



VOLCANICMETALS

VOLCANIC METALS CORP.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited - Expressed in Canadian Dollars)

FOR THE SIX MONTHS ENDED JUNE 30, 2011

UNAUDITED INTERIM FINANCIAL STATEMENTS

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited financial statements for the period ended June 30, 2011.

VOLCANIC METALS CORP
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
(Unaudited - Expressed in Canadian Dollars)
AS AT

	June 30, 2011	December 31, 2010 (Note 17)
ASSETS		
Current		
Cash	\$ 1,141,345	\$ 719,414
Receivables and prepaid expenses (Note 5)	<u>29,891</u>	<u>23,216</u>
	1,171,236	742,630
Property and equipment (Note 6)	152,933	3,285
Exploration advances (Note 7)	228,367	340,111
Exploration and evaluation - Oil and gas interests (Note 7)	-	296,867
Exploration and evaluation - Mineral properties (Note 8)	<u>1,787,871</u>	<u>1,746,562</u>
	<u>\$ 3,340,407</u>	<u>\$ 3,129,455</u>
LIABILITIES AND EQUITY		
Current		
Accounts payable and accrued liabilities (Note 9)	\$ 150,056	\$ 158,803
Decommissioning provision (Note 10)	8,114	-
Flow-through share premium (Note 12)	<u>45,000</u>	<u>45,000</u>
	<u>203,170</u>	<u>203,803</u>
Equity		
Share capital (Note 12)	4,669,404	3,961,242
Reserves (Note 12)	327,223	291,939
Deficit	<u>(1,859,390)</u>	<u>(1,327,529)</u>
	<u>3,137,237</u>	<u>2,925,652</u>
	<u>\$ 3,340,407</u>	<u>\$ 3,129,455</u>

Nature and continuance of operations (Note 1)

Approved and authorized by the Board on August 24, 2011.

<u>“John LaGourgue”</u>	Director	<u>“Michael Iverson”</u>	Director
John LaGourgue		Michael Iverson	

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

VOLCANIC METALS CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited - Expressed in Canadian Dollars)

	Three months ended June 30, 2011	Three months ended June 30, 2010 (Note 17)	Six months ended June 30, 2011	Six months ended June 30, 2010 (Note 17)
REVENUE				
Oil and natural gas revenue	\$ 4,843	\$ -	\$ 4,843	\$ -
Royalties	(668)	-	(668)	-
	4,175	-	4,175	-
EXPENSES				
Production and operating	3,635	-	3,635	-
Depletion and amortization	504	174	750	348
Accretion	262	-	262	-
Accounting and audit	40,166	21,711	49,166	32,011
Consulting and management fees	60,500	36,075	86,000	89,675
Insurance	2,378	1,745	3,471	2,378
Interest expense and bank charges	253	356	431	792
Investor relations	5,380	50,417	17,637	50,417
Legal	-	4,584	-	7,711
Office and administration	2,852	2,506	3,748	5,505
Regulatory and filing fees	1,502	5,121	11,786	22,106
Rent	4,125	5,096	7,514	11,078
Shareholder communication	164	7,310	(227)	12,187
Site investigations	11,761	-	14,011	12,194
Stock-based compensation	-	20,181	22,216	168,347
Travel	5,484	57,042	9,430	60,324
	(138,966)	(212,318)	(229,830)	(475,073)
Loss before other items	(134,791)	(212,318)	(225,655)	(475,073)
OTHER ITEMS				
Interest income	-	1,099	-	2,326
Impairment of oil and gas interest	(280,627)	-	(306,206)	-
	(280,627)	1,099	(306,206)	2,326
Loss before income taxes	(415,418)	(211,219)	(531,861)	(472,747)
Loss and comprehensive loss for the period	\$ (415,418)	\$ (211,219)	\$ (531,861)	\$ (472,747)
Basic and diluted loss per common share	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.03)
Weighted average number of common shares outstanding	30,489,315	18,879,895	30,489,315	17,233,549

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

VOLCANIC METALS CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS
(Unaudited - Expressed in Canadian Dollars)
Six Months Ended June 30

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss for the period	\$ (531,861)	\$ (472,747)
Items not affecting cash:		
Depletion and amortization	750	348
Accretion	262	-
Interest income	-	(1,227)
Stock-based compensation	22,216	168,347
Impairment of oil and gas interests	306,206	-
Non-cash working capital item changes:		
Receivables and prepaid expenses	(6,675)	(35,791)
Payables and accrued liabilities	<u>(7,271)</u>	<u>(11,606)</u>
Net cash used in operating activities	<u>(216,373)</u>	<u>(352,676)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of Cougar Mining Sh.p.k (Note 4)	-	70,081
Acquisition of equipment	-	(2,325)
Disposal of equipment	-	1,916
Exploration advances	(9,788)	-
Expenditures on oil and gas interests	(31,576)	-
Expenditures on mineral properties	<u>(41,562)</u>	<u>(511,892)</u>
Net cash used in investing activities	<u>(82,926)</u>	<u>(442,220)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of shares for cash, net of costs	<u>721,230</u>	<u>1,121,967</u>
Net cash provided by financing activities	<u>721,230</u>	<u>1,121,967</u>
Change in cash for the period	421,931	327,071
Cash, beginning of period	<u>719,414</u>	<u>435,972</u>
Cash, end of period	<u>\$ 1,141,345</u>	<u>\$ 763,043</u>

Supplemental disclosure with respect to cash flows (Note 15)

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

VOLCANIC METALS CORP.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Unaudited - Expressed in Canadian Dollars)

