

# **GENCO RESOURCES LTD.**

Consolidated Financial Statements  
As at September 30, 2007

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GGC (TSX Venture Exchange)

NOTICE OF NO REVIEW BY AUDITOR

In accordance with National Instrument 51-02 *Continuous Disclosure Obligations* of the Canadian Securities Administrators **WE HEREBY GIVE NOTICE THAT** our financial statements for the nine month period ended September 30, 2007, which follow this notice, have not been reviewed by an auditor.

# **GENCO RESOURCES LTD.**

## **Consolidated Balance Sheets**

As at September 30, 2007 and December 31, 2006

*(Expressed in Canadian dollars)*

	<b>September 30 2007</b>	<b>December 31 2006</b>
	<u>\$</u>	<u>\$</u>
<b>Assets</b>		
Current assets		
Cash	<b>18,405,908</b>	2,184,209
Accounts receivable	<b>2,620,833</b>	1,738,315
Inventory (Note 4)	<b>600,366</b>	481,821
Prepaid expenses and deposits	<b>842,382</b>	399,128
	<u><b>22,469,489</b></u>	<u>4,803,473</u>
Mineral property interests (Note 5)	<b>45,930</b>	44,974
Property, plant, and equipment (Note 6)	<b>23,728,354</b>	17,596,628
	<u><b>46,243,773</b></u>	<u>22,445,075</u>
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	<b>2,081,349</b>	2,695,089
Current portion of long term debt (Note 7)	<b>498,150</b>	582,650
	<u><b>2,579,499</b></u>	<u>3,277,739</u>
Long term debt (Note 7)	<b>1,282,987</b>	1,992,789
Asset retirement obligation (Note 8)	<b>185,206</b>	171,057
Future income tax (Note 12)	<b>1,214,276</b>	841,996
	<u><b>5,261,968</b></u>	<u>6,283,581</u>
<b>Shareholders' equity</b>		
Share capital (Note 9)	<b>42,728,735</b>	21,357,790
Contributed surplus (Note 9)	<b>7,898,726</b>	1,936,985
Retained earnings (deficit)	<b>(9,645,565)</b>	(7,133,281)
	<u><b>40,981,805</b></u>	<u>16,161,494</u>
	<u><b>46,243,773</b></u>	<u>22,445,075</u>

See accompanying notes to the consolidated financial statements.

# GENCO RESOURCES LTD.

## Consolidated Statements of Operations and Deficit

For the nine months ended September 30, 2007 and 2006

(Expressed in Canadian dollars)

	3 Months September 30 2007 \$	3 Months September 30 2006 \$	9 Months September 30 2007 \$	9 Months September 30 2006 \$
Sales	1,894,089	2,009,404	5,475,664	7,026,100
Cost of sales	890,777	918,468	2,957,591	3,723,021
Gross profit	<u>1,003,312</u>	<u>1,090,936</u>	<u>2,518,073</u>	<u>3,303,079</u>
Operating expenses				
Administrative expenses	1,533,810	741,647	3,421,242	1,652,786
Stock-based compensation (Note 9)	48,085	221,650	1,275,586	746,035
	<u>1,581,895</u>	<u>963,297</u>	<u>4,696,828</u>	<u>2,398,821</u>
Operating income (loss)	<u>(578,583)</u>	<u>127,639</u>	<u>(2,178,755)</u>	<u>904,258</u>
Other income (expense)				
Accretion on long term debt	(25,109)	(28,866)	(86,091)	(91,791)
Interest and other income	114,715	15,896	124,751	52,223
	<u>89,606</u>	<u>(12,970)</u>	<u>38,660</u>	<u>(39,568)</u>
Net income (loss) before tax	<u>(488,977)</u>	<u>114,669</u>	<u>(2,140,095)</u>	<u>864,690</u>
Income tax expense (Note 10)				
Future	348,944	466,279	372,280	1,411,774
	<u>348,944</u>	<u>466,279</u>	<u>372,280</u>	<u>1,411,774</u>
Net income (loss)	<u>(837,921)</u>	<u>(351,610)</u>	<u>(2,512,375)</u>	<u>(547,084)</u>
Retained earnings (deficit), beginning	<u>(8,807,735)</u>	<u>(5,836,363)</u>	<u>(7,133,281)</u>	<u>(5,640,889)</u>
Retained earnings (deficit), ending	<u>(9,645,656)</u>	<u>(6,187,973)</u>	<u>(9,645,656)</u>	<u>(6,187,973)</u>
Earnings (loss) per share				
Basic	<u>(0.02)</u>	<u>(0.01)</u>	<u>(0.08)</u>	<u>(0.02)</u>
Fully diluted	<u>(0.02)</u>	<u>(0.01)</u>	<u>(0.07)</u>	<u>(0.02)</u>
Weighted average common shares				
Basic	<u>39,319,259</u>	<u>28,631,406</u>	<u>31,927,955</u>	<u>27,574,597</u>
Fully diluted	<u>40,696,514</u>	<u>31,690,315</u>	<u>33,602,352</u>	<u>30,930,786</u>

