

STORNOWAY DIAMOND CORPORATION

(An Exploration Stage Company)

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED JULY 31, 2011

Stornoway Diamond Corporation

(An Exploration Stage Company)

Condensed Interim Consolidated Balance Sheets

Unaudited

(expressed in thousands of Canadian dollars)

ASSETS	Notes	July 31, 2011	April 30, 2011 (Note 16)	May 1, 2010 (Note 16)
Current				
Cash and cash equivalents		\$ 13,208	\$ 22,745	\$ 9,212
Short-term deposits		11,816	11,777	1,641
Other receivables	5&11	1,120	955	1,582
Investments	6	202	242	147
Prepaid expenses		261	772	136
Prepaid fuel		218	206	170
		26,825	36,697	12,888
Rough Diamond Inventory	8a	1,004	1,004	330
Property, Plant and Equipment	7	4,986	5,194	3,737
Exploration and Evaluation Assets	8h	214,496	214,544	85,441
		\$ 247,311	\$ 257,439	\$ 102,396
LIABILITIES				
Current				
Trade accounts payable	9&11	\$ 1,272	\$ 928	\$ 1,548
Accrued liabilities and provisions	9	3,102	3,862	1,636
		4,374	4,790	3,184
Other Liabilities		15	265	-
Asset Retirement Obligation	12	1,443	1,442	728
		5,832	6,497	3,912
SHAREHOLDERS' EQUITY				
Share Capital	10	335,839	335,802	225,100
Convertible Shares	10b	56,182	56,182	-
Contributed Surplus	10	13,733	13,580	11,852
Accumulated Other Comprehensive Loss		(59)	(25)	(61)
Deficit		(164,216)	(154,597)	(138,407)
		241,479	250,942	98,484
		\$ 247,311	\$ 257,439	\$ 102,396

Commitments (Note 14)

ON BEHALF OF THE BOARD:

“Anthony Walsh”, Director

“Matthew Manson”, Director

– See Accompanying Notes –

Stornoway Diamond Corporation

(An Exploration Stage Company)

Condensed Interim Consolidated Statements of Loss

Unaudited

(expressed in thousands of Canadian dollars except for loss per share and weighted average number of shares outstanding)

		For the Three Months Ended	
	Note	July 31, 2011	July 31, 2010 (Note 16)
Expenses			
Accretion		\$ 5	\$ 2
Amortization		211	159
Exploration expenses	8i	8,290	303
Office and sundry		130	147
Professional fees		302	91
Regulatory and shareholder communication expense		208	96
Rent and facility fees		117	118
Salaries, benefits and director's fees		189	198
Share-based payments	10i	160	312
Loss Before the Following		(9,612)	(1,426)
Other Income (Expenses)			
Bad debt recovery		-	101
Finance expense	3	(436)	-
Cost recovery		132	142
Interest income		105	14
Write-off of exploration and evaluation assets	8g	(49)	-
		(248)	257
Loss Before Income Taxes		(9,860)	(1,169)
Current tax expense		(2)	-
Deferred income tax recovery (expense)		243	(6)
Loss for the Period		(9,619)	(1,175)
Loss per Share - Basic and Diluted		\$ (0.07)	\$ (0.02)
Weighted Average Number of Shares Outstanding*		141,155,452	72,932,603

* Post-share consolidation (Note 10a)

Condensed Interim Consolidated Statements of Comprehensive Loss

Unaudited

(expressed in thousands of dollars)

	Note	July 31, 2011	July 31, 2010 (Note 16)
Loss for the Period		\$ (9,619)	\$ (1,175)
Unrealized loss on available for sale investments, net of taxes	6	(34)	(33)
Comprehensive Loss		(9,653)	(1,208)

– See Accompanying Notes –

Stornoway Diamond Corporation

(An Exploration Stage Company)

Condensed Interim Consolidated Statements of Changes in Equity

Unaudited

(expressed in thousands of Canadian dollars except for loss per share and weighted average number of shares outstanding)

	Share Capital		Convertible Shares		Contributed Surplus	AOCL*	Deficit	Total
	Number of shares	Amount	Number of shares	Amount				
Balance at May 1, 2011	118,596,004	\$ 335,802	22,543,918	\$ 56,182	\$ 13,580	\$ (25)	\$ (154,597)	\$250,942
Exercise of options	4,000	2	-	-	(1)	-	-	1
Exercise of warrants	19,736	19	-	-	(6)	-	-	13
Share-based payments	-	-	-	-	160	-	-	160
Share issuance costs	-	16	-	-	-	-	-	16
Unrealized loss on available-for-sale financial assets	-	-	-	-	-	(40)	-	(40)
Income tax recovery in AOCL*	-	-	-	-	-	6	-	6
Net loss for the period	-	-	-	-	-	-	(9,619)	(9,619)
Balance at July 31, 2011	118,619,740	335,839	22,543,918	56,182	13,733	(59)	(164,216)	(241,479)
Balance – May 1, 2010	72,167,258	225,100	-	-	11,852	(61)	(138,407)	98,484
Shares issued for cash – private placement	2,193,750	5,002	-	-	-	-	-	5,002
Exercise of options	12,500	6	-	-	(1)	-	-	5
Share-based payments	-	-	-	-	312	-	-	312
Share issuance costs	-	(544)	-	-	156	-	-	(388)
Flow-through share premium	-	(527)	-	-	-	-	-	(527)
Unrealized loss on available-for-sale financial assets	-	-	-	-	-	(39)	-	(39)
Income tax recovery in AOCL*	-	-	-	-	-	6	-	6
Net loss for the period	-	-	-	-	-	-	(1,175)	(1,175)
Balance at July 31, 2010	74,373,508	\$ 229,037	\$ -	\$ -	\$ 12,319	\$ (94)	\$ (139,582)	\$ 101,680

*Accumulated Other Comprehensive Loss

– See Accompanying Notes –

Stornoway Diamond Corporation

(An Exploration Stage Company)

Condensed Interim Consolidated Statements of Cash Flows

Unaudited

(expressed in thousands of Canadian dollars)

Cash Resources Provided By (Used In)	For the Three Months Ended	
	July 31, 2011	July 31, 2010 (Note 16)
Operating Activities		
Loss for the period	\$ (9,619)	\$ (1,175)
Items not affecting cash		
Accretion	5	2
Amortization	211	159
Deferred income tax expense (recovery)	(243)	6
Share-based payments	160	312
Write-off of exploration and evaluation assets	49	-
Changes in non-cash working capital		
Decrease (increase) in other receivables	(165)	409
Decrease in prepaid expenses	511	8
Decrease in trade accounts payable, accrued liabilities and provisions	(401)	(885)
Prepaid fuel	(12)	-
	(9,504)	(1,164)
Investing Activities		
Increase in short-term deposits	(39)	(46)
Exploration and evaluation assets	(6)	(120)
Acquisition of property, plant and equipment	(3)	(49)
	(48)	(215)
Financing Activities		
Share capital issued for cash	-	5,002
Share issue costs	-	(387)
Options and warrants exercised	15	6
	15	4,621
Net Increase (Decrease) in Cash and Cash Equivalents	(9,537)	3,242
Cash and Cash Equivalents – Beginning of period	22,745	9,212
Cash and Cash Equivalents – End of Period	\$ 13,208	\$ 12,454
Cash and Cash Equivalents consist of:		
Cash	\$ 1,110	\$ 1,066
Cash Equivalents	12,098	11,388
Total	\$ 13,208	\$ 12,454

Supplemental Schedule of Non-Cash Investing and Financing Transactions (Note 13)

- See Accompanying Notes -

Stornoway Diamond Corporation

(An Exploration Stage Company)

Notes to Condensed Interim Consolidated Financial Statements

Unaudited

1. Nature and continuance of operations

Stornoway Diamond Corporation (“Stornoway” or the “Company”) is a diamond exploration company existing under the Business Corporations Act (British Columbia) and listed on the Toronto Stock Exchange (“TSX”). The Company’s primary asset is the development-stage Renard Diamond Project in Quebec, Canada. The head office and principal address of the Company is Unit 116, 980 West 1st Street, North Vancouver, British Columbia, V7P 3N4.

The Board of Directors approved these condensed interim consolidated financial statements on September 15, 2011.