	<u>Capital Stock</u>				
	Number	Amount	Reserves	Deficit	Total
Balance as at December 31, 2009	13,760,000	\$ 1,271,190	\$ 32,806	\$ (587,980)	\$ 716,016
Acquisition of Cougar (Note 4)	2,600,000	598,000	-	-	598,000
Agent's warrants	57,215	7,855	(2,134)	-	5,721
Stock-based compensation for the period	-	-	168,347	-	168,347
Loss for the period	-	-	-	(472,747)	(472,747)
Balance as at June 30, 2010	16,417,215	\$ 1,877,045	\$ 199,019	\$ (1,060,727)	\$ 1,015,337
Private placement	11,263,056	2,205,265	47,960	-	2,253,225
Share issuance costs	-	(168,074)	35,913	-	(132,161)
Agent's warrants	142,785	19,606	(5,327)	-	14,279
Debt settlement	109,600	27,400	-	-	27,400
Stock-based compensation for the period	-	-	43,832	-	43,832
Forfeiture of options	-	-	(29,458)	29,458	-
Loss for the period	-	-	-	(296,260)	(296,260)
Balance as at December 31, 2010	27,932,656	3,961,242	291,939	(1,327,529)	2,925,652
Private placement	2,960,000	740,000	-	-	740,000
Share issuance costs	-	(31,838)	13,068	-	(18,770)
Stock-based compensation for the period	-	-	22,216	-	22,216
Loss for the period	-	-	-	(531,861)	(531,861)
Balance, June 30, 2011	30,892,656	\$ 4,669,404	\$ 327,223	\$ (1,859,390)	\$ 3,137,237

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

1. NATURE AND CONTINUANCE OF OPERATIONS

Volcanic Metals Corp. is a publicly listed exploration company incorporated in Canada under the British Columbia Corporations Act on April 25, 2007. The Company together with its subsidiary (collectively referred to as the "Company") is principally engaged in acquisition and exploration of resource properties. Upon completion of its qualifying transaction the Company was classified as a Tier II mining company, effective January 28, 2010 (Note 4), and trades on the TSX Venture Exchange under the symbol VOL. On February 19, 2010, the Company changed its name from Volcanic Capital Corp to Volcanic Metals Corp.

The head office, registered address and records office of the Company are located at suite 680-789 West Pender Street, Vancouver, British Columbia, Canada, V6C 1H2.

The Company's financial statements and those of its controlled subsidiary ("Condensed consolidated interim financial statements") are presented in Canadian dollars.

The Company is in the process of exploring and developing its resource properties and has not yet determined whether the properties contain ore reserves that are economically recoverable. The recoverability of the amounts shown for mineral properties and related deferred exploration costs are dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves and upon future profitable production.

2. BASIS OF PREPARATION

These unaudited condensed consolidated interim financial statements, including comparatives have been prepared using accounting policies consistent with International Financial Reporting Standards ("IFRS") and in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*. The condensed consolidated interim financial statements have been prepared on a historical cost basis, except for financial instruments classified as financial instruments at fair value through profit and loss, which are stated at their fair value. In addition, these financial statements have been prepared using the accrual basis of accounting except for cash flow information.

The preparation of these condensed consolidated interim financial statements resulted in changes to the accounting policies as compared with the most recent annual financial statements prepared under Canadian Generally Accepted Accounting Principles ("GAAP"). The accounting policies set out below have been applied consistently to all periods presented in these condensed consolidated interim financial statements. They also have been applied in preparing an opening IFRS balance sheet at January 1, 2010 for the purposes of the transition to IFRS, as required by IFRS 1, First Time Adoption of International Financial Reporting Standards (IFRS 1). The impact of the transition from GAAP to IFRS is explained in Note 17.

Critical Accounting Estimates

The preparation of these condensed consolidated interim financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported expenses during the period. Actual results could differ from these estimates.

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

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

2. BASIS OF PREPARATION (cont'd...)

- i) The carrying value and the recoverability of mineral properties and oil and gas interests, which are included in the condensed consolidated interim statements of financial position.
- ii) The inputs used in calculating the fair value for stock-based compensation expense included in profit and loss and stock-based share issuance costs included in equity.
- iii) The inputs used in calculating the fair value of warrants included in units issued in private placements.
- iv) The valuation of shares issued in non-cash transactions.
- v) The valuation allowance applied against deferred tax assets.
- vi) The inputs used in calculating the decommissioning provision.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

These condensed consolidated interim financial statements include the financial statements of the Company and the entity controlled by the Company (Note 10). Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the condensed consolidated interim financial statements from the date that control commences until the date that control ceases. All significant intercompany transactions and balances have been eliminated.

Foreign exchange

The functional currency is the currency of the primary economic environment in which the entity operations and has been determined for each entity within the Company. The functional currency for all entities within the Company is the Canadian dollar. The functional currency determinations were conducted through an analysis of the consideration factors identified in IAS 21, *The Effects of Changes in Foreign Exchange Rates*.

Transactions in currencies other than the Canadian dollar are recorded at exchange rates prevailing on the dates of the transactions. At the end of each reporting periods, the monetary assets and liabilities of the Company that are denominated in foreign currencies are translated at the rate of exchange at the balance sheet date while non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at the exchange rates approximating those in effect on the date of the transactions. Exchange gains and losses arising on translation are included in the statement of operations.

Financial instruments

Financial assets

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

Fair value through profit or loss - This category comprises derivatives, or assets acquired or incurred principally for the purpose of selling or repurchasing it in the near term. They are carried in the balance sheet at fair value with changes in fair value recognized in the income statement.

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Financial instruments (cont'd...)

Financial assets (cont'd...)

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

Held-to-maturity investments - These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in the income statement.

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

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

Financial liabilities

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

Fair value through profit or loss - This category comprises derivatives, or liabilities acquired or incurred principally for the purpose of selling or repurchasing it in the near term. They are carried in the balance sheet at fair value with changes in fair value recognized in the income statement.

Other financial liabilities: This category includes promissory notes, amounts due to related parties and accounts payables and accrued liabilities, all of which are recognized at amortized cost.

The Company has classified its cash as fair value through profit and loss. The Company's receivables are classified as loans and receivables. The Company's accounts payable and accrued liabilities are classified as other financial liabilities.

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Exploration and evaluation - mineral properties

Pre-exploration costs are expensed as incurred. Costs related to the acquisition and exploration of mineral properties are capitalized by property until the commencement of commercial production. If commercially profitable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the unit of production method. If, after management review, it is determined that capitalized acquisition, exploration and development costs are not recoverable over the estimated economic life of the property, or the property is abandoned, or management deems there to be an impairment in value, the property is written down to its net realizable value.

