

# **Northern Graphite Corporation**

(an Exploration Stage Company)

## **Financial Statements**

**For the Years Ended December 31, 2012, and 2011**

To the Shareholders of Northern Graphite Corporation:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors and the Audit Committee are composed primarily of Directors who are neither management nor employees of the Company. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Board fulfills these responsibilities by reviewing the financial information prepared by management and discussing relevant matters with management and external auditors. The Audit Committee has the responsibility of meeting with management, and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Board is also responsible for recommending the appointment of Northern Graphite Corporation's external auditors.

MNP LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, the Board of Directors, Audit Committee and management to discuss their audit findings.

April 9, 2013

" Gregory Bowes "  
Gregory Bowes, CEO

" Stephen Thompson "  
Stephen Thompson, CFO



## INDEPENDENT AUDITORS' REPORT

To the Shareholders of **Northern Graphite Corp.**:

We have audited the accompanying financial statements of **Northern Graphite Corp.**, which comprise the statement of financial position as at December 31, 2012 and 2011 and the statements of comprehensive loss, changes in equity, and cash flows for the years then ended and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Financial Statements*

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

### *Auditors' Responsibility*

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

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

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

### *Opinion*

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

### *Emphasis of Matter*

Without qualifying our opinion, we draw attention to Note 1 of these financial statements, which states that Northern Graphite Corp. incurred significant losses from operations, negative cash flows from operating activities and has an accumulated deficit. This, along with other matters described in Note 1, indicates the existence of a material uncertainty which may cast doubt about the ability of Northern Graphite Corp. to continue as a going concern.

MNP LLP

April 9, 2013  
Vancouver, British Columbia

Chartered Accountants



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# Northern Graphite Corporation

(an exploration stage company)

## Statements of Financial Position

(audited)

	As at December 31 2012 \$	As at December 31 2011 \$
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	8,281,725	1,624,696
HST receivable	150,803	117,745
Prepaid expenses and deposits	46,785	39,825
	8,479,313	1,782,266
Deposits	26,500	407,482
Reclamation deposit (note 14)	319,590	317,042
Property and equipment (note 4)	516,583	574,165
Exploration and evaluation assets (notes 5 and 6)	7,143,817	3,353,146
	16,485,803	6,434,101
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	481,129	443,642
Due to Mindesta Inc. (note 12)	-	16,127
	481,129	459,769
Reclamation and close down provision (note 14)	319,590	317,042
	800,719	776,811
<b>Shareholders' equity</b>		
Share capital (note 7)	20,238,328	7,859,427
Warrants (note 7)	53,976	134,647
Contributed surplus (note 7)	2,605,984	1,241,085
Retained earnings (deficit)	(7,213,204)	(3,577,869)
Total shareholders' equity	15,685,084	5,657,290
Total liabilities and shareholders' equity	16,485,803	6,434,101

*The accompanying notes are an integral part of these financial statements*

**Approved by the Board of Directors and authorized for issue on April 9, 2013**

(signed) Gregory Bowes  
Director

(signed) Donald Christie  
Director

**Northern Graphite Corporation**  
(an exploration stage company)  
**Statements of Comprehensive Loss**

	<b>Years ended December 31</b>	
	<b>2012</b>	<b>2011</b>
	\$	\$
<b>General and administrative expenses</b>		
Management and consulting fees (note 12)	1,133,804	576,923
Legal and audit	133,994	137,448
Office and miscellaneous (note 6)	942,316	443,585
Share-based payments (note 7)	1,438,646	1,241,085
Depreciation	71,782	62,117
Foreign exchange (gain)	(1,256)	(6,272)
	<u>3,719,286</u>	<u>2,454,886</u>
<b>Loss from operations</b>	(3,719,286)	(2,454,886)
Finance cost	-	(19,904)
Interest income	83,951	11,767
Loss on sale of assets	-	25,858
Gain (loss) on debt settlement	-	(22,587)
	<u>83,951</u>	<u>(4,866)</u>
<b>Loss and comprehensive loss for the year</b>	(3,635,335)	(2,459,752)
Loss per share	(0.08)	(0.08)
Weighted average number of shares – basic and fully diluted	45,200,127	30,001,851

*The accompanying notes are an integral part of these financial statements*

# Northern Graphite Corporation

(an exploration stage company)

## Statements of Changes in Shareholders' Equity

	Number of Shares	Share capital Amount \$	Warrants reserve \$	Contributed Surplus Reserve \$	Deficit \$	Total \$
Balance at December 31, 2011	37,415,167	7,859,427	134,647	1,241,085	(3,577,869)	5,657,290
Share capital issued through private placement	6,206,377	10,550,841	-	-	-	10,550,841
Issued pursuant to the exercise of warrants	5,234,737	1,727,601	-	-	-	1,727,601
Issued pursuant to the exercise of options	225,000	112,500	-	-	-	112,500
Fair value of options exercised		73,747		(73,747)		-
Warrants issued in private placement	-	(53,976)	53,976	-	-	-
Fair value of warrants exercised	-	133,957	(133,957)	-	-	-
Fair value of expired warrants	-	690	(690)	-	-	-
Share issuance costs	-	(166,459)	-	-	-	(166,459)
Share-based payment expense	-	-	-	1,438,646	-	1,438,646
Net loss	-	-	-	-	(3,635,335)	(3,635,335)
<b>Balance, December 31, 2012</b>	<b>49,081,281</b>	<b>20,238,328</b>	<b>53,976</b>	<b>2,605,984</b>	<b>(7,213,205)</b>	<b>15,685,084</b>
Balance at December 31, 2010	22,936,925	2,519,869	-	-	(1,118,117)	1,401,752
Share capital issued through initial public offering	8,000,000	4,000,000	-	-	-	4,000,000
Warrants issued through initial public offering	-	(149,152)	149,152	-	-	-
Share-based compensation issued	-	-	-	1,144,752	-	1,144,752
Share issuance costs of initial public offering	-	(621,347)	-	-	-	(621,347)
Shares issued pursuant to exercise of warrants	6,478,242	2,110,057	(14,505)	-	-	2,095,552
Share-based payment expense	-	-	-	96,333	-	96,333
Net loss	-	-	-	-	(2,459,752)	(2,459,752)
<b>Balance at December 31, 2011</b>	<b>37,415,167</b>	<b>7,859,427</b>	<b>134,647</b>	<b>1,241,085</b>	<b>(3,577,869)</b>	<b>5,657,290</b>