See accompanying notes to the consolidated financial statements.

# GENCO RESOURCES LTD.

## Consolidated Statements of Cash Flows

For the nine months ended September 30, 2007 and 2006

(Expressed in Canadian dollars)

	3 Months September 30 2007 \$	3 Months September 30 2006 \$	9 Months September 30 2007 \$	9 Months September 30 2006 \$
<b>Cash provided (used) by operating activities</b>				
Net income (loss)	(837,921)	(351,610)	(2,512,375)	(547,084)
Adjustments				
Accretion on long term debt	25,109	28,866	86,091	91,791
Amortization and accretion	220,697	200,556	717,311	522,186
Future income tax	348,944	466,279	372,280	1,411,774
Stock-based compensation (Note 9)	48,085	221,650	1,275,586	746,035
	<u>(195,086)</u>	<u>565,741</u>	<u>(61,107)</u>	<u>2,224,702</u>
Change in non-cash working capital (Note 11)	<u>(1,769,548)</u>	<u>(67,677)</u>	<u>(2,050,638)</u>	<u>89,182</u>
	<u>(1,964,634)</u>	<u>498,064</u>	<u>(2,111,745)</u>	<u>2,313,884</u>
<b>Cash provided (used) by investing activities</b>				
Deferred exploration and development	(2,951,088)	(1,533,152)	(6,187,167)	(3,132,833)
Mine development changes in accounts payable	-	-	(7,419)	-
Mineral properties	(848)	(905)	(956)	(1,030)
Purchase of property, plant, and equipment	(192,145)	(27,338)	(647,721)	(179,547)
	<u>(3,144,081)</u>	<u>(1,561,395)</u>	<u>(6,843,263)</u>	<u>(3,313,410)</u>
<b>Cash provided (used) by financing activities</b>				
Change in long term debt	(537,750)	(562,950)	(537,750)	(562,950)
Shares issued for cash (less costs)	23,457,748	212,850	26,057,100	2,553,529
	<u>22,919,998</u>	<u>(350,100)</u>	<u>25,519,350</u>	<u>1,990,579</u>
<b>Increase (decrease) in cash during the period</b>	<b>17,811,283</b>	<b>(1,413,431)</b>	<b>16,564,342</b>	<b>991,053</b>
<b>Effect of changes in foreign exchange rates</b>	<b>(113,530)</b>	<b>131,626</b>	<b>(342,643)</b>	<b>6,978</b>
<b>Cash, beginning</b>	<b>708,155</b>	<b>3,004,593</b>	<b>2,184,209</b>	<b>724,757</b>
<b>Cash, ending</b>	<b>18,405,908</b>	<b>1,722,788</b>	<b>18,405,908</b>	<b>1,722,788</b>

Supplementary cash flow information (Note 12)

See accompanying notes to the consolidated financial statements.

# **GENCO RESOURCES LTD.**

## **Notes to the Consolidated Financial Statements**

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### **1. Introduction**

Genco Resources Ltd. (“Company”) was incorporated under the laws of the Province of British Columbia on February 28, 1980 as Senlac Oil & Gas Ltd. The Company changed its name to Rule Resources Ltd. on June 13, 1980, to Globe Resources Inc. on March 9, 1990, and to Genco Resources Ltd. on March 30, 1998.