Any option payments received by the Company from third parties or tax credits refunded to the Company are credited to the capitalized cost of the mineral property. If payments received exceed the capitalized cost of the mineral property, the excess is recognized as income in the year received. The amounts shown for mineral properties do not necessarily represent present or future values. Their recoverability is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete the development, and future profitable production or proceeds from the disposition thereof.

Equipment

Equipment is carried at cost, less accumulated depreciation and accumulated impairment losses. Depreciation of computer equipment is recognized using the declining balance method at an annual rate of 30%. Equipment that is withdrawn from use, or have no reasonable prospect of being recovered through use or sale, are regularly identified and written off. The assets' residual values, depreciation methods and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Subsequent expenditure relating to an item of property, plant and equipment is capitalized when it is probable that future economic benefits from the use of the assets will be increased. All other subsequent expenditure is recognized as repairs and maintenance.

Exploration and evaluation - oil and gas interests

Recognition and measurement

Pre-license costs are recognized in the statement of comprehensive loss as incurred.

Costs relating to oil and gas exploration and evaluation (E&E), including the costs of acquiring licenses and directly attributable general and administrative costs, initially are capitalized as either tangible or intangible E&E assets according to the nature of the assets acquired. The costs are accumulated in cost centers by well, field or exploration area pending determination of technical feasibility and commercial viability.

E&E assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, E&E assets are allocated to cash-generating units (CGU's).

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proven reserves have been discovered. Upon determination of proven reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to a separate category within property, plant and equipment referred to as oil and natural gas interests.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**Oil and gas interests (cont'd...)**Development and production costs

Items of property, plant and equipment (PP&E), which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into CGU's for impairment testing. The Company has grouped its development and production assets into the Viewfield and Moosomin oilfield CGU's.

When significant parts of an item of PP&E have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of PP&E are determined by comparing the net proceeds from disposal with the carrying amount of PP&E and are recognized in the statement of comprehensive income.

Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of PP&E are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing on or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of PP&E are recognized in profit or loss as incurred.

Depletion and depreciation

The net carrying value of development or production assets is depleted using the unit-of production method by reference to the ratio of production in the year to the related proved and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. These estimates are reviewed by independent reserve engineers at least annually.

Proved and probable reserves are estimated using independent reserve engineer reports and represent the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible.

For other assets, depreciation is recognized in profit or loss on either a straight-line or declining balance method over the estimated useful lives of each part of an item of PP&E. Land is not depreciated. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

Cash

Cash is comprised of cash on deposit.

Loss per share

The Company presents basic loss per share for its common shares, calculated by dividing the loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted loss per share does not adjust the loss attributable to common shareholders or the weighted average number of common shares outstanding when the effect is anti-dilutive.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**Impairment**

At the end of each reporting period, the Company's assets are reviewed to determine whether there is any indication that those assets may be impaired. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. The recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in the profit or loss for the period. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but to an amount that does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

Decommissioning provision

The Company recognizes liabilities for statutory, contractual, constructive or legal obligations associated with the retirement of mineral properties, oil and gas interests, and equipment, when those obligations result from the acquisition, construction, development or normal operation of the assets. The net present value of future rehabilitation cost estimates arising from the decommissioning of plant and other site preparation work is capitalized to the production assets along with a corresponding increase in the rehabilitation provision in the period incurred. Discount rates using a pre-tax rate that reflect the time value of money are used to calculate the net present value. The rehabilitation asset is depreciated on the same basis as mining assets.

The Company's estimates of reclamation costs could change as a result of changes in regulatory requirements, discount rates and assumptions regarding the amount and timing of the future expenditures. These changes are recorded directly to mining assets with a corresponding entry to the rehabilitation provision. The Company's estimates are reviewed annually for changes in regulatory requirements, discount rates, effects of inflation and changes in estimates.

Changes in the net present value, excluding changes in the Company's estimates of reclamation costs, are charged to profit and loss for the period.

Stock-based compensation

The Company grants stock options to acquire common shares of the Company to directors, officers, employees and consultants. An individual is classified as an employee when the individual is an employee for legal or tax purposes, or provides services similar to those performed by an employee.

The fair value of stock options is measured on the date of grant, using the Black-Scholes option pricing model, and is recognized over the vesting period. Consideration paid for the shares on the exercise of stock options is credited to capital stock. Upon expiry, the recorded value is transferred to deficit.

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

VOLCANIC METALS CORP.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited - Expressed in Canadian Dollars)
FOR THE THREE MONTHS ENDED JUNE 30, 2011

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Stock-based compensation (cont'd...)

Income taxes

Income tax on the profit or loss for the periods presented comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax is recorded using the statement of financial position liability method, providing for temporary differences, between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes; the initial recognition of assets or liabilities that affect neither accounting or taxable loss; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

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

Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Flow-through shares

Canadian Income Tax legislation permits an enterprise to issue securities referred to as flow-through shares, whereby the investor can claim the tax deductions arising from the renunciation of the related resource expenditures. A premium liability is recognized for the share price premium paid by investors when acquiring the flow-through shares. The premium liability is reduced and deferred income taxes are recognized on the renounced tax deductions as eligible expenditures are incurred.

Newly adopted significant accounting policies

Revenue

Revenue from the sale of the Company's oil is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party. This is generally at the time the product is delivered to the refinery.

New standards yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective as of June 30, 2011 and have not been applied in preparing these Interim Financial Statements. None of these are expected to have a material effect on the financial statements of the Company.

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

New standards yet adopted (cont'd...)

Financial instruments disclosure

In October 2010, the IASB issued amendments to IFRS 7 – Financial Instruments: Disclosures that improve the disclosure requirements in relation to transferred financial assets. The amendments are effective for annual periods beginning on or after July 1, 2011, with earlier adoption permitted. The Company does not anticipate this amendment to have a significant impact on its financial statements

Income taxes

In December 2010, the IASB issued an amendment to IAS 12 – Income taxes that provides a practical solution to determining the recovery of investment properties as it relates to the accounting for deferred income taxes. This amendment is effective for annual periods beginning on or after July 1, 2011, with earlier adoption permitted. The Company does not anticipate this amendment to have a significant impact on its financial statements.