*The accompanying notes are an integral part of these financial statements*

# Northern Graphite Corporation

(an exploration stage company)

## Statements of Cash Flows

	Years ended December 31	
	2012	2011
	\$	\$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Loss for the year	(3,635,335)	(2,459,752)
Items not affecting cash		
Depreciation	71,782	62,117
Share-based payments	1,438,646	1,241,085
Loss on sale of assets	-	22,587
Gain on debt settlement	-	(25,858)
Changes in non-cash operating working capital:		
HST receivable	(33,058)	47,069
Prepaid expenses and deposits	(6,960)	117,462
Accounts payable and accrued liabilities	(25,315)	(232,195)
<b>Net cash used in operating activities</b>	<b>(2,190,240)</b>	<b>(1,227,485)</b>
<b>Financing activities</b>		
Due to Mindesta Inc.	(16,127)	130,015
Decrease in loans payable	-	(152,340)
Issuance of common shares in initial public offering	-	4,000,000
Issuance of share capital in private placement	10,550,841	-
Proceeds from the exercise of options	112,500	-
Proceeds from the exercise of warrants	1,727,601	2,095,553
Share issuance costs	(166,459)	(489,015)
<b>Net cash generated from financing activities</b>	<b>12,208,356</b>	<b>5,584,213</b>
<b>Investing activities</b>		
Proceeds from the sale of fixed assets	-	20,000
Purchase of fixed assets	(14,200)	(149,954)
Decrease (increase) in deposits	380,982	(407,482)
Exploration and evaluation costs	(3,727,869)	(2,240,539)
<b>Net cash used in investing activities</b>	<b>(3,361,087)</b>	<b>(2,777,975)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>6,657,029</b>	<b>1,578,753</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>1,624,696</b>	<b>45,943</b>
<b>Cash and cash equivalents, end of year</b>	<b>8,281,725</b>	<b>1,624,696</b>

*The accompanying notes are an integral part of these financial statements*

**Northern Graphite Corporation**  
(an Exploration Stage Company)  
**Notes to Financial Statements**  
**For the years ended December 31, 2012 and 2011**

**1. Corporate Information**

Northern Graphite Corporation ("Northern" or "the Company") was incorporated under the laws of the Province of Ontario on February 25, 2002, under the name Industrial Minerals Canada Inc. The Company's name was changed to Northern on March 1, 2010. Northern was incorporated by its parent company, Mindesta Inc. ("Mindesta" formerly Industrial Minerals, Inc.), to develop and hold title to a 100% interest in the Bissett Creek Graphite Property (the "Bissett Creek Property"). Mindesta is a Delaware corporation which trades on the OTC Bulletin Board ("MDST") in the United States. The Company was a wholly owned subsidiary of Mindesta until early in 2010. Mindesta's interest in Northern was reduced to 26.1% as at December 31, 2011 as the result of a number of financing transactions. At the close of trading on January 25, 2012, Mindesta completed the distribution to Mindesta's shareholders of 9,413,581 shares of Northern owned by Mindesta on the basis of one share of Northern for each share of Mindesta held. As at December 31, 2012, Mindesta's interest in Northern had decreased to less than 1%. Subsequent to the end of the year, Mindesta no longer holds any shares of Northern. Northern is listed on the TSX Venture Exchange and trades under the symbol "NGC".

The Company's address and head office is 290 Picton Avenue, Suite 201, Ottawa, Ontario K1Z 8P8 Canada.

**2. Basis of Preparation**

**a. Statement of compliance**

These financial statements and the notes thereto (the "Financial Statements") present Northern's financial results of operations and financial position under IFRS as at and for the years ended December 31, 2012 and 2011.

In the opinion of management, all adjustments necessary to present fairly the financial position of the Company as at December 31, 2012 and the results of its operations and cash flows for the year then ended have been made.

The policies set out in note 3 were consistently applied to all the periods presented.

The Financial Statements were approved and authorized for issue by the Board of Directors on April 9, 2013.

**b. Basis of measurement**

The Financial Statements have been prepared on a historical cost basis except those accounts as noted in the financial instruments section (note 11). In addition, the Financial Statements have been prepared using the accrual basis of accounting.

**c. Going Concern**

The Company is an exploration stage company that incurred a net loss of \$3,635,335 for the year ended December 31, 2012 (2011 - \$2,459,752) and has an accumulated deficit of \$7,213,204 since the inception of the Company. As at December 31, 2012, the Company had working capital of \$7,998,183 (December 31, 2011 - \$1,322,497). The Company's ability to continue as a going concern is dependent upon its ability to raise additional capital to continue the development of the Bissett Creek Property. On March 16, 2012, the Company raised financing with gross proceeds of \$10,550,841 as described in note 7. While the Company has been successful in raising capital to advance the Bissett Creek Property, substantial additional capital is required to ultimately build a mine and processing plant on the Bissett Creek Property and to enable the Company to continue its operations. However, there is a high degree of risk and many inherent uncertainties in the mining industry and there is no assurance management will be successful in its endeavors.

The Financial Statements have been prepared on a going concern basis, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

The Company's management believes that it will continue to be able to generate sufficient funds from public or private debt or equity financings for the Company to continue to operate. The Financial Statements do not include any adjustments that might result from negative outcomes with respect to these uncertainties.

**d. Functional and presentation currency**

The Company's functional and presentation currency is the Canadian dollar.

**Northern Graphite Corporation**  
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**Notes to Financial Statements**  
**For the years ended December 31, 2012 and 2011**

*e. Critical accounting estimates and judgments*

The preparation of the Financial Statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of the Financial Statements, and revenues and expenses for the period. By their nature, these estimates and judgments are subject to uncertainty and the effect on the Financial Statements of changes in such estimates in future periods could be significant. Actual results may differ from those estimates and judgments.

*Significant estimates used in the preparation of the Financial Statements include, but are not limited to:*

- (i) asset carrying values and impairment charges;
- (ii) the economic recoverability of exploration expenditures incurred and the probability of future economic benefits from development expenditures incurred;
- (iii) the expected costs of asset retirement obligations; and
- (iv) the calculation of share-based compensation and warrants which includes the assumptions used in the Black-Scholes option pricing model including volatility, estimated forfeiture rates and expected time until exercise.

