sale prices are determined by quoted market prices in a period subsequent to the date of sale. In

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

these circumstances, revenue from sales is recorded at the time of sale based on forward prices for the expected date of final settlement.

Subsequent variations in prices and metal quantities are recognized as revenue adjustments as they occur.

Revenue includes treatment and selling costs if payment of those amounts are enforced at the time of sale.

(f) *Finance costs*

Finance costs comprise interest on the convertible debentures and note payable calculated using the effective interest method. The convertible debentures and note payable were fully repaid in 2011.

(g) *Share-based payments*

The Company's stock option plan allows its employees (including directors and officers) and non-employees to acquire shares of the Company. Accordingly, the fair value of the option is either charged to operations or capitalized to exploration or development expenditures, depending on the accounting for the optionee's other compensation, with a corresponding increase in equity reserve.

In situations where equity instruments are issued and some or all of the goods or services received by the Company as consideration cannot be specifically identified, they are measured at fair value of the share-based payment at the date the goods or services are received.

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which they are granted using the Black-Scholes model.

The costs of equity-settled transactions are recognized, together with a corresponding increase in equity reserve, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense recognized for equity-settled transactions at each reporting date up to the vesting date reflects the Company's best estimate of the number of equity instruments that will ultimately vest. The charge or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of that period and the corresponding amount is represented in equity reserve. No expense is recognized for awards that do not ultimately vest.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

(h) *Income taxes*

Income tax expense consists of current and deferred tax expense. Income tax expense is recognized in the statements of operations.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates substantively enacted at the end of the year, adjusted for amendments to tax payable with regards to previous years.

Deferred taxes are recorded using the liability method, where deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities for financial reporting purposes and their respective tax bases. Deferred

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

tax assets and liabilities are measured using the substantively enacted tax rates expected to apply when the asset is realized or the liability settled.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. To the extent that the Company does not consider it probable that a deferred tax asset will be recovered, it provides a valuation allowance against the excess.

Deferred tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

(i) *Earnings per share*

Basic earnings per share are computed by dividing the net earnings by the weighted average number of common shares outstanding for the year. The diluted earnings per share reflects the potential dilution of common share equivalents, such as outstanding stock options and warrants, in the weighted average number of common shares outstanding during the reporting periods, if dilutive. For this purpose, the number of additional shares is calculated using the assumed proceeds upon the exercise of stock options and share purchase warrants that are used to purchase common shares at the average market price during the period.

(j) *Comprehensive income*

Comprehensive income is the change in the Company's net assets that results from transactions, events and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in net earnings such as foreign currency gains or losses related to the Company's net investment in foreign operations and unrealized gains or losses on available-for-sale securities net of tax. The Company's comprehensive income, components of other comprehensive income and cumulative translation adjustments are presented in the consolidated statements of comprehensive income and the consolidated statements of changes in equity.

(k) *Inventories*

Spare parts and supplies are recorded at the lower of cost, using the weighted average cost formula, and net realizable value. In the event that the cost of ore inventory produced using these supplies exceeds its net realizable value, then the supplies are written down to net realizable value. In such circumstances, the Company uses replacement cost as the best available measure of the net realizable value of supplies.

Scorpio Mining Corporation

Notes to the consolidated financial statements

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(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

Ore stockpile represents material that is extracted from the mining operations and is expected to be processed into a saleable form and sold at a profit and is recorded at the lower of cost and net realizable value. Ore is recorded as an asset that is classified within inventory at the point that it is extracted from the mine. The net realizable value of the ore stockpile is measured by estimating the number of tons of the stockpile, the amount of contained metal (based on assay data) and the estimated metallurgical recovery rates. Costs are allocated to the stockpile using current costs incurred up to the point of stockpiling the ore. Provisions, if any, are recorded to reduce inventory to net realizable value.

Concentrate inventory is recorded at the lower of cost and net realizable value.

(l) *Investments*

An associate is an entity over which the Company has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

Investments in companies over which the Company exercises neither control nor significant influence and are designated as available-for sale financial instruments are recorded at fair value. Unrealized gains and losses on available-for-sale financial instruments are recognized in other comprehensive income (loss), unless the decrease in value is significant or prolonged, in which case, the loss is recorded in the statements of operations.

(m) *Property, plant and equipment*

(i) *Producing mining interests*

Producing mining interests are carried at cost less accumulated depletion and amortization and accumulated impairment losses. Following the completion of commissioning, the costs related to the mining interests are depleted and charged to operations on the unit of production method as a proportion of estimated recoverable mineral reserves.

Completion of the commissioning is deemed to have occurred when major mine and processing plant components are completed, operating results are being achieved consistently for a period of time and that there are indicators that these operational results, including mill capacity and recovery, will be sustainable in the future.