Joint ventures

The IASB issued Exposure Draft 9 – Joint Arrangements (“ED-9”) in September 2007. ED-9 proposed to eliminate the Company’s choice to proportionately consolidate jointly controlled entities and required such entities to be accounted for using the equity method. During the second quarter of 2009, the IASB commenced re-deliberations of ED-9 and now proposes to establish a principles-based approach to the accounting for joint arrangements which focuses on the nature, extent and financial effects of the activities that an entity carries out through joint arrangements and its contractual rights and obligations to assets and liabilities, respectively, of the joint arrangements. The IASB plans on publishing the final standard during the first half of 2011, with an anticipated effective date of January 1, 2013. The Company does not anticipate that the adoption of this standard will have a significant impact on its financial statements.

Consolidation

On September 29, 2010, the IASB posted a staff draft of a forthcoming IFRS on consolidation. The staff draft reflects tentative decisions made to date by the IASB with respect to the IASB’s project to replace current standards on consolidation, IAS 27 - Consolidated and Separate Financial Statements and SIC-12, with a single standard on consolidation. The IASB plans on publishing the final standard on consolidation during the first half of 2011, with an anticipated effective date of January 1, 2013. . The Company is currently evaluating the impact the final standard is expected to have on its financial statements.

Financial instruments

The IASB intends to replace IAS 39 – Financial Instruments: Recognition and Measurement (“IAS 39”) in its entirety with IFRS 9 – Financial Instruments (“IFRS 9”) in three main phases. IFRS 9 will be the new standard for the financial reporting of financial instruments that is principles-based and less complex than IAS 39, and is effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted. In November 2009 and October 2010, phase 1 of IFRS 9 was issued and amended, respectively, which addressed the classification and measurement of financial assets and financial liabilities. IFRS 9 requires that all financial assets be classified as subsequently measured at amortized cost or at fair value based on the Company’s business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified as at FVTPL, financial guarantees and certain other exceptions. The IASB has issued exposure drafts addressing impairment of financial instruments, hedge accounting and the offsetting of financial assets and liabilities, with comments due in March and April of 2011. The complete IFRS 9 is anticipated to be issued during the second half of 2011. The Company is currently evaluating the impact the final standard is expected to have on its financial statements.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

4. ACQUISITION OF COUGAR MINING Sh.p.k

The Company entered into a loan agreement dated September 25, 2009 with Cougar Mining Sh.p.k. ("Cougar"), whereby the Company advanced \$175,000 to Cougar. Cougar used the loan proceeds for the conversion of the existing prospecting permits as required by Albanian mining regulations. The loan was secured by the assets of Cougar and earned interest at 8.0% per annum.

By a separate agreement dated September 25, 2009, the Company advanced \$25,000 as a non-recourse loan. Cougar used the funds to convert its prospecting permits pertaining to its mineral properties in Albania to exploration permits. The loan earned interest at a rate of 8.0% per annum.

The Company also advanced Cougar \$23,469 during the year ended December 31, 2009 for exploration expenditures.

On January 28, 2010, the Company completed its Qualifying Transaction and acquired 100% of the issued and outstanding capital stock of Cougar in consideration for:

- 1) 2,600,000 common shares of the Company's capital stock with a fair value of \$598,000;
- 2) loans and interest accrued of \$205,479;
- 3) an advance of \$23,469;
- 4) a royalty equivalent to 2.5% of net smelter returns; and
- 5) professional fees totalling \$143,541 (2009 - \$128,181) related to the acquisition that were recorded as deferred acquisition costs.

The transaction was accounted for as an asset acquisition of mineral properties and related assets and liabilities using the purchase method, rather than as a business combination, as the net assets acquired did not represent a separate business. The results of operations of Cougar have been included in the condensed consolidated interim financial statements from the date of acquisition.

The total purchase price of \$970,489 was allocated to the fair value of the net assets of Cougar as follows:

Cash	\$ 70,081
Mineral properties	1,052,782
Accounts payable and accrued liabilities	<u>(152,374)</u>
	<u>\$ 970,489</u>

5. RECEIVABLES AND PREPAID EXPENSES

The Company's receivables and prepaid expenses arise from two main sources harmonized sales tax ("HST") and prepaid expenses. These are broken down as follows:

	June 30, 2011	December 31, 2010
HST receivable	\$ 25,269	\$ 7,616
Prepayments	<u>4,622</u>	<u>15,600</u>
Total	<u>\$ 29,891</u>	<u>\$ 23,216</u>

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

6. PROPERTY AND EQUIPMENT

	Oil and gas interests	Computer & office equipment	Total
Cost			
Balance, January 1, 2010	\$ -	\$ 2,472	\$ 2,472
Additions	-	4,612	4,612
Disposals	-	(2,472)	(2,472)
Balance, December 31, 2010	-	4,612	4,612
Transfer from oil and gas interests	142,546	\$ -	142,546
Decommissioning provision	7,852	\$ -	7,852
Balance, June 30, 2011	150,398	\$ 4,612	\$ 155,010
Accumulated depreciation			
Balance, January 1, 2010	\$ -	\$ 556	\$ 556
Depreciation	-	1,327	1,327
Disposals	-	(556)	(556)
Balance, December 31, 2010	-	1,327	1,327
Depreciation and depletion	319	431	750
Balance, June 30, 2011	\$ 319	\$ 1,758	\$ 2,077
Carrying amounts			
As at December 31, 2010	\$ 3,285	\$ 3,285	\$ 3,285
As a June 30, 2011	\$ 150,079	\$ 2,854	\$ 152,933

7. EXPLORATION AND EVALUATION - OIL AND GAS INTERESTS

Balance, January 1, 2010	\$ -
Additions	371,375
Impairment	(74,508)
Balance, December 31, 2010	296,867
Additions	151,885
Transfer to property and equipment	(142,546)
Impairment	(306,206)
Balance, June 30, 2011	\$ -

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

7. EXPLORATION AND EVALUATION - OIL AND GAS INTERESTS (cont'd...)

Exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of proved or probable reserves. Additions represent the Company's share of costs incurred on exploration and evaluation assets during the period. Transfers to property and equipment represent successful drilling and related land costs to which technical feasibility and commercial viability are determined to exist. Transfers to impairment represent unsuccessful drilling costs

Viewfield Property, Southeast Saskatchewan

During fiscal 2010, the Company entered into an agreement to acquire a 15% interest in a test well at the Viewfield Property, Southeast Saskatchewan. To earn its interest the Company funded 25% of the drilling, completion, and equipping costs on the test well. The Company also has the option to participate on all future wells on the property by funding its working interest. The property is subject to a 12.5% Freehold Royalty Tax ("FRT") and a 1% Gross Overriding Royalty ("GORR").