2. Significant accounting policies

a) Basis of preparation and first time adoption of International Financial Reporting Standards (“IFRS”)

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) as set out in the Handbook of the Canadian Institute of Chartered Accountants (“CICA Handbook”). In 2010, the CICA Handbook was revised to incorporate IFRS, and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these interim consolidated financial statements. In these financial statements, the term “Canadian GAAP” refers to Canadian GAAP before the adoption of IFRS.

These interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting (“IAS 34”) and IFRS 1, First-Time Adoption of International Financial Reporting Standards (“IFRS 1”). Subject to certain transition elections disclosed below, we have consistently applied the same accounting policies in our opening IFRS balance sheet as at May 1, 2010 and throughout all periods presented, as if these policies had always been in effect.

Note 16 discloses the impact of the transition to IFRS on our reported balance sheets, statements of loss and comprehensive loss and deficit and cash flows, including the nature and effect of significant changes in accounting policies from those used in our consolidated financial statements for the year ended April 30, 2011.

The policies applied in these consolidated financial statements are presented below and are based on IFRS issued and outstanding as of September 15, 2011, the date the Board of Directors approved the financial statements. Any subsequent changes to IFRS that are given effect in our annual consolidated financial statements for the year ending April 30, 2012 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The interim consolidated financial statements should be read in conjunction with our Canadian GAAP annual financial statements for the year ended April 30, 2011. Note 16 discloses IFRS information for the year ended April 30, 2011 that is material to the understanding of these interim consolidated financial statements.

We applied IFRS 1 in preparing these first IFRS interim consolidated financial statements. The effects of the transition to IFRS on equity, total comprehensive loss and cash flows are presented in Note 16.

Stornoway Diamond Corporation

(An Exploration Stage Company)

Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – Continued

a) Basis of preparation and first time adoption of International Financial Reporting Standards (“IFRS”) – Continued

First-time Adoption Exemptions Applied

IFRS 1, which governs the first-time adoption of IFRS, generally requires accounting policies to be applied retrospectively to determine the opening balance sheet on our transition date of May 1, 2010, and allows certain exemptions on the transition to IFRS. The elections we have chosen to apply and that are considered significant to the Company include decisions to:

- not restate previous business combinations and the accounting thereof prior to May 1, 2010;
- measure property, plant and equipment at deemed cost, being the carrying value of property, plant and equipment at the date of previously recorded impairments;
- not apply IFRS 2, Share-based Payments to liabilities arising from share-based payment transactions that were settled (vested) before May 1, 2010;
- apply IFRIC 1, Changes in Existing Decommissioning, Restoration and Similar Liabilities (“IFRIC 1”) as of the date of transition to IFRS. IFRIC 1 requires specified changes in decommissioning, restoration or similar liabilities to be added to or deducted from the cost of the asset to which it relates and the adjusted depreciable amount of the asset to then be depreciated prospectively over its remaining useful life; and
- apply the requirements of IAS 23, Borrowing Costs to only capitalize borrowing costs on qualifying assets effective May 1, 2010.

b) Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned Canadian subsidiaries Ashton Mining of Canada Inc. (“Ashton”) and Contact Diamond Corporation (“Contact”).

All inter-company balances and transactions have been eliminated upon consolidation.

The consolidated financial statements include the financial statements of Stornoway Diamond Corporation and the subsidiaries listed in the following table:

Name of Subsidiary	Place of Incorporation	Ownership Interest	Principal Activity
Ashton Mining of Canada Inc.	Canada	100%	Holding Company
Ashton Mining (Northwest Territories) Ltd.	Northwest Territories	100%*	Not active
Ashton US Diamonds Inc.	Delaware	100%*	Not active
Ashton Great Lakes Inc.	Michigan	100%*	Not active
Contact Diamond Corporation	Ontario	100%	Exploration Company
Stornoway Diamonds (Canada) Inc.	Canada	100%*	Exploration Company

*Indirect wholly-owned subsidiary through Ashton Mining of Canada Inc.

c) Foreign Currencies

The presentation currency of the Company and the functional currency of the Company and each of its subsidiaries is the Canadian dollar. Transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on dates of transactions. At each financial position reporting date, monetary assets and liabilities that are denominated in foreign currencies are translated at the rates prevailing at the date of the statement of financial position. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

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(An Exploration Stage Company)

Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – Continued

d) Financial Instruments

Financial assets

The Company classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Loans and receivables – These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at cost less any provision for impairment. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default.

Held-for-trading – These assets are acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried on the balance sheet at fair value with changes in fair value recognized in the income statement.

Available-for-sale – Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized directly in equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in statement of loss.

All financial assets are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, which are described above.

Financial liabilities

Other financial liabilities - This category includes amounts due to related parties and trade accounts payables and accrued liabilities, all of which are recognized initially at fair value net of any directly attributable transaction costs. Subsequent to initial recognition these financial instruments are measured at amortized cost using the effective interest method.

e) Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers cash and cash equivalents to include amounts held in banks and highly liquid debt investments with remaining maturities at point of purchase of 90 days or less. The Company places its cash and cash equivalents with institutions of high credit worthiness. At times, such investments may be in excess of federal insurance limits. Cash and cash equivalents are classified as loans and receivables.

f) Short-term Deposits

For purposes of reporting cash flows, the Company considers short-term deposits to include amounts held with remaining maturities at the point of purchase of more than 90 days and less than one year. Short-term deposits are classified as held-for-trading.

g) Investments

Investments, in which the Company has less than a 20% interest and where the Company has no significant influence, have been classified as available-for-sale and are measured at fair value with changes in fair value reported in equity. If a decline in value is deemed to be permanent, the investment is written-down to its estimated fair value and the realized loss is recognized on the statement of loss.

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – Continued

h) Provisions

Asset Retirement Obligation

An obligation to incur restoration, rehabilitation and environmental costs arises when environmental disturbance is caused by the exploration, development or ongoing production of a mineral property interest. Such costs arising for the decommissioning of plant and other site preparation work, discounted to their net present value, are provided for and capitalized at the start of each project to the carrying value of the asset, as soon as the obligation to incur such costs arises. Discount rates using a pre-tax market based discount rate that reflects the time value of money are used to calculate the net present value. The related liability is adjusted for each period for the unwinding of the discount rate and for changes to the pre-tax market based discount rate and amount or timing of the underlying cash flows needed to settle the obligation.

Other provisions

Provisions are recognized when a present legal or constructive obligation exists, as a result of past events, and it is probable that an outflow of resources that can be reliably estimated will be required to settle the obligation. Where the effect is material, the provision is discounted using an appropriate pre-tax market based discount rate.

i) Exploration and Evaluation Assets and Exploration Expenses

Exploration and evaluation assets include acquisition costs. Exploration expenses include expenditures associated with exploration and evaluation activity. Exploration expenses relate to the initial search for deposits with economic potential and to detailed assessments of deposits or other projects that have been identified as having economic potential. Exploration expenses and financing and interest costs are expensed as incurred except for the costs of acquiring licenses and the expenditures associated with the acquisition of exploration and evaluation assets. Costs incurred before the Company has obtained the legal rights to explore an area are expensed immediately. Exploration expenses are capitalized when these costs relate to specific properties for which resources, as defined under National Instrument 43-101, exist and it is expected that the expenditure can be recovered through future exploitation or sale.

When it has been established that a mineral deposit is commercially mineable and an economic analysis has been completed, the costs subsequently incurred to develop a mine on the property are capitalized and will be amortized on a unit-of-production method based on proven and probable reserves following commencement of commercial production. Mineral acquisition costs are capitalized on an individual project basis until such time as the economics of an ore body are defined.

Exploration and evaluation assets are assessed for impairment if (i) insufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

Recoverability of the carrying amount of the exploration and evaluation asset is dependent on successful development and commercial exploitation, or alternatively, sale of the respective areas of interest.

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – *Continued*

j) Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated amortization and impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the item.

Amortization is provided on property, plant and equipment. Amortization is calculated on a declining-balance basis so as to write off the net cost or other revalued amount of each asset over its expected useful life to its estimated residual value. The estimated useful lives, residual values and amortization method are reviewed at the end of each annual reporting period. Construction in progress is not amortized; rather it is deferred until the asset is put into use, at which point the deferred amount is transferred to the appropriate asset category and amortized on the applicable basis as set out below.

