

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)

CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND SEPTEMBER 30, 2005

(Expressed in Canadian Dollars)



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Fortuna Silver Mines Inc. as at December 31, 2006 and the consolidated statements of earnings, deficit and cash flows for the fifteen month period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the fifteen month period then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at September 31, 2005 and for the year then ended were audited by other auditors, who expressed an opinion without reservation on those statements in their report, dated January 20, 2006.

KPMG LLP

Chartered Accountants

Vancouver, Canada

April 17, 2007

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)
CONSOLIDATED BALANCE SHEETS
AS AT DECEMBER 31, 2006 AND SEPTEMBER 30, 2005
(Expressed in Canadian Dollars)

	December 31, 2006	September 30, 2005
ASSETS		
CURRENT		
Cash and cash equivalents (Note 3)	\$ 1,641,264	\$ 5,850,257
Accounts receivable and prepaid expenses (Note 13)	5,638,611	81,355
Inventories (Note 8)	826,165	-
Due from related parties (Note 6)	13,869	-
	8,119,909	5,931,612
LONG-TERM INVESTMENTS (Note 4)	741,250	-
PROPERTY, PLANT & EQUIPMENT (Note 7)	9,160,546	3,160,874
MINERAL PROPERTIES (Note 7)	41,186,418	15,048,653
	\$ 59,208,123	\$ 24,141,139
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Note 6)	\$ 2,238,031	\$ 870,663
Due to related parties (Note 6)	41,147	8,925
Loans (Note 5)	5,730,105	5,270,850
	8,009,283	6,150,438
Obligation under capital lease (Note 5)	97,100	-
Asset retirement obligations (Note 14)	1,757,970	1,578,441
Future income tax liability (Note 10)	4,910,377	1,207,149
Non-controlling interest	3,226,631	-
	18,001,361	8,936,028
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 9)	43,341,404	12,163,851
SHARE SUBSCRIPTIONS (Note 15)	-	2,030,888
OBLIGATION TO ISSUE SHARES AND WARRANTS (Note 7)	-	4,584,954
CONTRIBUTED SURPLUS (Note 9)	6,084,540	296,313
DEFICIT	(8,219,182)	(3,870,895)
	41,206,762	15,205,111
	\$ 59,208,123	\$ 24,141,139

Nature of operations (Note 1)
Subsequent event (Note 5, 9 & 17)

(See accompanying Notes)

APPROVED BY THE DIRECTORS:

"signed"
Jorge Ganoza Durant, Director

"signed"
Simon Ridgway, Director

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)
CONSOLIDATED STATEMENTS OF DEFICIT
FOR THE FIFTEEN MONTH PERIOD ENDED DECEMBER 31, 2006 AND THE YEAR ENDED SEPTEMBER 30, 2005
(Expressed in Canadian Dollars)

	15 month period ended December 31,	Year ended September 30,
	2006	2005
DEFICIT - BEGINNING OF PERIOD	\$ (3,870,895)	\$ (3,265,262)
Net loss for the period	(4,348,287)	(605,633)
DEFICIT - END OF PERIOD	<u>\$ (8,219,182)</u>	<u>\$ (3,870,895)</u>

(See accompanying Notes)

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE FIFTEEN MONTH PERIOD ENDED DECEMBER 31, 2006 AND YEAR ENDED SEPTEMBER 30, 2005
(Expressed in Canadian Dollars)

	15 month period ended December 31,	Year ended September 30,
	2006	2005
Sales	\$ 3,371,698	\$ -
Cost of sales including depletion, depreciation and accretion of \$918,617	2,174,488	-
MINE OPERATING INCOME (LOSS)	1,197,210	-
Selling, general and administrative expenses	2,024,883	648,810
Stock-based compensation (Note 9)	4,132,075	228,721
Write-off of deferred exploration costs (Note 16)	40,218	182,657
	<u>6,197,176</u>	<u>1,060,188</u>
OPERATING INCOME (LOSS)	(4,999,966)	(1,060,188)
Interest and other income and expenses	470,002	279
Interest and finance expenses	(23,147)	-
Foreign exchange gain (Note 5)	673,031	454,276
Gain on disposal of investment (Note 4)	25,875	-
	<u>1,145,761</u>	<u>454,555</u>
LOSS BEFORE INCOME TAXES	(3,854,205)	(605,633)
Income tax provision (Note 10)	494,082	-
NET LOSS FOR THE PERIOD	\$ (4,348,287)	\$ (605,633)
Loss per share (Basic and Diluted)	\$ (0.12)	\$ (0.08)
Weighted average number of shares outstanding	36,834,106	7,186,858

(See accompanying Notes)