During the six months ended June 30, 2011, the Company commenced production on the Viewfield wells and the recoverable amount of \$142,546 was transferred to property and equipment. The recoverable amount of each CGU was estimated based on the higher of the value in use and the fair value less cost to sell. The estimate of fair value less cost to sell was determined using proved plus probable forecasted cash flows, discounted at 10%, with escalating prices and future development costs, as obtained from the Corporation's reserve report, adjusted for internal estimates and results since that date. The prices used to estimate the fair value less cost to sell are those used by independent industry reserve engineers.

Based on the assessment for the period ended June 30, 2011 the recoverable amount, assessed as the fair value less cost to sell, was determined to be lower than the respective carrying amount and an impairment loss of \$280,327 (2010 - \$Nil) was recognized in the condensed statement of loss

Moosomin Property, Southeast Saskatchewan

During fiscal 2010, the Company entered into an agreement to acquire a 12.5% working interest in a test well at the Moosomin Property, Southeast Saskatchewan. To earn its interest the Company will fund 12.5% of the drilling, completion, and equipping costs. The property is subject to a 15% FRT and a 5% GORR. Due to unfavourable results the Company wrote-off costs associated with the first test well of \$100,387 (2010 - \$74,508).

Exploration advances

As at June 30, 2011, the Company advanced \$228,367 (December 31, 2010 - \$340,111) to the operators for the Company's interest in drilling and equipping costs.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

8. EXPLORATION AND EVALUATION - MINERAL PROPERTIES

	June 30, 2011	December 31, 2010
Exploration costs		
Balance, beginning of period	\$ 693,780	\$ -
Assay	684	10,648
Equipment maintenance and rental	-	7,881
Fees and licenses	-	60,722
Field expenditures	15,129	80,109
Geological consulting	-	143,311
Geophysics	-	239,388
Project administration	25,496	113,329
Report preparation	-	9,767
Travel and transportation	-	28,625
	<u>41,309</u>	<u>693,780</u>
Balance, end of period	<u>735,089</u>	<u>693,780</u>
Acquisition costs		
Balance, beginning of period	<u>1,052,782</u>	-
Acquisition of Cougar Mining Sh.p.k (Note 4)	-	<u>1,052,782</u>
Balance, end of period	<u>1,052,782</u>	<u>1,052,782</u>
	<u>\$ 1,787,871</u>	<u>\$ 1,746,562</u>

Title to mineral properties

Title to mineral properties involves certain inherent risks due to the difficulties of determining the validity of certain mineral titles as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties is in good standing.

Gjegjan Project, Albania

On January 28, 2010, the Company acquired 100% of the issued and outstanding capital stock of Cougar from the previous shareholders of Cougar (Note 4).

Cougar, the Albanian subsidiary, holds the exploration rights to the Gjegjan Project in Albania. The Gjegjan Project consists of prospecting Permit No. 1446, which is a two year permit, issued by the Ministry of Economy, Trade and Energy of Albania on December 2, 2009. The permit is subject to an annual license fee of 30,000 Albanian Leke per km² and upon conversion to a Mining Permit will be subject to an Albanian Government Royalty, as set by the Albanian government on an annual basis.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

8. EXPLORATION AND EVALUATION - MINERAL PROPERTIES (cont'd...)***Gjegjan Project, Albania*** (cont'd...)

Pursuant to the acquisition agreement, the Company acquired all of the issued and outstanding shares of Cougar. The property is subject to a royalty equivalent to 2.5% of net smelter returns, meaning net proceeds actually received by the Company from the sale of all mineral products derived from the Property, less the cost of transportation of such products after they leave the Property (the "Royalty").

The Company may purchase one-half (1.25%) of the Royalty from the former Cougar shareholders at any time, up to one year following commencement of commercial production on the Property, for \$750,000 (the "NSR Purchase Right"). The Royalty is fully transferable by the former Cougar shareholders subject to the Company's NSR Purchase Right.

9. ACCOUNTS PAYABLES AND ACCRUED LIABILITIES

Payables and accrued liabilities for the Company are broken down as follows:

	June 30, 2011	December 31, 2010
Trade payables	\$ 119,206	\$ 104,675
Accrued liabilities	30,000	53,000
Cash calls	<u>850</u>	<u>1,128</u>
Total	<u>\$ 150,056</u>	<u>\$ 158,803</u>

All payables and accrued liabilities for the Company fall due within the next 12 months.

10. DECOMMISSIONING PROVISION

The Company's decommissioning provision results from its ownership interest in oil and natural gas assets. The total decommissioning provision is estimated based on the Corporation's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The total estimated, inflated undiscounted risked cash flows required to settle the provisions, before considering salvage, is approximately \$11,374 at June 30, 2011 (December 31, 2010 - \$Nil), which has been discounted using a risk-free rate of approximately 10% at June 30, 2011 (December 31, 2010 - Nil%). These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 6 years into the future and will be funded from general corporate resources at the time of abandonment.

The following table summarizes changes in the decommissioning provision for the six months ended June 30, 2011 and for the year ended December 31, 2010:

Decommission provision, December 31, 2010	\$ -
Liabilities incurred	7,852
Accretion (unwinding of discount)	<u>262</u>
Decommission provision, June 30, 2011	<u>\$ 8,114</u>

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

11. RELATED PARTY TRANSACTIONS

The financial statements include the financial statements of Volcanic Metals Corp. and its 100% owned mineral exploration Albanian subsidiary Cougar Mining Sh.p.k.

