FORTUNA SILVER MINES INC.

CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2009 and 2008

(Expressed in thousands of United States Dollars, unless otherwise stated)

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Auditors' Report

To the Shareholders of
Fortuna Silver Mines Inc.

We have audited the consolidated balance sheets of Fortuna Silver Mines Inc. as at December 31, 2009 and 2008 and the consolidated statements of operations, comprehensive income (loss), cash flows, and shareholders' equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) Deloitte & Touche LLP

Chartered Accountants
March 18, 2010

FORTUNA SILVER MINES INC.
CONSOLIDATED BALANCE SHEETS
AS AT DECEMBER 31,
(Expressed in thousands of US Dollars)

	Notes		2009		2008
ASSETS					
CURRENT					
Cash		$	**30,763**	$	29,454
Short term investments	4		**6,034**		-
Derivatives	5		**-**		1,418
Accounts receivable and prepaid expenses	6		**8,635**		1,865
GST and value added tax			**601**		5,127
Inventories	7		**2,329**		1,727
			48,362		39,591
LONG TERM INVESTMENT AND RECEIVABLE	8		**16**		3,207
PROPERTY, PLANT AND EQUIPMENT	9		**17,233**		13,285
MINERAL PROPERTIES	10		**74,127**		59,285
		$	**139,738**	$	115,368
LIABILITIES					
CURRENT					
Accounts payable and accrued liabilities	11	$	**8,083**	$	4,735
Due to related parties, net	12		**49**		38
Derivatives	5		**3,055**		-
Current portion of long term liability	13 a), 13 b)		**1,038**		762
			12,225		5,535
LONG TERM LIABILITY	13 a), 13 b)		**1,454**		1,382
ASSET RETIREMENT OBLIGATION	14		**2,529**		1,066
FUTURE INCOME TAX LIABILITY	15		**10,973**		9,410
NON-CONTROLLING INTEREST	3		**-**		9,007
			27,181		26,400
SHAREHOLDERS' EQUITY					
SHARE CAPITAL			**104,701**		98,206
CONTRIBUTED SURPLUS			**14,315**		11,854
DEFICIT			**(9,357)**		(9,980)
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)			**2,898**		(11,112)
			(6,459)		(21,092)
			112,557		88,968
		$	**139,738**	$	115,368

Commitments and contingencies	18
Subsequent events	10, 22

APPROVED BY THE DIRECTORS:

"Jorge Ganoza Durant", Director
Jorge Ganoza Durant

" Simon Ridgway", Director
Simon Ridgway

FORTUNA SILVER MINES INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31,
(Expressed in thousands of US Dollars, except for share and per share amounts)

	Notes		2009		2008
Sales		**$**	**51,428**	$	24,867
Cost of sales			**17,755**		15,605
Depletion, depreciation and accretion			**5,944**		5,363
MINE OPERATING INCOME			**27,729**		3,899
Selling, general and administrative expenses (includes depreciation of $64 (2008: $49))	**12**		**9,558**		7,815
Stock-based compensation	**16 d)**		**2,707**		1,348
Write-off of deferred exploration costs			**1,081**		329
			13,346		9,492
OPERATING INCOME (LOSS)			**14,383**		(5,593)
Interest and other income and expenses			**433**		1,361
Interest and finance expenses			**(160)**		(98)
Net (loss) gain on commodity contracts			**(7,356)**		4,269
(Loss) on disposal of property, plant and equipment			**(101)**		(45)
(Loss) on disposal of investment			**(236)**		-
Foreign exchange (loss) gain			**(651)**		793
			(8,071)		6,280
INCOME BEFORE INCOME TAXES AND NON-CONTROLLING INTEREST			**6,312**		687
Income tax provision			**5,869**		1,699
Non-controlling interest			**(180)**		(102)
NET INCOME (LOSS) FOR THE YEAR		**$**	**623**	$	(910)
Earnings (Loss) per Share - Basic and Diluted		**$**	**0.01**	$	(0.01)
Weighted average number of shares outstanding - Basic and Diluted			**91,802,881**		84,400,969

FORTUNA SILVER MINES INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31,
(Expressed in thousands of US Dollars)

		2009		2008
Net income (loss) for the year	**$**	**623**	$	(910)
Other comprehensive income (loss)				
Unrealized gain (loss) on available for sale long term investments, net of taxes		**148**		(745)
Transfer of unrealized loss to realized loss upon derecognition of available for sale long term investment, net of taxes		**462**		-
Unrealized gain on translation of functional currency to reporting currency		**13,400**		(21,754)
Other comprehensive income (loss)		**14,010**		(22,499)
Comprehensive income (loss)	**$**	**14,633**	$	(23,409)

FORTUNA SILVER MINES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,
(Expressed in thousands of US Dollars)

	Notes	2009	2008
OPERATING ACTIVITIES			
Net income (loss) for the year		$ 623	$ (910)
Items not involving cash			
Depletion and depreciation		5,858	5,350
Accretion expense		150	102
Future income tax		794	1,698
Stock-based compensation		2,707	1,348
Unrealized loss on commodity contracts		4,473	8
Non-controlling interest		(180)	(102)
Write-off of deferred exploration costs		1,081	329
Loss on disposal of equipment		101	45
Loss on disposal of investments		236	-
Unrealized foreign exchange loss		67	785
		15,910	8,653
Changes in non-cash working capital items			
Accounts receivable and prepaid expenses		(5,073)	255
Inventories		(313)	(411)
Accounts payable		3,158	(172)
Due to related parties		4	31
Net cash provided by operating activities		13,686	8,356
INVESTING ACTIVITIES			
Costs relating to the acquisition of Continuum	3	(162)	-
Acquisition of short term investments		(5,990)	-
Mineral property expenditures		(11,023)	(21,200)
Value added taxes on purchase of property, plant and equipment		2,897	(1,473)
Property, plant & equipment		(3,098)	(3,535)
Long term receivable		96	(16)
Proceeds on disposal of equipment		47	37
Acquisition of long term investments		(235)	-
Proceeds on disposal of long term investments		489	-
Net cash (used in) investing activities		(16,979)	(26,187)
FINANCING ACTIVITIES			
Net proceeds on issuance of common shares		1,025	7,586
Capital lease obligations		(976)	(351)
Net cash provided by financing activities		49	7,235
Effect of exchange rate changes on cash		4,553	(8,106)
(DECREASE) IN CASH		(3,244)	(10,596)
Cash - beginning of year		29,454	48,156
CASH - END OF YEAR		$ 30,763	$ 29,454
Supplemental cash flow information	21		

The accompanying notes are an integral part of these audited consolidated financial statements

FORTUNA SILVER MINES INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008
(Expressed in thousands of US Dollars, except for share amounts)

		Share Capital										
	Notes	Shares		Amount		Contributed Surplus		(Deficit)		Accumulated Other Comprehensive (Loss) Income		Total Shareholders' Equity
Balance - December 31, 2007		80,977,663	$	90,176	$	10,533	$	(9,070)	$	135	$	91,774
Effect of change in reporting currency		-		-		-		-		11,252		11,252
Exercise of options		31,400		37		-		-		-		37
Exercise of warrants		4,322,596		7,966		-		-		-		7,966
Transfer of contributed surplus on exercise of options		-		27		(27)		-		-		-
Stock-based compensation		-		-		1,348		-		-		1,348
(Loss) for the year		-		-		-		(910)		-		(910)
Unrealized loss of available for sale long term investments		-		-		-		-		(745)		(745)
Unrealized (loss) on translation of functional currency to reporting currency		-		-		-		-		(21,754)		(21,754)
Balance - December 31, 2008		85,331,659	$	98,206	$	11,854	$	(9,980)	$	(11,112)	$	88,968
Exercise of options		389,000		281		-		-		-		281
Exercise of warrants		2,475,355		776		-		-		-		776
Issuance of shares for property		6,786,674		5,192		-		-		-		5,192
Cancellation of fractional shares		(36)		-		-		-		-		-
Transfer of contributed surplus on exercise of options		-		246		(246)		-		-		-
Stock-based compensation		-		-		2,707		-		-		2,707
Income for the year		-		-		-		623		-		623
Unrealized gain on available for sale long term investments		-		-		-		-		148		148
Transfer of unrealized loss to realized loss upon derecognition of available for sale long-term investment		-		-		-		-		462		462
Unrealized gain on translation of functional currency to reporting currency		-		-		-		-		13,400		13,400
Balance - December 31, 2009		**94,982,652**	**$**	**104,701**	**$**	**14,315**	**$**	**(9,357)**	**$**	**2,898**	**$**	**112,557**

1. Nature of Operations

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

2. Summary of Significant Accounting Policies

a) Basis of presentation and principles of consolidation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and presented in US dollars. The consolidated financial statements include the accounts of the Company and wholly owned subsidiaries: Minera Bateas S.A.C. ("Bateas"); Fortuna Silver (Barbados) Inc.; Compania Minera Cuzcatlan SA ("Cuzcatlan"); Continuum Resources Ltd. ("Continuum"); and Fortuna Silver Mines Peru S.A.C.

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

b) Change in Reporting Currency

Effective January 1, 2009, the Company changed its reporting currency to the US dollar. The change in reporting currency better reflects the Company's business activities and improves investors' ability to compare the Company's financial results with other publicly traded businesses in the mining industry. Prior to January 1, 2009, the Company reported its annual and quarterly consolidated balance sheets and the related consolidated statements of operations and cash flows in Canadian dollars (CAD).

In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants ("CICA"), set out in EIC-130, "Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency".