Property, plant and equipment are depreciated annually on a declining-balance basis at the following rates:

Office equipment	20-50%
Buildings	5%
Leasehold improvements	Straight-line over the term of the lease
Exploration equipment	15-30%
Vehicles	15-30%
Laboratory equipment	10-30%

Where an item of property, plant and equipment comprises major components with different useful lives, the components are accounted for as separate items of property, plant and equipment. Expenditures incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditures are capitalized.

k) Impairment of Assets

The carrying amounts of the Company's assets are reviewed for impairment whenever facts and circumstances suggest that the carrying amounts may not be recoverable. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax market-based discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. Previously recognized impairment losses are reversed if in subsequent periods, conditions giving rise to the impairment reverse.

l) Investment Tax Credits

The Company is eligible to receive investment tax credits ("ITCs") related to certain of its exploration and evaluation expenditures. The amount of the ITC reduces the Company's exploration expenses. Due to the uncertainty around the timing and amount of the ITC, it is recorded only when a notice of assessment is received.

Stornoway Diamond Corporation

(An Exploration Stage Company)

Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – *Continued*

m) Flow-through Shares

Under Canadian income tax legislation, a company is permitted to issue flow-through shares whereby the Company agrees to incur qualifying expenditures and renounce the related income tax deductions to the investors. For accounting purposes, the proceeds from issuance of these shares are allocated between the offering of shares and the sale of tax benefits. The allocation is made based on the difference between the quoted price of the existing shares and the amount the investor pays for the shares. A liability is recognized in other liabilities for this difference. The liability is reduced and the reduction of premium liability is recorded in deferred tax recovery on a pro-rata basis as eligible expenditures are incurred.

n) Property Option Agreements

From time to time, the Company may acquire or dispose of properties pursuant to the terms of option agreements. Due to the fact that options are exercisable entirely at the discretion of the optionee, the amounts payable or receivable are not recorded. Option payments are recorded as exploration and evaluation expenditures or recoveries when the payments are made or received.

o) Jointly Controlled Properties

Certain of the Company's properties are the subject of agreements which specify proportionate interests. Accordingly, the Company's proportionate share of assets, liabilities, costs and expenditures relating to these agreements have been recorded in the accounts.

p) Rough Diamond Inventory

Rough diamond inventory is recorded at its estimated fair value at the time of acquisition based on market prices for rough diamonds and taking into account anticipated costs of disposal. It is not the Company's intention to dispose of these rough diamonds in the near term.

q) Income Taxes

The asset and liability method is used for determining deferred income taxes. Under the asset and liability method, the change in the net deferred tax asset or liability is included in income. The income tax effects of temporary differences in the time when income and expenses are recognized in accordance with Company accounting practices and the time they are recognized for income tax purposes are reflected as deferred income tax assets or liabilities. Deferred income tax assets and liabilities are measured using enacted, or substantially enacted statutory rates that are expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. Deferred income tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the assets will be realized.

As an exception, deferred tax assets and liabilities are not recognized if the temporary differences arise from the initial recognition of an asset or liability in a transaction (other than in a business combination) that affects neither income/loss.

r) Share-based payment transactions

The share option plan allows the Company's directors, officers, employees and consultants to acquire shares of the Company. The fair value of options granted is recognized as a share-based payment expense with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

Stornoway Diamond Corporation

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – Continued

r) Share-based payment transactions – Continued

The fair value is measured at grant date and each tranche is recognized on a graded-vesting basis over the period during which the options vest. The fair value of the options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. At each balance sheet date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

s) Loss per Share

Basic earnings (loss) per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings (loss) per share. Since the Company has losses, the exercise of outstanding stock options and warrants has not been included in this calculation as it would be anti-dilutive.

t) Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of the asset until such a time as the asset is substantially complete and ready for its intended use. The amount of borrowing costs capitalized cannot exceed the actual amount of borrowing costs incurred during the period. All other borrowing costs are expensed as incurred.

The Company discontinues the capitalization of borrowing costs when substantially all of the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Capitalized borrowing costs are amortized over the useful life of the related asset.

u) Significant Accounting Judgments and Estimates

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. The consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and the revision affects both current and future periods.

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the balance sheet date, that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

- the recoverability of other receivables and prepaid expenses which are included in the condensed interim consolidated balance sheet;
- the carrying value of the investments and the recoverability of the carrying values which are included in the condensed interim consolidated balance sheet;
- the estimated useful lives of property, plant and equipment which are included in the condensed interim consolidated balance sheet, the componentization of property, plant and equipment and the related amortization included in the condensed interim consolidated statement of loss;

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – *Continued*

u) Significant Accounting Judgments and Estimates – *Continued*

- the inputs used in accounting for share-based payments (warrants and options) in the condensed interim consolidated statements of loss and deficit;
- the provision for income taxes which is included in the condensed interim consolidated statements of loss and deficit and composition of deferred income tax liabilities included in the condensed interim consolidated balance sheet at July 31, 2011;
- the inputs used in determining the recoverable amounts of exploration and evaluation assets, if an impairment trigger exists;
- the carrying value of rough diamond inventory which is included in the condensed interim consolidated balance sheet;
- the inputs used in determining asset retirement obligations included in the condensed interim consolidated balance sheet;
- the inputs used in determining the various commitments and contingencies accrued in the condensed interim consolidated balance sheet; and
- the going concern assumption.

v) Operating Segments

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), whose operating results are regularly reviewed by the entity's chief operating decision makers to make decisions about resources to be allocated to the segments and assess their performance and for which discrete financial information is available. This includes start-up operations which are yet to earn revenues.

Operating segments have been identified based on the information presented to the chief operating decision makers – being the executive management team.

Information about other business activities and operating segments that do not meet the quantitative criteria set out in IFRS 8, "Operating Segments" are combined and disclosed in a separate category called "Other".

w) New Accounting Standards and Interpretations

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 9, Financial Instruments (IFRS 9), IFRS 10, Consolidated Financial Statements (IFRS 10), IFRS 11, Joint Arrangements (IFRS 11), IFRS 12, Disclosure of Interests in Other Entities (IFRS 12), IAS 27, Separate Financial Statements (IAS 27), IFRS 13, Fair Value Measurement (IFRS 13) and amended IAS 28, Investments in Associates and Joint Ventures (IAS 28). Also in June 2011, the IASB amended IAS 19, Employee Benefits (IAS 19) and IAS 1, Presentation of Financial Statements (IAS 1), which has not yet been adopted by the Company. Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements. The following is a brief summary of the new standards:

IAS 1 – Presentation of Financial Statements

This standard requires companies preparing financial statements under IFRS to group items within Other Comprehensive Income ("OCI") that may be reclassified to profit or loss. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The amendments to IAS 1 are set out in Presentation of Items of Other Comprehensive Income and are effective for fiscal years beginning on or after January 1, 2013.

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

2. Significant accounting policies – Continued

w) New Accounting Standards and Interpretations – Continued

IAS 19 - Post-Employment Benefits

In June 2011, the IASB issued an amended version of IAS 19, Employee Benefits (“IAS 19”). The amendments to IAS 19 are meant to improve the quality, transparency and comparability of information presented for postemployment benefits. For defined benefit plans, the amendments eliminate the option to defer actuarial gains and losses on the balance sheet through the “corridor method”. The amendments also require any remeasurement gains or losses, including actuarial gains and losses, to be recognized immediately and presented in other comprehensive income, eliminating the option to recognize and present these through the income statement. Additional disclosures will also be required to present better information about the characteristics, amounts recognized, and risks related to defined benefit plans. The amendments to IAS 19 are effective for financial years beginning on or after January 1, 2013 with earlier adoption permitted. The Company does not have post-employment benefits thus this policy will not have an impact on the Company’s financial statements.

IFRS 9 – Financial Instruments – classification and measurement

This is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 has two measurement categories: amortized cost and fair value. All equity instruments are measured at fair value. A debt instrument is recorded at amortized cost only if the entity is holding the instrument to collect contractual cash flows and the cash flows represent principal and interest. Otherwise it is recorded at fair value through profit or loss.

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation—Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

IFRS 11 - Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities—Non-monetary Contributions by Venturers.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity’s interests in other entities.