*Significant judgements used in the preparation of these Financial Statements include, but are not limited to:*

- (i) those relating to the assessment of the Company's ability to continue as a going concern;
- (ii) the useful lives and related depreciation of property and equipment;
- (iii) the identification of separately identifiable components in property and equipment where their respective cost is significant in comparison to the total cost;
- (iv) the classification of expenditures as exploration and evaluation assets; and
- (v) the recognition of deferred tax.

*The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the amounts recognized in the financial statements are as follows:*

- (i) Exploration and evaluation assets

The Company is required to review the carrying value of its exploration and evaluation properties for potential impairment. Impairment is indicated if the carrying value of the Company's exploration and evaluation is not recoverable. If impairment is indicated, the amount by which the carrying value of exploration and evaluation assets exceeds their estimated fair value is changed to the statement of loss.

Evaluating for recoverability during the exploration and evaluation phase requires judgment in determining whether future economic benefits from future exploitation, sale or otherwise are likely. Evaluations may be more complex where activities have not reached a stage which permits a reasonable assessment of the existence of reserves or resources. Management must make certain estimates and assumptions about future events or circumstances including, but not limited to, the interpretation of geological, geophysical and seismic data, the Company's financial ability to continue exploration and evaluation activities, contractual issues with joint venture partners, the impact of government legislation and political stability in the region, and the impact of current and expected future metal prices to potential reserves.

- (ii) Share-based payments

The Company has an equity-settled share-based scheme for directors, officers, employees and consultants. Services received, and the corresponding increase in equity, are measured by reference to the fair value of the equity instruments at the date of the grant, excluding the impact of any non-market vesting conditions. The fair value of share options are estimated by using the Black-Scholes model on the date of the grant based on certain assumptions. Those assumptions are described in Note 7 and include, among others, expected volatility, expected life of the options and number of options expected to vest.

- (iii) Useful lives of equipment, buildings and improvements depreciation

The Company estimates the useful lives of equipment, buildings, and improvements based on the period over which the assets are expected to be available for use. The depreciation method and useful lives reflect the pattern in which management expects the asset's future economic benefits to be consumed by the Company. The amounts and timing of recorded expenses for any period would be affected by changes in assumptions and estimates used.

- (iv) Taxes

Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable income realized, including the usage of tax planning strategies.

# Northern Graphite Corporation

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## Notes to Financial Statements

For the years ended December 31, 2012 and 2011

(v) Restoration and site closure provision

The Company recognizes the liability for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of mineral properties, when those obligations result from the exploration or development of its properties. The Company assesses its provision for site restoration and site closure at each reporting date. The fair value of an asset retirement obligation is recorded in the period in which it is incurred. When the liability is initially recorded, the cost is capitalized by increasing the carrying amount of the related long-lived asset. Over time, the liability is adjusted to reflect the passage of time (accretion expense) and for changes in estimated future cash flows. The provision at the reporting date represents management's best estimate of the present value of the future restoration and site closure costs required.

### 3. Significant accounting policies

#### Cash and cash equivalents

Cash and cash equivalents include bank balances, funds held in trust with lawyers, and short term investments that are readily convertible into cash with original maturities of three months or less.

#### Property and equipment

Upon initial acquisition, land, buildings, plant and equipment are valued at cost, being the purchase price and the directly attributable costs of acquisition or construction required to bring the asset to the location and condition necessary for the asset to be capable of operating in the manner intended by management.

In subsequent periods, buildings, plant and equipment are stated at cost less accumulated depreciation and any impairment in value, whilst land is stated at cost less any impairment in value and is not depreciated.

Each component or part of property and equipment with a cost that is significant in relation to total cost of the item will be depreciated separately unless there is no difference in depreciation on the respective components.

#### Impairment of long-lived assets

At each balance sheet date, the Company assesses whether there is any indication that any long-lived assets or finite life tangible assets are impaired. The Company monitors the recoverability of long-lived assets based on factors such as current market value, future asset utilization, business climate and future undiscounted cash flows expected to result from the use of the assets. An impairment is recognized if the recoverable amount, determined as the higher of an asset's fair value less cost to sell and the discounted future cash flows generated from use and eventual disposal of an asset, is less than its carrying value. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

Mining properties and exploration and evaluation assets are also assessed for impairment upon the transfer of exploration and evaluation assets to development assets regardless of whether facts and circumstances indicate that the carrying amount of the exploration and evaluation assets is in excess of their recoverable amount.

#### Mining properties and exploration and evaluation expenditures

Mining properties correspond to acquired interests in mining exploration leases/permits/claims which include the rights to explore, mine, extract and sell all minerals. All pre-exploration costs, i.e. costs incurred prior to obtaining the legal right to undertake exploration and evaluation activities on an area of interest, are expensed as incurred.

Once the legal right to explore has been acquired, exploration and evaluation expenditures are capitalized in respect of each identifiable area of interest until the technical feasibility and commercial viability of extracting a mineral resource have been demonstrated.

General and administration expenditures relating to exploration are capitalized where they can be directly attributed to the site undergoing exploration and evaluation.

Exploration and evaluation assets are carried at historical cost, less any impairment losses recognized.

When the technical feasibility and commercial viability of extracting a mineral resource are demonstrated for an area of interest, the Company stops capitalizing exploration and evaluation costs for that area, tests recognized exploration and evaluation assets for impairment and reclassifies any unimpaired exploration and evaluation assets either as tangible or intangible mine development assets according to the nature of the assets.

**Northern Graphite Corporation**  
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**Notes to Financial Statements**  
**For the years ended December 31, 2012 and 2011**

**Depreciation and depletion**

Depreciation and depletion is provided so as to write off the cost less estimated residual values of mining properties, buildings, plant and equipment on the following bases:

Buildings, plant and equipment unrelated to production are depreciated using the straight-line method based on estimated useful lives. Where significant parts of an asset have differing useful lives, depreciation is calculated on each separate part. The estimated useful life of each item or part has due regard to both its own physical life limitations and the present assessment of economically recoverable reserves of the mine property on which the item is located, and to possible future variations in those assessments. Estimates of remaining useful lives and residual values are reviewed annually. Changes in estimates which affect depreciation are accounted for prospectively.