On August 1, 2003 the Company acquired all of the issued and outstanding shares of La Guitarra Compania Minera S.A. de C.V. (“La Guitarra”). The purchase price for the acquisition was US\$5,000,000 with consideration being a combination of the issuance of shares and debt. Under the purchase agreement and as part of the consideration, Genco issued 1,380,315 shares valued at C\$1.02 per share to the vendor to satisfy US\$1,000,000 of the purchase price. Genco agreed to pay the balance of US\$4,000,000 by payments of US\$500,000, payable in cash or shares at the Company’s option, on each of the first through eighth anniversaries of the closing date. On September 22, 2004 the Company issued 790,427 shares valued at C\$0.82 for the first instalment payment to the vendor. On September 1, 2005, September 1, 2006, and August 16, 2007, the Company made the second, third, and fourth instalment payments of US\$500,000 each in cash. La Guitarra Compania Minera S.A. de C.V. is a wholly owned subsidiary incorporated under the laws of Mexico.

The Company is engaged in silver and gold mining and related activities including exploration, extraction, processing and reclamation. The Company has mining operations in Mexico and owns exploration projects in the United States and Canada.

### **2. Significant Accounting Policies**

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern and reflect the policies below.

#### **a) Basis of Presentation**

These consolidated financial statements include the accounts of the parent company and its wholly owned subsidiaries, Rule Nevada Inc., La Guitarra Compania Minera, S.A. de C.V. and Servicios para la Industria Minera, S.A. de C.V. All significant inter-company accounts and transactions have been eliminated.

The Company is in the process of exploring, developing, and operating mineral properties and has yet to determine whether some of the properties contain economically recoverable reserves. The recovery of amounts shown for resource properties and related assets are dependent on the existence of economically recoverable reserves, on the ability of the Company to obtain financing to complete development, and on future profitable operations.

#### **b) Cash**

Cash consists of deposits in the bank and highly liquid investments with an original maturity of 90 day or less.

#### **c) Share Option Plan**

As of August 1, 2002 the Company adopted the standard of the CICA Handbook, *Stock-Based Compensation and Other Stock-Based Payments*, which has been applied prospectively. All stock-based awards made to non-employees and employees are recognized and measured using the fair value based method at the date of grant. The Company uses the Black-Scholes model to estimate fair value.

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 2. Significant Accounting Policies (continued)

#### d) Inventory

Inventory is valued at the lower of cost and net realizable value. Cost is determined on an average cost basis. Concentrate inventory includes all direct costs of extracting the ore, direct labour, and all indirect pro-rated costs associated with operating La Guitarra mine.

#### e) Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Amortization is provided for as follows:

##### Straight line:

Automotive equipment	25.00 %
Buildings	5.00 %
Computer equipment	30.00 %
Furniture and fixtures	10.00 %
Leasehold improvements	20.00 %
Mine equipment	12.00 %
Mine infrastructure	Unit of production basis

##### Declining balance:

Computer equipment	30.00 % to 45.00 %
Office equipment	20.00 %

Significant costs related to property acquisitions including undeveloped mineral interests are capitalized until the viability of the mineral interest is determined. The costs are capitalized until such time that it has been determined that a mineral deposit is commercially recoverable and a decision has been made to prepare a mining plan (which occurs upon completion of a positive economic analysis of the mineral deposit). Major development expenditures incurred to expose the ore, increase production or extend the life of an existing mine are capitalized. Capitalized costs are amortized over the life of the mineral interest once commercial mining of the mineral interest has commenced. Capitalized costs are written down to their estimated recoverable amount if the properties are determined to be uneconomic or are placed for sale.

Interest and finance costs relating to the construction of plant and equipment are capitalized prior to the commencement of commercial production of a new mine. Depletion of the mine properties is charged on a unit of production basis over the estimated useful life of the mine.

Evaluations of the carrying values of each operation and development property are undertaken in each reporting period to determine if estimated undiscounted future net cash flows are less than the carrying value. Estimated undiscounted future net cash flows are calculated using estimated production sales prices and operating costs, capital costs and reclamation and closure costs. If it is determined that the future net cash flows from an operation or development property are less than the carrying value a write down is recorded with a charge to operations.

# **GENCO RESOURCES LTD.**

## **Notes to the Consolidated Financial Statements**

For the nine months ended September 30, 2007

*(Expressed in Canadian dollars)*

### **2. Significant Accounting Policies (continued)**

#### f) Foreign Currency Translation

The Company's functional and reporting currency is the Canadian dollar. Foreign currency monetary assets and liabilities are translated into Canadian dollars at the exchange rates prevailing at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange at the transaction date. Foreign currency transactions are translated at the Canadian dollar rate prevailing on the transaction dates. Foreign exchange gains and losses are included in the determination of earnings.