IFRS 13 - Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is 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. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

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Notes to Condensed Interim Consolidated Financial Statements

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2. Significant accounting policies – Continued

u) New Accounting Standards and Interpretations – Continued

Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, Separate Financial Statements (IAS 27), and IAS 28, Investments in Associates and Joint Ventures (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

3. Acquisition of the Renard Diamond Project

On April 1, 2011, the Company acquired the remaining 50% interest in the Renard Diamond Project and related assets from Diaquem, Inc. (“Diaquem”). Diaquem is a wholly-owned subsidiary of SOQUEM INC., itself a wholly-owned subsidiary of Investissement Québec (formerly Société générale de financement du Québec) (“IQ”). This acquisition brings the Company’s interest in the Renard Diamond Project to 100%. The Renard Diamond Project, located within the Foxtrot Property, consists of approximately 54,550 hectares around the Otish Mountains region. Exploration on the property resulted in the discovery of a field of kimberlite intrusions, all of which are diamondiferous and are currently being assessed for possible mining.

Under the terms of the acquisition, Diaquem received 29,588,892 common shares and 22,543,918 non-voting, convertible shares of the Company, and retained a 2% direct royalty interest on future diamond production. IQ also agreed to enter into a credit support agreement with the Company for a minimum of \$100 million to fund a portion of future construction and development costs at the Renard Diamond Project. A commitment fee equal to 1.75% per annum on the \$100 million facility is payable quarterly, in arrears, beginning on April 1, 2011. There are no restrictions and no expiry date on the convertible shares except that Diaquem cannot hold more than 25% of Stornoway’s voting, common shares.

Total consideration of \$132.6 million includes the fair value of 29,588,892 common shares and 22,543,918 convertible common shares issued at \$2.49 per share (based on the five-day volume weighted average price of the Company’s shares calculated before the April 1, 2011 closing date), plus transaction costs of \$2.7 million.

This transaction has been accounted for as an asset acquisition under IFRS. The consideration paid has been allocated to the acquired assets based on their fair value at the date of acquisition. The purchase price of the acquisition has been primarily allocated as follows (*expressed in thousands of Canadian dollars*):

Purchase Price	
Common shares issued (29,588,892 shares)	\$ 73,739
Convertible shares issued (22,543,918 shares)	56,182
Transaction costs	2,715
	<hr/>
	\$ 132,636
Net Assets Acquired	
Current assets	\$ 548
Rough diamond inventory	674
Property, plant and equipment	2,011
Exploration and evaluation assets	130,880
Current liabilities	(757)
Asset retirement obligations	(720)
	<hr/>
	\$ 132,636

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4. Financial Instruments and Risk Management

Fair value

The Company's financial instruments consist of cash and cash equivalents, short-term deposits, other receivables, investments, trade accounts payable, accrued liabilities and provisions and amounts due to related parties. The carrying value of cash and cash equivalents, short-term deposits, other receivables, trade accounts payable, accrued liabilities and provisions and amounts due to related parties approximate their fair values due to their immediate or short-term maturity. Investments are recorded at fair value based on the quoted market prices in active markets at the balance sheet date, which is consistent with Level 1 of the fair value hierarchy. Short-term deposits are recorded consistent with Level 2 of the hierarchy.

The fair values of financial instruments at July 31, 2011 and April 30, 2011 are summarized as follows (expressed in thousands of Canadian dollars):

	July 31, 2011		April 30, 2011	
	Carrying amount	Fair value	Carrying amount	Fair value
	\$	\$	\$	\$
Financial Assets				
<i>Held-for-trading</i>				
Short-term deposits	11,816	11,816	11,777	11,777
<i>Loans and Receivables</i>				
Cash and cash equivalents	13,208	13,208	22,745	22,745
Other receivables	1,120	1,120	955	955
<i>Available for sale</i>				
Investments	202	202	242	242
Financial Liabilities				
Trade accounts payable, accrued liabilities, provisions and due to related parties	4,374	4,374	4,790	4,790

Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, foreign currency or credit risks arising from these financial instruments.

The Company is exposed to a variety of financial risks by virtue of its activities, including credit risk, interest rate risk and liquidity risk. The Company has limited exposure to foreign currency risk as greater than 99% of its assets and liabilities are denominated in Canadian dollars. The Company's objective with respect to risk management is to minimize potential adverse effects on the Company's financial performance. The Company's Board of Directors provides direction and guidance to management with respect to risk management. Management is responsible for establishing controls and procedures to ensure that financial risks are mitigated to acceptable levels.

Credit risk

Credit risk is the risk of financial loss to the Company if a counter-party to a financial instrument fails to meet its contractual obligations. The Company manages credit risk by investing its excess cash in short-term investments with an investment grade rating of "AAA" (R-1 high for money market securities) or better, issued by a Canadian chartered bank. The Company is exposed to credit risk by virtue of its receivables from companies with which it has exploration agreements or options (11% of receivables). Other miscellaneous receivables total approximately 3% of the Company's receivables while the remainder of the Company's receivables at the balance sheet date (86% of receivables totalling \$959,300 as at July 31, 2011) consist of federal and provincial sales tax refunds where management believes the risk of loss to be remote. The maximum exposure to credit risk at the reporting date is the carrying value of the Company's financial assets.

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Notes to Condensed Interim Consolidated Financial Statements

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4. Financial Instruments and Risk Management – Continued

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Financial assets and liabilities with variable interest rates expose the Company to interest rate risk with respect to its cash flow. The risk that the Company will realize a loss as a result of a decline in the fair value of any short-term investment included in cash and cash equivalents is limited because these investments, although readily convertible into cash, are generally held-to-maturity. As of July 31, 2011, management estimates that if interest rates had changed by 1% for those funds invested in guaranteed investment certificates (“GICs”), and 0.2% for the other cash equivalents assuming all other variables remained constant, the impact on the Company’s loss for the three months ended July 31, 2011 would have been approximately \$43,000.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they become due. The Company’s ability to continue as a going concern is dependent on management’s ability to raise the funds required through future equity financings, asset sales or exploration option agreements, or a combination thereof.

The Company has no regular cash flow from its operating activities. The Company manages its liquidity risk by forecasting cash flow requirements for its planned exploration and corporate activities and anticipating investing and financing activities. Failure to realize additional funding, as required, could result in the delay or indefinite postponement of further exploration and development of the Company’s properties. As at July 31, 2011, the Company had cash and cash equivalents, and short-term deposits of \$25.0 million (April 30, 2011 - \$34.5 million) as well as other receivables of \$1.1 million (April 30, 2011 - \$955,000) to settle current liabilities of \$4.4 million (April 30, 2011 - \$4.8 million). See Note 14 for details on other commitments.

5. Other Receivables

The Company’s other receivables arise primarily from goods and services tax (“GST”), harmonized sales tax (“HST”) and Quebec sales tax (“QST”) receivables due from various government taxation authorities (*expressed in thousands of Canadian dollars*).

	As at July 31, 2011	As at April 30, 2011
Sales tax receivables	959	833
Other receivables	161	122
Other Receivables - Current	\$ 1,120	\$ 955

6. Investments

The Company’s investments consist of common shares in two public companies. The Company acquired these common shares in July 2007 pursuant to the sale of a property interest and in October 2008 pursuant to a property option agreement. These investments represent less than a 5% interest in these companies. As at July 31, 2011, the fair value of these investments was \$202,000 (April 30, 2011 - \$242,000). During the period ended July 31, 2011, the Company recognized an unrealized loss of \$34,000, net of taxes (July 31, 2010 – \$33,000) in accumulated other comprehensive income/loss.