The expected useful lives are as follows:

Electrical building	7 years
Office furniture	7 years
Office building	10 years
Equipment	3 – 20 years
Process buildings	20 years
Laboratory equipment	3 years

**Income taxes**

Income tax expense comprises current and deferred income tax. Income tax is recognized in the statement of comprehensive income (loss) except to the extent it relates to items recognized in other comprehensive income or directly in equity.

**Current income tax**

Current income tax expense is based on the results for the period as adjusted for items that are not taxable or not deductible. Current income tax is calculated using tax rates and laws that were enacted or substantively enacted at the end of the reporting period. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. Provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

**Deferred income tax**

Deferred income taxes are the taxes expected to be payable or recoverable between the carrying amounts of assets in the consolidated statement of financial position and their corresponding tax bases used in the computation of taxable profit, and are accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences between the carrying amounts of assets and their corresponding tax bases. Deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets in a transaction that affects neither the taxable profit nor the accounting profit.

**Deferred income tax liabilities**

Deferred income tax liabilities are generally recognized for all taxable temporary differences, are recognized for taxable temporary differences arising on investments in subsidiaries except where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future, and are not recognized on temporary differences that arise from goodwill which is not deductible for tax purposes.

**Deferred income tax assets**

Deferred income tax assets are recognized to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilized, and are reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of an asset to be recovered.

**Translation of foreign currencies**

Monetary items denominated in foreign currencies are translated to Canadian dollars at the exchange rate in effect at the balance sheet date, and non-monetary items are translated at exchange rates in effect when the assets were acquired or liabilities incurred. Revenue and expense items are translated at the rate of exchange in effect on the transaction date. Foreign currency transaction gains or losses are reflected in the results of operations.

# Northern Graphite Corporation

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## Notes to Financial Statements

For the years ended December 31, 2012 and 2011

### Restoration and site closure provision

The fair value of an asset retirement obligation is recorded in the period in which it is incurred. When the liability is initially recorded, the cost is capitalized by increasing the carrying amount of the related long-lived asset. Over time, the liability is adjusted to reflect the passage of time (accretion expense) and for changes in estimated future cash flows. Accretion expense is charged to the statement of comprehensive profit or loss, while adjustments related to changes in estimated cash flows are recorded as increases or decreases in the carrying value of the asset. The capitalized cost is amortized over the useful life of the related asset. Upon settlement of the liability, a gain or loss is recorded if the actual costs incurred are different from the liability recorded.

### Comprehensive income

Other comprehensive income represents the change in net equity for the period resulting from unrealized gains and losses on available-for-sale financial instruments, and changes in the fair market value of derivative instruments designated as cash flow hedges. These amounts are shown net of tax. Cumulative changes in other comprehensive income are included in accumulated other comprehensive income which is presented, if any, as a new category in shareholders' equity. The Company did not have any transactions during the year ended December 31, 2012 and 2011 that give rise to other comprehensive income, and therefore no balance has accumulated.

### Share capital

Financial instruments issued by the Company are classified as equity only to the extent that they do not meet the definition of a financial asset or liability. The Company's common shares and common share purchase warrants are classified as equity instruments. Incremental costs directly attributable to the issuance of new equity instruments are shown in equity as deduction from the proceeds of issuance.

### Earnings per share

Basic loss per share is calculated by dividing the net loss by the weighted average number of shares outstanding during the period. Fully diluted loss per share is calculated using the treasury share method and reflects the potential dilution by including share options and contingently issuable shares, in the weighted average number of common shares outstanding for the year. For the year ended December 31, 2012 and the year ended December 31, 2011, all outstanding share options and warrants were anti-dilutive.

### Share-based payments

The Company has a share option plan (the "Plan") described in Note 7. The Company measures the compensation cost of share options issued under the Plan using the fair-value method as determined using the Black-Scholes option pricing model. Compensation costs are measured at the grant date based on the fair value of the award and are recognized over the vesting period in net income (loss) with a corresponding increase to contributed surplus. Upon exercise, common shares are issued from treasury and the amount reflected in contributed surplus is credited to share capital, as adjusted for any consideration paid.

The Black-Scholes option pricing model incorporates highly subjective assumptions, including volatility, estimated forfeiture rates and expected time until exercise, which affect the calculated values. At the end of each reporting period, the Company reviews the option pricing model and updates model inputs for any changes for the purposes of determining the fair value of new grants, and reflects the impact of changes to non-market input estimates for previous grants in net income (loss) with a corresponding adjustment to contributed surplus.

### Financial instruments

All financial instruments are required to be measured at fair value on initial recognition. Measurement in subsequent periods depends upon whether the financial instrument is classified as fair value through profit or loss ("FVTPL"), available-for-sale assets, held-to-maturity investments, loans and receivables, or other liabilities measured at amortized cost ("Other Financial Liabilities"). Financial instruments classified as FVTPL are measured at fair value with unrealized gains and losses recognized in the statement of operations. Available-for-sale asset financial instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Financial assets classified as held-to-maturity investments, loans and receivables and Other Financial Liabilities, are measured at amortized cost. Transaction costs in respect of financial assets and liabilities which are FVTPL are recognized in profit or loss immediately. Transaction costs in respect of Other Financial Liabilities are included in the initial fair value measurement of the financial instrument.

The Company may enter into derivative contracts or, financial instruments and non-financial contracts containing embedded derivatives. Embedded derivatives are required to be accounted for separately at fair value as derivatives when the risks and characteristics of the embedded derivatives are not closely related to those of their host contract, and the host contract is not carried at fair value.

**Northern Graphite Corporation**  
 (an Exploration Stage Company)  
**Notes to Financial Statements**  
**For the years ended December 31, 2012 and 2011**

The Company has designated each of its significant categories of financial instruments as follows:

Cash and cash equivalents	FVTPL
Deposits	Loans and receivables
Reclamation deposit	Loans and receivables
Accounts payable and accrued liabilities	Other Financial Liabilities
Due to (from) Mindesta Inc.	FVTPL

**Recent pronouncements issued**

Certain pronouncements were issued by the IASB or the International Financial Reporting Interpretations Committee (“IFRIC”) that are mandatory for accounting periods after December 31, 2012. Pronouncements that are not applicable or do not have a significant impact to the Company have been excluded from the table below.