In accordance with EIC-130, the financial statements for all years and periods presented have been translated into the new reporting currency using the current rate method. Under this method, the statements of operations and cash flows statements items for each year and period have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the consolidated balance sheets dates. All resulting exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US dollars.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

2. Summary of Significant Accounting Policies (continued)

b) Change in Reporting Currency (continued)

	Condensed Consolidated Balance Sheet As at December 31, 2008		
	expressed in CAD 000's	foreign currency translation at 1.22267	expressed in USD 000's
Current Assets	$ 48,413	$ (8,822)	$ 39,591
Total Assets	141,072	(25,704)	115,368
Current Liabilities	6,769	(1,234)	5,535
Total Liabilities	32,282	(5,882)	26,400
Shareholders' Equity	108,790	(19,822)	88,968
Total Liabilities and Shareholders' Equity	141,072	(25,704)	115,368

	Condensed Consolidated Statement of Operations As at December 31, 2008		
	expressed in CAD 000's	foreign currency translation at 1.05921	expressed in USD 000's
Sales	$ 26,339	$ (1,472)	$ 24,867
Mine operating income	4,130	(231)	3,899
Operating (loss)	(5,925)	332	(5,593)
Income before income taxes and non-controlling interest	727	(40)	687
Net (loss) for the year	(964)	54	(910)

2. Summary of Significant Accounting Policies (continued)

c) Adoption of New Accounting Standards

i. Goodwill and Intangible Assets (Section 3064)

In February 2008, the CICA issued the following Handbook Sections : Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs", and amended Section 1000, "Financial Statement Concepts". The standard intends to reduce the differences with International Financial Reporting Standards ("IFRS") in the accounting for intangible assets and results in closer alignment with U.S. GAAP. Under previous Canadian standards, more items are recognized as assets than under IFRS or U.S. GAAP. The objectives of Section 3064 are to reinforce the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition; and clarify the application of the concept of matching revenues and expenses such that the current practice of recognizing assets that do not meet the definition and recognition criteria are eliminated. The standard also provides guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. This standard is effective for fiscal years beginning on or after October 1, 2008. The Company has evaluated the new section and determined that adoption of these new requirements did not have a material impact on the Company's consolidated financial statements.

ii. Credit risk and fair value of financial assets and financial liabilities

In January 2009, the Emerging Issues Committee of the CICA issued EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments, for presentation and disclosure purposes.

The guidance is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after the date of issuance of this Abstract. Retrospective application with restatement of prior periods is permitted but not required.

The Company has evaluated the new section and determined that adoption of these new requirements did not have a material impact on the Company's consolidated financial statements.

iii. Mining Exploration Costs

On March 27, 2009, the Emerging Issues Committee of the CICA issued EIC-174 "Mining Exploration Costs" which applies to interim and annual financial statements for periods ending on or after January 20, 2009. This guidance clarified that an entity that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

2. Summary of Significant Accounting Policies (continued)

c) Adoption of New Accounting Standards (continued)

iii. Mining Exploration Costs (continued)

The Company has adopted this new standard in its December 31, 2009 annual financial statements with no impact on the Company's consolidated financial statements.

iv. Financial Instruments - Disclosure

In 2009, the Accounting Standards Board ("AcSB") amended CICA Handbook Section 3862, *Financial Instruments - Disclosures* ("Section 3862"), to require enhanced disclosures about liquidity and about the relative reliability of the data, or "inputs", that an entity uses in measuring the fair values of its financial instruments. The new requirements are effective for annual financial statements for fiscal years ending after September 30, 2009. The Company has adopted this new standard in its December 31, 2009 annual financial statements.

d) Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates are: quantities of proven and probable silver reserves; the value of mineralized material beyond proven and probable reserves; future costs and expenses to produce proven and probable reserves; future commodity prices and foreign currency exchange rates; the future cost of asset retirement obligations; amounts of contingencies; and the fair value of acquired assets and liabilities including pre-acquisition contingencies. Significant items that require estimates as the basis for determining the stated amounts include inventories, trade accounts receivable, mineral properties, property, plant and equipment, investments in non-producing properties, revenue recognition, stock-based compensation, unrealized gains and losses on commodity contracts, fair value of assets and liabilities acquired in a business combination, and taxes.

e) Revenue Recognition

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

2. Summary of Significant Accounting Policies (continued)

f) Cash

Cash which is designated as held-for-trading financial assets and measured at fair value, include cash on hand and demand deposits.

g) Short term investments

Short term investments, which are designated as held-for-trading financial assets and measured at fair value, include bank notes, guaranteed investment certificates, term deposits, and money market instruments with maturities greater than 90 days, but less than one year, from the date of acquisition.

h) Long term investments

Long term investments are those investments which the Company will be retaining for a period longer than one year. These investments are classified as available-for-sale and are recorded at fair value.

i) Property, Plant and Equipment

Property, plant and equipment are recorded at cost and are depreciated over the estimated economic life of the asset on a straight line basis as follows:

Buildings, mine site	Life of mine
Buildings, other	6 - 20 years
Machinery and equipment	3 - 8 years or Life of mine
Furniture and other equipment	3 - 13 years
Transport units	4 - 5 years

The expected remaining life of Caylloma mine as at December 31, 2009 is 8.3 years.

Land is not depreciated. Equipment under capital lease is initially recorded at the present value of minimum lease payments at the inception of the lease. Spare parts and components included in machinery and equipment, depending on the replacement period of the initial component, is depreciated over 8 to 18 months.

2. Summary of Significant Accounting Policies (continued)

j) Depletion and Mineral Properties Cost

The Company defers the cost of acquiring, maintaining its interest, exploring, and developing mineral properties until such time as the properties are placed into production, abandoned, sold or considered to be impaired in value. General exploration costs that do not relate to a property where the Company has a vested interest are expensed as incurred. Costs of producing properties are depleted on a unit-of-production basis over proven and probable reserves and costs of abandoned properties are written-off. Proceeds received from the sale of interests in mineral properties are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment in value are charged to operations.

Significant payments related to the acquisition of land and mineral rights are capitalized as incurred. Prior to acquiring such land or mineral rights, the Company makes a preliminary evaluation to determine that the property has significant potential to develop an economic ore body. The time between initial acquisition and full evaluation of a property's potential is dependent on many factors including location relative to existing infrastructure, the property's stage of development, geological controls, and metal prices. If a mineable ore body is discovered, such costs are amortized when production commences. If no mineable ore body is discovered, such costs are expensed in the period in which it is determined the property has no future economic value. In countries where the Company paid Value Added Tax ("VAT") and where there is uncertainty of its recoverability, the VAT payments are capitalized with mineral property costs relating to the property or expensed if the exploration costs have been expensed according to our accounting policy. If the Company recovers amounts that have been deferred, the amount received will be applied to reduce mineral property costs or taken as a credit against current expenses depending on the prior treatment.

k) Operational Mining Properties and Mine Development

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

Costs associated with commissioning activities on constructed plants are deferred from the date of mechanical completion of the facilities until the date the Company is ready to commence commercial production. Any revenues earned during this period are recorded as a reduction in deferred commissioning costs. These costs are depleted using the units-of-production method over the life of the mine, commencing on the date of commercial service.

2. Summary of Significant Accounting Policies (continued)

l) Asset Impairment

Management reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Impairment is considered to exist if total estimated future cash flows or probability-weighted cash flows on an undiscounted basis are less than the carrying amount of the assets, including mineral property, plant and equipment and producing and non-producing properties. An impairment loss is measured and recorded based on discounted estimated future cash flows or the application of an expected present value technique to estimate fair value in the absence of a market price. Future cash flows are based on recoverable proven and probable reserves and a portion of recoverable resources, silver, zinc, copper, lead and gold prices (considering current and historical prices, price trends and related factors), production levels, capital and reclamation costs, all based on detailed engineering life-of-mine plans. Assumptions underlying future cash flow estimates are subject to risks and uncertainties.

Any differences between significant assumptions and market conditions and/or the Company's performance could have a material effect on any impairment provision, and on the Company's financial position and results of operations. In estimating future cash flows, assets are grouped at the lowest levels for which there are identifiable cash flows that are largely independent of cash flows from other groups. Generally, in estimating future cash flows, all assets are grouped at a particular mine for which there is identifiable cash flow.

m) Asset Retirement Obligation

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

n) Inventories

Inventories include metals contained in concentrates, stockpile ores, and operating materials and supplies. The classification of metals inventory is determined by the stage at which the ore is in the production process. Inventories of ore are sampled for metal content and are valued based on the lower of actual production costs incurred or estimated net realizable value based upon the period ending prices of contained metal. Mined material that does not contain a minimum quantity of metal to cover estimated processing expense to recover the contained metal is not classified as inventory and is assigned no value.

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

2. Summary of Significant Accounting Policies (continued)

o) Income Taxes

The Company uses the asset and liability method of accounting for income taxes in accordance to the CICA Handbook Section 3465 *"Income Taxes"*. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of substantive enactment. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

p) Stock-based Compensation

The Company has a share option plan which is described in Note 16. d). The Company records all stock-based compensation relating to options granted using the fair value method such that stock-based payments are measured at fair value and expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

q) Earnings (loss) per Share

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period.

The diluted earnings (loss) per share calculation is based on the weighted average number of common shares outstanding during the period, plus the effects of dilutive common share equivalents. This method requires that the dilutive effect of outstanding options and warrants issued should be calculated using the treasury stock method. This method assumes that all common share equivalents have been exercised at the beginning of the period (or at the time of issuance, if later), and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the period, but only if dilutive.

2. Summary of Significant Accounting Policies (continued)

r) Foreign Currency Translation

Fortuna Silver Mines Inc.'s functional currency is the Canadian dollar. Effective January 1, 2009, the Company changed its reporting currency to the US dollar.

All subsidiaries, except its wholly owned subsidiary, Bateas, are considered to be self sustaining operations. Bateas's integrated foreign operations and their financial statements are translated to US dollars under the temporal method. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at historical exchange rates. Revenues and expenses are translated at the average exchange rate in effect during the period. Realized and unrealized foreign exchange gains and losses are included in earnings.

Commencing January 1, 2009, Bateas is an integrated foreign operation because Bateas translates its financial statements denominated in Peruvian Soles to US dollars using the temporal method.

All other subsidiaries' financial statements are translated using the current rate method. Assets and liabilities are translated into US dollars using the current rate method at period-end exchange rates and resulting translation adjustments are reflected in comprehensive income. Revenues and expenses are translated at average exchange rates for the period.

s) Financial Instruments

The Company applies as prescribed Section 3855, "Financial Instruments - Recognition and Measurement". CICA Standard 3855 establishes standards for recognizing and measuring financial assets, financial liabilities, and non-financial derivatives. Under CICA 3855, all financial assets must be classified as either held-for-trading, available-for-sale, held-to-maturity investments or loans and receivables. All financial liabilities must be classified as held-for-trading or other financial liabilities. All financial instruments, including derivatives, are included on the Consolidated Balance Sheets and are measured at fair value, except for held-to-maturity investments, loans and receivables, and other financial liabilities, and these are all measured at amortized cost. The carrying value of receivables, and accounts payable and accrued liabilities approximate their fair value because of the short-term maturity of those instruments. Subsequent measurements and recognition of changes in fair value depend on the instrument's initial classification. Held-for-trading financial instruments are measured at fair value, and all gains and losses are included in net income (loss) in the period in which they arise. Available- for-sale financial instruments are measured at fair value, determined by published market prices in an active market, except for investments in equity instruments that do not have quoted market prices in an active market which are measured at cost. Changes in fair value are recorded in other comprehensive income (loss) until the assets are removed from the balance sheet. Investments classified as available-for-sale are written down to fair value through income whenever it is necessary to reflect other than-temporary impairment. Realized gains and losses on the disposal of available-for-sale securities are recognized in investment and other income. Also, transaction costs related to all financial assets and liabilities are recorded in the acquisition or issue cost, unless the financial instrument is classified as held-for-trading or other liabilities, in which case the transaction costs are recognized immediately in net income (loss).