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE FIFTEEN MONTH PERIOD ENDED DECEMBER 31, 2006 AND YEAR ENDED SEPTEMBER 30, 2005
(Expressed in Canadian Dollars)

	15 months ended December 31,	Year ended September 30,
	<u>2006</u>	<u>2005</u>
OPERATING ACTIVITIES		
Net loss for the period	\$ (4,348,287)	\$ (605,633)
Items not involving cash		
Depletion, depreciation and amortization	739,088	3,043
Accretion expense	179,529	
Future Income tax	494,082	-
Write-off of deferred exploration costs	40,218	182,657
Non-cash gain on disposal of investment	(25,875)	-
Stock based compensation charge	4,132,075	228,721
Foreign Exchange gain on long-term debt	(200,700)	(287,100)
Foreign Exchange gain other	(71,552)	-
Changes in non-cash working capital items		
Accounts receivable and prepaid expenses	(2,255,756)	(65,220)
Inventory	(826,164)	-
Accounts payable	1,367,369	801,742
	<u>(775,973)</u>	<u>258,210</u>
Net cash provided by (used in) operating activities		
FINANCING ACTIVITIES		
Proceeds on issuance of common shares	25,589,238	8,267,674
Share subscriptions (Note 15)	-	2,030,888
Capital lease obligations	(29,281)	-
Payments received from related parties (Note 6)	(13,869)	-
Payments to related parties (Note 6)	32,222	8,925
Repayment of debt (Note 5)	(5,070,150)	(3,643,545)
Proceeds from loans (Note 5)	5,685,160	-
	<u>26,193,320</u>	<u>6,663,942</u>
INVESTING ACTIVITIES		
Mineral property expenditures	(20,656,849)	(793,124)
Business acquisition expenditures	-	(641,018)
VAT on mineral properties expenditures	(3,301,501)	-
Purchase of long-term investment	(1,000,000)	-
Expenditures on plant & equipment	(4,667,990)	(34,074)
	<u>(29,626,340)</u>	<u>(1,468,216)</u>
INCREASE (DECREASE) IN CASH	(4,208,993)	5,453,936
Cash - beginning of period	5,850,257	396,321
CASH - END OF PERIOD	<u>\$ 1,641,264</u>	<u>\$ 5,850,257</u>
Supplementary disclosure of cash flow information:		
Cash paid for interest	\$ 83,640	\$ 83,025
Cash paid for income taxes	\$ -	\$ -
Non-cash Transactions - Note 12		

(See accompanying Notes)

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

1. Nature and Continuance of Operations

Fortuna Silver Mines Inc. (the "Company") is engaged in silver mining and related activities, including exploration, extraction, and processing. The Company operates the Caylloma zinc/lead/silver mine in southern Peru and is currently developing the San Jose silver/gold project in Mexico.

The Company's continuing operations and the recoverability of amounts shown for its exploration stage mineral properties are dependent upon the availability of the necessary financing to complete the exploration and development of such mineral property interests, and upon future profitable production or proceeds from the disposition of its mineral property interests. Future profitable production is primarily dependent on the quality of ore resources, ability to obtain permits, future metal prices, operating and environmental costs, fluctuations in currency exchange rates, political risks and varying levels of taxation.

These financial statements have been prepared on a going concern basis, which assumes the realization of assets and liquidation of liabilities in the normal course of business. As at December 31, 2006 the Company had working capital of approximately \$.11 million. Subsequent to the period end, the Company raised \$34.2 million via a closed brokered private placement, which is expected to be sufficient to fund its planned activities for 2007. The ability of the Company to continue as a going concern may be dependent upon its ability to raise equity financing and to achieve profitable operations. It may be necessary to raise further financing to fund future activities and there can be no assurances that the Company will be able to obtain addition financing or achieve positive cashflows.

2. Significant Accounting Policies

The Company changed its year end from September 30, to December 31, and therefore the current year end reflects a fifteen month period ended December 31, 2006 and the comparative figures reflect the 12 month period ended September 30, 2005.

a) Basis of presentation:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of the Company's wholly owned subsidiaries, Minera Bateas SAC (Bateas) and Fortuna Silver (Barbados) Inc. and of the Company's 76% interest in Compania Minera Cuzcatlan SA, a variable interest entity for which a non-controlling interest has been recorded to reflect the 24% interest of the Company's partner. All significant intercompany balances and transactions have been eliminated on consolidation.

Fortuna Silver Mines Inc.

(Formerly Fortuna Ventures Inc.)