#### g) Earnings (Loss) Per Share

Basic earnings (loss) per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share amounts are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares using the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to redeem common shares at the prevailing market value.

#### h) Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions the company may undertake in the future, actual results may differ from the estimates.

#### i) Revenue Recognition

Revenue from the sale of metals is recognized in the accounts when title and risk passes to the buyer, collection is reasonably assured and the price is reasonably determinable. Revenue from the sale of metals may be subject to adjustment upon final settlement of estimated metal prices, weights and assays. Adjustments to revenue for metal prices are recorded monthly and other adjustments are recorded on final settlement.

#### j) Exploration and Development Expenditures and Mineral Properties

Significant property acquisition costs and exploration and development expenditures are capitalized. Capitalized costs are written down to their estimated recoverable amount if the properties are determined to be uneconomic, abandoned, or are placed for sale.

Although the Company has taken steps to verify title to mineral properties in which it has an interest, according to usual industry standards for the stage of exploration on such properties, these procedures do not guarantee the Company's title. Such properties may be subject to prior agreements or transfers and title may be affected by undetected defects.

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 2. Significant Accounting Policies (continued)

#### k) Income Taxes

The provision for income taxes is based on the liability method. Future taxes arise from the recognition of the tax consequences of temporary differences by applying enacted or substantively enacted tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of certain assets and liabilities. The Company records a valuation allowance against any portion of those future income tax assets that it believes will, more likely than not, fail to be realized.

#### l) Provision for Reclamation and Closure

On January 1, 2003, the Company adopted the standard of the CICA Handbook, *Asset Retirement Obligations*, which requires that the fair value of liabilities for asset retirement obligations be recognized in the period in which they are incurred. A corresponding increase to the carrying amount of the related assets is generally recorded and depreciated over the life of the asset. The amount of the liability is subject to re-measurement at each reporting date. Reclamation and closure costs have been estimated based on the Company's interpretation of current regulatory requirements.

### 3. Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities, loans from related parties, prepaid expenses and deposits, investments, and long term debt. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency, or credit risks arising from these financial instruments. The fair values of the financial instruments other than long term debt approximate their carrying values, unless otherwise noted.

Long term debt consists of a non-interest bearing promissory note of US\$2,000,000 (December 31, 2006 - US\$2,500,000). This debt has been recorded at its fair value based on equal payments of US\$500,000 over eight years starting August 1, 2004 and discounted at 5% per annum.

### 4. Inventory

	September 30 2007 \$	December 31 2006 \$
Concentrate	137,722	117,879
Major spares	142,706	—
Parts and supplies	319,938	363,942
	<u>600,366</u>	<u>481,821</u>

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 5. Mineral Property Interests

	September 30 2007 \$	December 31 2006 \$
Oest Property	25,930	24,974
Transvaal Property	20,000	20,000
	<u>45,930</u>	<u>44,974</u>

#### Oest Property - Lyon County, Nevada, USA

The Company owns eight patented and six unpatented claims in the Devil's Gate - Chinatown Mining District. The Company spent \$956 maintaining these claims during the nine months ended September 30, 2007 (September 30, 2006 - \$1,030).

#### Transvaal Property - Kamloops Mining Division, BC, Canada

The Company owns nine mineral claims in the Highland Valley subject to a 1.5% net smelter returns royalty. The Company did not expend any funds on exploration during the nine months ended September 30, 2007 (September 30, 2006 - Nil).

As of September 30, 2007, the Company still maintains the properties in good standing for further exploration and development or potential sale.