The following amended or new Standards were issued by the IASB and are effective for annual periods beginning on or after January 1, 2013. The Company has not early adopted these Standards in these Financial Statements:

- IFRS 7, “Financial Instruments: Disclosures”;
- IFRS 9, Financial Instruments, “IFRS 9”;
- IFRS 10, “Consolidated Financial Statements”;
- IFRS 11, “Joint Arrangements”;
- IFRS 12, “Disclosure of Interests in Other Entities”;
- IFRS 12, “Disclosure of Interests in Other Entities”;
- IFRS 13, “Fair Value Measurement”;
- IAS 1, “Presentation of Financial Statements”;
- IAS 27, “Separate Financial Statements”; and
- IAS 28, “Investments in Associates and Joint Ventures”.

Consolidated Financial Statements - IFRS 10 Consolidated Financial Statements (“IFRS 10”) will replace existing guidance on consolidation in IAS 27 Consolidated and Separate Financial Statements, and SIC 12 Consolidation – Special Purpose Entities. The portion of IAS 27 that deals with separate financial statements will remain. IFRS 10 changes the definition of control, such that the same consolidation criteria will apply to all entities. The revised definition focuses on the need to have both “power” and “variable returns” for control to be present. Power is the current ability to direct the activities that significantly influence returns. Variable returns can be positive, negative or both. IFRS 10 requires continuous assessment of control of an investee in line with any changes in facts and circumstances.

Joint Arrangements - IFRS 11 Joint Arrangements (“IFRS 11”) will replace IAS 31 Interests in Joint Ventures, and SIC 13 Jointly Controlled Entities – Non-monetary Contributions by Venturers. IFRS 11 defines a joint arrangement as an arrangement where two or more parties contractually agree to share control. Joint control exists only when the decisions about activities that significantly affect the returns of an arrangement require the unanimous consent of the parties sharing control. The focus is not solely on the legal structure of joint arrangements, but rather on how the rights and obligations are shared by the parties to the joint arrangement. IFRS 11 eliminates the existing policy choice of proportionate consolidation for jointly controlled entities. In addition, the Standard categorizes joint arrangements as either joint operations or joint ventures.

Disclosure of Interests in Other Entities - IFRS 12 Disclosure of Interests in Other Entities (“IFRS 12”) is the new Standard for disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. Matters covered include information about the significant judgments and assumptions that any entity has made in determining whether it has control, joint control or significant influence over another entity.

Separate Financial Statements - IAS 27 Separate Financial Statements (“IAS 27”) has been updated to require an entity presenting separate financial statements to account for those investments at cost or in accordance with IFRS 9 Financial Instruments. The amended IAS 27 excludes the guidance on the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent currently within the scope of the current IAS 27 Consolidated and Separate Financial Statements that is replaced by IFRS 10.

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Investments in Associates and Joint Ventures - IAS 28 Investments in Associates and Joint ventures (“IAS 28”) has been revised and it is to be applied by all entities that are investors with joint control of, or significant influence over, an investee. The scope of IAS 28 Investments in Associates does not include joint ventures.

IFRS 13 Fair Value Measurement (“IFRS 13”) was issued by the IASB in May 2011, and is effective for annual periods beginning on or after January 1, 2013. Early application is permitted. IFRS 13 was issued to remedy the inconsistencies in the requirements for measuring fair value and for disclosing information about fair value measurement in various current IFRSs. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price.

The IASB has issued an amendment to IFRS 7, Financial Instruments: Disclosures (“IFRS 7”), requiring incremental disclosures regarding transfers of financial assets. This amendment is effective for annual periods beginning on or after July 1, 2011. The Company will apply the amendment at the beginning of its 2012 financial year. The Company does not expect the implementation to have a significant impact on the Company’s disclosures.

The IASB has issued a new standard, IFRS 9, Financial Instruments (“IFRS 9”), which will ultimately replace IAS 39, “Financial Instruments: Recognition and Measurement” (“IAS 39”). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments and the issuance of IFRS 9 is part of the first phase of this project. IFRS 9 uses a single approach to determine whether a financial asset or liability is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial assets, the approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. IFRS 9 requires a single impairment method to be used, replacing multiple impairment methods in IA 39. For financial liabilities measured at fair value, fair value changes due to changes in an entity’s credit risk are presented in other comprehensive income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015. The Company does not expect the implementation to have a significant impact on the Company’s results of operations, financial position and disclosures.

The IASB has issued an amendment to IAS 1, Presentation of Financial Statements (“IAS 1”), which requires entities to group items presented in other comprehensive income (OCI) on the basis of whether they might at some point be reclassified from OCI to profit or loss at a later date when specified conditions are met. By requiring items of OCI to be grouped on this basis, their potential effect on profit or loss in future periods will be clearer. This amendment is effective for annual periods beginning on or after July 1, 2012 and requires full retrospective application. The Company does not expect IAS 1 to have a material impact on the financial statements.

**4. Property and equipment**

	<b>Building and improvements</b>	<b>Equipment</b>	<b>Total property plant &amp; equipment</b>
<b>Cost</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
December 31, 2011	800,097	632,794	1,432,891
Additions	-	14,200	14,200
Disposals	-	-	-
Impairment	-	-	-
<b>December 31, 2012</b>	<b>800,097</b>	<b>646,994</b>	<b>1,447,091</b>
<i>Accumulated depreciation</i>			-
<b>December 31, 2011</b>	<b>367,809</b>	<b>490,917</b>	<b>858,726</b>
Additions	40,739	31,043	71,782
Disposals	-	-	-
Impairment	-	-	-
<b>December 31, 2012</b>	<b>408,548</b>	<b>521,960</b>	<b>930,508</b>
<b>Net book value</b>	<b>391,549</b>	<b>125,034</b>	<b>516,583</b>

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	Building and improvements \$	Equipment \$	Total property plant & equipment \$
<b>Cost</b>			
January 1, 2011	800,097	1,153,286	1,953,383
Additions	-	149,954	149,954
Disposals	-	(670,446)	(670,446)
Impairment	-	-	-
<b>December 31, 2011</b>	<b>800,097</b>	<b>632,794</b>	<b>1,432,891</b>
<b>Accumulated depreciation</b>			
January 1, 2011	325,292	1,099,175	1,424,467
Additions	42,517	19,600	62,117
Disposals	-	(627,858)	(627,858)
Impairment	-	-	-
<b>December 31, 2011</b>	<b>367,809</b>	<b>490,917</b>	<b>858,726</b>
<b>Net book value</b>	<b>432,288</b>	<b>141,877</b>	<b>574,165</b>

**5. Exploration and evaluation assets**

The Company has a 100% interest in the Bissett Creek Property which consists of a 565 hectare mining lease expiring September 22, 2014 and 18 unpatented claims totaling approximately 2,424 hectares, located in the United Townships of Head, Clara and Maria, in the County of Renfrew, Ontario.