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

2. Significant Accounting Policies (cont'd)

b) Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the determination of mineral reserves, the carrying amount of mineral property, plant and equipment, assay grades of metal concentrates sold, inventories and future income taxes, provisions for asset retirement obligation and reclamation, fair value estimation of acquisitions and stock based compensation. Actual results could differ from those estimates.

c) Revenue Recognition:

Revenue arising from the sale of metal concentrates is recognized when title and the significant risks and rewards of ownership of the concentrates have been transferred to the buyer. The passing of title to the customer is based on the terms of the sales contract and final commodity prices are set on a specified quotational period, either one or three months after delivery. The Company's metal concentrates are provisionally priced at the time of sale based on the prevailing market price.

d) Cash and equivalents

Cash and cash equivalents include highly liquid investments with original maturities of ninety days or less.

e) Short-term investments

Short-term investments will typically consist of a portfolio of money market instruments and highly liquid debt securities which the Company regards as available for sale within a one year horizon. These investments are recorded at cost, less any amount for impairment.

f) Mineral Properties, Plant and Equipment

Mineral Properties

The Company defers the cost of acquiring, maintaining its interest, exploring and developing mineral properties until such time as the properties are placed into production, abandoned, sold or considered to be impaired in value. Costs of producing properties, including capitalized interest are amortized on a unit of production basis over proven and probable reserves and costs of abandoned properties are written-off. Proceeds received on the sale of interests in mineral properties are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment in value are charged to operations.

For operating mines all replacement and expansion exploration within the mineral deposit is capitalized and amortized on a unit of production basis over proven and probable reserves as part of the production cost.

Fortuna Silver Mines Inc.

(Formerly Fortuna Ventures Inc.)

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

2. Significant Accounting Policies (cont'd)

f) Mineral Properties, Plant and Equipment (cont'd)

Plant and Equipment

Plant and equipment are recorded at cost. Plant and equipment is depreciated over the estimated economic life of the asset as follows:

Buildings, mine site	Life of mine
Buildings, other	20 – 30 years
Machinery and equipment	5 years
Furniture and other equipment	3 – 5 years
Transport units	3 – 5 years

Property under capital leases is initially recorded at the present value of minimum lease payments at the inception of the lease.

Impairment

Management reviews the carrying value of mineral properties, plant, and equipment when events or changes in circumstances indicate that their carrying values may not be recoverable. Impairment of an asset is considered to exist if total estimated future cash flows on an undiscounted basis expected to be generated by the asset are less than the carrying amount of the asset. If a shortfall exists, the asset is written down to the fair value. Amounts shown for properties represent costs incurred net of write-downs and recoveries, and are not intended to represent present or future values.

g) Asset Retirement Obligation

The fair value of an obligation associated with the retirement of a tangible long-lived asset is recorded in the period in which it is incurred and a reasonable estimate of the fair value can be made, with a corresponding increase to the carrying amount of the related asset. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset.

h) Inventories

Ore stockpile and finished goods inventories are valued at the lower of production cost and net realizable value. Production costs include all mine site costs. Materials and supplies are valued at weighted average cost less allowances for obsolescence.

Fortuna Silver Mines Inc.

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Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

2. Significant Accounting Policies (cont'd)

i) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of substantive enactment. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

j) Stock-based Compensation

The Company has a share option plan which is described in note 9. The Company records all stock-based compensation for options using the fair value method such that stock-based payments are measured at fair value and expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

k) Basic and Diluted Loss Per Share

Basic loss per share ("LPS") is calculated by dividing the net loss applicable to common shareholders by the weighted average number of common shares outstanding for the year. Potentially dilutive outstanding options and warrants are excluded from the calculation of LPS, as they would be anti-dilutive.

l) Foreign Currency Translation

The Company's subsidiaries are accounted for as integrated foreign operations. Monetary items denominated in a foreign currency are translated into Canadian dollars at exchange rates prevailing at the balance sheet date and non-monetary items are translated at exchange rates prevailing when the assets were acquired or obligations incurred. Foreign currency denominated revenue and expense items are translated at the exchange rates prevailing at the transaction date. Gains or losses arising from the translations are included in operations.

m) Financial Instruments

The carrying value of cash and cash equivalents, receivables, accounts payable and accrued liabilities approximate their fair value. The fair value of the Company's investments is disclosed in Note 4. The fair values of the Company's loans approximate their fair value due to the short period to maturity. See Note 5.

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

3. Cash and cash-equivalents

Cash and cash-equivalents include a term deposit of \$140,297 securing a Stand By Letter of Credit issued on behalf of one of the Company's subsidiaries and which expires on August 21, 2007. These funds are restricted until the expiry of the Stand By Letter of Credit.