2. Summary of Significant Accounting Policies (continued)

s) Financial Instruments (continued)

CICA Handbook Section 3855 also requires financial and non-financial derivative instruments to be measured at fair value and recorded as either assets or liabilities. Certain derivatives embedded in non-derivative contracts must also be measured at fair value. Any changes in the fair value of recognized derivatives are included in net income (loss) for the period in which they arise, unless specific hedge accounting criteria are met, as defined in CICA Section 3865. The same accounting treatment applied to these non-financial derivative contracts prior to the adoption of CICA Section 3855. Fair values for the Company's recognized commodity-based derivatives are based on the forward prices of the associated market index.

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

Financial Instrument	Classification	Measurement
Cash	Held-for-trading	Fair value
Short term investments	Held-for-trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Long term receivables	Loans and receivables	Amortized cost
Long term investments and receivables	Available for sale	Fair value
Derivatives	Held-for-trading	Fair value
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Due to related parties, net	Other liabilities	Amortized cost
Long term liability	Other liabilities	Amortized cost

t) Derivatives and Trading Activities

The Company employs metals contracts, including forward contracts to manage exposure to fluctuations in metal prices. For metals production, these contracts are intended to reduce the risk of falling prices on the Company's future sales.

All derivative instruments are recorded on the balance sheet at fair value. Unrealized gains and losses on derivative instruments are marked to market at the end of each accounting period with the results included in gain or loss on commodity and foreign currency contracts in the Consolidated Statement of Operations.

2. Summary of Significant Accounting Policies (continued)

u) Comparative figures

Certain comparative figures have been reclassified to conform with the presentation adopted for the current year. In particular, certain balance sheet items were condensed.

v) Recently released Canadian Accounting Standards

The Company has assessed new and revised accounting pronouncements that have been issued and determined that the following may have an impact on the Company:

i. Convergence with International Financial Reporting Standards (“IFRS”)

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with International Financial Reporting Standards (“IFRS”) over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will begin reporting its financial statements in accordance with IFRS on January 1, 2011, with comparative figures for 2010.

The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

ii. Business Combinations

In January 2009, the CICA issued the following Handbook Sections: Section 1582, “Business Combinations”, Section 1601, “Consolidated Financial Statements”, and Section 1602, “Non-controlling Interests”. These new standards are harmonized with International Financial Reporting Standards (IFRS). Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 specifies that non-controlling interests be treated as a separate component of equity, not as a liability or other item outside of equity. The new standards will become effective in 2011 but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

2. Summary of Significant Accounting Policies (continued)

v) Recently released Canadian Accounting Standards (continued)

iii. Comprehensive revaluation of assets and liabilities and Equity

In August 2009, the CICA amended Handbook Section 1625, "Comprehensive revaluation of assets and liabilities" as a result of issuing "Business Combinations, Section 1582, "Consolidated Financial Statements", Section 1601, and Non-Controlling Interests", Section 1602, in January 2009.

In August 2009, the CICA amended Handbook Section 3251, "Equity" as a result of issuing Section 1602, "Non-controlling Interests". These amendments only apply to entities that have adopted Section 1602.

These amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011, but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

iv. Financial Instruments and Impaired Loans

In August 2009, the CICA issued amendments to Section 3855, "Financial Instruments: Recognition and Measurement". These amendments will permit (or require in certain circumstances) entities to reclassify certain investments in debt instruments, will amend the guidance regarding impairment measurement for Held-to-Maturity debt instruments and will require reversals of impairment losses for Available for Sale debt instruments when conditions have changed. These amendments apply only to investments in debt instruments and do not apply to investments in equity investments or to debt instruments that have been designated at origination as Held-for-Trading.

In August 2009, the CICA amended Section 3025, "Impaired loans" to conform with the definition of a loan to that in amended Section 3855 and to include held-to-maturity investments within the scope of this Section.

These amendments are effective for annual financial statements relating to fiscal years beginning on or after November 1, 2008 with early adoption permitted for interim financial statements issued on or after August 20, 2009. The Company has evaluated the new section and determined that adoption of these new requirements, for fiscal year end December 31, 2009, did not have a material impact on the Company's consolidated financial statements.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

3. Acquisition of mining interest

On March 6, 2009, the Company closed the acquisition of all the issued and outstanding shares of Continuum which had 124,037,920 shares outstanding as of March 6, 2009. The Company agreed to issue to the Continuum shareholders a total of 6,995,738 shares, which is an exchange ratio of approximately 0.0564 of a share of the Company for every one Continuum share held.

As Fortuna held 3,706,250 common shares of the issued and outstanding share capital of Continuum as at March 6, 2009, those shares were cancelled and Fortuna issued a total of 6,786,674 shares to the Continuum shareholders other than Fortuna. As a result of the acquisition of Continuum, Fortuna now owns 100% of the San Jose Project in Oaxaca, Mexico.

The acquisition is being accounted for as a purchase of assets. The following calculations include the fair value of Fortuna shares issued, based on the issuance of 6,786,674 Fortuna shares at CAD$0.98 per share for consideration of $5,194 (CAD$6,651). A valuation date of March 6, 2009 was determined for the share value.

The difference between the purchase consideration and the fair values of Continuum's other assets and liabilities has been allocated to "Mineral properties". The fair value of all identifiable assets and liabilities acquired was determined by a valuation effective March 6, 2009. No future tax asset has been recorded. The resulting "negative" purchase price discrepancy would have resulted in a future tax asset as it is more likely than not that this will not be recovered.

The purchase price allocation is as follows:

Purchase price		
6,786,674 common shares of Fortuna	$	5,194
Acquisition costs		113
Loan to Continuum		3,184
Cost of shares previously acquired		130
Total purchase price	**$**	**8,621**
Purchase price allocation		
Net assets acquired:		
Cash received	$	5
Property, plant & equipment		6
Mineral property interests		8,749
Accounts payable and accrued liabilities		(139)
Net identifiable assets of Continuum	**$**	**8,621**

Included as part of the mineral property interests purchased was the Predilecta project in Mexico with a value of $87 at acquisition date.

As a result of the acquisition of Continuum, the non-controlling interest previously in Cuzcatlan was eliminated.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

4. Short term investments

	December 31, 2009			December 31, 2008		
Held-for-Trading	**Fair Value**	**Cost**	**Accumulated unrealized holding gains (losses)**	Fair Value	Cost	Accumulated unrealized holding gains (losses)
Short term investments	**$ 6,034**	**$ 6,034**	**$ -**	**$ -**	**$ -**	**$ -**
	$ 6,034	**$ 6,034**	**$ -**	$ -	$ -	$ -

5. Derivatives

During the year, the Company entered into commodity forward and option contracts to secure a minimum price level on part of its Caylloma's zinc and lead metal production throughout the period covering February 2009 to December 2010 with the objective of securing short term capital requirements for project development.

The counterparties are Standard Bank PLC, Banco Bilbao Vizcaya Argentaria, S.A., Macquarie Bank Limited, Goldman Sachs, and Scotia Bank.

<u>*Forward Sales Contracts - Swap Basis*</u>

The contracts are spread evenly over the periods shown below with settlement occurring on a monthly basis. No initial premium associated with these trades has been paid.

The following forward sale contracts were entered into on a SWAP basis, as defined below:

January 2009 - settlements throughout February 2009 to July 2009:

Lead forward contracts:	$1,109/t, for the total of 3,150 tons
Zinc forward contracts:	$1,240/t, for the total of 3,850 tons

July 2009 - settlements throughout August 2009 to December 2009:

Lead forward contracts:	$1,645/t, for the total of 2,675 tons
Zinc forward contracts:	$1,561/t, for the total of 3,000 tons

August 2009 - settlements throughout January 2010 to June 2010:

Lead forward contracts:	$1,910/t, for the total of 1,800 tons
Zinc forward contracts:	$1,787/t, for the total of 1,050 tons

5. Derivatives (continued)

Forward Sales Contracts - Swap Basis (continued)

The SWAP basis contracts are settled against the arithmetic average of zinc and lead spot prices over the month in which the contract matures.

Put and Call Option Commodity Arrangements

As at December 31, 2009, the Company had entered into a series of put and call option commodity arrangements. A long put refers to put options that have been bought by the Company, and a short call refers to call options that have been sold by the Company. Settlement of these options occurs monthly during the period of January 2010 to December 31, 2010 as follows:

Period January 2010 - Jun 2010

The following Zinc Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 2,100 tons
- 6 Short call options at strike price: $3,010/t, for the total of 2,100 tons

The following Lead Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 1,200 tons
- 6 Short call options at strike price: $2,975/t, for the total of 1,200 tons

Period July 2010 - December 2010

The following Zinc Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 3,150 tons
- 6 Short call options at strike price: $3,010/t, for the total of 3,150 tons

The following Lead Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 2,850 tons
- 6 Short call options at strike price: $2,974/t, for the total of 2,850 tons

The estimated fair value of the outstanding derivative contracts of ($3,055) (2008: $1,418) was determined with reference to the published market prices for underlying commodities quoted at the London Metal Exchange.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

6. Accounts receivable and prepaid expenses

		December 31, 2009		December 31, 2008
Trade accounts receivable	**$**	**7,154**	$	-
Advances and other receivables		**1,168**		1,701
Prepaid expenses and deposits		**313**		164
	$	**8,635**	$	1,865

Accounts receivable and prepaid expenses include prepaid income tax of $9 (2008: $605), $121 (2008: $102) short term portion of the long term receivable, $34 (2008: $33) in guaranteed deposits. Trade accounts receivable includes receivables from the sale of concentrates of $7,154 (2008: $nil) and are aged less than 30 days.

7. Inventories

Inventories consist of the following:

		December 31, 2009		December 31, 2008
Stockpile ore	**$**	**204**	$	322
Concentrate inventory		**651**		90
Materials and supplies		**1,474**		1,315
	$	**2,329**	$	1,727

8. Long term investment and receivable

As at December 31, 2008, the Company had an investment in 3,706,250 shares of Continuum Resources Ltd. ("Continuum"). The Company measures these investments at fair value and this was determined based on published share prices of underlying securities on the active market. In addition, the Company had granted a loan to Continuum under the terms of the agreement by which Fortuna acquired all of the issued and outstanding shares of Continuum. This amount was used by Continuum to meet its share of the San Jose project capital contributions as well as general corporate expenditures.