Definition drilling and related costs are charged to operations.

Construction in progress is not depreciated until the assets are ready for their intended use.

(ii) *Non-producing mining interests*

The Company follows the method of accounting for its non-producing mining interests whereby all costs, net of incidental revenues, relating to the acquisition, exploration and development are deferred and capitalized by property until the property to which they directly relate is placed into production, sold, discontinued or subject to a condition of impairment. In the event that a mining interest is placed into production, capitalization of costs ceases, the costs are transferred to producing mining interests and the mining interest is depleted on a unit of production basis. The recoverability of amounts is dependent upon the discovery of economically recoverable mineral reserves, the ability of the Company to finance the development of the properties, and on the future profitable production or proceeds from the disposition thereof. The Company is in

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Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

the process of exploring its non-producing mining interests and has not yet determined whether they contain ore reserves that are economically recoverable.

(iii) *Plant and equipment*

Plant and equipment are carried at cost less accumulated amortization and accumulated impairments. Amortization of plant and equipment, including construction in progress, begins when assets are ready for their intended use and is calculated over the estimated useful lives of the assets using the straight-line method at rates ranging from three to twelve years.

Where an item of plant and equipment comprises significant components with different useful lives, the components are accounted for as separate items of plant and equipment and depreciated separately.

Expenditures incurred to replace a component of an item of plant and equipment that are accounted for separately, including major inspection and overhaul expenditures, are capitalized and day-to-day maintenance costs are expensed. Directly attributable expenses incurred for major capital projects and site preparation are capitalized until the asset is brought to a working condition for its intended use. These costs include dismantling and site restoration costs to the extent these are recognized as a provision.

The cost of self-constructed assets includes the cost of materials and direct labour.

The amortization methods, useful life and residual values of plant and equipment are assessed annually and adjusted where required.

(iv) *Other assets*

Corporate office equipment is depreciated using the straight-line method based on estimated useful lives, which generally range from three to ten years.

(v) *Impairment of mining interests*

The Company reviews and evaluates the carrying values of its tangible and intangible assets to determine whether there is an indication of impairment. For exploration and evaluation assets, indication includes but is not limited to expiration of the right to explore, substantive expenditure in the specific area is neither budgeted nor planned, and if the entity has decided to discontinue exploration activity in the specific area.

When such conditions exist, estimated recoverable amounts are determined as the higher of fair value less costs to sell and value in use. In assessing value in use, the Company uses discounted estimated future cash flows which take into account estimated future prices, recoverable reserves, operating and capital costs. When the carrying value of assets exceeds the recoverable amount, the carrying value of the assets is reduced to the recoverable amount.

(vi) *Reversal of impairment*

An impairment loss is reversed if there is an indication that there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization if no impairment loss had been recognized.

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

(In thousands of Canadian dollars unless otherwise indicated)

3. Summary of significant accounting policies (Continued)

(vii) *Ownership of mining interests*

Although the Company has taken steps to verify ownership and legal title to mining interests in which it has an interest according to the usual industry standards, these procedures do not guarantee the Company's title. Such properties may be subject to prior agreements or transfers and title may be affected by undetected defects. Management is not aware of any such agreements, transfers or defects.

(n) *Provision for environmental rehabilitation*

The Company recognizes contractual, statutory and legal obligations associated with retirement of mining properties when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, the provision for environmental rehabilitation is recognized at its fair value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding provision for environmental rehabilitation is added to the carrying amount of that asset and the cost is amortized as an expense over the economic life of the related asset. Following the initial recognition of the provision for environmental rehabilitation, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the amount or timing of the underlying cash flows to settle the obligation.

(o) *Financial instruments*

The Company classifies its financial instruments into one of the following categories: fair value through profit or loss ("FVTPL") (assets and liabilities), assets available-for-sale, loans and receivables, assets held-to-maturity and other financial liabilities. All financial instruments are measured at fair value on initial recognition.

Financial assets and liabilities designated as FVTPL are subsequently measured at fair value with changes in fair value recognized in net earnings. Financial assets designated as "available-for-sale" are subsequently measured at fair value with changes in fair value recognized in other comprehensive income (loss), net of tax. Transaction costs for FVTPL financial assets and liabilities are recognized in income when incurred.

Financial assets designated as "loans and receivables" or "held-to-maturity", and financial liabilities designated as "other financial liabilities" are recorded at amortized cost. Transaction costs from loans and receivables and other financial liabilities offset the carrying amount of the related financial assets or liabilities.