4. Investments

Long-term Investments

The Company purchased by way of a private placement 5,000,000 shares of Continuum Resources Ltd. at a price of \$0.20 per share for a total purchase price of \$1,000,000. Continuum is required to use the proceeds to perform geological work on several silver projects that Continuum holds in the State of Oaxaca, Mexico, and for the acquisition of additional silver targets in that State. Continuum has granted to the Company an exclusive right to review all data prepared by or made available to Continuum in respect of those properties and an exclusive right to acquire an undivided 60% interest in Continuum's interest in any of those properties upon the Company conducting additional exploration activities on a property in an amount not less than the greater of (a) twice the amount expended by Continuum on that property and (b) \$500,000.

In November 2006 the Company and Continuum purchased a 100% interest in the San Jose property, where the Company holds a majority interest of 76%. As part of the purchase agreement the Company paid to the property owner 1,293,750 previously held shares of Continuum which were valued at \$0.22 per share. The remaining shares in possession of the Company are carried at cost with a total value of \$741,250. At December 31, 2006 the market value of these shares was \$1,260,125.

5. Loans

On June 27, 2006 the Company paid the last instalment of the US\$4,500,000 non-interest bearing promissory note it executed in June of 2005 in connection with the acquisition of the Caylloma mine. The cancellation of this liability generated a foreign exchange gain of \$200,700 for a recorded amount paid of \$5,070,150.

On November 21 2006 the Company borrowed \$4,600,000 from Quest Capital Corporation in connection with the acquisition of the San Jose property. The loan was due on May 30, 2007 but was paid back on January 15, 2007 and it bore interest of 12 %. As additional consideration for the facility 153,333 shares of the Company were issued to the lender as payment of a bonus in the amount of \$276,000.

On October 30, 2006 a revolving credit line of US\$ 950,000, with a CDN value of \$1,078,915 as of December 31, 2006, was taken for working capital purposes from Traxys North America. This credit was paid back on February 8, 2007 and it bore interest of Libor + 1.5% plus a variable utilization fee. Interest of \$6,245 was accrued during the period.

The Company has capital lease obligations of \$142,045 at December 31, 2006. These are related to the acquisition of mining equipment, have a 3 year term, and bear interest at a fixed rate of 8.5%. The current portion of the capital lease, \$44,945, is shown under "Loans".

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

6. Related Party Transactions

The Company incurred charges with directors, officers, and companies having a common director or officer as follows:

	15 months Ended December 31; <u>2006</u>	Year Ended September 30, <u>2005</u>
Mineral property costs – geological fees	\$174,332	\$115,468
Consulting fees	\$ 75,342	\$ 7,371
Salaries and wages	\$ 16,384	\$ 79,185
Management fees	\$146,146	\$ 2,629

These charges were measured at the exchange amount, which is the amount agreed upon by the transacting parties.

At December 31, 2006, accounts payable and accrued liabilities included \$395 (2005: \$181,036) to an officer of the Company.

At December 31, 2006, due to related parties consists of \$41,147 owing to an officer and to companies with a common director. These amounts were incurred as a result of shared administrative costs. These amounts are unsecured, non-interest bearing and payable in the normal course of business.

At December 31, 2006, due from related parties consists of \$13,869 owed from companies with a common director which were incurred as a result of shared administrative costs. This amount is unsecured, non-interest bearing and will be collected in the normal course of business.

7. Mineral Properties, Plant & Equipment

Plant and Equipment comprise of the following:

	15 month period ended December 31, 2006			Year ended September 30, 2005		
	Cost	Accumulated Depreciation	Net	Cost	Accumulated Depreciation	Net
Buildings	\$ 2,329,922	\$ 10,241	\$ 2,319,681	\$ 1,163,891	\$ -	\$ 1,163,891
Machinery & equipment	6,454,156	132,778	6,321,378	1,897,540	450	1,897,090
Transport units	131,029	5,852	125,177	6,800	-	6,800
Furniture and other equipment	301,013	14,449	286,565	95,687	2,594	93,093
Work in progress	107,746	-	107,746	-	-	-
	<u>\$ 9,323,866</u>	<u>\$ 163,320</u>	<u>\$ 9,160,546</u>	<u>\$ 3,163,918</u>	<u>\$ 3,043</u>	<u>\$ 3,160,874</u>

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

7. Mineral Properties, Plant & Equipment (cont'd)

Mineral Properties

Mineral Properties are located in Peru and Mexico and comprise of the following:

	15 month period ended December 31, 2006				Year ended September 30, 2005			
	Cost	Write-offs	Accumulated Amortization	Net	Cost	Write-offs	Accumulated Amortization	Net
Mexico - San Jose	\$18,580,057	-	\$ -	\$18,580,057	\$ -	-	\$ -	\$ -
Peru - Caylloma	23,166,440	-	571,628	22,594,812	15,040,182	-	-	15,040,182
Other	51,767	40,218	-	11,549	191,128	182,657	-	8,471
	<u>\$41,798,264</u>	<u>\$ 40,218</u>	<u>\$ 571,628</u>	<u>\$41,186,418</u>	<u>\$ 15,231,310</u>	<u>\$ 182,657</u>	<u>\$ -</u>	<u>\$ 15,048,653</u>

The carrying amount for San Jose includes \$336,493 of capitalized interest on loans (Note 5). Additions for development and capitalized exploration consist of \$8,126,258 for the 15 month period ended December 31, 2006 at Peru Caylloma and \$43,296 at other properties.