### 6. Property, Plant, and Equipment

	September 30, 2007		
	Cost \$	Accumulated Amortization \$	Net \$
Automotive	386,239	173,895	212,344
Buildings	930,277	208,179	722,098
Computer equipment	116,382	76,242	40,140
Furniture and fixtures	64,996	34,880	30,116
Leasehold improvements	44,250	41,300	2,950
Mine equipment	2,498,264	685,949	1,812,315
Mine infrastructure	11,668,318	1,134,626	10,533,692
Mine reclamation	118,116	22,415	95,701
	<u>15,826,842</u>	<u>2,377,486</u>	<u>13,449,356</u>
Work in progress			
Construction	182,031	—	182,031
Exploration	10,096,967	—	10,096,967
	<u>10,278,998</u>	<u>—</u>	<u>10,278,998</u>
	<u>26,105,840</u>	<u>2,377,486</u>	<u>23,728,354</u>

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 6. Property, Plant, and Equipment (continued)

	December 31, 2006		
	Cost \$	Accumulated Amortization \$	Net \$
Automotive	220,220	121,519	98,701
Buildings	930,277	173,556	756,721
Computer equipment	103,576	56,965	46,611
Furniture and fixtures	63,258	30,724	32,534
Leasehold improvements	44,250	34,663	9,587
Mine equipment	1,881,007	551,861	1,329,146
Mine infrastructure	11,794,987	718,012	11,076,975
Mine reclamation	120,948	21,779	99,169
	<u>15,158,523</u>	<u>1,709,079</u>	<u>13,449,444</u>
Work in progress			
Construction	128,980	—	128,980
Equipment not depreciated	235,073	—	235,073
Exploration	3,783,131	—	3,783,131
	<u>4,147,184</u>	<u>—</u>	<u>4,147,184</u>
	<u>19,305,707</u>	<u>1,709,079</u>	<u>17,596,628</u>

### 7. Long Term Debt

Pursuant to the acquisition of La Guitarra the Company agreed to pay US\$4,000,000 (C\$5,318,000) to the vendor to satisfy the balance of the purchase price. The debt bears no interest, is unsecured, and is repayable by instalments of US\$500,000 on each of the first through eighth anniversaries of the closing date. The outstanding instalment due in August 2008 is C\$498,150 and is recorded as a current liability.

The debt has been discounted for financial reporting purposes to its fair value. The rate used to discount the debt to its fair value was 5% which was based on the cost of borrowing of similar companies for the same purpose.

	September 30 2007 \$	December 31 2006 \$
Current portion	498,150	582,650
Long term portion	1,282,987	1,992,789
Total debt	<u>1,781,137</u>	<u>2,575,439</u>

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 8. Provision for Asset Retirement Obligation

	September 30 2007 \$	December 31 2006 \$
Balance, beginning	171,057	198,542
Accretion expense for the period	4,403	7,421
Change in estimate	9,746	(34,906)
Balance, ending	<u>185,206</u>	<u>171,057</u>

### 9. Share Capital

**Authorized:** Unlimited number of common shares without par value.

<b>Issued and outstanding:</b>	Number of Common Shares	Share Capital \$	Contributed Surplus \$
<b>Balance, December 31, 2005</b>	<b>25,917,855</b>	<b>15,740,114</b>	<b>616,662</b>
Exercise of stock options	744,872	966,674	(346,147)
Exercise of warrants	4,616,001	4,651,002	—
Stock-based compensation	—	—	1,666,470
<b>Balance, December 31, 2006</b>	<b>31,278,728</b>	<b>21,357,790</b>	<b>1,936,985</b>
Private placement	6,666,666	18,237,415	5,189,333
Exercise of stock options	762,822	1,523,362	(503,179)
Exercise of warrants	1,789,075	1,610,168	—
Stock-based compensation	—	—	1,275,587
<b>Balance, September 30, 2007</b>	<b><u>40,497,291</u></b>	<b><u>42,728,735</u></b>	<b><u>7,898,726</u></b>

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 9. Share Capital (continued)

#### a) Options

The Company has established a share purchase option plan whereby the Company's directors may from time to time grant options to directors, employees or consultants. The maximum term of any option may be ten years, but generally options are granted for five years or less. Compensation expense is determined using an option pricing model assuming no dividends are to be paid, a weighted average volatility of the Company's share price ranging from 49% to 65%, an annual risk free interest rate ranging from 4.00% to 4.25% and vesting over various periods from immediately to 5 years. The fair value of the stock options ranged from \$0.40 to \$2.17 per stock option.