The Company has classified cash and cash equivalents and trade and other receivables as "loans and receivables", trade and other payables are classified as "other financial liabilities", and investment in Scorpio Gold shares as "available-for-sale".

(p) *Business combinations*

Acquisitions of subsidiaries and businesses (other than entities which were under the control of the parent) are accounted for using the acquisition method. The cost of the business combination is measured as the aggregate of the fair value (at the date of acquisition) of assets transferred, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree. Any acquisition-related costs incurred to effect a business combination are expensed. The acquiree's identifiable assets, liabilities and contingent liabilities are recognized at their fair value at the acquisition date except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which are recognized and measured at fair value less cost to sell.

Scorpio Mining Corporation

Notes to the consolidated financial statements

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3. Summary of significant accounting policies (Continued)

(q) *Borrowing costs*

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of that asset. Other borrowing costs not directly attributable to a qualifying asset are expensed in the period incurred.

(r) *Provisions*

Provisions are recognized when the Company has a present obligation (legal or constructive) that has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

(s) *Related party transactions*

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence, and related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. Related party transactions that are in the normal course of business and have commercial substance are measured at the exchange amount.

(t) *Non-controlling interests*

Non-controlling interests exist in less than wholly-owned subsidiaries of the Company and represent the outside interests' share of the carrying values of the subsidiaries. When the subsidiary company issues its own shares to outside interests, a dilution gain or loss arises as a result of the difference between the Company's share of the proceeds and the carrying value of the underlying equity.

4. Recent accounting pronouncements

Certain pronouncements were issued by the IASB or IFRIC that are mandatory for accounting periods after December 31, 2012 or later periods. Many are not applicable or do not have a significant impact to the Company and have been excluded from the table below. The following have not yet been adopted and are being evaluated to determine their impact on the Company.

(i) *Financial instruments*

IFRS 9 Financial Instruments was issued in November 2009 with the intent to replace IAS 39 – Financial Instruments: Recognition and Measurement ("IAS 39") in three phases. In November 2009 and October 2010, phase 1 of IFRS 9 was issued and amended, respectively, which addressed the classification and measurement of financial assets and financial liabilities. IFRS 9 requires that all financial assets be classified as subsequently measured at amortized cost or at fair value based on the Company's business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified as FVTPL, financial guarantees and certain other exceptions. The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2015 (with earlier application still permitted). The Company is currently evaluating the impact the final standard is expected to have on its consolidated financial statements.

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

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4. Recent accounting pronouncements (Continued)

(ii) *Stripping costs in the production phase of a surface mine*

On October 19, 2011, the IFRS Interpretation Committee published *IFRIC 20* that applies to all types of resources that are extracted using the surface mining activity process. *IFRIC 20* clarifies the requirements for accounting for stripping costs in the production phase of a surface mine. It provides guidance on when production stripping should lead to the recognition of an asset and how that asset should be measured, both initially and in subsequent periods. *IFRIC 20* is effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company currently does not have any surface mines but will evaluate the impact of this standard when it becomes applicable.

(iii) *Consolidated financial statements*

IFRS 10 *Consolidated Financial Statements* ("IFRS 10") will replace IAS 27 *Consolidated and Separate Financial Statements* ("IAS 27"), and SIC 12 *Consolidation – Special Purpose Entities*. The portion of IAS 27 that deals with separate financial statements will remain. IFRS 10 changes the definition of control, such that the same consolidation criteria will apply to all entities. The revised definition focuses on the need to have both "power" and "variable returns" for control to be present. Power is the current ability to direct the activities that significantly influence returns. Variable returns can be positive, negative or both. IFRS 10 requires continuous assessment of control of an investee based on changes in facts and circumstances. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. The Company is currently evaluating the impact IFRS 10 and the revised IAS 27 is expected to have on its consolidated financial statements.

(iv) *Items of other comprehensive income*

In June 2011, the IASB issued an amendment to IAS 1 – *Presentation of items of Other Comprehensive Income* ("amendments to IAS1"). The amendments to IAS1 are the result of a joint project with the US Financial Accounting Standards Board and provide guidance on presentation of items contained in other comprehensive income ("OCI") and their classification within OCI. The amendments to IAS1 require items of OCI, along with their tax effects, to be grouped into those that will and will not subsequently be reclassified to profit or loss. The measurement and recognition of items of profit or loss and OCI are not affected by the amendments. This amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

(v) *Fair Value Measurement*

In May 2011, the IASB issued IFRS 13 – *Fair Value Measurement* ("IFRS 13"). This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. IFRS 13 sets out a single IFRS framework for measuring fair value and outlines disclosure requirements about fair value measurements. IFRS 13 does not determine when an asset, a liability or an entity's own equity instrument is measured at fair value. Rather, the measurement and disclosure requirement of IFRS 13 apply when another IFRS requires or permits the item to be measured at fair value. IFRS 13 is effective for annual periods on or after January 1, 2013, with earlier application permitted. This IFRS is to be applied prospectively as of the beginning of the annual period in which it is initially applied and the disclosure requirements do not need to be applied in comparative periods before initial application. The Company is currently assessing the impact of this standard on its financial statements.