Caylloma Mine, Peru

On June 27, 2005 the Company completed the acquisition of the Caylloma Silver Mine located in southern Peru, by acquiring 100% of the outstanding common shares of Minera Bateas S.A.C. (Bateas). Bateas was incorporated in Peru on March 23, 2005 to facilitate the sale to the Company and its assets consisting of mining rights to properties located in southern Peru and other property and equipment located on the properties. The purchase price consisted of US\$7,550,000 and the issue of shares and share purchase warrants up to 10.803% of the fully diluted capital of the Company until such time as the Company subsequently completed equity financings of \$10 million. This resulted in 2,472,365 shares and 2,475,355 share purchase warrants being issued. The Company also paid a \$220,000 finder's fee in connection with the transaction. A 2% net smelter returns royalty payable to the vendors will accrue after 21 million ounces of silver have been recovered from the property. This acquisition was accounted for using the purchase method of accounting.

The allocation of fair value and liabilities of assets acquired and the consideration paid are summarized as follows:

Net assets acquired, at fair value

Property, plant and equipment	\$4,708,284
Mineral rights	12,772,059
Less: asset retirement obligations	(1,578,440)
Less: future tax liability	<u>(1,207,149)</u>
	<u>\$14,694,754</u>

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

7. Mineral Properties, Plant & Equipment (cont'd)

Caylloma Mine, Peru (cont'd)

Consideration

Cash and acquisition costs	\$641,018
Shares issued on acquisition date – 574,744 at \$0.345 per share	198,287
Fair value of share purchase warrants issued on acquisition date	69,000
Convertible note payable of US\$2,950,000	3,643,545
Note payable of US\$4,500,000	5,557,950
Shares issued on completion of equity financing on November 17, 2005 1,897,621 at \$1.43 per share	2,713,598
Fair value of share purchase warrants issued on completion of equity financing on November 17, 2005	<u>1,871,356</u>
	<u>\$14,694,754</u>

The fair value of the share purchase warrants was determined using the Black-Scholes option pricing model using the following assumptions:

	Issued June 27, <u>2005</u>	Issued November 17, <u>2005</u>
Expected dividend yield	0.0%	0.0%
Expected volatility	34.2%	93.8%
Risk-free interest rate	3.75%	3.6%
Expected term in years	2 years	2 years

San Jose Project, Mexico

In November 2005, the Company entered into an agreement (the “Option Agreement”) with Continuum Resources Ltd. (“Continuum”) whereby the Company was granted the option to acquire a 70% interest in Continuum’s rights to earn an 80% interest in the San Jose Project, Mexico.

In September 2006, the Company and Continuum agreed to form a jointly owned Mexico company to be held 76% by the Company and 24% by Continuum, which company would purchase a 100% interest in the San Jose Project from the underlying property owner. The Option Agreement was superseded by this agreement.

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

7. Mineral Properties, Plant & Equipment (cont'd)

San Jose Project, Mexico (cont'd)

In November 2006, this company, Compañía Minera Cuzcatlan ("Cuzcatlan"), paid the purchase price consisting of US\$9,000,000 cash (in addition to this the transaction commanded payment of US\$1,350,000 on account of the 15% goods and services tax applicable under Mexican law). Additionally the Company issued to the property owner 168,417 shares of the Company and 1,293,750 shares of Continuum already owned by the Company. In order to provide part of the cash payment due to the property owner, the Company borrowed \$4.6 million pursuant to a credit facility granted by Quest Capital Corp. of Vancouver, BC. The loan was secured by the Peru assets of the Company. In consideration for the loan, the Company issued 153,333 shares to Quest Capital Corp. (Note 5.)

Of the US\$9,000,000 cash purchase price paid by Cuzcatlan, US\$8,760,000 was contributed by the Company and on completion of the acquisition of the San Jose Project, the Company and Continuum entered into a shareholders agreement which governs the operations of Cuzcatlan. The Company is the operator of the work programs and the Company and Continuum, must contribute to the costs thereof in proportion to its ownership percentage in Cuzcatlan.