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Notes to Condensed Interim Consolidated Financial Statements

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7. Property, Plant and Equipment

(Expressed in thousands of Canadian dollars)

Details are as follows:

	Office Equipment	Buildings	Leasehold improvements	Exploration equipment	Vehicles	Laboratory equipment	Total
Cost							
As at May 1, 2010	\$ 743	\$ 91	\$ 800	\$ 826	\$ 610	\$ 6,154	\$ 9,224
Additions	101	-	-	-	-	11	112
Acquisition (Note 3)	67	-	-	656	560	3,752	5,035
Disposals	(56)	-	-	(12)	-	(59)	(127)
As at April 30, 2011	855	91	800	1,470	1,170	9,858	14,244
Additions	3	-	-	-	-	-	3
As at July 31, 2011	\$ 858	\$ 91	\$ 800	\$ 1,470	\$ 1,170	\$ 9,858	\$ 14,247
Accumulated amortization							
As at May 1, 2010	\$ (667)	\$ (22)	\$ (451)	\$ (681)	\$ (497)	\$ (3,169)	\$ (5,487)
Charge for the year	(54)	(4)	(93)	(79)	(48)	(713)	(991)
Acquisition (Note 3)	(12)	-	-	(534)	(451)	(1,701)	(2,698)
Eliminated on disposals	55	-	-	13	-	58	126
As at April 30, 2011	(678)	(26)	(544)	(1,281)	(996)	(5,525)	(9,050)
Charge for the period	(16)	(1)	(23)	(14)	(8)	(149)	(211)
As at July 31, 2011	\$ (694)	\$ (27)	\$ (567)	\$ (1,295)	\$ (1,004)	\$ (5,674)	\$ (9,261)
Net book value							
As at May 1, 2010	\$ 76	\$ 69	\$ 349	\$ 145	\$ 113	\$ 2,985	\$ 3,737
As at April 30, 2011	\$ 177	\$ 65	\$ 256	\$ 189	\$ 174	\$ 4,333	\$ 5,194
As at July 31, 2011	\$ 164	\$ 64	\$ 233	\$ 175	\$ 166	\$ 4,184	\$ 4,986

8. Exploration and Evaluation Assets and Exploration Expenses

a) Renard Project, located on the Foxtrot Property, Quebec (Eastern Canada)

The Company has a 100% interest in the Eastern Ungava property interest located in north-central Quebec, including the Foxtrot Property. On April 1, 2011, the Company acquired Diaquem's 50% interest in the Renard Diamond Project and related assets (Note 3). Rough diamonds weighing approximately 7,500 carats have been derived from exploration activities at Renard. The Company has estimated their value based on market prices for rough diamonds and taking into account anticipated costs of disposal. It is not the Company's intention to dispose of these rough diamonds in the near term. As at July 31, 2011, the carrying value of exploration and evaluation assets, consisting primarily of capitalized acquisition costs for this property totaled \$206.9 million.

b) Aviat One Property, Melville Peninsula, Nunavut (Eastern Arctic)

The Company has a 90% interest in certain mineral claims and leases, known as the Aviat One properties and 100% of the diamond marketing rights for the Aviat properties. Hunter Exploration Group ("Hunter") holds a 10% interest in the properties, carried up to the development of a mine on the properties.

The Aviat One property is subject to a 2% net smelter return royalty ("NSR") on products other than diamonds and a 2% gross over-riding royalty ("GOR") on diamond production. In addition, advance royalty payments of \$50,000 annually commenced October 1, 2006 for the Aviat One property. As at July 31, 2011, the carrying value of exploration and evaluation assets, consisting primarily of capitalized acquisition costs for this property totaled \$1.9 million.

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Notes to Condensed Interim Consolidated Financial Statements

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8. Exploration and Evaluation Assets and Exploration Expenses – Continued

c) Churchill, Melville Peninsula, Nunavut (Eastern Arctic)

The Company has a 38% interest (approximately) in the Churchill property. The remaining 62% interest is held by Shear Minerals Ltd. (“Shear”). Shear is the operator of the Churchill Project. The Churchill property is subject to a 2% GOR/NSR. As at April 30, 2011, the Company wrote-off \$2.1 million of capitalized property interests, resulting in a carrying value of \$Nil. A portion of the Churchill property (the “Chesterfield Inlet” project) was subject to an option out agreement between the Company, Shear and Kennecott Canada Exploration (optionee) as of August 2009. The Company has received a termination notice from the optionee.

d) Qilalugaq Property (“Area 8”), Melville Pensiula, Nunavut (Eastern Arctic)

The Company has a 100% interest in the Qilalugaq property, subject to a 3% NSR and 3% GOR.

e) Generative Projects

The Company has signed agreements with several individuals or companies as part of its generative exploration program. Under the terms of these non-material agreements, the Company may be required to make cash payments, issue shares or fund an exploration program to earn its interest under the terms of the specific agreement. Properties acquired as part of the Company’s generative exploration program may be subject to GORs ranging from 0% to 3% and NSRs ranging from 0% to 3%.

No cash payments or shares were issued pursuant to the Company’s generative agreements during the period ended July 31, 2011 or the year ended April 30, 2011.

f) Other Property Interests

The Company and its subsidiaries continue to hold a number of property interests in other parts of Canada, either as 100% ownership or as part of a property option agreement.

No acquisition cash payments or shares were issued pursuant to the Company’s other property interests during the period ended July 31, 2011 or the year ended April 30, 2011.

g) Write-offs

During the period ended July 31, 2011, the Company wrote-off the exploration and evaluation assets related to capitalized acquisition costs of \$49,000 where no future exploration programs were planned for the foreseeable future (July 31, 2010 – \$Nil).

h) Exploration and Evaluation Assets

(Expressed in thousands of Canadian dollars)

	April 30, 2011	Acquisition Expenditures	Write-down	Change in ARO estimate	July 31, 2011
	\$	\$	\$	\$	\$
Arctic Properties	2,121	5	(49)	-	2,077
Eastern Canada Properties	212,312	1	-	(5)	212,308
Other Canadian Properties	111	-	-	-	111
	214,544	6	(49)	(5)	214,496

	April 30, 2010	Acquisition Expenditures	Acquisition (Note 3)	Write-down	April 30, 2011
	\$	\$	\$	\$	\$
Arctic Properties	4,166	97	-	(2,142)	2,121
Eastern Canada Properties	81,255	201	130,862	(6)	212,312
Other Canadian Properties	20	91	-	-	111
	85,441	389	130,862	(2,148)	214,544

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

8. Exploration and Evaluation Assets and Exploration Expenses – Continued

i) Exploration Expenses

(Expressed in thousands of Canadian dollars)

	<u>For the Three Months Ended</u>	
	July 31, 2011	July 31, 2010
<i>Arctic Properties</i>		
Assays and laboratory	\$ 79	\$ 5
Camp and general	783	77
Drilling	558	-
Sampling and ground surveys	6	9
	<u>1,426</u>	<u>91</u>
<i>Eastern Canada Properties</i>		
Airborne geophysics	105	-
Assays and laboratory	39	53
Camp and general	508	299
Drilling	-	11
Pre-feasibility and feasibility studies	5,472	413
Sampling and ground surveys	11	77
Mineral exploration tax re-assessment (credits received)	36	(775)
	<u>6,171</u>	<u>78</u>
<i>Other Canadian Properties</i>		
Camp and general	13	(10)
Sampling and ground surveys	359	3
	<u>372</u>	<u>(7)</u>
<i>Generative Exploration</i>		
Assays and laboratory	185	101
Camp and general	55	40
Drilling	76	-
Sampling and ground surveys	5	-
	<u>321</u>	<u>141</u>
Total exploration expenses during the period	<u>\$ 8,290</u>	<u>\$ 303</u>

9. Trade Accounts Payable, Accrued Liabilities and Provisions

(Expressed in thousands of Canadian dollars)

Trade and other payables of the Company are principally comprised of amounts outstanding for trade purchases relate to exploration and development activities. The usual credit period taken for trade purchases is between 30 to 90 days.

	As at July 31, 2011	As at April 30, 2011
Trade payables	\$ 1,272	\$ 928
Accrued liabilities and provisions	3,089	3,638
Other current liabilities	13	224
Total trade accounts payable, accrued liabilities and provisions	<u>\$ 4,374</u>	<u>\$ 4,790</u>

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Notes to Condensed Interim Consolidated Financial Statements

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10. Share Capital

a) Authorized Share Capital

At July 31, 2011, the authorized share capital comprised an unlimited number of common shares. The common shares do not have a par value. All issued shares are fully paid.