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

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5. Financial risk management

(a) Financial risk factors

The Company's risk exposures and the impact on its financial instruments are summarized below:

(i) Credit risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash and cash equivalents and trade and other receivables. The credit risk on cash and cash equivalents is limited because the Company invests its cash in deposits with well-capitalized financial institutions with strong credit ratings. Under current concentrate offtake agreements, risk on trade receivables related to concentrate sales is managed by receiving payments for 80% to 95% of the estimated value of the concentrate shipped at the time of shipment. As of December 31, 2012, the Company's exposure to credit risk with respect to trade receivables amounts to \$5,439 (US\$5,457) (December 31, 2011, \$2,965 (US\$2,902)). The Company believes credit risk for other receivables of \$2,807 (December 31, 2011: \$1,226) is not significant as they relate to Mexican value added taxes. There are no receivables that are past due and the Company has no allowance for doubtful accounts at December 31, 2012 and December 31, 2011.

(ii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they arise.

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. The Company's current policy to manage liquidity risk is to keep cash in bank accounts and term deposits. As at December 31, 2012, the Company had cash and cash equivalents of \$23,595 to settle trade and other payables of \$2,190. The Company's trade payables have contractual maturities of less than 30 days and are subject to normal trade terms.

(iii) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and price risk.

(1) Interest rate risk

The Company is not subject to significant interest rate risk.

(2) Currency risk

As at December 31, 2012, the Company is exposed to foreign currency risk through the following financial assets and liabilities denominated in USD and Mexican pesos ("MXP"):

Financial instruments that may impact the Company's net earnings or other comprehensive income due to currency fluctuations include USD and MXP denominated assets and liabilities which are included in the following table:

	As at December 31, 2012	
	USD	MXP
	(000s)	(000s)
Cash	9,946	3,389
Trade and other receivables	5,457	43,339
Trade and other payables	(250)	(36,240)

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

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5. Financial risk management (Continued)

As at December 31, 2012, the USD/CAD and CAD/MXP exchange rates were 1.00 and 13.0, respectively. The sensitivity of the Company's net earnings and other comprehensive income due to changes in the exchange rates as at December 31, 2012 is included in the following table:

	USD/CAD Exchange rate +/- 10%	CAD/MXP Exchange rate +/- 10%
	\$ (000's)	\$ (000's)
Approximate impact on:		
Net earnings	62	80
Comprehensive income	1,580	-

The Company may, from time to time, employ derivative financial instruments to manage exposure to fluctuations in foreign currency exchange rates as discussed above.

(3) Price risk

Price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments in the market. As at December 31, 2012, the Company had certain amounts related to the sales of concentrate that have only been provisionally priced. A +/- 10% fluctuation in silver, lead, copper and gold prices would affect trade receivables by approximately \$489 (US\$490). The Company does not use derivatives to manage its exposure to price risk. The Company sometimes fixes metal prices with the purchaser of its concentrates for specific sales for which concentrates have been delivered.

(b) Fair values

The fair value of cash and cash equivalents, trade and other receivables, and trade and other payables approximate their carrying amounts due to their short-term nature. The investment in Scorpio Gold shares have been marked to market based on the trading price as at December 31, 2012. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value;

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts and volatility measurements used to value option contracts), or inputs that are derived principally from or corroborated by observable market data or other means.
- Level 3 inputs are unobservable (supported by little or no market activity).

The Company has no Level 2 or 3 inputs. Available-for-sale investments are considered Level 1 inputs on the fair value hierarchy.

Scorpio Mining Corporation

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6. Trade and other receivables and prepaid expenses

	December 31, 2012	December 31, 2011
	\$	\$
Trade receivables	5,439	2,965
Value added taxes receivable	2,807	1,226
Prepaid expenses and other receivables	545	-
	8,791	4,191

7. Inventories

	December 31, 2012	December 31, 2011
	\$	\$
Concentrates	312	479
Spare parts and supplies	5,965	4,088
Ore stockpile	737	442
	7,014	5,009

The amount of inventories recognized as an expense during the year is equivalent to cost of sales for the year. During the year ended December 31, 2012, the concentrate inventory write-down included in cost of sales was \$Nil (2011: \$825).