Cuzcatlan has been accounted for as a variable interest entity, as defined in CICA Accounting Guideline 15 *Consolidation of Variable Interest Entities* and has been consolidated from the date of acquisition. A non-controlling interest of \$3,226,631 has been recorded as at December 31, 2006.

8. Inventories

Inventories comprise of the following:

	15 months ended Dec. 31, 2006	Year ended Sept. 30, 2005
Ore stock piles	\$ 77,664	\$ -
Concentrate stock piles	165,551	-
Materials and supplies	582,949	-
Total	\$ 826,164	\$ -

Fortuna Silver Mines Inc.
(Formerly Fortuna Ventures Inc.)
Notes to the Consolidated Financial Statements
For The 15 Month Period Ended December 31, 2006

9. Share Capital

Authorized	Number of shares	Amount
Unlimited common shares without par value		
Balance, September 30, 2004	6,452,691	\$ 3,697,482
Cancellation of shares for debt	(4,000)	(1,000)
Cancellation of escrow shares	(87,470)	(6,123)
Private placement for cash	11,100,000	8,250,000
Property acquisition	574,744	198,287
Exercise of options	47,500	17,575
Exercise of warrants	2,000,000	600,000
Transfer of contributed surplus on exercise of options		7,530
	<u>13,630,774</u>	<u>9,066,269</u>
Less issue costs		(599,900)
Balance, September 30, 2005	<u>20,083,465</u>	<u>\$ 12,163,851</u>
Exercise of options	650,000	423,775
Exercise of warrants	6,124,631	5,600,546
Private placement for cash	16,700,000	22,050,000
Private placement commission non-cash transaction (Note 12)	760,261	1,140,392
Property acquisition non-cash transaction (Note 12)	1,897,621	2,713,598
Property finders fee non-cash transaction (Note 12)	50,000	68,000
Property acquisition non-cash transaction (Note 12)	168,417	284,625
Loan fee (Note 12)	153,333	275,999
Transfer of contributed surplus on exercise of options		215,256
Less issue costs (Non-cash amount \$1,140,443)		(1,594,638)
Balance, December 31, 2006	<u><u>46,587,728</u></u>	<u><u>\$ 43,341,404</u></u>

The private placement for cash of \$22,050,000 includes \$2,030,888 received in September 2005. (Note 15)

Stock Options

The Company has established a formal stock option plan in accordance with the policies of the TSX Venture Exchange under which it is authorized to grant options up to 10% of its outstanding shares to officers, directors, employees and consultants. The exercise price of each option equals the market price of the Company's stock as calculated on the date of grant. Upon the Company becoming a Tier 1 issuer on the TSX Venture Exchange on January 13, 2006, the options are for a maximum term of ten years.

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

9. Share Capital (cont'd)

Stock Options (cont'd)

A summary of stock options granted and exercised under the Company's stock option plan is as follows:

	15 months ended December 31, 2006		Year ended September 30, 2005	
	Number of Options	Weighted Average Exercised Price	Number of Options	Weighted Average Exercised Price
Outstanding, beginning year	860,000	\$ 0.56	-	\$ -
Granted	3,555,000	1.70	907,500	0.55
Exercised	(650,000)	0.65	(47,500)	0.37
Outstanding, end of period	<u>3,765,000</u>	<u>\$ 1.62</u>	<u>860,000</u>	<u>\$ 0.56</u>

The following stock options were outstanding and exercisable at December 31, 2006:

Number of shares	Exercise Price \$	Expiry Date
125,000	2.29	March 30, 2007 *
162,500	0.37	December 2, 2009
72,500	0.72	July 13, 2010
40,000	0.80	July 24, 2010
75,000	1.35	November 17, 2010
655,000	1.35	February 5, 2016
500,000	2.29	March 30, 2016
130,000	1.75	May 8, 2016
200,000	1.75	May 22, 2016
485,000	1.55	July 5, 2016
995,000	1.66	July 10, 2016
225,000	1.61	Sept. 13, 2016
50,000	1.90	Nov. 20, 2016
50,000	1.96	Nov. 23, 2016
<u>3,765,000</u>		

* 50,000 of these options were exercised subsequent to December 31, 2006 and the balance expired unexercised.