Share Consolidation

On February 22, 2011, shareholders approved a 1-new-for-4-old share consolidation. All share, per share, share option, warrant and weighted average exercise price information included in the condensed interim consolidated financial statements and accompanying notes has been adjusted to reflect this share consolidation for all periods presented.

b) Convertible Shares (expressed in thousands of Canadian dollars except share numbers):

	Number	Amount
Authorized:		
Unlimited non-voting convertible shares without par value		
Issued and fully paid:		
Balance – May 1, 2010	-	\$ -
Issuance of convertible shares for asset acquisition (Note 3)	22,543,918	56,182
Balance – July 31, 2011 and April 30, 2011	22,543,918	\$ 56,182

The non-voting convertible shares have no expiry date and no restrictions except that Diaquem cannot hold more than 25% of Stornoway's voting, common shares. The convertible shares can be converted into common shares of the Company at any time either by way of a disposition or sale which is exempt from prospectus requirements under applicable securities law, or by way of a distribution to the public. The Company has the right, in connection with a Multilateral Instrument 61-101 transaction, to require that all convertible shares be converted into common shares of the Company.

c) Equity Financings

On June 29, 2010, the Company completed a private placement, with Desjardins Securities Inc. as lead agent, which consisted of 2,193,750 flow-through common shares of the Company for gross proceeds of \$5,001,750. The flow-through common shares were issued at a price of \$2.28 per share. The Company paid a 6.5% cash commission on certain subscriptions received and issued 131,625 Compensation Options. The Compensation Options are exercisable at \$2.28 to acquire one non-flow-through common share and expire on December 29, 2011. The fair value of the Compensation Options was estimated to be \$157,300 using the Black-Scholes option-pricing model (1.38% risk-free interest rate; expected life of eighteen months, 105% volatility) with this amount being recorded in contributed surplus.

On January 6, 2011, the Company completed a prospectus offering and issued 14,350,000 common shares at \$2.44 for gross proceeds of \$35.0 million. The transaction was completed by a syndicate of underwriters led by RBC Capital Markets and including Desjardins Securities, BMO Capital Markets and Canaccord Genuity (the "Underwriters"). The Underwriters received a cash fee equal to 6% of the gross proceeds from the sale of the common shares.

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Notes to Condensed Interim Consolidated Financial Statements

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10. Share Capital – Continued

d) Flow-through Funds

To finance certain of its exploration activities, the Company raised \$1,431,617 in May 2009 (renounced to shareholders as at December 31, 2009) and \$5,001,750 in June 2010 (renounced to shareholders as at December 31, 2010) by way of flow-through private placements. Under the terms of the June 2010 subscription agreement, the Company is required to spend the following on Canadian Exploration Expenditures (“CEE”) (expressed in thousands of Canadian dollars):

Flow-through commitment at June 29, 2010	\$	5,002
Qualifying expenditures to July 31, 2011		(4,856)
Flow-through funds on hand at July 31, 2011	\$	146

Flow-through common shares provide for the Company’s CEE to be transferred to the shareholders and, as a result, the tax base for these expenditures is not available to the Company.

e) Stock Option Plan

The maximum number of common shares currently available for issuance under the Company’s existing Stock Option Plan (the “Plan”) was approved by shareholders at the 2008 Annual General Meeting (“AGM”) and is fixed at 5,680,659, representing 10% of the Company’s issued and outstanding common shares as at August 15, 2008. There were no amendments to the Plan during the year ended April 30, 2011.

The Plan provides the directors with discretion to set vesting terms for each stock option grant. Historically, the Company’s options have vested in thirds over a one year period from the grant date, with the first third vesting immediately, the second third vesting six months from the grant date and the final third vesting one year from the grant date. Effective for the fiscal year beginning May 1, 2009, a Stock Option Grant Policy (the “Policy”) was adopted. This Policy sets annual stock option grants and five-year option level targets for optionees, by level of responsibility. Options granted as part of the annual grant vest immediately on the grant date.

In addition, the number of shares which may be reserved for issuance to any one individual may not exceed 5% of the issued shares on a yearly basis or 2% if the optionee is engaged in investor relations activities or is a consultant.

f) A summary of the Company’s outstanding options is as follows:

	Number of Options		Weighted Average Exercise Price
Balance May 1, 2010	3,632,951	\$	3.16
Granted	1,195,000		2.32
Forfeited	(53,750)		3.15
Expired	(378,355)		4.85
Exercised	(138,750)		0.61
Balance April 30, 2011	4,257,096	\$	2.86
Granted	75,000		2.08
Forfeited	(13,875)		2.75
Expired	(94,050)		5.00
Exercised	(4,000)		0.40
Balance July 31, 2011	4,220,171	\$	2.80
Number of options currently exercisable	4,213,505	\$	2.80

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Notes to Condensed Interim Consolidated Financial Statements

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10. Share Capital - Continued

g) As at July 31, 2011, the Company had the following stock options outstanding:

Range of Exercise Prices	Number of Options Outstanding	Weighted Average Exercise Price	Year of Expiry	Weighted Average Remaining Contractual Life
\$ 4.08	27,750	\$ 4.08	2011	0.39 years
\$ 2.52 ~ \$ 27.76	1,248,495	\$ 4.68	2012	0.96 years
\$ 0.40 ~ \$ 29.68	980,301	\$ 2.03	2013	2.31 years
\$ 0.40 ~ \$ 19.44	671,025	\$ 1.18	2014	3.20 years
\$ 2.24 ~ \$ 5.36	1,167,600	\$ 2.40	2015	4.03 years
\$ 2.08 ~ \$ 2.50	125,000	\$ 2.25	2016	4.85 years
	<u>4,220,171</u>			

The Company granted the following stock options between May 1, 2010 and July 31, 2011:

Grant Date	Stock Options Granted	Exercise Price	Expiry Date	Vesting Terms
May 3, 2010	305,000	\$2.48	May 3, 2015	a
September 14, 2010	820,000	\$2.24	September 14, 2015	b
September 14, 2010	20,000	\$2.60	September 14, 2015	a
April 1, 2011	50,000	\$2.50	April 1, 2016	b
July 20, 2011	75,000	\$2.08	July 20, 2016	b
	<u>1,270,000</u>			

a These stock options vest in thirds over one-year following the grant date.

b These stock options vest on the grant date.

h) A summary of the Company's outstanding warrants is as follows:

	Number of Warrants	Weighted Average Exercise Price
Balance May 1, 2010	409,833	\$ 1.90
Issued – Compensation options	131,625	2.28
Exercised	(157,354)	0.54
Balance April 30, 2011	384,104	\$ 1.95
Exercised	(19,737)	0.68
Balance July 31, 2011	364,367	\$ 2.02

As at July 31, 2011, the Company had the following warrants outstanding:

Number of Warrants	Exercise Price	Expiry Date
26,325	\$ 2.28	December 29, 2011
338,042	\$ 2.00	February 23, 2012
<u>364,367</u>		

i) Share-Based Payments

The fair value of each option grant that has vested during the current period is estimated on the date of grant using the Black-Scholes Option Pricing Model, with the following weighted average assumptions:

	Period Ended July 31, 2011	Year Ended April 30, 2011
Risk-free interest rate	2.0%	1.7% - 2.7%
Expected dividend yield	NIL	NIL
Expected stock price volatility ⁽ⁱ⁾	83%	84 - 99%
Expected option life in years	5 years	3 – 5 years

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

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Notes to Condensed Interim Consolidated Financial Statements

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10. Share Capital - Continued

i) Share-Based Payments - Continued

During the period ended July 31, 2011, the Company granted options to purchase up to 75,000 (April 30, 2011 – 1,195,000) shares of the Company's stock to employees at an exercise price of \$2.08 (April 30, 2011 - exercise price range of \$2.24 – \$2.60). These options expire five years from the grant date. The Company used the Black-Scholes Option Pricing Model to estimate a fair value of \$103,000 (April 30, 2011 - \$1.8 million) for this grant.

For the period ended July 31, 2011, the Company recorded a share-based payment expense of \$160,000 (July 31, 2010 - \$312,000).

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

11. Related Party Transactions

a) Key Management Personnel Remuneration

Key management includes the Company's directors and officers. Compensation awarded to key management includes (expressed in thousands of Canadian dollars):

	Three Months Ended	
	July 31, 2011	July 31, 2010
Salaries and other short-term employee benefits	\$ 285	\$ 295
Director's fees	12	23
Share-based payments	103	419
	<u>\$ 400</u>	<u>\$ 737</u>

b) Transactions with related parties

The Company entered into the following transactions with related parties not disclosed elsewhere in these financial statements:

- i) During the period ended July 31, 2011, the Company paid \$8,500 (July 31, 2010 - \$13,500), charged \$8,300 (July 31, 2010 - \$9,700) and included \$1,200 in receivables (April 30, 2011 – accrued as payable \$1,000) for the reimbursement of administrative and technical time to Strongbow Exploration Inc., a company with an officer in common.
- ii) During the period ended July 31, 2011, the Company charged \$4,600 (July 31, 2010 - \$8,300) and included \$15,000 (April 30, 2011 - \$12,000) in receivables for the reimbursement of administrative and technical time to North Arrow Minerals Inc., ("North Arrow") a company with an officer in common. In addition, the Company has recorded a receivable of \$125,000 from North Arrow for North Arrow's share of exploration expenses incurred as at July 31, 2011 on the Hammer property, which is a 75%-25% option agreement between the Company and North Arrow, respectively.