8. Investment in Scorpio Gold

In the first quarter of 2011, Scorpio Gold issued approximately 21.9 million shares, none of which were subscribed for by the Company, which resulted in the Company's ownership interest of 27,901,106 shares in Scorpio Gold decreasing its interest from approximately 35% to approximately 27% which created a gain on dilution of \$1,051.

In March 2011, the Company disposed of 8,139,570 shares of Scorpio Gold for proceeds of \$5,172 and recognized a loss on disposal of \$945, which decreased the Company's ownership to 20%.

At June 15, 2011, the Company determined that it no longer maintained significant influence over the operations of Scorpio Gold at that time, as there was only one director in common and the Company no longer exercised significant influence over operational and financial activities of Scorpio Gold. Accordingly, as of that date, the Company no longer accounted for its investment in Scorpio Gold as an equity investment and instead accounted for it as an available-for-sale financial instrument. The difference between the fair value of \$13,832 and the carrying value of \$14,571, as of that date, resulted in a loss of \$739 which was recorded in the statement of operations.

In August 2011, the Company disposed of a further 4,234,615 shares of Scorpio Gold for proceeds of \$2,902 and recognized losses of \$63 and \$212 in the statement of operations and other comprehensive income, respectively.

At December 31, 2011, the Company held 15,526,921 common shares in Scorpio Gold which represented approximately 13.7% of Scorpio Gold's outstanding shares.

On January 26, 2012, the Company disposed of 4,234,615 shares of Scorpio Gold for net proceeds of \$3,663 and recognized a gain on disposal of \$699. The remaining 11,292,306 shares represent approximately 9.0% of Scorpio Gold's outstanding shares as at December 31, 2012.

Scorpio Mining Corporation

Notes to the consolidated financial statements

Years ended December 31, 2012 and 2011

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8. Investment in Scorpio Gold (Continued)

On July 20, 2012, the Company appointed its Interim President and CEO who is also the President and CEO of Scorpio Gold and who is the director in common described earlier. This relationship does not alter the determination that there is no significant influence over Scorpio Gold.

	December 31, 2012	December 31, 2011
	\$	\$
Investment, beginning of year	14,285	20,256
Share of loss from operations for the year	-	(618)
Gain on dilution following share issuance	-	1,051
Disposition of shares	(2,964)	(9,081)
Fair value adjustment on classification as available-for-sale instrument	-	(739)
(Loss) gain on adjustment to fair value at end of year	(3,868)	3,416
Investment, end of year	7,453	14,285

The (income) loss from investment in Scorpio Gold is made up of the following:

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
(Gain) loss on disposal	(699)	1,008
Share of loss	-	618
Gain on dilution	-	(1,051)
Loss on adjustment to fair value	-	739
(Income) loss from investment	(699)	1,314

Scorpio Mining Corporation

Notes to the consolidated financial statements

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9. Property, plant and equipment

	Producing property				Total mining interests	Corporate office equipment	Total
	Nuestra Señora mining interest	Plant and equipment	Long-term deposit	Non-producing properties			
	\$	\$	\$	\$	\$	\$	\$
Cost							
Balance at January 1, 2011	13,688	7,735	979	49,884	72,286	413	72,699
Assets acquired	2,167	3,651	4,008	5,424	15,250	77	15,327
Reclassification	-	778	(778)	-	-	-	-
Disposals	-	(120)	-	-	(120)	(413)	(533)
Foreign exchange movement	515	432	14	1,469	2,430	2	2,432
Balance at December 31, 2011	16,370	12,476	4,223	56,777	89,846	79	89,925
Reclassification	-	3,614	(3,614)	-	-	-	-
Assets acquired	2,870	6,093	-	7,990	16,953	22	16,975
Foreign exchange movement	(410)	(570)	45	(596)	(1,531)	-	(1,531)
Balance at December 31, 2012	18,830	21,613	654	64,171	105,268	101	105,369
Accumulated depreciation and depletion							
Balance at January 1, 2011	5,180	2,296	-	160	7,636	261	7,897
Depreciation/depletion for the year	2,583	1,043	-	63	3,689	33	3,722
Disposals	-	(82)	-	-	(82)	(286)	(368)
Foreign exchange movement	231	(143)	-	7	95	1	96
Balance at December 31, 2011	7,994	3,114	-	230	11,338	9	11,347
Depreciation/depletion for the year	2,203	1,789	-	42	4,034	15	4,049
Foreign exchange movement	(164)	228	-	(6)	58	-	58
Balance at December 31, 2012	10,033	5,131	-	266	15,430	24	15,454
Net book value							
at December 31, 2011	8,376	9,362	4,223	56,547	78,508	70	78,578
at December 31, 2012	8,797	16,482	654	63,905	89,838	77	89,915

Scorpio Mining Corporation

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10. Provision for environmental rehabilitation

The provision for environmental rehabilitation consists of land rehabilitation, demolition of buildings and mine facilities, and related costs. Although the ultimate amount of the environment rehabilitation provision is uncertain, the fair value of these obligations is based on information currently available, including closure plans and the Company's interpretation of current regulatory requirements.