As at March 6, 2009, the Company closed the acquisition of Continuum as discussed in Note 3.

		December 31, 2009		December 31, 2008
Investment in shares in Continuum	**$**	**-**	$	91
Loan to Continuum		**-**		3,002
Receivables		**16**		114
	$	**16**	$	3,207

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

9. Property, Plant and Equipment

Property, plant and equipment are comprised of the following:

	December 31, 2009			December 31, 2008		
	Cost	**Accumulated Depreciation**	**Net Book Value**	Cost	Accumulated Depreciation	Net Book Value
Land	**$ 316**	**$ -**	**$ 316**	$ 231	$ -	$ 231
Buildings	**4,740**	**1,040**	**3,700**	3,410	602	2,808
Machinery & equipment	**10,152**	**3,023**	**7,129**	7,867	1,704	6,163
Equipment under capital lease	**3,249**	**568**	**2,681**	1,615	216	1,399
Furniture & other equipment	**1,627**	**438**	**1,189**	1,193	218	975
Transport units	**430**	**239**	**191**	526	171	355
Work in progress	**2,027**	**-**	**2,027**	1,354	-	1,354
	$22,541	**$ 5,308**	**$ 17,233**	$16,196	$ 2,911	$ 13,285

Machinery & equipment includes costs of $526 (2008: $nil) and accumulated depreciation of $131 (2008: $nil) resulting from the estimate for the asset retirement obligation.

10. Mineral Properties

Mineral properties are located in Peru and Mexico and are comprised of the following:

	December 31, 2009				December 31, 2008			
	Cost	**Depletion**	**Write-off**	**Net Book Value**	Cost	Depletion	Write-off	Net Book Value
Caylloma, Peru	**$42,209**	**$11,685**	**$ 160**	**$30,364**	$32,915	$ 7,154	$ -	$ 25,761
San Jose, Mexico	**44,745**	**-**	**1,091**	**43,654**	33,809	-	285	33,524
Predilecta, Mexico	**109**	**-**	**-**	**109**	-	-	-	-
	$87,063	**$11,685**	**$ 1,251**	**$74,127**	$66,724	$ 7,154	$ 285	$ 59,285

a) Caylloma Project, Peru

For the year ended December 31, 2009, additions to the Caylloma mineral property includes development and exploration costs of $5,178, an increase of $944 resulting from a revision to the estimate for the asset retirement obligation, and $160 write off of exploration costs.

b) San Jose Project, Mexico

For the year ended December 31, 2009, additions to the San Jose mineral property consist of development and exploration costs capitalized of $5,742. Included in the additions for the San Jose property is $66 relating to the accretion of the payable for the Monte Alban II concession. This property was acquired for a total of $1,900 and consists of a payment of $1,100 made in May 2008 and a future payment of $800 is to be made in May 2012 (Note 13. b)). The present value of the $800 was $589 and this is being accreted monthly with the accretion amount being capitalized to the mineral property.

10. Mineral Properties (continued)

b) San Jose Project, Mexico (continued)

Also included in additions to the San Jose mineral property is depreciation of equipment involved in construction work of $220 (2008: $181), and general and administrative costs to develop the mine of $1,425 (2008: $1,087), and $141 received as interest on VAT recovered. The San Jose Project is owned and operated by Cuzcatlan, a wholly owned subsidiary of the Company.

In February 2009, the Company made effective a reduction of 8,344 ha out of the approximately 49,000 ha surrounding the San Jose project for which it holds exploration and mining rights. This resulted in a write-down of $1,091. This decision was based on existing geological information and is part of an effort to prioritize capital expenditures.

c) Tlacolula Project, Mexico

In September 2009, the Company, through its wholly owned subsidiary, Cuzcatlan, was granted an option to acquire a 60% interest in the Tlacolula silver project ("property") located in the State of Oaxaca, Mexico from Radius Gold Inc.'s wholly owned subsidiary, Radius (Cayman) Inc. ("Radius") (a related party by way of directors in common with the Company).

The Company can earn the interest by spending $2,000, which includes a commitment to drill 1,500 meters within three years, and making staged annual payments of $250 cash and $250 in common stock of the Company to Radius according to the following schedule:

- $20 cash and $20 cash equivalent in shares upon stock exchange approval;
- $30 cash and $30 cash equivalent in shares by the first year anniversary;
- $50 cash and $50 cash equivalent in shares by the second year anniversary;
- $50 cash and $50 cash equivalent in shares by the third year anniversary; and,
- $100 cash and $100 cash equivalent in shares by the fourth year anniversary.

Upon completion of the cash payments and share issuances, and the incurring of the exploration expenditures as set forth above, the Company, will be deemed to have exercised the option and acquired a 60% interest in the property, whereupon a joint venture will be formed to further develop the property on the basis of the Company 60% and Radius 40%.

As at December 31, 2009, the transaction is pending stock exchange approval and no payments have been made.

On January 15, 2010, the transaction was approved by the TSX Venture Exchange, The Company has issued 7,813 common shares of the Company, at a fair market value of $2.56 per share and paid $20 cash according to the option agreement.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

11. Accounts payable and accrued liabilities

		December 31, 2009		December 31, 2008
Trade accounts payable	**$**	**2,577**	$	3,877
Income taxes payable		**2,949**		-
Payroll and other payables		**2,557**		858
	$	**8,083**	$	4,735

Payroll and other payables includes $1,084 (2008: $ nil) attributable to workers' participation under Peruvian law.

12. Related Party Transactions

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

Transactions with related parties		**Years ended December 31, 2009**		2008
Consulting fees [1]	**$**	**145**	$	62
Salaries and wages [2,3]		**122**		104
Other general and administrative expenses [3]		**159**		74
	$	**426**	$	240

[1] Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Szotlender.

[2] Salaries and wages includes employees' salaries and benefits charged to the Company based on an estimated percentage of the actual hours worked for the Company.

[2, 3] Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for various general and administrative costs incurred on behalf of the Company.

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius. Refer to Notes to the Consolidated Financial Statements Note 10. c)).

Amounts due to/(from) related parties		**December 31, 2009**		December 31, 2008
Owing (from)/to a director and officer [4]	**$**	**(1)**	$	-
Owing to a company with common directors [3]	**$**	**50**	$	38
	$	**49**	$	38

[4] Owing from a director includes a non-interest bearing loan to Jorge A. Ganoza Durant with no specific terms of repayments.

The transactions with related parties are measured at the agreed upon exchange amount, which is the amount of consideration established and agreed upon by the parties. The balances with related parties are unsecured, non-interest bearing, and payable in the normal course of business.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

13. Leases and Long Term Liabilities

a) Obligations under capital lease

The following is a schedule of the Company's capital lease obligations. These are related to the acquisition of mining equipment, vehicles, and buildings.

	Interest Rate	Maturity Date		**December 31, 2009**		December 31, 2008
Scotia Bank	9.29%	2009	**$**	**-**	$	14
Banco Interamericano de Finanzas	8.50%	2009		**-**		38
Scotia Bank	8.20%	2009		**-**		134
Scotia Bank	8.66%	2010		**101**		226
Scotia Bank	8.20%	2010		**252**		26
Scotia Bank	8.49%	2010		**57**		534
Scotia Bank	8.34%	2010		**14**		110
Scotia Bank	8.49%	2011		**100**		248
Scotia Bank	6.75%	2011		**16**		-
Scotia Bank	6.75%	2011		**20**		-
Interbank	4.00%	2011		**198**		-
Interbank	9.12%	2011		**170**		69
Interbank	9.75%	2012		**91**		-
Interbank	9.75%	2012		**829**		-
Lease payments			**$**	**1,848**	$	1,399
Less current amount				**(1,038)**		(682)
			$	**810**	$	717

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

13. Leases and Long Term Liabilities (continued)

b) Long term liability

In November 2007, Bateas acquired the Minera Condor II and the Minera Condor III concessions for $250. A payment of $50 was made upon the signing of the contract, payments of $30 are required to be made every six months for a total of five payments, and $50 is required to be made November 2010. This contract was cancelled in March 2009 and the obligation of $156 recorded has been reversed.

In May 2008, Cuzcatlan acquired the Monte Alban II concession (Note 10. b)) for which a payment of $800 is due May 2012. This payment is non-interest bearing and all debt relating to the acquisition of the mineral resource property has been recognized as at December 31, 2009.

		December 31, 2009		December 31, 2008
Face value of long term liability	**$**	**970**	$	1,000
Less: adjustment to amortized cost		**(225)**		(271)
Opening fair value of liability measured at amortized cost		**745**		729
Cancellation of contract		**(156)**		-
Add: accretion to period end		**55**		46
Less: payments		**-**		(30)
Liability at period end		**644**		745
Less: current portion of long term liability		**-**		(80)
	$	**644**	$	665

Principal minimum repayment terms will be :

2009	**$**	**-**
2010		**-**
2011		**-**
2012		**800**
	$	**800**

c) Contingent liability

The Caylloma mine closure plan was approved in November 2009 with the total closure costs of $3,346 of which $1,756 is subject to annual collateral in the form of a letter of guarantee, to be awarded each year in increments of $146 over 12 years, and is based on the life of the mine.

Banco Bilbao Vizcaya Argentaria, S.A., a third party, has established a bank letter of guarantee on behalf of Bateas in favor of the Peruvian mining regulatory agency in compliance with local regulation associated with the approved Bateas' mine closure plan, for the sum of $146. This bank letter of guarantee expires 360 days from December 2009.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

14. Asset Retirement Obligation

A summary of the Company's provision for asset retirement obligation is presented below.

		December 31, 2009		December 31, 2008
Asset retirement obligation - beginning of year	$	**1,066**	$	1,953
Revisions in estimates		**1,286**		(589)
Accretion expense, included in depreciation, depletion and accretion		**150**		88
Foreign exchange impact		**27**		(386)
Asset retirement obligation - end of year	$	**2,529**	$	1,066

The accretion expense was calculated over the year using a risk free interest rate of 7.46%. The Company has reviewed its reclamation obligations at the property in light of changing regulations and on the basis of further data in respect of the mine life and has made an increase to the estimated amount of the asset retirement obligation of $1,286.