These amounts are non-interest bearing, unsecured and are due on demand. All transactions with related parties have occurred in the normal course of the Company's operations and are based on agreed upon amounts between the parties.

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12. Asset Retirement Obligations

Details are as follows (expressed in thousands of Canadian dollars):

	July 31, 2011	April 30, 2011
Balance – beginning of the period	\$ 1,442	\$ 728
Accretion	5	13
Acquisition (Note 3)	-	720
Change in estimate	(4)	(19)
Balance – end of the period	\$ 1,443	\$ 1,442

The Company has recorded an asset retirement obligation, which reflects the present value of the estimated amount of undiscounted cash flow required to satisfy the asset retirement obligation in respect of the Renard Diamond Project in Quebec. The primary component of this obligation is the removal of equipment currently used at the site as well as costs associated with securing an underground shaft on the property. If the Company decides not to go into production on the property, it is assumed that the asset retirement obligation will be incurred at the end of 2011. Should the Company decide to proceed with a production decision on the Renard Diamond Project, the obligation will be realized further into the future. The pre-tax market based discount rate at which the estimated cash flows have been discounted to arrive at the obligation is 1.39%. The discounted amount of inflation-adjusted estimated future cash flows is \$1,443,000.

13. Supplemental Schedule of Non-Cash Investing and Financing Activities

(expressed in thousands of Canadian dollars)

	July 31, 2011	July 31, 2010 (Note 16)
Issuance of compensation options (Note 10)	\$ -	\$ 157
Options and warrants exercised (Note 10)	\$ 6	\$ 2
Finance expense accrual (Note 3)	\$ 145	\$ -

14. Commitments

The Company is committed to minimum future operating lease payments for its office premises and to minimum future financial capital contributions for the construction and maintenance of the Route 167 segment for a maximum of ten years from year 2015 as follows (expressed in thousands of Canadian dollars):

	Operating lease payments	Commitment fee	Route 167	Total
Fiscal year ending April 30, 2013	\$ 454	\$ 1,750	\$ -	\$ 2,204
Fiscal year ending April 30, 2014	380	1,750	-	2,130
Fiscal year ending April 30, 2015	117	1,750	-	1,867
Fiscal year ending April 30, 2016	19	-	4,042	4,061
Fiscal year ending April 30, 2017	-	-	7,275	7,275
Thereafter	-	-	61,430	61,430
	\$ 970	\$ 5,250	\$ 72,747	\$ 78,967

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14. Commitments - Continued

In August 2011, the Company entered into two financing agreements with the Government of Québec by which the Company will contribute to the construction and maintenance costs of the Route 167 extension, the road development project that will provide year round highway access to the Renard Diamond Project by way of the communities of Mistissini and Chibougamau. In two separate agreements executed with the ministère des Ressources naturelles et de la Faune and the ministère des Transports, the Company has agreed to contribute \$44 million to the development of the Route 167 extension, to be amortized over a ten year period and starting in July 2015. The Company's contribution will be financed by Québec at 6.3% and will be conditional upon, amongst other things, the completion of the road on schedule, the receipt of all regulatory approvals for the construction of the Renard Diamond Project and the successful completion of project financing for the Renard Diamond Project. In addition, the Company has agreed to contribute a maximum of \$5,000 per kilometer, or \$1.215 million per year, to the maintenance of the road starting July 1, 2015. It is management's assumption that these conditions will be met, and therefore these commitments have been disclosed.

The Company has a \$100 million credit support agreement with IQ (*Note 3*) to fund a portion of future construction and development costs at the Renard Diamond Project, under which commitment fee payments equal to 1.75% per annum are payable by the Company. The obligations of IQ will terminate on the earlier to occur of: (a) the date on which the Company notifies IQ in writing that the credit support agreement is terminated; (b) the date of the initial borrowing under the IQ commitment; and (c) April 1, 2015.

In addition, the Company has GICs in the amount of \$328,000 as collateral security for its corporate credit cards and a line of credit of \$8,000 to satisfy exploration bonding requirements. A GIC equivalent to the utilization of the line of credit is provided as collateral security.

15. Segmented Information

The Company has identified its operating segments based on the internal reports that are reviewed and used by the executive management team in assessing performance and in determining the allocation of resources. The Company has two main operating segments being development stage exploration (Renard) and other advanced and grass roots exploration. The development stage exploration segment and the other advanced and grass roots exploration segments are principally engaged in the acquisition, exploration and development of diamond properties in distinct geographical locations within Canada. Refer to the Condensed Interim Consolidated Statements of Loss and Notes 8h and 8i for more information.

16. First Time Adoption of IFRS

As stated in Note 2, these are the Company's first interim consolidated financial statements for the period covered by the first annual consolidated financial statements prepared in accordance with IFRS.

The accounting policies in Note 2 have been applied as follows:

- in preparing the condensed interim consolidated financial statements for the three months ended July 31, 2011;
- the comparative information for the three months ended July 31, 2010;
- the condensed interim consolidated balance sheet as at April 30, 2011; and
- the preparation of an opening IFRS condensed interim consolidated balance sheet on the transition date of May 1, 2010 (the "Transition Date").

In preparing the opening IFRS condensed interim consolidated balance sheet and comparative information for the three months ended July 31, 2010, the Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian GAAP.

An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's balance sheet and statements of financial performance and cash flows is set out in the following tables.

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

16. First Time Adoption of IFRS – Continued

a) Reconciliation of Assets, Liabilities & Equity

IFRS employs a conceptual framework that is similar to Canadian GAAP. While the adoption of IFRS has not changed the actual cash flows of the Company, the adoption has resulted in significant changes to the reported balance sheets and statements of loss and deficit of the Company. Presented below are reconciliations prepared by the Company to reconcile to IFRS the assets, liabilities, equity, loss and comprehensive loss and cash flows of the Company from those reported under Canadian GAAP:

ASSETS	Notes	As at May 1, 2010		
		CDN GAAP	Effect of transition to IFRS	IFRS
Current				
Cash and cash equivalents		\$ 9,212	\$ -	\$ 9,212
Short-term deposits		1,641	-	1,641
Other receivables		1,582	-	1,582
Investments		147	-	147
Prepaid expenses		136	-	136
Prepaid fuel		170	-	170
		12,888	-	12,888
Rough Diamond Inventory		330	-	330
Property, Plant and Equipment	(i)	2,366	1,371	3,737
Exploration and Evaluation Assets	(ii)(iii)	93,854	(8,413)	85,441
		\$ 109,438	\$ (7,042)	\$ 102,396
LIABILITIES				
Current				
Trade accounts payable		\$ 1,548	\$ -	\$ 1,548
Accrued liabilities and provisions		1,636	-	1,636
		3,184	-	3,184
Deferred Income Tax Liabilities	(ii)	7,806	(7,806)	-
Asset Retirement Obligations	(iii)	710	18	728
		11,700	(7,788)	3,912
SHAREHOLDERS' EQUITY				
Share Capital	(v)	224,883	217	225,100
Contributed Surplus	(iv)	11,807	45	11,852
Accumulated Other Comprehensive Loss		(72)	11	(61)
Deficit		(138,880)	473	(138,407)
		97,738	746	98,484
		\$ 109,438	\$ (7,042)	\$ 102,396