A summary of the Company's options at September 30, 2007 is presented as follows:

	<u>Number of Common Shares</u>	<u>Weighted Average Exercise Price Per Share \$</u>
<b>Balance, December 31, 2005</b>	<b>2,183,194</b>	<b>0.86</b>
Granted	1,637,932	2.07
Exercised	(744,872)	0.83
Expired or cancelled	(13,750)	1.15
	<hr/>	
<b>Balance, December 31, 2006</b>	<b>3,062,504</b>	<b>1.51</b>
Granted	719,000	3.43
Exercised	(762,822)	1.34
Expired or cancelled	(114,250)	2.06
	<hr/>	
<b>Balance, September 30, 2007</b>	<b><u>2,904,432</u></b>	<b>2.01</b>

#### b) Warrants

A summary of the Company's warrants at September 30, 2007 is presented as follows:

	<u>Number of Common Shares</u>	<u>Weighted Average Exercise Price Per Share \$</u>
<b>Balance, December 31, 2005</b>	<b>6,405,076</b>	<b>0.98</b>
Exercised	(4,616,001)	1.01
	<hr/>	
<b>Balance, December 31, 2006</b>	<b>1,789,075</b>	<b>0.90</b>
Granted	3,733,333	5.25
Exercised	(1,789,075)	0.90
	<hr/>	
<b>Balance, September 30, 2007</b>	<b><u>3,733,333</u></b>	5.25

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 10. Income Tax

The following table reconciles the expected income tax payable (recovery) at the Canadian federal and provincial statutory income tax rates to the amounts recognized in the consolidated statements of operations for the years ended December 31, 2006 and 2005.

	December 31 2006 \$	December 31 2005 \$
Net income (loss) before tax	(599,387)	815,424
Income tax rate	34.12 %	34.12 %
Expected income tax expense (recovery) at above rates	(204,511)	278,223
Increase (decrease) due to:		
Impact of lower statutory rates on foreign subsidiaries	(153,992)	(98,300)
Non-deductible stock compensation expense	568,600	92,213
Non-deductible accretion on long term debt	40,627	46,817
Non-deductible expenses	13,147	2,100
Effect of the expiry of tax losses	(26,308)	(25,900)
Temporary difference not recognized in the period	—	—
Valuation allowance	654,247	(197,402)
Provision for income taxes	<u>891,810</u>	<u>97,751</u>
	December 31 2006 \$	December 31 2005 \$
The provision for income taxes consists of:		
Current income taxes	51,009	4,118
Future income taxes	840,801	93,633
	<u>891,810</u>	<u>97,751</u>

The potential benefit arising from operating losses has been recognized as a future tax asset. To the extent that these benefits may not be realized, a valuation allowance is provided.

The following table reflects future income tax assets (liabilities) as at December 31, 2006 and 2005:

	December 31 2006 \$	December 31 2005 \$
Future income tax assets (liabilities)		
Impact of reduction in tax rates on future income taxes	—	—
Unclaimed non-capital losses	3,482,377	2,547,247
Accounting value of mineral properties in excess of tax	(3,038,598)	(1,721,945)
Non-deductible reclamation costs and other	47,896	59,563
Valuation allowance	(1,333,671)	(884,865)
	<u>(841,996)</u>	<u>—</u>

# GENCO RESOURCES LTD.

## Notes to the Consolidated Financial Statements

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### 10. Income Tax (continued)

The Company has non-capital loss carryforwards expiring in the following years:

	Canada \$	Mexico \$	Total \$
2007	78,933	—	78,933
2008	86,180	—	86,180
2009	96,951	—	96,951
2010	297,849	—	297,849
2013	—	2,692,258	2,692,258
2014	894,865	2,383,797	3,278,662
2015	1,664,483	—	1,664,483
2016	—	1,143,108	1,143,108
2026	1,983,350	—	1,983,350
	<u>5,102,611</u>	<u>6,219,163</u>	<u>11,321,774</u>

### 11. Changes in Non-Cash Working Capital

	3 Months September 30 2007 \$	3 Months September 30 2006 \$	9 Months September 30 2007 \$	9 Months September 30 2006 \$
Accounts receivable	<b>(430,898)</b>	(484,001)	<b>(882,518)</b>	(887,827)
Inventory	<b>(84,441)</b>	(136,162)	<b>(118,545)</b>	32,557
Prepaid expenses and deposits	<b>(388,066)</b>	94,463	<b>(443,254)</b>	6,320
Accounts payable	<b>(866,143)</b>	458,023	<b>(613,740)</b>	938,132
	<u><b>(1,769,548)</b></u>	<u>(67,677)</u>	<u><b>(2,058,057)</b></u>	<u>89,182</u>
Less: mine development changes in accounts payable	—	—	<b>(7,419)</b>	—
	<u><b>(1,769,548)</b></u>	<u>(67,677)</u>	<u><b>(2,050,638)</b></u>	<u>89,182</u>