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

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

15. Income Tax

a) Income tax expense differs from the amount that would be computed by applying the Canadian statutory income tax rate of 30% (2008 - 31%) to loss before income taxes and non-controlling interest. The reasons for the differences are as follows:

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

15. Income Tax (continued)

		December 31, 2009		December 31, 2008
Income before income taxes and non-controlling interest	**$**	**6,312**	$	686
Statutory income tax rate		**30%**		31%
Expected income tax	**$**	**1,894**	$	212
Items non-deductible (deductible) for income tax purposes		**948**		715
Difference between Canadian and foreign tax rates		**1,130**		191
Change in income tax rates		**346**		206
Change in exchange rates		**818**		143
Change in valuation allowance		**733**		232
Total income taxes	**$**	**5,869**	$	1,699
Represented by:				
Current income tax	**$**	**4,922**	$	-
Future income tax		**947**		1,699
	$	**5,869**	$	1,699

Current income taxes payable of $2,949 (2008: $nil) is included within accounts payable and accrued liabilities in Note 11.

b) The tax effects items that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2009 and 2008 are presented below:

		December 31, 2009		December 31, 2008
Future income tax assets:				
Non-capital losses	**$**	**5,416**	$	2,204
Share issue costs		**275**		352
Unrealized foreign exchange losses and other		**207**		272
Financial derivatives		**1,125**		-
Mineral properties and property, plant and equipment		**927**		1,261
Total future income tax assets		**7,950**		4,089
Valuation allowance		**(6,599)**		(2,142)
Net future income tax assets		**1,351**		1,947
Future income tax liabilities:				
Mineral properties – Peru	**$**	**(10,366)**	$	(8,498)
Mineral properties – Mexico		**(1,958)**		(1,743)
Unrealized foreign exchange gains and other		**-**		(1,116)
Net future income tax liabilities	**$**	**(12,324)**	$	(11,357)
Net future income tax liabilities	**$**	**(10,973)**	$	(9,410)

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

15. Income Tax (continued)

The Company has non-capital loss carry-forwards that will expire if unused of $20,931 that may be available for tax purposes. The loss carry-forwards expire as follows:

	Canada	Peru	Mexico
Non-capital losses, expiring as follows:			
2013	$ 362	-	-
2014	1,076	-	-
2016	960	-	15
2017	-	-	2,848
2025	2,039	-	-
2026	2,233	-	-
2027	3,669	-	-
2028	1,364	-	-
2029	4,508		987
No expiry	-	870	-
	$ 16,211	**$ 870**	**$ 3,850**

A full valuation allowance has been recorded against the potential future income tax assets associated with the Canadian loss carry-forwards as their utilization is not considered more likely than not at this time.

16. Share Capital

a) Authorized: Unlimited common shares without par value

On June 17, 2009, an aggregate of 36 common shares resulting from rounding of previous capital consolidations were returned to treasury to reduce the accumulated fractional shares held in the Company’s trustee account.

Subsequent to December 31, 2009, the Company issued 7,813 common shares, at a fair market value of CAD$2.63 per share, to Radius (refer to Note 10.c)) and issued 15,007,500 common shares at a price of CAD$2.30 per shares, under the bought deal financing (refer to Note 22.c)), and 64,500 share purchase options were exercised at CAD$0.85 per share, resulting in issued and outstanding shares of 110,062,465.

b) Stock Options

The following is a summary of option transactions:

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

16. Share Capital (continued)

b) Stock Options (continued)

	Number of Shares	Weighted Average Exercise Price Per Share in CAD$
Balance, December 31, 2007	6,686,400	$ 2.24
Granted	2,655,000	1.03
Exercised	(31,400)	1.22
Expired	-	-
Forfeited	(1,576,000)	2.77
Balance, December 31, 2008	7,734,000	$ 1.87
Granted	**2,915,000**	**1.56**
Exercised	**(389,000)**	**0.81**
Expired	**(970,000)**	**2.35**
Forfeited	**(1,075,000)**	**3.22**
Balance, December 31, 2009	**8,215,000**	**$ 1.50**

During the period, 970,000 share purchase options with exercise prices ranging from CAD$0.85 to CAD$3.22 per share expired unexercised, 389,000 share purchase options were exercised at exercise prices ranging from CAD$0.37 to CAD$0.85 per share. During the period, the Company granted to officers and employees an aggregate of 2,915,000 share purchase options with exercise prices ranging from CAD$0.83 to CAD$2.23 per share, exercisable for ten years, vesting from 4 months or immediately. As at December 31, 2009, 2,665,000 share purchase options are subject to shareholder approval.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

16. Share Capital (continued)

b) Stock Options (continued)

The following share purchase options were outstanding at December 31, 2009:

Number of shares		Exercise Price CAD$	Expiry Date	Weighted Average Remaining Contractual Life - Years
30,000	$	0.80	July 24, 2010	0.6
270,000	$	1.35	February 5, 2016	6.1
250,000	$	2.29	March 30, 2016	6.2
60,000	$	1.75	May 8, 2016	6.4
200,000	$	1.75	May 22, 2016	6.4
20,000	$	0.85	July 5, 2016	6.5
225,000	$	1.55	July 5, 2016	6.5
860,000	$	1.66	July 10, 2016	6.5
225,000	$	1.61	September 13, 2016	6.7
110,000	$	0.85	January 11, 2017	7.0
700,000	$	2.22	January 11, 2017	7.0
50,000	$	2.75	February 6, 2017	7.1
15,000	$	0.85	April 22, 2017	7.3
5,000	$	0.85	May 31, 2017	7.4
50,000	$	0.85	June 27, 2017	7.5
30,000	$	0.85	July 2, 2017	7.5
25,000	$	0.85	October 24, 2017	7.8
250,000	$	2.52	February 5, 2018	8.1
150,000	$	1.25	August 25, 2018	8.7
1,125,000	$	0.85	October 5, 2018	8.8
650,000	$	0.85	November 5, 2018	8.9
250,000	$	0.83	July 6, 2019	9.5
2,150,000	$	1.60	October 27, 2019	9.8
490,000	$	1.70	November 8, 2019	9.9
25,000	$	2.23	November 23, 2019	9.9
8,215,000				**8.29**

As at December 31, 2009, 8,215,000 share purchase options have vested with 2,665,000 share purchase options subject to shareholder approval.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

16. Share Capital (continued)

b) Stock Options (continued)

Subsequent to December 31, 2009 to March 11, 2010, 64,500 share purchase options were exercised at CAD$0.85 per share.

c) Warrants

The following is a summary of share purchase warrant transactions:

	Number of Share Purchase Warrants	Weighted Average Exercise Price Per Share Purchase Warrant in CAD$
Balance, December 31, 2007	16,479,375	$ 1.89
Issued	-	-
Exercised	(4,322,596)	1.85
Expired	(1,093,424)	2.30
Balance, December 31, 2008	11,063,355	$ 1.86
Issued	**-**	**-**
Exercised	**(2,475,355)**	**0.35**
Expired	**(8,588,000)**	**2.30**
Balance, December 31, 2009	**-**	**$ -**

d) Stock-based Compensation

The Company has established a formal stock option plan in accordance with the policies of the TSX Venture Exchange under which it is authorized to grant options up to 10% of its outstanding shares to officers, directors, employees, and consultants, and is subject to shareholder approval. The exercise price of each option must not be less than the closing market price of the Company's shares on the trading day immediately prior to the date of grant. The options are for a maximum term of ten years.

The Company uses the fair value based method of accounting for share options granted to consultants, directors, officers, and employees. The non-cash compensation charge of $2,707 recognized for the year ended December 31, 2009 (2008: $1,348) is associated with the granting of options to a consultant, directors and employees. These compensation charges have been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

16. Share Capital (continued)

d) Stock-based Compensation (continued)

	Years ended December 31,	
	2009	2008
Risk-free interest rate	**2.42% - 3.45%**	2.57% - 3.97%
Expected stock price volatility	**70% - 78%**	62% - 78%
Expected term in years	**5 & 10**	2, 3, 5 & 10
Expected dividend yield	**0%**	0%

The weighted average grant date fair value of options granted during the year ended December 31, 2009 was CAD$0.91 (2008 - CAD$0.57).

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

e) Reserves

During the year, the Board of Directors of Bateas has appropriated reserves of $1,130 (2008: $nil) from its retained earnings representing ten percent of the net income earned in the calendar years 2006, 2007, and 2008. The reserve is required under the Republic of Peru's General Corporate Law (Ley General de Sociedades) article 229, whereas a legal reserve equivalent to a minimum of ten percent of the distributable value of each financial year, net of income taxes until the reserve reaches an amount equal to one fifth of its capital (capital defined as share capital and retained earnings) must be established. The excess over this limit is not a legal reserve. Dividends can only be paid on profits free of reserves.

17. Segmented Information

a) Industry Information

The Company operates in one reportable operating segment, being the acquisition, exploration, development, and operation of mineral properties.

b) Geographic Information

The following is the summary of operations and summary of certain assets on a geographical basis.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

17. Segmented Information (continued)

b) Geographic Information (continued)

	Canada	Peru	Mexico	Other	Total
Year ended ended December 31, 2009					
Sales	**$ -**	**$ 51,428**	**$ -**	**$ -**	**$ 51,428**
Operating income (loss)	**$ (5,612)**	**$ 20,992**	**$ (921)**	**$ (76)**	**$ 14,383**
Year ended December 31, 2008					
Sales	$ -	$ 24,867	$ -	$ -	$ 24,867
Operating (loss) income	$ (4,294)	$ (947)	$ (329)	$ (23)	$ (5,593)
As at December 31, 2009					
Mineral Properties	**$ -**	**$ 30,364**	**$ 43,763**	**$ -**	**$ 74,127**
Property, plant and equipment	**$ 11**	**$ 12,298**	**$ 4,922**	**$ 2**	**$ 17,233**
Total assets	**$ 25,120**	**$ 67,978**	**$ 46,614**	**$ 26**	**$ 139,738**
As at December 31, 2008					
Mineral Properties	$ -	$ 25,761	$ 33,524	$ -	$ 59,285
Property, plant and equipment	$ 4	$ 9,105	$ 4,174	$ 2	$ 13,285
Total assets	$ 25,071	$ 46,124	$ 41,348	$ 2,825	$ 115,368

c) Major Customers

For the year ended December 31, 2009 and 2008, there was one customer accounting for 94% and 100% of total sales of the Company, respectively.

18. Commitments and Contingencies

The Company has a contract to guarantee power supply at its Caylloma mine. Under the contract, the seller is obligated to deliver a "maximum committed demand" (for the present term this stands at 2,800 Kw) and Bateas is obligated to purchase subject to exemptions under provisions of "Force Majeure". The contract is automatically renewed every two years for a period of 10 years. Renewal can be avoided without penalties by notifying 10 months in advance of renewal date. Tariffs are established yearly by the energy market regulator in accordance with applicable regulations in Peru.