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

16. First Time Adoption of IFRS – Continued

a) Reconciliation of Assets, Liabilities & Equity – Continued

ASSETS	Notes	As at July 31, 2010		
		CDN GAAP	Effect of transition to IFRS	IFRS
Current				
Cash and cash equivalents		\$ 12,454	\$ -	\$ 12,454
Short-term deposits		1,687	-	1,687
Other receivables		1,173	-	1,173
Investments		108	-	108
Prepaid expenses		127	-	127
Prepaid fuel		170	-	170
		15,719	-	15,719
Rough Diamond Inventory		330	-	330
Property, Plant and Equipment	(i)	2,243	1,383	3,626
Exploration and Evaluation Assets	(ii)(iii)	93,974	(8,420)	85,554
		\$ 112,266	\$ (7,037)	\$ 105,229
LIABILITIES				
Current				
Trade accounts payable		\$ 704	\$ -	\$ 704
Accrued liabilities and provisions		1,595	-	1,595
		2,299	-	2,299
			-	
Other Liabilities	(v)	-	527	527
Deferred Income Tax Liabilities	(ii)	7,796	(7,796)	-
Asset Retirement Obligations	(iii)	731	(8)	723
		10,826	(7,277)	3,549
SHAREHOLDERS' EQUITY				
Share Capital	(v)	229,347	(310)	229,037
Contributed Surplus	(iv)	12,121	198	12,319
Accumulated Other Comprehensive Loss		(111)	17	(94)
Deficit		(139,917)	335	(139,582)
		101,440	240	101,680
		\$ 112,266	\$ (7,037)	\$ 105,229

Stornoway Diamond Corporation

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

16. First Time Adoption of IFRS – Continued

a) Reconciliation of Assets, Liabilities & Equity – Continued

ASSETS	Notes	As at April 30, 2011		
		CDN GAAP	Effect of transition to IFRS	IFRS
Current				
Cash and cash equivalents		\$ 22,745	\$ -	\$ 22,745
Short-term deposits		11,777	-	11,777
Other receivables		955	-	955
Investments		242	-	242
Prepaid expenses		772	-	772
Prepaid fuel		206	-	206
		36,697	-	36,697
Rough Diamond Inventory		1,004	-	1,004
Property, Plant and Equipment	(i)	2,869	2,325	5,194
Exploration and Evaluation Assets	(ii)(iii)	223,932	(9,388)	214,544
		\$ 264,502	\$ (7,063)	\$ 257,439
LIABILITIES				
Current				
Trade accounts payable		\$ 928	\$ -	\$ 928
Accrued liabilities and provisions		3,862	-	3,862
		4,790	-	4,790
Other Liabilities	(v)	-	265	265
Deferred Income Tax Liabilities	(ii)	5,960	(5,960)	-
Asset Retirement Obligations	(iii)	1,590	(148)	1,442
		12,340	(5,843)	6,497
SHAREHOLDERS' EQUITY				
Share Capital	(v)	334,762	1,040	335,802
Convertible Shares		56,182	-	56,182
Contributed Surplus	(iv)	13,630	(50)	13,580
Accumulated Other Comprehensive Loss		(30)	5	(25)
Deficit		(152,382)	(2,215)	(154,597)
		252,162	(1,220)	250,942
		\$ 264,502	\$ (7,063)	\$ 257,439

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

16. First Time Adoption of IFRS – Continued

b) Reconciliation of Loss and Comprehensive Loss

	Notes	Three months ended July 31, 2010		
		CDN GAAP	Effect of transition to IFRS	IFRS
Expenses				
Accretion	(iii)	\$ 21	\$ (19)	\$ 2
Amortization	(i)	172	(13)	159
Exploration expenses		303	-	303
Office and sundry		147	-	147
Professional fees		91	-	91
Regulatory and shareholder communication expense		96	-	96
Rent and facility fees		118	-	118
Salaries, benefits and director's fees		198	-	198
Share-based payments	(iv)	158	154	312
Loss Before the Following		(1,304)	(122)	(1,426)
Other Income				
Bad debt recovery		101	-	101
Cost recovery		142	-	142
Interest income		14	-	14
		257	-	257
Loss Before Income Taxes		(1,047)	(122)	(1,169)
Deferred income tax recovery (expense)	(ii&v)	10	(16)	(6)
Loss for the Period		(1,037)	(138)	(1,175)
Unrealized loss on available for sale investments, net of taxes		(33)	-	(33)
Comprehensive Loss		\$ (1,070)	\$ (138)	\$ (1,208)

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Notes to Condensed Interim Consolidated Financial Statements

Unaudited

16. First Time Adoption of IFRS – Continued

b) Reconciliation of Loss and Comprehensive Loss – Continued

	Notes	Year ended April 30, 2011		
		CDN GAAP	Effect of transition to IFRS	IFRS
Expenses				
Accretion	(iii)	\$ 106	\$ (93)	\$ 13
Amortization	(i)	714	(52)	662
Exploration expenses		8,495	-	8,495
Office and sundry		575	-	575
Professional fees		426	-	426
Regulatory and shareholder communication expense		489	-	489
Rent and facility fees		478	-	478
Salaries, benefits and director's fees		1,729	-	1,729
Share-based payments	(iv)	1,876	(94)	1,782
Loss Before the Following		(14,888)	239	(14,649)
Other Income (Expenses)				
Bad debt recovery		(277)	-	(277)
Cost recovery		544	-	544
Interest income		204	-	204
Finance expense		(146)	-	(146)
Write-off of exploration and evaluation assets		(2,148)	-	(2,148)
		(1,823)	-	(1,823)
Loss Before Income Taxes		(16,711)	239	(16,472)
Current income tax recovery		13	-	13
Deferred income tax recovery	(ii&v)	3,196	(2,927)	269
Loss for the Year		(13,502)	(2,688)	(16,190)
Unrealized gain on available for sale investments, net of taxes		36	-	36
Comprehensive Loss		\$ (13,466)	\$ (2,688)	\$ (16,154)

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Notes to Condensed Interim Consolidated Financial Statements

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16. First Time Adoption of IFRS – Continued

c) Reconciliation of Cash Flows

The adoption of IFRS has had no impact on the net cash flows of the Company. The changes made to the condensed interim consolidated statements of loss and comprehensive loss and to the condensed interim consolidated balance sheets have resulted in reclassification of various amounts on the statements of cash flows, however as there have been no changes to the net cash flows, no reconciliations have been prepared.

d) Notes to the IFRS Reconciliations

- i) *Property, plant and equipment* – Under IFRS, where an item of property, plant and equipment comprises major components with different useful lives, the components are accounted for as separate items of property, plant and equipment, and are depreciated separately. Under Canadian GAAP, there was no such requirement.
- ii) *Deferred tax on exploration and evaluation assets* – Under Canadian GAAP, the Company recognized a future income tax liability on temporary differences arising on the initial recognition of mineral property interests (where the fair value of the asset acquired exceeded its tax basis) in a transaction which was not a business combination and affected neither accounting profit or loss nor taxable profit or loss. IAS 12, “Income Taxes” does not permit the recognition of deferred taxes on such transactions. As of May 1, 2010, the Company has derecognized the impacts of all future income tax liabilities which had previously been recognized on the initial acquisition of the mineral property interests through transactions deemed not to be business combinations and affecting neither accounting profit or loss nor taxable profit or loss.
- iii) *Asset retirement obligation* – At May 1, 2010, the Company did an analysis of the discount rate used to present value its ARO liability. Under Canadian GAAP, a change in the discount rate alone did not result in a re-measurement of the ARO liability. Under IFRS, IAS 37, “Provisions, Contingent Liabilities and Contingent Assets” a change in the current market-based discount rate will result in a change in the measurement of the provision. As a result, the ARO liability recorded in 2010 has been re-measured using the pre-tax market-based discount rate in effect at each reporting period and an adjustment has been recorded to the corresponding asset.
- iv) *Share-based payments* – Under Canadian GAAP, the Company used the straight-line method of calculating vested options. The fair value of share-based awards with graded vesting was calculated as one grant and the resulting fair value was recognized on a straight-line basis over the vesting period. Also, forfeitures of awards were recognized as they occurred. Under IFRS, each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value, and the resulting fair value is recognized using the graded-vesting method. Also, forfeiture estimates are recognized on the grant date and revised for actual experiences in subsequent periods.
- v) *Flow-through shares* – Flow-through shares are a unique Canadian tax incentive which is the subject of specific guidance under Canadian GAAP, however there is no equivalent IFRS guidance. Therefore, the Company intends to adopt a policy whereby the premium paid for flow through shares in excess of the market value of the shares without the flow through features at the time of issue is credited to other liabilities and included in income as a deferred income tax recovery at the time the qualifying expenditures are made.