As of December 31, 2012, accumulated costs with respect to the Bissett Creek Property consisted of the following:

	\$
Balance, December 31, 2010	1,065,179
Exploration expenditures made from January 1, 2011 to December 31, 2011:	
Drilling & exploration	144,861
Environmental & mine permitting	776,524
Metallurgical	260,639
Feasibility study	923,502
Engineering	41,715
Site & royalties	49,166
Surveying & geophysics	91,560
Balance, December 31, 2011	3,353,146
Exploration expenditures made from January 1, 2012 to December 31, 2012:	
Drilling & exploration	483,066
Environmental & mine permitting	919,925
Metallurgical	1,155,482
Feasibility study	524,484
Engineering	34,247
Site & royalties	183,879
Surveying & geophysics	268,425
Geotechnical	221,163
Balance, December 31, 2012	7,143,817

The Company is required to make royalty payments of \$20 per ton of graphite carbon concentrate produced to the previous owners and is subject to a 2.5% net smelter return payable on any other minerals derived and sold from the Bissett Creek Property. An advance royalty of \$27,000 per annum is payable in semi-annual installments and is recorded in exploration and evaluation assets.

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### 6. Scientific research and experimental development program claims

The Company has filed federal and provincial claims for scientific research and experimental development program in the amount of \$317,736. The refundable portion of these claims is \$101,708. The Company cannot be reasonably assured that it will receive these claims as filed as these are the Company's first claims under this program and as such, the Company has no history on the success of claims. Upon acceptance of the claims, the Company will recognize a reduction of \$99,787 against Exploration and Evaluation assets and a reduction of \$1,921 against Office and miscellaneous expenses.

### 7. Share capital

#### Authorized

The Company is authorized to issue an unlimited number of common shares. On March 1, 2010, the Company subdivided its common shares on the basis of 11,750,000 common shares for the one common share outstanding.

#### Private placement

On March 16, 2012, the Company completed a private placement of 6,206,377 common shares at a price of \$1.70 for gross proceeds of \$10,550,841. In connection with the offering, the Company paid finders' fees totaling \$121,517, and issued to the agents 71,480 common share purchase warrants entitling the holder to purchase one common share at a price of \$2.00 until March 16, 2013.

#### Initial public offering

On April 18, 2011 the Company completed an initial public offering of 8,000,000 common shares at a price of \$0.50 per share for gross proceeds of \$4,000,000. In connection with the offering, the Company paid to the Agents a commission of \$280,000 equal to 7% of the gross proceeds of the offering, and issued to the agents 560,000 common share purchase warrants entitling the holder to purchase one common share at a price of \$0.50 per common share until April 18, 2012.

#### Issued

	Common shares	
	Number of shares	Amount \$
Balance, December 31, 2010	22,936,925	2,519,869
Issued pursuant to initial public offering	8,000,000	4,000,000
Fair value of warrants issued	-	(149,152)
Share issue costs	-	(621,347)
Issued on the exercise of warrants	6,478,242	2,110,057
Balance, December 31, 2011	37,415,167	7,859,427
Share capital issued through private placement	6,206,377	10,550,841
Issued pursuant to the exercise of warrants	5,234,737	1,727,601
Issued pursuant to the exercise of options	225,000	112,500
Fair value of options exercised	-	73,747
Warrants issued in private placement	-	(53,976)
Fair value of warrants exercised	-	133,957
Fair value of warrants expired	-	690
Share issuance costs	-	(166,459)
Balance at December 31, 2012	49,081,281	20,238,328

The fair value of the broker warrants issued during the year ended December 31, 2012 of \$53,976 was calculated using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	1.12%
Expected volatility	79%
Expected life of warrants	1 year
Expected dividend yield	Nil

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The fair value of the broker warrants during the year ended December 31, 2011 of \$149,152 was calculated using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	1.36%
Expected volatility	144%
Expected life of warrants	1 year
Expected dividend yield	Nil

As of December 31, 2012, no common shares are held in escrow. As of December 31, 2011, 8,221,074 common shares were held in escrow.

**Warrants**

A summary of the Company's warrants based on a weighted average price is presented below:

	<b>Number of Warrants</b>	<b>Price \$</b>
Balance, December 31, 2010	11,155,571	0.32
Issued pursuant to initial public offering, April 18, 2011	560,000	0.50
Exercised	(6,478,242)	0.32
Balance, December 31, 2011	5,237,329	0.33
Issued pursuant to private placement March 16, 2012	71,480	2.00
Exercised	(5,234,737)	0.33
Expired	(2,592)	0.50
Balance, December 31, 2012	71,480	2.00

<b>Exercise price</b>	<b>Number of warrants outstanding</b>	<b>Expiry date</b>
\$2.00	71,480	March 16, 2013

As of December 31, 2012, no warrants are held in escrow. As of December 31, 2011, 803,574 warrants were held in escrow.

The weighted average share price of warrants exercised during the year ended December 31, 2012 was \$1.54.

**Share options**

The Company has adopted a stock option plan (the "Option Plan") for directors, officers, employees and consultants of the Company. Under the Option Plan, the Company may grant non-transferable options to purchase common shares of the Company for a period of up to ten years from the date of the grant. The maximum number of common shares reserved for issuance under the Option Plan together with any common shares reserved for issuance pursuant to any other stock options may not exceed 10% of the issued and outstanding common shares of the Company.

The exercise price of each option shall be determined by the Board of Directors at the time of grant, and shall not be less than the price permitted by any stock exchange on which the common shares are then listed or other regulatory body having jurisdiction. Currently, the TSX Venture Exchange (the "TSX-V") requires that the exercise price of the options must be equal to or greater than the Discounted Market Price (as defined in the policies of the TSX-V). The exercise price of options is solely payable in cash. The Board of Directors has the discretion to determine the term and vesting provisions of any options granted under the Option Plan at the time of grant subject to the policies of the TSX-V.