The Company acts as guarantor to capital lease obligations held by two of its mining contractors. These capital lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at December 31, 2009, these obligations amounted to $1,075 and mature in 2010.

18. Commitments and Contingencies (continued)

a) Environmental Matters

The Company's mining and exploration activities are subject to various laws and regulations governing the protection of the environment. These laws and regulations are continually changing and are generally becoming more restrictive. The Company conducts its operations so as to protect the public health and environment and believes its operations are in compliance with applicable laws and regulations in all material respects. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations, but cannot predict the full amount of such future expenditures.

Estimated future reclamation costs are based principally on legal and regulatory requirements. As of December 31, 2009 and 2008, $2,529 and $1,066, respectively, were accrued for reclamation costs relating to mineral properties in accordance with Section 3110, "Asset Retirement Obligations". See Note 13. c) and 14.

b) Income Taxes

The Company operates in numerous countries around the world and accordingly it is subject to, and pays annual income taxes under the various income tax regimes in the countries in which it operates. Some of these tax regimes are defined by contractual agreements with the local government, and others are defined by the general corporate income tax laws of the country. The Company has historically filed, and continues to file, all required income tax returns and to pay the taxes reasonably determined to be due. The tax rules and regulations in many countries are highly complex and subject to interpretation. From time to time, the Company is subject to a review of its historic income tax filings and in connection with such reviews, disputes can arise with the taxing authorities over the interpretation or application of certain rules to the Company's business conducted within the country involved.

c) Title Risk

Although the Company has taken steps to verify title to properties in which it has an interest, these procedures do not guarantee the Company's title. Property title may be subject to, among other things, unregistered prior agreements or transfers and may be affected by undetected defects.

19. Capital Disclosure

The Company's objectives when managing capital are to provide shareholder returns through maximization of the profitable growth of the business and to maintain a degree of financial flexibility relevant to the underlying operating and metal price risks while safeguarding the Company's ability to continue as a going concern.

19. Capital Disclosure (continued)

The capital of the Company consists of shareholders' equity and the line of credit, net of cash. The Board of Directors does not establish a quantitative return on capital criteria for management. The Company manages the capital structure and make adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

The management of the Company believes that the capital resources of the Company as at December 31, 2009, are sufficient for its present needs for the next 12 months.

The Company's overall strategy with respect to capital risk management remained unchanged during the year. The Company is not subject to externally imposed capital requirements.

20. Management of financial risk

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk, and price risk. The Company's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

a) Fair value of financial instruments

The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3862 "Financial Instruments - Disclosure" requires disclosure of a three-level-hierarchy for fair value measurements based upon transparency of inputs to the valuation of financial instrument carried on the balance sheet at fair value. The three levels are defined as follows:

- Level 1 - inputs to the valuation methodology are quoted (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to valuation methodology include quoted market prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value of measurement.

The carrying value of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, due to related parties, net, approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments.

Fair value estimates are made a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

20. Management of financial risk (continued)

a) Fair value of financial instruments (continued)

The Company has classified the determination of fair value of accounts receivable, and derivatives as level 2, as the valuation method used by the Company includes an assessment of assets in quoted markets with significant observable inputs.

Financial assets (liabilities) at fair value as at December 31, 2009

	Level 1	Level 2	Level 3	Total
Short term investments	**$ 6,034**	**$ -**	**$ -**	**$ 6,034**
Accounts receivable	**-**	**8,322**	**-**	**8,322**
Derivatives	**-**	**(3,055)**	**-**	**(3,055)**
	$ 6,034	**$ 5,267**	**$ -**	**$ 11,301**

[1] Comparative information has not been presented in the table because this information is not required in the year of adoption. For periods subsequent to the year of adoption, comparative information would be necessary.

Accounts receivable includes accounts receivable from provisional sales. The fair value of accounts receivable resulting from provisional pricing reflect observable market commodity prices. Resulting fair value changes accounts receivable are through sales. Transactions involving accounts receivable are with counterparties the Company believes are creditworthy.

Derivatives are carried at their fair value, which is determined based on internal valuation models that reflect observable forward market commodity prices. Resulting fair value changes to derivatives are through net gain(loss) on commodity contracts. Transactions involving derivatives are with counterparties the Company believes to be creditworthy.

b) Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico and Barbados and a portion of its expenses are incurred in Canadian dollars, Nuevo Soles, and Mexican Pesos. A significant change in the currency exchange rates between the United States dollar relative to the other currencies could have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

As at December 31, 2009, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, Nuevo Soles and Mexican Pesos (all amounts are expressed in thousands of Canadian dollars, thousands of Nuevo Soles or thousands of Mexican Pesos):

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

20. Management of financial risk (continued)

b) Currency risk (continued)

	December 31, 2009			December 31, 2008		
	Canadian Dollars	**Nuevo Soles**	**Mexican Pesos**	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash	**$ 21,283**	**S/. 302**	**$ 1,283**	$29,748	S/. 629	$ 3,864
Short term investments	**560**	**-**	**-**	-	-	-
Accounts receivable	**5**	**880**	**6,565**	13	10,400	46,460
Accounts payable and accrued liabilities	**(194)**	**(17,150)**	**(623)**	(172)	(5,281)	(10,259)

Based on the above net exposure as at December 31, 2009, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, expressed in US dollars, as follows:

Impact to other comprehensive income (loss)	$ 2,293		
Impact to net income (loss)		$ (614)	$ 65

c) 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 equivalents and short term investments are held through large Canadian, international and foreign national financial institutions. These investments mature at various dates within one year. All of the Company's trade accounts receivables are held with large international metals trading companies.

The Company holds derivative contracts with financial institutions and in this regard is exposed to counterparty risk. The Company mitigates this risk by transacting only with reputable financial institutions to minimize credit risk.

As at December 31, 2009, the Company has a Mexican value added tax of $421 and Peruvian value added tax of $176. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

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 by continuing to monitor forecasted and actual cash flows. The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its development plans. The Company strives to maintain sufficient liquidity to meet its short term business requirements, taking into account its anticipated cash flows from operations, its holdings of cash, short term investments, and its committed liabilities.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

20. Management of financial risk (continued)

d) Liquidity risk (continued)

The Company expects the following maturities of its financial liabilities (including interest), operating leases, and other contractual commitments:

	Expected payments due by period as at December 31, 2009				
	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years	Total
Accounts payable and accrued liabilities	$ 8,083	$ -	$ -	$ -	$ 8,083
Due to related parties, net	49	-	-	-	49
Derivatives	3,055	-	-	-	3,055
Long term liability	1,038	1,454	-	-	2,492
Total [1]	$ 12,225	$ 1,454	$ -	$ -	$ 13,679

[1] Amounts above do not include payments related to the following: (i) the Company's anticipated asset retirement obligation of $2,529 associated with mine closure, land reclamation, and other environmental matters.

e) 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 is limited because the balances are generally held with major financial institutions in demand deposit accounts.

f) Metal price risk

The Company is exposed to metals price risk with respect to silver, gold, zinc, and lead sold through its mineral concentrate products. The Company mitigates this risk by implementing price protection programs for some of its zinc and lead production through the use of derivative instruments. As a matter of policy, the Company does not hedge its silver production.

A 10% change in zinc, lead, silver, gold, and copper prices would cause an $811, $848, $1,528, $149, and $27 change in net earnings, respectively.

(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

21. Supplemental cash flow information

Supplementary disclosure of cash flow information:

	Notes		Years ended December 31, 2009		2008
Cash received or paid for interest and income taxes:					
Cash received for interest		**$**	**210**	$	(1,417)
Cash paid for income taxes		**$**	**596**	$	479
Non-cash Transactions:					
Issue of shares on purchase of resource property	**10**	**$**	**5,194**	$	-
Reassessment of asset retirement obligation	**10, 14**	**$**	**1,286**	$	-
Cancellation of Minera Condor liability	**13 b)**	**$**	**156**	$	-
Equipment purchased through capital lease		**$**	**1,425**	$	-
Purchase of resource property on a deferred payment plan		**$**	**-**	$	860
Sale of equipment for a long-term receivable		**$**	**-**	$	143
Fair value of options exercised		**$**	**246**	$	25

22. Subsequent Events up to March 11, 2010

a) Credit Facility

On January 6, 2010, the Company has signed a commitment letter to enter into a $20 million senior secured revolving credit facility with The Bank of Nova Scotia. The facility will have a 2.5 year maturity. The proceeds of the facility may be used for general corporate purposes, including the development of the San Jose Project in Mexico.

The facility is intended to complement Fortuna's strong cash position and provide additional financing flexibility during the construction stage at San Jose. The San Jose pre-feasibility study is scheduled to be concluded the first quarter of 2010.

b) Exchange listing

The Company's common shares were listed and begun trading on the Toronto Stock Exchange (TSX) at the opening of trading on Monday, January 18, 2010 under its current symbol "FVI". Fortuna's common shares were delisted from the TSX Venture Exchange upon commencement of trading on the TSX.

22. Subsequent Events (continued)

c) Other

On February 3, 2010, the Company ("Fortuna") entered into a bought deal financing ("Offering") with a syndicate of underwriters co-led by CIBC and Canaccord Financial Ltd.

The Offering closed on March 2, 2010 and the Company issued 15,007,500 common shares at a price of CAD$2.30 per shares (refer to Note 16.a) under the bought deal financing for gross proceeds of CAD$34.5 million. Net proceeds of CAD$32.8 million after underwriting fees of CAD$1.7 million were raised from the bought deal financing.

The Company intends to use the net proceeds from the Offering to partially fund the construction of its 100% owned San Jose project in the state of Oaxaca, Mexico and for general corporate purposes.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE

YEAR ENDED DECEMBER 31, 2009

(Dollar amounts expressed in US dollars, unless otherwise indicated)

Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the significant factors that have affected Fortuna Silver Mines Inc. and its subsidiaries' ("Fortuna" or the "Company") performance and such factors that may affect its future performance. For a comprehensive understanding of Fortuna's financial condition and results of operations, this MD&A should be read in conjunction with the Company's audited consolidated financial statements for year ended December 31, 2009 and the related notes contained therein. The Company reports its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). In addition, the following should be read in conjunction with the Consolidated Financial Statements of the Company for the year ended December 31, 2008, the related MD&A, and Fortuna's Annual Information Form (available on SEDAR at www.sedar.com). This MD&A refers to various non-GAAP measures, such as cash cost per tonne of processed ore, cash cost per ounce of payable silver, adjusted net income (loss), cash generated by operating activities before changes in working capital, used by the Company to manage and evaluate operating performance and ability to generate cash and are widely reported in the silver mining industry as benchmarks for performance. Cash costs are presented as they represent an industry standard method of comparing certain costs on a per unit basis. The Company believes that certain investors use these non-GAAP measures to evaluate the Company's performance. Non-GAAP measures do not have standardized meaning. Accordingly, non-GAAP measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. To facilitate a better understanding of these measures as calculated by the Company, we have provided detailed descriptions and reconciliations where applicable.