Fair value is determined based on the net present value of future cash expenditures upon reclamation and closure. Reclamation and closure costs are capitalized into property, plant and equipment depending on the nature of the asset related to the obligation and amortized over the life of the related asset.

The provision for environmental rehabilitation relates to reclamation and closure costs of the Company's Nuestra Señora Mine, plant and tailings dam. The provision for environmental rehabilitation is estimated at \$2,922, over a period of 2 to 12 years, and discounted using a risk free rate varying from 4.69% to 5.55%.

	December 31, 2012	December 31, 2011
	\$	\$
Balance, beginning of year	1,137	1,028
Changes in estimates	466	-
Unwinding of discount	78	79
Foreign currency translation adjustments	(24)	30
Balance, end of year	1,657	1,137

11. Share capital

(a) Authorized

Authorized share capital consists of an unlimited number of common shares.

	December 31, 2012	December 31, 2011
	\$	\$
Issued		
198,388,913 (2011: 197,775,614) common shares	170,304	169,328

(b) Warrants

	December 31, 2012		December 31, 2011	
	Number	Weighted average exercise price	Number	Weighted average exercise price
	(thousands)	\$	(thousands)	\$
Outstanding, beginning of year	-	-	2,967	0.57
Exercised	-	-	(2,967)	0.56
Outstanding, end of the year	-	-	-	-

Scorpio Mining Corporation

Notes to the consolidated financial statements

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11. Share capital (Continued)

The Company's functional currency is the Canadian dollar. These warrants, acquired upon the acquisition of Platte River Gold Inc., were denominated in US dollars, and were recorded as a liability and measured at fair value, with changes in fair value from period to period recorded as a gain or loss in the statement of operations.

	December 31, 2012	December 31, 2011
	\$	\$
Balance, beginning of year	-	1,368
Fair value adjustments during the year	-	1,466
Exercise of warrants	-	(2,834)
Balance, end of year	-	-

The fair value of the outstanding warrants at each reporting date was determined based on the Black-Scholes model and using the following assumptions:

	Year ended December 31, 2012	Year ended December 31, 2011
Expected volatility	-	66%
Risk free interest rate	-	1.24%
Expected life	-	0.01 year
Price (Canadian dollars)	-	\$1.94
Foreign exchange rate	-	0.99
Dividend yield	-	0%

(c) Stock option plan

The number of shares reserved for issuance under the Company's stock option plan is limited to 10% of the number of common shares which are issued and outstanding on the date of a particular grant of options. Under the plan, the Board of Directors determines the term of a stock option to a maximum of 10 years, the period of time during which the options may vest and become exercisable as well as the option exercise price which shall not be less than the closing price of the Company's share on the Toronto Stock Exchange on the date immediately preceding the date of grant. The Compensation Committee determines and makes recommendations to the Board of Directors as to the recipients of, and nature and size of, share-based compensation awards in compliance with applicable securities law, stock exchange and other regulatory requirements.

Scorpio Mining Corporation

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11. Share capital (Continued)

A summary of changes in the Company's outstanding stock options is presented below:

	December 31, 2012		December 31, 2011	
	Number	Weighted average exercise price	Number	Weighted average exercise price
	(thousands)	\$	(thousands)	\$
Balance, beginning of year	15,474	1.27	14,884	1.10
Granted	300	1.95	5,920	1.42
Exercised	(613)	1.05	(4,945)	0.84
Expired	(3,288)	1.73	(385)	0.79
Balance, end of year	11,873	1.17	15,474	1.27

The weighted average share price of the Company when stock options were exercised during the year ended December 31, 2012 was \$1.77 (2011: \$1.63).