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For The 15 Month Period Ended December 31, 2006

9. Share Capital (cont'd)

Warrants

A summary of share purchase warrants issued and exercised is as follows:

	15 months ended		Year ended	
	December 31, 2006		September 30, 2005	
	Number of Warrants	Weighted Average	Number of Warrants	Weighted Average
Outstanding, beginning year	13,114,117	\$ 0.91	2,000,000	\$ 0.30
Issued	13,576,699	1.40	13,114,117	0.91
Exercised	(6,124,631)	0.91	(2,000,000)	0.30
Outstanding, end of period	<u>20,566,185</u>	<u>\$ 1.23</u>	<u>13,114,117</u>	<u>\$ 0.91</u>

The following share purchase warrants were outstanding at December 31, 2006:

Number of warrants	Exercise Price \$	Expiry Date
26,875	1.50	February 20, 2007 *
940,912	1.85	September 23, 2007
8,670,000	1.25	September 26,2007
270,085	0.80	September 26,2007
1,366,833	1.25	October 6, 2007 **
114,056	0.80	October 6, 2007
6,702,069	1.85	March 23, 2008
862,117	0.345	June 27, 2010
<u>1,613,238</u>	0.345	Nov 17, 2010
<u>20,566,185</u>		

* These warrants were exercised in full subsequent to December 31, 2006.

** Pursuant to the terms of these warrants, the exercise price increased from \$1.00 per share to \$1.25 per share effective October 7, 2006.

Escrow Securities

87,470 shares held in escrow pursuant to an escrow agreement dated July 1, 1991 were cancelled by the regulatory authorities on March 9, 2005. The issued share capital reflects the cancellation of these shares.

As at June 1, 2005, there were placed in escrow 495,422 common shares and warrants and options to purchase up to 694,800 common shares. As at September 30, 2005, 733,880 shares and 337,320 warrants and options remained in escrow. As at December 31, 2006, all of the securities had been released, and the Company had no securities held in escrow.

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Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

9. Capital Stock (cont'd)

Stock-Based Compensation

The Company uses the fair value based method of accounting for share options granted to consultants, directors, officers and employees. The non-cash compensation charge of \$4,132,075 recognized for the fifteen months ended December 31, 2006 is associated with the granting of options to a consultant, directors and employees. These compensation charges have been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

	15 months ended December 31, 2006	Year ended September 30, 2005
Risk-free interest rate	2.93% - 4.59%	2.93% - 3.75%
Expected stock price volatility	43.0% - 92.0%	43.0% - 88.0%
Expected term in years	5 & 10	1 - 5
Expected dividend yield	0%	0%

10. Income Taxes

Income tax expense differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rate of 34.12% (2005 – 34.12%) to loss before income taxes. The reasons for the differences are as follows:

	15 months ended Dec. 31, 2006	Year ended Sep. 30, 2005
Expected Tax recovery	\$ (1,315,055)	\$ (141,299)
Non-deductible items	1,429,801	(31,552)
Differences in tax rates in foreign jurisdictions and non-recognition benefits	379,336	172,851
	\$ 494,082	\$ -

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2006 and September 30, 2005 are presented below:

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Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

10. Income Taxes (cont'd)

	15 months ended Dec. 31, 2006	Year ended Sep. 30, 2005
Future tax assets (all arising in Canada):		
Non-capital losses	\$ 725,296	163,749
Financing costs	473,036	-
Mineral properties	512,027	563,560
Less valuation allowance	(1,710,359)	(727,309)
	-	-
Future tax liabilities:		
Mineral properties - Peru	(2,624,247)	(1,207,149)
Mineral properties - Mexico	(2,286,130)	-
	(4,910,377)	(1,207,149)
Net future income tax liability	\$ (4,910,377)	\$ (1,207,149)

At December 31, 2006, the Company has net operating loss carryforwards for Federal income tax purposes of \$2,339,665 which are available to offset future Federal taxable income, if any, through 2026.

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Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

11. Segmented Information

Details of identifiable assets by geographic segments are as follows:

	<u>December 31, 2006</u>	<u>September 30, 2005</u>
Canada		
Current assets	\$ 1,852,778	\$ 5,846,705
Investments	741,250	-
Plant and equipment	9,326	18,624
	<u>\$ 2,603,354</u>	<u>\$ 5,865,329</u>
Peru		
Current assets	\$ 5,020,408	\$ 82,452
Plant and equipment	9,146,296	-
Mineral properties	22,594,813	18,179,522
	<u>\$ 36,761,517</u>	<u>\$ 18,261,974</u>
Guatemala		
Current assets	\$ -	\$ 2,455
Plant and equipment	2,910	2,910
	<u>\$ 2,910</u>	<u>\$ 5,365</u>
Mexico		
Current assets	\$ 1,246,722	\$ -
Mineral properties	18,580,057	8,471
Plant and equipment	2,014	-
	<u>\$ 19,828,793</u>	<u>\$ 8,471</u>
Latin America - General		
Mineral properties	\$ 11,549	\$ -
	<u>\$ 59,208,123</u>	<u>\$ 24,141,139</u>

All revenues are generated in Peru

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

12. Supplementary Disclosure of Non-cash Transactions

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows.