This MD&A is prepared as of March 11, 2010.

Forward Looking Information

Certain statements contained in this MD&A and elsewhere constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, and performance of achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, changes in project parameters to deal with unanticipated economic factors, risks related to technological and operational nature of the Company's business, the speculative nature of exploration and development, and changes in local and national government legislation.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made, and readers are advised to consider such forward-looking statements in light of the risks set forth in the section Risks and Uncertainties.

This MD&A also contains references to estimates of mineral reserves and mineral resources. The estimation of reserves and resources is inherently uncertain and involves subjective judgments about many relevant factors. The accuracy of any such estimates is a function of the quantity and quality of available data, and of the assumptions made and judgments used in engineering and geological interpretation, which may prove to be unreliable. There can be no assurance that these estimates will be accurate or that such mineral reserves and mineral resources can be mined or processed profitably. Mineral resources that are not mineral reserves do not have demonstrated economic viability. Except as required by law, the Company does not assume the obligation to revise or update these forward looking statements after the date of this document or to revise them to reflect the occurrence of future unanticipated events.

In particular, forward-looking information and statements include:

- "A pre-feasibility study covering all pre-construction engineering projects for the mine, processing plant and supporting infrastructure is scheduled to be completed in the first quarter of 2010, with construction activities to commence shortly thereafter." (page 4);
- "The ore mix in 2010 is expected to be similar." (page 9);
- "In 2010, 14,800 m of development and preparation have been budgeted as part of ongoing operations." (page 9);
- "The first phase of the project will demand $2.5 million and construction is scheduled for the second quarter of 2011." (page 9);
- "The Company expects to publish a pre-feasibility and start construction activities during the first quarter of 2010. The Company looks forward to commissioning San Jose in 2011, which will drive further growth in Fortuna's silver production."(page 11);
- "The new resource estimate will serve as the basis for pre-feasibility level engineering studies projected for the first quarter of 2010." (page 11);
- "The Company´s engineering staff is currently conducting an internal review of the various engineering projects and continues to work towards the delivery of the final feasibility study by the first quarter of 2010."(page 12);
- "Management believes the Company's cash position as well as its ongoing operation in Caylloma is sufficient to support the Company's operating and capital requirements on an ongoing basis." (page 15);
- "For 2010, the Company expects to sustain silver production at 1,700,000 ounces, with base metal production also remaining level at current rates." 2010 Production Guidance table. (page 31).

Business of the Company

Fortuna Silver Mines Inc. (the "Company") is a mining company focused on producing silver and developing silver projects in Latin America. The Company's principal assets are the Caylloma Polymetallic Mine in southern Peru and the San Jose Silver-Gold Project in southern Mexico.

Recent Developments and 2009 Highlights

Financial and Operating Results

During the year ended December 31, 2009, the Company generated record sales of $51.43 million compared to $24.87 million in 2008, representing an increase of 107%.

In 2009, Caylloma produced 1,682,546 ounces of silver, representing an increase of 109% over the 2008 production of 805,057 ounces of silver. This increase is primarily attributable to a 64% increase in silver head grade.

The income in 2009 of $0.62 million (2008: loss $0.91 million) was due primarily to record sales of $51.43 million (2008: $24.87 million) resulting in record mine operating income of $27.73 million (2008: $3.90 million) offset by losses on our commodity hedge book. The Company's base metal price protection program generated a loss on commodity contracts of $7.36 million during 2009 compared to a gain of $4.27 million in 2008.

Adjusting for the mark-to-market effect on the loss on commodity contracts, a non-GAAP measure, the year of 2009 resulted in adjusted net income of $1.98 million compared to a loss of $1.30 million in 2008.

	Expressed in millions			
	Years ended December 31,			
		2009		2008
NET (LOSS) INCOME FOR THE PERIOD	**$**	**0.62**	$	(0.91)
Items of note, net of tax:				
Mark to Market effect on derivatives		**1.36**		(0.39)
ADJUSTED NET INCOME (LOSS) FOR THE PERIOD [1]	**$**	**1.98**	$	(1.30)

[1] **A non-GAAP measure**

Cash generated by operating activities before changes in working capital, a non-GAAP measure, for the year was $15.91 million up from $8.65 million in 2008.

During the year ended December 31, 2009, silver production amounted to 1,755,017 ounces with a negative cash cost per ounce of payable silver of $4.93, net of by-product credits. In 2009, 395,561 tonnes of ore were treated compared to 331,380 tonnes in the prior year and the cash cost per tonne of treated ore was $46.00 (Cash cost is a non-GAAP measure). See page 14 for reconciliation of cash cost to the cost of sales in the consolidated statement of operations).

Financing

On January 6, 2010, the Company signed a commitment letter to enter into a $20 million senior secured revolving credit facility with The Bank of Nova Scotia. The facility has a 2.5 year maturity. The proceeds of the facility may be used for general corporate purposes, including the development of the San Jose Project in Mexico. The facility is intended to complement Fortuna's strong cash position and provide additional financing flexibility during the construction stage at San Jose. No funds have been drawn under this facility.

On February 3, 2010, the Company entered into a bought deal financing ("Offering") with a syndicate of underwriters co-led by CIBC and Canaccord Financial Ltd.

The Offering closed on March 2, 2010 and the Company issued 15,007,500 common shares at a price of CAD$2.30 per shares (refer to Note 16.a) under the bought deal financing for gross proceeds of CAD$34.5 million. Net proceeds of CAD$32.8 million after underwriting fees of CAD$1.7 million were raised from the bought deal financing.

The Company intends to use the net proceeds from the Offering to partially fund the construction of its 100% owned San Jose project in the state of Oaxaca, Mexico and for general corporate purposes.

Approval of Change of Land Use for San Jose Project, Mexico

On December 14, 2009, the "Secretaria de Medio Ambiente y Recursos Naturales" (Mexican Environmental Agency) approved the Company's application for a change of land use from agricultural to industrial for the San Jose silver-gold project, located in the southern State of Oaxaca, Mexico.

This is the final permit required to commence construction activities and complements the Environmental Impact Study, which was approved in late October 2009.

A pre-feasibility study covering all pre-construction engineering projects for the mine, processing plant and supporting infrastructure is scheduled to be completed in the first quarter of 2010, with construction activities to commence shortly thereafter.

Exchange Listings

The Company's common shares began trading on the Toronto Stock Exchange (TSX) at the opening of trading on Monday, January 18, 2010 under the symbol "FVI".

Discovery of high-grade silver-gold at Caylloma Mine, Peru

On February 2, 2010, the Company announced the discovery of high-grade silver-gold mineralization in the upper portion of the Animas Vein at the Caylloma Mine in southern Peru. The Animas vein, traditionally a polymetallic vein, is the source of 85% per cent of production at the Caylloma mine. The Company is currently investigating the impact of the new discovery and are working to define resources to be included in the mine plan.

Selected Annual Information

	Years Ended December 31,		
Expressed in $000's, except per share data	**2009**	2008	2007
Sales	**51,428**	24,867	29,796
Income before income taxes and non-controlling interest	**6,312**	687	1,566
Net income (loss)	**623**	(910)	(2,437)
Earnings (loss) per share, basic and diluted	**0.01**	(0.01)	(0.04)
Total assets	**139,738**	115,368	126,860
Long term liability	**1,454**	1,382	441

In 2009, the Company generated record sales of $51.43 million compared to $24.87 million in 2008. This increase was primarily driven by higher silver and lead head grades, in particular silver which increased by 64%, higher throughput, and reduced treatment charges. Sales in 2008, decreased from 2007, by 16.5% in spite of higher metal production due to decreased unit values of concentrates comprised of decreases in metal prices and increases in smelter treatment charges.

Quarterly Information

The following table provides information for the eight fiscal quarters ended December 31, 2009:

Expressed in $000's, except per share data

	Quarters Ended							
	31-Dec-09	30-Sep-09	30-Jun-09	31-Mar-09	31-Dec-08	30-Sep-08	30-Jun-08	31-Mar-08
Sales	**16,356**	13,230	12,862	8,980	2,795	7,492	7,772	6,808
Mine operating income (loss) *	**10,376**	7,074	6,792	3,487	(2,986)	1,734	2,848	2,303
Net income (loss)	**1,037**	(556)	1,196	(1,054)	(2,468)	(297)	2,493	(638)
Earnings (loss) per share - basic	**0.01**	(0.01)	0.01	(0.02)	(0.03)	0.00	0.03	(0.01)
- diluted	**0.01**	(0.01)	0.01	(0.02)	(0.03)	0.00	0.03	(0.01)

*** Mine operating income (loss) is a non-GAAP measure used by the Company as a measure of operating performance**

Sales have consistently increased quarter over quarter since the fourth quarter of 2008 with the fourth quarter of 2009 reaching a record high at $16.36 million. This upward trend in sales is mainly attributable to increases in metal prices. Higher sales throughout 2009 compared to the corresponding quarters of 2008 have been significantly driven by higher silver head grades, higher production, and lower treatment charges.

Financial Results

During the year ended December 31, 2009, the Company generated record sales of $51.43 million compared to $24.87 million in 2008, representing an increase of 107%.

When broken down by type of concentrate: silver-lead concentrate sales increased in tonnage by 50%, and the unit value of concentrate increased by 11%. The latter increase is a result of lower smelter treatment charges of $197 per ton of concentrate and higher silver grade offset by a 18% and 2% decrease in lead and silver prices, respectively. Zinc concentrate sales increased in tonnage by 23% and the unit value of concentrate increased by 4%. The latter increase is a result of lower smelter treatment charges of $140 per ton of concentrate offset by a 12% decrease in the metal price.

During the year ended December 31, 2009, **mine operating income** was $27.73 million, 6 times above the $3.90 million achieved in the same period of 2008. This improvement is a reflection of improved head grades, higher throughput, increased recoveries, and better commercial terms. Contributing negatively to the income for the year of $0.62 million (2008: loss $0.91 million) is primarily the non-operating loss in commodity contracts of $7.36 million (2008: gain $4.27 million).