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A summary of the Option Plan activity based on a weighted average price is presented below:

	Number of options	Price \$
Balance, December 31, 2010	-	-
Issued pursuant to initial public offering, April 18, 2011	2,950,000	0.50
Granted to consultant November 16, 2011	25,000	0.94
Granted to employee and consultant December 20, 2011	225,000	0.80
Balance, December 31, 2011	3,200,000	0.52
Granted	1,025,000	1.70
Exercised	(225,000)	0.50
Balance, December 31, 2012	4,000,000	0.83
Exercisable	3,729,167	0.83

The weighted average share price of options exercised during the year ended December 31, 2012 was \$2.02.

A summary of the Company's share options outstanding and exercisable at December 31, 2012 is presented below:

Exercise price	Options outstanding	Options exercisable	Expiry date
\$0.50	2,725,000	2,566,667	April 18, 2016
\$0.94	25,000	25,000	November 16, 2016
\$0.80	225,000	112,500	December 20, 2016
\$2.50	525,000	525,000	April 11, 2017
\$0.85	500,000	500,000	December 20, 2017
	4,000,000	3,729,167	

The weighted average remaining contractual life of options outstanding is 3.68 years.

The following is a summary of stock option grant activity and related Black-Scholes option pricing model input factors used for the periods ended December 31, 2012 and December 31, 2011:

	Year ended December 31, 2012	Year ended December 31, 2011
Stock options granted during the period	1,025,000	3,200,000
Weighted-average exercise price	\$1.70	\$0.52
Expected stock option life <sup>(1)</sup>	5 years	1 to 5 years
Expected volatility <sup>(2)</sup>	96%	144%
Risk-free interest rate <sup>(3)</sup>	1.40%-1.50%	1.09% to 2.60%
Dividend yield	0.00%	0.00%
Forfeiture rate	0.00%	0.00%
Weighted-average fair value (Black-Scholes value)	\$1.26	\$0.44

1. The Company estimates the expected stock option life (estimated period of time outstanding) of options granted to be the length of time before the stock option's expiry until such time that the Company can base its estimate on historical information on the Company's options.
2. The expected volatility was based on the average of certain comparative companies' historical volatilities which the Company had deemed to be an appropriate measure of volatility until the Company had sufficient trading history in order to use its own volatility measurement. Upon having achieved sufficient trading history, the Company based its expected volatility on its own trading history.
3. The risk-free rate is based on the yield of a Government of Canada marketable bond in effect at the time of grant with an expiry commensurate with the expected life of the award.

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The fair value is calculated using the Black-Scholes option valuation model. As at December 31, 2012, there was \$29,304 (December 31, 2011 – \$153,133) of total unrecognized share-based compensation costs related to unvested stock option awards granted under the Option Plan which are expected to be recognized over a weighted-average period of 0.4 years (2011-0.60 years).

**Contributed surplus**

	\$
Balance, December 31, 2010	-
Share-based compensation	1,241,085
Balance, December 31, 2011	1,241,085
Fair value of options exercised	(73,747)
Share-based compensation	1,438,646
Balance, December 31, 2012	2,605,984

Contributed surplus as at December 31, 2012 and December 31, 2011 consists of a share-based payment reserve related to stock options issued under the Option Plan.

**8. Income taxes**

The following table reconciles the expected income tax expense at the Canadian statutory income tax rates to the amounts recognized in the statement of comprehensive income for the years ended December 31, 2012 and 2011:

	Dec 31, 2012	Dec 31, 2011
Income tax (loss) before income taxes	\$ (3,635,334)	\$ (2,459,752)
Canadian statutory income tax rate	26.25%	28.25%
Expected income tax expense (recovery)	(954,275)	(694,880)
Differences resulting from:		
Share-based payments	378,341	350,607
Change in estimates	(634,374)	-
Tax losses expired	-	434,070
Share issuance costs	(43,695)	(155,337)
Tax rate differences	29,506	38,981
Other permanent differences	-	5,441
Increase (decrease) in deferred tax assets not recognized	1,224,498	21,118
Provision for income taxes	-	-

Deferred taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes. Deferred tax assets at December 31, 2012 and 2011 are comprised of the following:

	Dec 31, 2012	Dec 31, 2011
<b>Deferred tax assets</b>		
Non-capital loss carry forwards	\$ 3,702,636	\$ 2,686,396
SR&ED pool	218,545	-
Mineral properties	(227,625)	-
Share issuance costs	127,474	125,740
Reclamation close down provision	-	79,260
Investment tax credits	276,544	-
Property and equipment	36,458	18,138
<b>Total deferred tax asset not recognized</b>	\$ 4,134,032	\$ 2,909,534

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The Company has non-capital loss carry forwards of approximately \$14,810,542 (2011 – \$10,745,585), which may be carried forward to apply against future year income tax for Canadian income tax purposes, subject to the final determination by taxation authorities, expiring in the following years:

2014	\$	1,443,884
2015		2,259,969
2026		1,345,807
2027		2,672,335
2028		857,236
2029		393,269
2030		444,321
2031		3,111,945
2032		2,281,776
<b>Total</b>	<b>\$</b>	<b>14,810,542</b>

Deferred tax assets have not been recognized because at this stage of the Company's development, it is not determinable that future taxable profit will be available against which the Company can utilize such deferred tax assets.

**9. Capital disclosures**

Capital of the Company consists of the equity attributable to the common shareholders, comprised of share capital and deficit. The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern so that it can continue to explore and develop its mineral resource property for the benefit of its shareholders. The Company manages its capital structure and makes adjustments based on the funds available to the Company in light of changes in economic conditions. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain the future development of the Company. In order to facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that consider various factors, including successful capital deployment and general industry conditions. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

As the Company is an exploration stage company, it has no revenues and its principal source of capital is from the issue of common shares. In order to achieve its objectives, the Company will spend its existing working capital and raise additional funds as required.

The Company is not subject to externally imposed capital requirements and there were no changes to the Company's approach to capital management during the year.