The following table summarizes information on stock options outstanding and exercisable as at December 31, 2012:

Exercise price	Weighted average remaining contractual life	Outstanding	Exercisable
\$	(in years)	(thousands)	(thousands)
0.295 to 0.395	0.87	625	625
0.74 to 0.95	1.92	2,996	2,996
1.12 to 1.42	2.20	6,440	6,440
1.42 to 1.70	3.27	1,182	1,182
1.77 to 2.15	3.85	630	397
		11,873	11,640

(d) Share-based payment

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Weighted average fair value at grant date	0.84	0.79

Scorpio Mining Corporation

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11. Share capital (Continued)

The Company used the Black-Scholes model to estimate fair value using the following weighted-average assumptions:

	Year ended December 31, 2012	Year ended December 31, 2011
Expected stock price volatility ⁽¹⁾	60%	76%
Risk free interest rate	0.95%	2.38%
Expected life	3.5 years	4 years
Expected forfeiture rate	3.45%	3.45%
Expected dividend yield	0%	0%
	\$	\$
Share-based payment included in cost of sales	413	1,133
Share-based payment included in general and administrative expenses ⁽²⁾	954	4,562
Total share-based payment ⁽²⁾	1,367	5,695

(1) Expected volatility has been based on historical volatility of the Company's publicly traded shares.

(2) Incremental expense of \$119 (2011: \$514) has been included in share-based payment expense as a result of stock options that were modified during 2011 as their expiration dates were extended.

12. Weighted average basic and diluted number of shares outstanding

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Basic weighted average number of shares	198,154,955	193,152,266
Effect of dilutive stock options	1,415,158	3,467,004
Diluted weighted average number of shares	199,570,113	196,619,270

The following potentially dilutive securities were excluded from the dilutive number of shares outstanding for the year ended December 31, 2012 as they were anti-dilutive.

- 7,252,356 stock options (2011: 4,400,000 stock options)

13. Revenue

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Metal payable	54,966	70,323
Treatment and selling costs	(9,161)	(9,259)
Revenue	45,805	61,064

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14. General and administrative expenses

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Salaries and benefits	1,345	1,410
Share-based payments	954	4,562
Severance paid to former executive	1,382	-
Professional fees	532	710
Other	974	901
Foreign exchange gain	(300)	(111)
Total	4,887	7,472

15. Finance costs (income)

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Unwinding of discount on provision for environmental rehabilitation	79	79
Interest on debt component of convertible debenture	-	746
Finance income from lease receivable	-	(22)
Interest income	(108)	(82)
Total	(29)	721

16. Debt

a) Convertible debentures

On May 5, 2008, the Company closed a private placement financing to issue convertible debentures in the aggregate principal amount of \$20,000. The debentures were issued at par, maturing on May 5, 2011, with interest at a rate of 7% per year, and payable semi-annually in arrears. The debentures were convertible at any time prior to maturity at the option of the holders into common shares of the Company at a conversion price of \$1.55 per common share and were redeemable by the Company. On May 5, 2011, the Company repaid the entire principal amount of \$20,000.

At issuance, the Company estimated the fair value of the conversion option by deducting the present value of the future cash outflows of the convertible debentures, calculated using a risk-adjusted discount rate of 11%, from the face value of the principal of the convertible debentures. The residual value of \$1,998 allocated to the conversion option was added to the face value of the convertible debentures over the life of the debentures by a charge to earnings until May 5, 2011, using the effective interest method.

The financial liability component of the convertible debentures was as follows:

	December 31, 2012	December 31, 2011
	\$	\$
Balance, beginning of year	-	19,734
Accretion expense	-	266
Repayments	-	(20,000)
Balance, end of year	-	-

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Years ended December 31, 2012 and 2011

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16. Debt (Continued)

b) Note payable

The note payable ("Note") was unsecured, non-interest bearing, repayable in monthly instalments of \$89 (US\$92) until May 2011 and related to the purchase of a mineral processing plant. The Note was recorded at net present value using an imputed interest rate of 8.50%. On May 2, 2011 the outstanding balance was repaid in full. Total principal repayments in fiscal 2011 were \$455.

17. Income taxes

The provision for income taxes differs from the amount that would have resulted by applying the combined Canadian federal and provincial statutory income tax rate of 26.50% (2011 - 28.30%) to applicable earnings.

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Earnings before income taxes	11,043	22,268
Expected tax expense	2,926	6,302
Effect of higher tax rate in foreign jurisdiction	415	523
Non-deductible items and other	285	1,134
Benefit of prior year tax assets not previously recognized	(72)	(391)
Foreign exchange and inflation adjustments	385	1,563
Current year tax assets not recognized	(136)	(157)
Other	150	707
Total deferred income tax expense	3,953	9,681

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17. Income taxes (Continued)

Significant components of the Company's deferred tax assets and liabilities are shown below:

	December 31, 2012	December 31, 2011
	\$	\$
Deferred tax assets		
Mining interests	5,433	5,971
Non-capital loss carryforwards	16,663	17,085
Share issue costs	9	106
Provisions	715	302
Non-producing properties	562	528
Other	531	440
Total gross deferred tax assets	23,913	24,432
Unrecognized deferred tax assets related to non-capital loss carryforwards	(4,284)	(3,262)
Total deferred tax assets	19,629	21,170
Deferred tax liabilities		
Mining interests	(6,306)	(3,934)
Current assets	(2,540)	(2,263)
Total gross deferred tax liabilities	(8,846)	(6,197)
Net deferred tax asset	10,783	14,973

The Company has the following non-capital losses for income tax purposes which may be used to reduce future taxable income. Only the Mexican tax losses have been recognized as a deferred tax asset.