The Company entered into the following transactions with related parties during the period:

- a) Paid or accrued management fees of \$51,000 (2010 - \$51,000) to 1163775 Alberta Ltd, a management company controlled by the CEO and director of the Company.
- b) Paid or accrued management fees of \$Nil (2010 - \$7,500) to Triple K Ventures Ltd, a management company controlled by a director of the Company.
- c) Paid or accrued accounting fees of \$18,000 (2010 - \$14,300) to the CFO of the Company.
- d) Paid or accrued property investigation and engineering services of \$19,394 (2010 - \$Nil) to Flat Top Resources Inc, a company controlled by a director of the Company. At June 30, 2011, the amount payable to this company was \$1,339 (2010 - \$Nil).
- e) Granted stock options to directors and key management personnel and recorded stock-based compensation for the fair value of the options granted of \$ 22,619 (2010 - \$168,347).

The transactions with related parties were in the normal course of operations and were measured at the exchange value, which represented the amount of consideration established and agreed to by the parties.

12. SHAREHOLDERS EQUITY

- a) Authorized share capital:

As at June 30, 2011, the authorized share capital of the Company was an unlimited number of common shares without par value. All issued shares are fully paid.

- b) Escrow shares

Included in capital stock are 1,560,000 common shares subject to an escrow agreement that may not be transferred, assigned or otherwise dealt with without consent of the regulatory authorities.

- c) Issued share capital:

Private placements

During the period ended June 30, 2011, the Company completed a non-brokered private placement and issued 2,960,000 units at \$0.25 per unit for gross proceeds of \$740,000. Each unit comprises one common share and one-half share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at \$0.35 for a period of two years. The Company also issued 56,000 agent's options as finder's fees valued at \$13,068. Each option entitles the holder to acquire one common share at a price of \$0.35 for a period of 1.5 years. The fair value of these agents' warrants was estimated using the *Black-Scholes Option Pricing Model* with the following assumptions: risk-free interest rate of 1.84%; dividend yield 0%; volatility of 116%; and an expected life of 1.5 years. The Company paid other share issuance costs of \$18,770.

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

12. SHAREHOLDERS EQUITY (cont'd...)

During the year ended December 31, 2010, the Company:

- (i) Issued 4,796,000 units at \$0.25 per unit for gross proceeds of \$1,199,000. Each unit comprises one common share and one-half share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at \$0.40 for a period of two years. An estimated value of \$47,960 was assigned to the warrants and is included in contributed surplus. The Company issued 259,000 agents' warrants with similar characteristics to the placement warrants and paid \$80,533 as finder's fees and other share issuance costs. An estimated fair value of \$16,715 was assigned to the agents' warrants. The fair value of these agents' warrants was estimated using the *Black-Scholes Option Pricing Model* with the following assumptions: risk-free interest rate of 1.75%; dividend yield 0%; volatility of 75%; and an expected life of 2 years.
- (ii) Issued 3,661,501 flow-through common shares at \$0.15 per share for gross proceeds of \$549,225. The Company paid \$10,648 in share issuance costs. The Company used the residual method to calculate the fair value of the tax deduction attached with the flow-through common share and recorded a flow through liability of \$Nil.
- (iii) Issued 2,250,000 flow-through common shares at \$0.20 per share and 555,555 units at \$0.18 per unit for gross proceeds of \$550,000. Each unit comprises one common share and one-half share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at \$0.25 for a period of two years. The Company issued 158,929 agents' warrants with similar characteristics to the placement warrants, except for a period of 1.5 years, and paid \$40,980 as finder's fees and other share issuance costs. An estimated fair value of \$19,198 was assigned to the agents' warrants. The fair value of these agents' warrants was estimated using the *Black-Scholes Option Pricing Model* with the following assumptions: risk-free interest rate of 1.76%; dividend yield 0%; volatility of 116%; and an expected life of 1.5 years. The Company used the residual method to calculate the fair value of the tax deduction attached with the flow-through common share and recorded a flow-through liability of \$45,000.

Shares for Debt

During the year ended December 31, 2010 the Company issued 109,600 common shares to settle an outstanding debt of \$27,400.

d) Stock options:

The Company has a stock option plan whereby options may be granted to directors, employees, consultants and certain other service providers to encourage ownership of the Company's common shares. The Company can grant options for up to 10% of the issued and outstanding common shares. The term of any option granted under the Stock Option Plan may not exceed 5 years. The vesting periods for all options granted pursuant to the Stock Option Plan will be determined at the discretion of the Board of Directors at the time of the grant. The number of options granted to any one person may not exceed 5% of the outstanding listed common shares in a 12 month period.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

12. SHAREHOLDERS EQUITY (cont'd...)

The following is a summary of stock options outstanding as at June 30, 2011 and December 31, 2010 and changes during the periods then ended:

	Number of Options	Weighted Average Exercise Price
Outstanding, December 31, 2009	282,960	\$ 0.10
Cancelled/expired	(331,480)	0.13
Granted	<u>1,980,000</u>	<u>0.17</u>
Balance, December 31, 2010	1,931,480	0.17
Granted	<u>100,000</u>	<u>0.29</u>
Balance, outstanding and exercisable June 30, 2011	2,031,480	\$ 0.17

At June 30, 2011, the following stock options were outstanding and exercisable to directors, officers and employees:

	Number	Exercise Price	Expiry Date
Options	141,480	\$ 0.10	April 17, 2013
	1,120,000	0.16	February 3, 2015
	250,000	0.25	June 3, 2015
	370,000	0.16	September 21, 2015
	50,000	0.175	October 29, 2015
	<u>100,000</u>	<u>0.29</u>	<u>January 18, 2016</u>

The Company recognizes stock-based compensation expense for all stock options granted using the fair value based method of accounting. The fair value of the options vested in the three months ended June 30, 2011 is \$22,619 (2010 – \$148,166). The weighted average fair value of options granted in the period is \$0.23 (2010 - \$0.11).