The following non-cash transactions occurred:

	For the year ended September 30, 2005	
	<u>Number of shares</u>	<u>Amount</u>
Escrow shares were cancelled by regulatory authorities with the amount representing the original price paid for these shares transferred to contributed surplus	87,470	\$ 6,123
Shares issued for debt were cancelled and relating debt transferred back to payables	4,000	\$ 1,000
Shares issued for the acquisition of Minera Bateas	574,744	\$ 198,287

	15 months ended December 31, 2006	
	<u>Number of shares</u>	<u>Amount</u>
Shares issued for property acquisition, previously booked as an obligation	1,897,621	\$ 2,713,598
Warrants issued for property acquisition, previously booked as an obligation	1,613,238	\$ 1,871,356
Shares issued for property finders fee	50,000	\$ 68,000
Shares issued for commission on private placement	760,261	\$ 1,140,392
Shares issued for property acquisition	168,417	\$ 284,625
Continuum investment shares issued for property acquisition	1,293,750	\$ 284,625
Shares issued for consideration on Quest loan	153,333	\$ 275,999

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

13. Accounts Receivable and Prepaids

	<u>Dec. 31, 2006</u>	<u>Sept. 30, 2005</u>
GST and value added taxes	\$ 3,737,849	\$ 39,730
Accounts receivable	1,561,785	-
Advances and other receivables	279,376	215
Prepaid expenses and deposits	59,601	41,410
	<u>\$ 5,638,611</u>	<u>\$ 81,355</u>

During the fourth quarter of 2006 the Company advanced several payments on behalf of Continuum Resources Ltd. in connection to the acquisition of San Jose for a total of USD \$612,000. This amount was reimbursed on March 2, 2007 and is shown as a net of \$279,376 after offsetting payables from Cuzcatlan to Continuum reflected in the Company's consolidated Balance Sheet.

14. Asset Retirement Obligation

The Company has recorded an Asset Retirement Obligation of \$1,757,970 as of December 31, 2006. This is the result of having accreted the previously reported Asset Retirement Obligation of \$1,578,441 as of September 30, 2005 by \$179,529. The accretion expense was calculated over the fifteen month period using a rate of 9%. The initial amount was based on an estimate prepared by an independent third party at the time of acquisition as to the cost of reclamation associated with the Caylloma property. The Company is currently reviewing its reclamation obligations at the property in light of changing regulations and on the basis of further data in respect of the mine life.

In view of the uncertainties concerning environmental reclamation, the ultimate cost of reclamation activities could differ materially from the estimated amount recorded. The estimate of the Company's asset retirement obligation relating to the Caylloma mine is subject to change based on amendments to laws and regulations and as new information regarding the Company's operations becomes available.

Future changes, if any, to the estimated liability as a result of amended requirements, laws, regulations and operating assumptions may be significant and would be recognized prospectively as a change in accounting estimate. Any such change would result in an increase or decrease to the liability and a corresponding increase or decrease to the mineral property, plant and equipment balance.

15. Share Subscriptions

The Company recorded share subscriptions of \$2,030,888 as at September 30, 2005 for the funds received on the private placement completed on October 7, 2005 for 4,000,000 units at \$0.75 per unit for a total of \$3,000,000. The Company paid finder's fees consisting of \$153,587 cash and 231,056 share purchase warrants in connection with this transaction in October 2005. The share purchase warrants are exercisable into one common share of the Company for a price of \$0.80 until October 6, 2007.

Fortuna Silver Mines Inc.

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Notes to the Consolidated Financial Statements

For The 15 Month Period Ended December 31, 2006

16. Write-off of Deferred Exploration Costs

In 2004, the Company was granted an option to earn a 60% interest in the El Tambor Project, Guatemala in consideration of the Company incurring exploration expenditures totalling US\$4 million over four years. In 2005, this agreement was terminated by the Company as management decided to focus its exploration and development activities in Peru, and as at December 31, 2006, \$39,511 (2005 - \$108,707) was written off. Other write offs as at December 31, 2006 related to \$707 of project investigation costs (2005 \$73,950).

17. Subsequent Events

On January 11, 2007 the Company closed a brokered private placement by which it issued 18.0 million units at a price of \$1.90 per unit, to raise gross proceeds of \$34.2 million. Each unit consisted of one common share plus one-half common share purchase warrant. Each whole warrant entitles the owner to purchase one additional share of the Company for 18 months at a price of \$2.30.

Subsequent to December 31, 2006 the Company received \$782,405 from 610,000 options exercised and \$3.7 million from 2,128,450 warrants exercised.

18. Comparative Figures

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