Expiry	USA	Canada	Mexico
	\$	\$	\$
2015	-	294	997
2016	-	-	3,419
2017	-	-	4,712
2018	-	-	32,602
2021	-	-	171
2024	535	-	-
2025	705	-	-
2026	661	299	-
2027	530	2,009	-
2028	639	2,319	-
2029	615	2,111	-
2030	587	2,260	-
2031	182	143	-
2032	114	141	-
	4,568	9,576	41,901

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18. Supplementary cash flow information

Supplementary information regarding non-cash investing and financing transactions:

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Depreciation of property, plant and equipment capitalized in mining interests	211	48
Expenditures on mining interests included in trade and other payables	80	-
Transfer of equity reserve to share capital upon exercise of stock options	330	6,371
Non-cash change in estimate of provision for environmental rehabilitation	466	-

19. Related party transactions

Remuneration to directors and key management who have the authority and responsibility for planning, directing and continuing the activities of the Company:

	Year ended December 31, 2012	Year ended December 31, 2011
	\$	\$
Salaries and benefits	1,439	1,795
Severance paid to former executive	1,382	-
Director fees	236	229
Share-based payments	253	4,183

20. Segmented and geographic information, and major customers

(a) Segmented information

The Company operates in one reportable operating segment being acquisition, exploration, development and exploitation of mineral resource properties.

(b) Geographic information

All revenue from the sale of concentrates for the years ended December 31, 2012 and December 31, 2011 were earned in Mexico.

The Company's long-term assets by geographic location are as follows:

	December 31, 2012	December 31, 2011
	\$	\$
Canada	77	70
Mexico	100,621	93,481
	100,698	93,551

(c) Major customers

The Company sold concentrates to two customers during the year ended December 31, 2012 and three customers during the year ended December 31, 2011, with each customer accounting for 53% and 47% (2011: 55%, 42% and 3%), respectively.

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21. Capital management

Capital is defined as equity and debt, including the current portion. The Company's objectives when managing its capital are to safeguard its ability to continue as a going concern and to maximize the value for its shareholders.

The Company's activities have been funded so far through debt and equity financing based on cash needs, and through operations. The Company typically sells its shares by way of private placement. There were no changes in these objectives, policies and processes used to manage capital during the year.

The Company manages its capital structure and determines its capital requirements in light of the changing economic conditions and the risk characteristics of its assets. To reach its objectives the Company may have to maintain or adjust its capital structure by issuing new share capital or new debt.

At this stage of its development it is the policy of the Company to preserve cash to fund its operations and not to pay dividends. As of December 31, 2012 and 2011, the Company is not subject to any externally imposed capital requirements.

The following summarizes the Company's capital structure:

	December 31, 2012	December 31, 2011
	\$	\$
Equity attributable to shareholders of the Company	143,694	141,323
Capital	143,694	141,323

22. Contingencies

- a) Due to the size, complexity and nature of the Company's operations, various legal and tax matters arise in the ordinary course of business. The Company accrues for such items when a liability is both probable and the amount can be reasonably estimated.
- b) Mexican tax audit

In November 2010, the Company received a reassessment from the Mexican tax authorities related to its Mexican subsidiary, Minera Cosalá, for the year ended December 31, 2007. The tax authorities disallowed the deduction of transactions with certain suppliers for an amount of approximately \$15.1 million (MXP 196.8 million), of which \$6.5 million (MXP 84.4 million) would be applied against available tax losses. The Company appealed this reassessment and the Mexican tax authorities subsequently reversed \$7.3 million (MXP 94.6 million) of their original reassessment. The remaining \$7.8 million (MXP 102.2 million) consists of \$6.5 million (MXP 84.4 million) related to transactions with certain suppliers and \$1.3 million (MXP 17.8 million) of value added taxes thereon. The Company appealed the remaining reassessment with the Mexican Tax Court in December 2011. The Company may be required to post a bond of approximately \$1.3 million (MXP 17.8 million) to secure the value added tax portion of the reassessment. The deductions of \$6.5 million (MXP 84.4 million), if denied, would be offset by available tax losses. No amount has been recognized in the consolidated financial statements as the Company believes it is not likely that the reassessment will be upheld by the Tax Court.