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

12. SHAREHOLDERS EQUITY (cont'd...)

The following assumptions were used for the Black-Scholes valuation of stock options granted during the period:

	June 30, 2011	June 30, 2010
Risk-free interest rate	2.5%	2.5%
Expected life of options	4 years	2.5 years
Annualized volatility	116%	75%
Dividends	0.00	0.00%

e) Warrants:

The following is a summary of warrants outstanding as at June 30, 2011 and December 31, 2010 and changes during the periods then ended:

	Number of Warrants	Weighted Average Exercise Price
Outstanding, December 31, 2009	200,000	\$ 0.10
Exercised	(200,000)	0.10
Granted	<u>3,093,706</u>	<u>0.38</u>
Balance, December 31, 2010	3,093,706	0.38
Granted	<u>1,536,000</u>	<u>0.35</u>
Balance, outstanding and exercisable, June 30, 2011	<u>4,629,706</u>	<u>\$ 0.37</u>

At June 30, 2011, the following warrants were outstanding:

	Number	Exercise Price	Expiry Date
Warrants	2,657,000	\$ 0.40	May 18, 2012
	158,929	0.25	June 30, 2012
	56,000	0.35	September 3, 2012
	277,777	0.25	December 30, 2012
	<u>1,480,000</u>	<u>0.35</u>	<u>March 3, 2013</u>

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

13. SEGMENT INFORMATION

The Company operates in two reportable operating segments, being the acquisition, exploration, and development of mineral properties in Albania and Canada. Geographical information is as follows:

	June 30, 2011	December 31, 2010
Property and equipment Canada	<u>152,933</u>	<u>3,285</u>
Exploration and evaluation - Oil and gas interests Canada	<u>-</u>	<u>296,867</u>
Exploration and evaluation - Mineral properties Albania	<u>1,787,871</u>	<u>1,746,562</u>
	<u>\$ 1,940,804</u>	<u>\$ 2,046,714</u>

14. FINANCIAL AND CAPITAL RISK MANAGEMENT

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly;
and

Level 3 – Inputs that are not based on observable market data.

The fair value of the Company's receivables and accounts payable and accrued liabilities approximate carrying value, which is the amount payable on the consolidated statement of financial position. The Company's other financial instrument, cash, under the fair value hierarchy are based on level one quoted prices in active markets for identical assets or liabilities.

The Company is exposed to varying degrees to a variety of financial instrument related risks:

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations.

The Company's cash is held at large Canadian financial institution in interest bearing accounts. The Company has no investment in asset backed commercial paper.

The Company's accounts receivable consist mainly of HST receivable due from the government of Canada.

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

14. FINANCIAL AND CAPITAL RISK MANAGEMENT (cont'd...)

Liquidity risk

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

The Company manages liquidity risk through its capital management as outlined below. Accounts payable relating to mineral properties and other accounts payable and accrued liabilities are due within one year.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

a) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The risk that the Company will realize a loss as a result of a decline in the fair value of the short-term investments included in cash is minimal because these investments roll over daily.

b) Foreign currency risk

The majority of purchases are transacted in the Canadian dollar. From time to time, the Company funds certain operations, exploration and administrative expenses in Euro dollars on a cash call basis using Euro dollar currency converted from its Canadian dollar bank accounts held in Canada. Management believes the foreign exchange risk derived from currency conversions is not significant and therefore does not hedge its foreign exchange risk.

c) Price risk

The Company is exposed to price risk with respect to commodity prices, particularly gold, copper and oil and gas. The Company closely monitors commodity prices to determine the appropriate course of action to be taken by the Company.

Capital management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue acquisition, exploration and development of mineral properties and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk. In the management of capital, the Company includes its cash and components of shareholders' equity.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets or adjust the amount of cash.

In order to facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions.

The Company currently is not subject to externally imposed capital requirements. There were no changes in the Company's approach to capital management.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

15. SUPPLEMENTARY CASH FLOW INFORMATION

The following were significant non-cash investing and financing transactions during the period ended June 30, 2011:

- a) Mineral property costs of \$15,449 were included in accounts payable.
- b) Exploration and evaluation - oil and gas expenditures of \$121,532 were incurred through exploration advances and \$850 were included in accounts payable.
- c) Exploration and evaluation - oil and gas expenditures of \$142,546 were transferred to property and equipment.
- d) Share issuance costs of \$19,000 were included in accounts payable.
- e) Issuing 56,000 agent's warrants valued at \$13,068 as finder's fees.
- f) Recognition of a decommissioning provision of \$7,852 through property and equipment.

The following were significant non-cash investing and financing transactions during period ended June 30, 2010:

- a) Mineral property costs of \$86,957 were included in accounts payable
- b) Issuing 2,600,000 common shares valued at \$598,000 for the acquisition of Cougar (Note 4).
- c) Issued 259,000 agent's warrants valued at \$16,715 as finder's fees.
- d) Issued 109,600 common shares to settle debt of \$27,400

17. FIRST TIME ADOPTION OF IFRS

As stated in Note 2, these condensed consolidated interim financial statements are for the period covered by the Company's first six month condensed consolidated interim financial statements prepared in accordance with IFRS. The accounting policies in Note 3 have been applied in preparing the condensed consolidated interim financial statements for the period ended June 30, 2011 and 2010, the condensed consolidated interim financial statements for the year ended December 31, 2010 and the opening IFRS statement of financial position on January 1, 2010, the "Transition Date".

In preparing the opening IFRS statement of financial position and the financial statements for the interim period ended June 30, 2011, the Company has adjusted amounts reported previously in financial statements that were prepared in accordance with GAAP. An explanation of how the transition from GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables. The guidance for the first time adoption of IFRS is set out in IFRS 1. IFRS 1 provides for certain mandatory exceptions and optional exemptions for first time adopters of IFRS. The Company did not elect to take any of the IFRS 1 optional exemptions.

Mandatory Exceptions

The estimates previously made by the Company under pre-changeover Canadian GAAP were not revised for the application of IFRS except where necessary to reflect any difference in accounting policy or where there was objective evidence that those estimates were in error. As a result the Company has not used hindsight to revise estimates.