**10. Loss per share**

	<b>Year ended December 31, 2012</b>	<b>Year ended December 31, 2011</b>
Loss and comprehensive loss for period	(3,635,335)	(2,459,752)
Weighted average number of shares – basic and fully diluted	45,200,127	30,001,851
Loss and comprehensive loss per share	(\$0.08)	(\$0.08)

**11. Financial instruments and risk management**

**Fair value**

Certain of the Company's accounting policies and disclosures require the determination of fair value. Fair value represents the amount at which a financial instrument could be exchanged between willing parties, based on current markets for instruments with the same risk, principal and remaining maturity. Fair value estimates are based on quoted market values and other valuation methods. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

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In establishing fair value, the Company uses a fair value hierarchy based on levels as defined below:

- Level 1: defined as observable inputs such as quoted prices in active markets.
- Level 2: defined as inputs other than quoted prices in active markets that are either directly or indirectly observable.
- Level 3: defined as inputs that are based on little or no observable market data and, therefore, requiring entities to develop their own assumptions.

The carrying value of cash and cash equivalents, deposits, accounts payable and accrued liabilities, and due to (from) Mindesta Inc. approximates fair value due to the short-term nature of these financial instruments. The carrying value of the reclamation deposit and asset retirement obligations approximates fair value as they bear a market rate of interest.

### Currency risk

As the majority of the Company's expenditures are in Canadian dollars, the Company limits its exposure to currency risk by maintaining its cash and cash equivalents in Canadian dollars. The Company carries a portion of its accounts payable and accrued liabilities and notes payable in US dollars, and is subject to currency risk on these balances. However, the Company considers this risk to be minimal.

### Credit risk

Credit risk is the risk of a loss if a counterparty to a financial instrument fails to meet its contractual obligations. The Company limits its exposure to credit risk by holding its cash in deposits with high credit quality Canadian financial institutions, and considers this risk to be minimal.

### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity risk through the management of its capital structure as outlined in note 9. Further discussion on liquidity and management's plans are outlined in note 1. All of the Company's trade payables are due within 1 year.

### Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company is not exposed to interest rate risk due to the short-term nature of its financial instruments.

## 12. Related parties

### Major Shareholder

Mindesta's interest in Northern was reduced to 26.1% as at December 31, 2011 as the result of a number of financing transactions. At the close of trading on January 25, 2012, Mindesta completed the distribution to Mindesta's shareholders of 9,413,581 shares of Northern owned by Mindesta on the basis of one share of Northern for each share of Mindesta held. As at December 31, 2012, Mindesta's interest in Northern had decreased to less than 1% and since the end of the year, Mindesta has sold its remaining Northern shares.

### Key Management Compensation

In the year ended December 31, 2012, the Company expensed management fees to companies owned and controlled by key management personnel of \$201,250 (2011 – \$220,723) and expensed salary to key management personnel of \$414,375 (2011 – \$231,667). In the year ended December 31, 2012 and 2011, the Company provided short-term employee benefits totaling \$23,929 (2011 – \$4,148) to key management personnel. In the year ended December 31, 2012, the Company expensed share-based compensation for stock options granted to key management personnel of \$123,890 (1,800,000 share options, 1,616,667 share options vested, exercisable at \$0.50; and 225,000 share options, 112,500 share options vested, exercisable at \$0.80) and share-based payments of \$1,251,353 to directors (500,000 share options exercisable at \$2.50; and 500,000 share options exercisable at \$0.85). In the year ended December 31, 2011, the Company expensed share-based payments of \$731,310 (2,025,000 share options, 1,433,333 share options vested, exercisable at \$0.50 to key management personnel). In the year ended December 31, 2012, the Company provided bonus payments of \$236,911 (2011 - \$47,572) to key personnel.

### Other Related Party Transactions

During the year ended December 31, 2012, the Company expensed office rental payments of \$19,170 (2011 – \$18,000) to a Company whose CEO and a Director is also a Director of Northern.

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### **13. Commitments**

#### **Leased mineral claims**

In connection with the Bissett Creek Property, the Company is required to make production royalty payments of \$20 per ton of graphite carbon concentrate produced to the previous owners and a 2.5% net smelter return payable on any other minerals derived and sold from the Bissett Creek Property. An advance royalty of \$27,000 per annum is payable in semi-annual installments and has been paid for the year ended December 31, 2012. The advance will be credited against any future production royalty payments.

#### **Contractual obligations**

As at December 31, 2012, the Company had no contractual obligations (commitments as at December 31, 2011 – \$362,513) which related to costs associated with work at the Bissett Creek Property. As at December 31, 2012, the Company had a contractual obligation in the amount of \$28,000 (2011 - \$Nil) which relates to the cost of marketing services and which are due within one year.

### **14. Provisions**

A Mine Development and Closure Plan has been filed with, and accepted by, the Ministry of Northern Development and Mines (“MNDM”). A reclamation deposit which now totals \$319,590 (2011 - \$317,042), including accrued interest, has been paid to the Minister of Finance for the Province of Ontario, and has been accounted for as a long term deposit with a corresponding provision for reclamation and close down. The reclamation deposit and corresponding provision for reclamation and close down represent the estimated amount that would be required to restore the Bissett Creek Property to its original environmental state based on the original development plan. The money pledged for the reclamation deposit will be returned to the Company once the MNDM is satisfied that the obligations contained in the Mine Development and Closure Plan have been performed by the Company. Should the Company not perform its obligations contained in the Mine Development and Closure Plan the MNDM will restore the Bissett Creek Property site to its original environmental state using the funds from the reclamation deposit. The Company is liable for any costs in excess of the reclamation deposit. The Company is in the process of filing a revised Mine Development and Closure Plan for a new development scenario and an increased reclamation deposit will be required. The amount of the increase has not yet been determined.

### **15. Subsequent Event**

On January 8, 2012, the Company announced that it had signed a Letter of Intent with Caterpillar Financial Services Corporation (“Cat Financial”) to provide financing for up to US\$17.5 million in Cat mining and Cat power equipment purchases for the Company’s Bissett Creek graphite project. Cat Financial has preliminarily indicated its additional interest in participating in a Project Debt Facility, subject to receipt of an Information Memorandum relating thereto and its agreement with the terms and conditions thereof.

On January 18, 2013, the Company announced that it had awarded a \$3.5 million contract for the detailed engineering and design of the Bissett Creek project to PES-BECMA.

On March 16, 2013, 71,480 warrants with an exercise price of \$2.00 expired.