### 12. Supplementary Cash Flow Information

	3 Months September 30 2007 \$	3 Months September 30 2006 \$	9 Months September 30 2007 \$	9 Months September 30 2006 \$
Interest received	<b>114,715</b>	10,984	<b>124,751</b>	27,872
Interest paid	—	—	—	—
Income taxes paid	—	—	—	—

# **GENCO RESOURCES LTD.**

## **Notes to the Consolidated Financial Statements**

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### **13. Related Party Transactions**

During the nine month period ended September 30, 2007 the Company paid \$369,975 in consulting and management fees to directors and officers (September 30, 2006 - \$268,391). As at September 30, 2007 there are no amounts owing to directors and officers of the Company included in accounts payable (September 30, 2006: \$2,129).

During the nine month period ended September 30, 2007 directors and officers of the Company exercised 480,072 options ranging from \$0.75 to \$2.25 each and paid \$576,620. In addition, directors and officers of the Company exercised 10,700 share purchase warrants at a price of \$0.90 each and paid \$9,630.

### **14. Subsequent Events**

The Company has no subsequent events to report.

### **15. Economic Dependency**

All sales of concentrate ore are to Compania Minera Pena de Bernal, S.A. de C.V. Included in accounts receivable as at September 30, 2007 is \$817,900 (September 30, 2006: \$755,996) owing from Compania Minera Pena de Bernal.

### **16. Comparative Amounts**

Certain of the prior years' comparative amounts have been reclassified to conform to the presentation adopted in the current year.

### **17. Recent Accounting Pronouncements**

This Section details recent accounting pronouncements that impact these and future financial statements.

#### **a) Financial Instruments – Recognition and Measurement, Section 3855**

In 2005 the CICA issued Section 3855, *Financial Instruments, Recognition and Measurement*. This Section establishes guidelines for recognizing and measuring financial assets, financial liabilities, and non-financial derivatives. The following four fundamental decisions serve as cornerstones underlying this Section:

- i) financial instruments and non-financial derivatives represent rights or obligations that meet the definition of assets or liabilities and should be reported in the financial statements;
- ii) fair value is the most relevant measure for financial instruments and the only relevant measure for derivative financial instruments;
- iii) only items that are assets or liabilities should be reported as such in financial statements; and
- iv) special accounting for items designated as being part of a hedging relationship should be provided only for qualifying items.

# **GENCO RESOURCES LTD.**

## **Notes to the Consolidated Financial Statements**

For the nine months ended September 30, 2007

(Expressed in Canadian dollars)

### **17. Recent Accounting Pronouncements (continued)**

a) Financial Instruments – Recognition and Measurement, Section 3855 (continued)

The mandatory effective date for the new Section is for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Management does not expect the adoption of this standard to have a material effect on the Company's financial position and results of operation.

During 2005 the CICA also issued Section 3861, *Financial Instruments – Disclosure and Presentation*. This section establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. The presentation paragraphs deal with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset. The disclosure paragraphs deal with information about factors that affect the amount, timing and certainty of an entity's future cash flows relating to financial instruments, the business purposes they serve, the risks associated with them and management's policies for controlling these risks. This Section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Management does not expect the adoption of this standard to have a material effect on the Company's consolidated financial position and results of operations.

b) Hedges, Section 3865

This standard is applicable when a company chooses to designate a hedging relationship for accounting purposes. It builds on the existing Accounting Guideline 13 (AcG-13), *Hedging Relationships* and Section 1650, *Foreign Currency Translation*, by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

c) Comprehensive Income, Section 1530

This standard introduces new rules for the reporting and display of comprehensive income. Comprehensive income represents a change in shareholders' equity (net assets) of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. These items include holding gains and losses on certain investments, gain and losses on certain derivative investments, and foreign currency gains and losses related to self-sustaining foreign operations. The Company does not believe that it will have any comprehensive income when it adopts this standard commencing January 1, 2007.