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

17. FIRST TIME ADOPTION OF IFRS (cont'd...)

The reconciliation between the Canadian generally GAAP and IFRS consolidated statement of financial position as at June 30, 2010 is provided below:

		June 30, 2010		
	Note	GAAP	Effect of transition to IFRS	IFRS
ASSETS				
Current				
Cash		\$ 763,043	\$ -	\$ 763,043
Receivables and prepaid expenses		<u>74,561</u>	<u>-</u>	<u>74,561</u>
		837,604	-	837,604
Equipment		1,977	-	1,977
Mineral properties	(a)	1,900,501	(240,813)	1,609,066
	(b)	<u> </u>	<u>(50,622)</u>	<u> </u>
		\$ 2,740,082	\$ (291,435)	\$ 2,448,647
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current				
Accounts payable		\$ 267,164	\$ -	\$ 267,164
Future income taxes	(b)	<u>50,622</u>	<u>(50,622)</u>	<u>-</u>
		317,786	(50,622)	267,164
Shareholders' equity				
Share capital		3,007,823	-	3,007,823
Share compensation reserve		234,387	-	234,387
Deficit	(a)	<u>(819,914)</u>	<u>(240,813)</u>	<u>(1,060,727)</u>
		<u>2,422,296</u>	<u>(240,813)</u>	<u>2,181,483</u>
Total shareholders' equity and liabilities		\$ 2,740,082	\$ (291,435)	\$ 2,448,647

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

17. FIRST TIME ADOPTION OF IFRS (cont'd...)

The reconciliation between GAAP and IFRS total comprehensive income for the three months ended June 30, 2010, is provided below:

		Three Months Ended June 30, 2010		
	Note	GAAP	Effect of transition to IFRS	IFRS
EXPENSES				
Accounting and audit		\$ 21,711	\$ -	\$ 21,711
Depletion and amortization		174	-	174
Consulting and management fees		36,075	-	36,075
Insurance		1,745	-	1,745
Interest expense and bank charges		356	-	356
Investor relations		50,417	-	50,417
Legal		4,584	-	4,584
Office and administration		2,506	-	2,506
Regulatory and filing fees		5,121	-	5,121
Rent		5,096	-	5,096
Shareholder communication		7,310	-	7,310
Site investigations	(a)	-	-	-
Stock-based compensation		20,181	-	20,181
Travel and tradeshows		57,042	-	57,042
		(212,318)	-	(212,318)
OTHER ITEM				
Interest income		1,099	-	1,099
Loss and comprehensive loss for the period		\$ (211,219)	\$ -	\$ (211,219)

VOLCANIC METALS CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

17. FIRST TIME ADOPTION OF IFRS (cont'd...)

The reconciliation between GAAP and IFRS total comprehensive income for the six months ended June 30, 2010, is provided below:

		Six Months Ended June 30, 2010		
	Note	GAAP	Effect of transition to IFRS	IFRS
EXPENSES				
Accounting and audit		\$ 32,011	\$ -	\$ 32,011
Depletion and amortization		348	-	348
Consulting and management fees		89,675	-	89,675
Insurance		2,378	-	2,378
Interest expense and bank charges		792	-	792
Investor relations		50,417	-	50,417
Legal		7,711	-	7,711
Office and administration		5,505	-	5,505
Regulatory and filing fees		22,106	-	22,106
Rent		11,078	-	11,078
Shareholder communication		12,187	-	12,187
Site investigations		-	12,197	12,194
Stock-based compensation		168,347	-	168,347
Travel and tradeshows		60,324	-	60,324
		(462,879)	(12,194)	(475,073)
OTHER ITEMS				
Interest income		2,326	-	2,326
Loss and comprehensive loss for the year		\$ (460,553)	\$ (12,194)	\$ (472,747)

VOLCANIC METALS CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited - Expressed in Canadian Dollars)

FOR THE THREE MONTHS ENDED JUNE 30, 2011

17. FIRST TIME ADOPTION OF IFRS (cont'd...)

There are no significant differences between IFRS and Canadian GAAP in connection with the Company's statements of cash flows for the period ended June 30, 2010 or the year ended December 31, 2010.

a) Exploration on mineral properties

Under GAAP, the Company deferred certain exploration and evaluation expenditures incurred prior to the Company obtaining legal rights to explore the claims. IFRS 6, Exploration for and evaluation of Mineral Resources does not permit the deferral of exploration and evaluation expenditures prior to obtaining legal rights to the claims.

b) Deferred tax on mineral properties

Under GAAP, the Company recognized future income taxes on temporary differences arising on the initial recognition of the Gjegjan Project (where the fair value of the asset acquired exceeded its tax basis) in a transaction which was not a business combination and affected neither accounting profit (loss) nor taxable profit (loss). IAS 12, Income Taxes, does not permit the recognition of deferred taxes on such transactions.

As of the Transition Date and December 31, 2010, the Company has derecognized the impacts of all deferred taxes which had previously been recognized on the initial acquisition of the mineral properties through transactions deemed not to be business combinations and affecting neither accounting profit (loss) nor taxable profit (loss).

c) Flow through shares

Canadian GAAP has specific guidance for the treatment of flow-through shares, which are an equity instrument unique to Canada and therefore, there is no specific equivalent guidance under IFRS. Under the IFRS framework, the shares can be seen as a compound instrument, consisting of a share and a tax benefit and when the shares are issued the premium paid for the tax benefit in excess of the market value of the shares on a standalone basis is credited to flow-through liabilities. When the qualifying expenditures are made and the renouncement has been filed with the tax authorities, the obligation of the Company to pass the tax benefit to the shareholder has been discharged, and accordingly, the liability is taken into income at that point in time as a future income tax recovery.

As a result of this change in policy, during the year ended December 31, 2010, a flow through liability of \$45,000 was recognized and reallocated from share capital. This will be taken into income once the expenditures are incurred.

d) Share based payments

On transition to IFRS the Company elected to change its accounting policy for the treatment of share-based payments whereby amounts recorded for forfeited or expired unexercised stock options are transferred to deficit. Previously, the Company's Canadian GAAP policy was to leave such amounts in contributed surplus.