Mark-to-Market effect: Included in the $7.36 million loss recorded on commodity contracts, is a mark-to market effect of $1.36 million, net of tax, related to open contracts as at the end of December 2009 expiring between the months of January 2010 and December 2010.

Total **cost of sales, including depletion, depreciation and accretion**, in 2009 totalled $23.70 million (2008: $20.97 million) and represents an increase of 13% over 2008. While tonnage of concentrate sold during 2009 increased 35% compared to 2008, cost of sales increased only by 13%. Lead and silver head grades increased by 25% and 64%, respectively, over 2008. Other things being equal, an increase in head grades will deliver higher concentrate production for equal or similar production costs.

Selling and administrative expenses in 2009 increased 22% to $9.56 million (2008: $7.82 million). The increase is due mainly to higher selling expenses associated with higher tonnage of concentrate sold. Corporate general and administrative expenses increased by $0.67 million to $4.06 million (2008: $3.39 million); selling and administrative expenses increased by $0.81 million to $5.01 million (2008: $4.20 million) ; and government royalty paid by Minera Bateas increased by $0.26 million to $0.49 million (2008: $0.23 million).

Stock-based compensation charge totalled $2.71 million compared to $1.35 million in 2008.

Interest and other income and expenses in 2009 amounted to net income of $0.43 million compared to net income of $1.36 million in 2008. The decrease is attributable to the Company holding a comparatively smaller average cash balance and a reduction in interest rates.

Interest and finance expenses in 2009 were $0.16 million compared to $0.10 million in 2008. Interest expenses relate primarily to capital lease operations at our operating subsidiary.

Net loss on commodity contract in 2009 amounted to $7.36 million compared to a net gain of $4.27 million in 2008. This amount reflects the change in fair value of derivative contracts between the opening of the reporting period and either the expiry of the contracts or the closing of the period, whichever happened first. Included in the $7.36 million loss recorded on commodity contracts, is a mark-to market effect of $2.17 million ($1.36

million net of tax) related to open contracts as at the end of December 2009 expiring between the months of January 2010 and December 2010. The Company has entered into short term commodity forward and option contracts to secure a minimum price level on part of Caylloma's zinc and lead metal production, and enters regularly into forward lead and zinc contracts with banks to fix the final settlement price of metal delivered in concentrates, where the final settlement price is yet to be set at a future quotational period according to contract terms. The Company does not use hedge accounting.

The $5.87 million **Income tax provision** recorded for 2009 (2008: $1.70 million) comprises current and future income tax expense. Current income tax for the period, including the worker profit sharing plan regulated by Peruvian law was $5.08 million (2008: $nil). Future income tax expense, amounting to $0.79 million (2008: $1.70 million) is attributed to temporary differences arising on amounts of mineral properties at Peruvian operations where exploration and development are expensed for tax purposes.

(Dollar amounts expressed in US dollars, unless otherwise indicated)

Results of Operations

Peru - Caylloma Ag-Pb-Zn Mine

Caylloma Mine	**Years ended December 31, 2009**	**2008**
Tonnes milled	**395,560**	331,381
Average tons milled per day	**1,121**	936
Head Grade		
Silver (g/t)	**154.76**	94.58
Lead (%)	**3.10**	2.48
Zinc (%)	**3.66**	3.65
Copper (%)*	**0.24**	na
Recoveries		
Silver (%)**	**85.40**	79.47
Lead (%)	**93.02**	90.69
Zinc (%)	**89.07**	87.39
Copper (%) *	**51.94**	na
Production (metal contained)		
Silver (oz)***	**1,682,546**	805,057
Lead (lbs)	**25,137,107**	16,501,600
Zinc (lbs)	**28,441,836**	23,283,019
Copper (lbs)*	**88,185**	na
Average Selling Price		
Silver (US$ per oz)	**14.65**	15.02
Lead (US$ per lb)	**0.78**	0.95
Zinc (US$ per lb)	**0.75**	0.85
Copper (US$ per lb)*	**3.17**	na
Unit cash cost and Net smelter return		
Unit cash cost (US$/oz ag)	**(4.93)**	(3.78)
Unit Net Smelter Return (US$/tonne)	**124.00**	87.00

*** Copper figures for the month of December 2009**
**** Silver recovery in lead and copper concentrates**
***** Silver production contained in lead and copper concentrates**

In 2009, the Caylloma mine increased throughput by 19% compared to 2008 by processing 395,560 tonnes of ore, and surpassed its silver production forecast by 5%. Production in 2009, as compared to 2008, increased as follows:

- silver production increased by 109% to 1,682,546 ounces;
- lead metal production increased by 52% to 25,137,107 pounds;
- zinc metal production increased by 22% to 28,441,836 pounds; and,
- exceeded the Company's silver production forecast of 1.6 million ounces by 5%.

Increments against 2008 were achieved through a combination of higher grades, improved metallurgical recoveries, and a higher throughput which reached an average of 1,121 tonnes per day ("tpd") in 2009, 20% above the average throughput rate of 936 tpd in 2008.

Mine production throughout the year took place principally on the polymetallic Animas vein which provided 85% of ore sourced to the mill in 2009. The balance was sourced as follows: 9% from high grade silver veins Soledad and Bateas, and 6% from existing ore stocks. The ore mix in 2010 is expected to be similar.

Total underground preparation and development in 2009 amounted to 9,800 m, below the 13,000 m drifted in 2008. The gradual return to normality in metal prices throughout the year allowed the Company to get back on track with respect to required mine development after the significant budget cutbacks at the end of 2008 and the beginning of 2009. In 2010, 14,800 m of development and preparation have been budgeted as part of ongoing operations.

In 2009, the Company successfully commissioned the expansion project that allowed a ramp up in plant capacity to 1,200 tpd and the addition of a copper circuit. The copper project started commercial production in December of 2010 and is now operating at sustained recoveries of 56%.

In 2009, the Company completed the feasibility study for a new tailings facility. Total estimated capital for the project is $6.8 million for a capacity equivalent to 15 years of operations. The first phase of the project will demand $2.5 million and construction is scheduled for the second quarter of 2011.

Cash cost per ounce of payable silver net of by-product credits at Caylloma was negative $4.93 in 2009, a 30% drop compared to 2008 (2008: negative $3.78) attributable to a 45% increase in by-product credits and a 108% increase in payable silver ounces. Cash cost per tonne of treated ore in 2009 decreased by 1% to $46.00 (2008: $46.41). (See page 14 for reconciliation of cash production cost to the cost of sales in the consolidated statement of operations).

On July 16, 2009, the Company released an updated NI 43-101 resource estimation for Caylloma. The NI 43-101 Technical Report was filed on August 27, 2009. Highlights of the resource & reserve estimation include:

- Proven and Probable Mineral Reserves are estimated at 4.03 million tonnes averaging 156 g/t Ag, 0.55 g/t Au, 1.70% Pb and 2.58% Zn;
- Contained silver is estimated at 20.3 million ounces, representing a 304% increase in silver ounces in the Proven and Probable reserve categories over the previous resource and reserve estimate (NI 43-101 Technical Report published October 3, 2006);
- Inferred Mineral Resources are estimated at 1.3 million tonnes averaging 187 g/t Ag, 0.29 g/t Au, 1.92% Pb and 3.25% Zn;
- Contained silver in the Inferred Resource category is estimated at 7.7 million ounces.

Discovery of high-grade silver-gold at Caylloma Mine, Peru

On February 2, 2010, the Company announced the discovery of high-grade silver-gold mineralization in the upper portion of the Animas Vein at the Caylloma Mine in southern Peru. The Animas vein, traditionally a polymetallic vein, is the source of 85% per cent of production at the Company's Caylloma mine. The Company is currently investigating the impact of the new discovery and are working to define resources to be included in the Company's mine plan.

(Dollar amounts expressed in US dollars, unless otherwise indicated)

Price protection program

During the year, the Company entered into commodity forward and option contracts to secure a minimum price level on part of its Caylloma's zinc and lead metal production throughout the period covering February 2009 to December 2010 with the objective of securing short term capital requirements for project development.

The counterparties are Standard Bank PLC, Banco Bilbao Vizcaya Argentaria, S.A., Macquarie Bank Limited, Goldman Sachs, and Scotia Bank.

Forward Sales Contracts - Swap Basis

The contracts are spread evenly over the periods shown below with settlement occurring on a monthly basis. No initial premium associated with these trades has been paid.

The following forward sale contracts were entered into on a SWAP basis, as defined below:

January 2009 - settlements throughout February 2009 to July 2009:

Lead forward contracts:	$1,109/t, for the total of 3,150 tons
Zinc forward contracts:	$1,240/t, for the total of 3,850 tons

July 2009 - settlements throughout August 2009 to December 2009:

Lead forward contracts:	$1,645/t, for the total of 2,675 tons
Zinc forward contracts:	$1,561/t, for the total of 3,000 tons

August 2009 - settlements throughout January 2010 to June 2010:

Lead forward contracts:	$1,910/t, for the total of 1,800 tons
Zinc forward contracts:	$1,787/t, for the total of 1,050 tons

The SWAP basis contracts are settled against the arithmetic average of zinc and lead spot prices over the month in which the contract matures.

Put and Call Option Commodity Arrangements

As at December 31, 2009, the Company had entered into a series of put and call option commodity arrangements. A long put refers to put options that have been bought by the Company, and a short call refers to call options that have been sold by the Company. Settlement of these options occurs monthly during the period of January 2010 to December 31, 2010 as follows:

Period January 2010 - Jun 2010

The following Zinc Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 2,100 tons
- 6 Short call options at strike price: $3,010/t, for the total of 2,100 tons

The following Lead Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 1,200 tons
- 6 Short call options at strike price: $2,975/t, for the total of 1,200 tons

Period July 2010 - December 2010

The following Zinc Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 3,150 tons
- 6 Short call options at strike price: $3,010/t, for the total of 3,150 tons

The following Lead Option contracts were entered into:

- 6 Long put options at strike price: $2,000/t, for the total of 2,850 tons
- 6 Short call options at strike price: $2,974/t, for the total of 2,850 tons

<u>Mexico - San Jose Silver-Gold Project</u>

With the recent granting of the Change of Land Use permit (see Fortuna news release dated December 14, 2009), Fortuna now has all of the key permits necessary to start construction at San Jose. Project staffing for the construction phase is being conducted and the Company has initiated selective searches for long lead equipment. The Company expects to publish a pre-feasibility and start construction activities during the first quarter of 2010. The Company looks forward to commissioning San Jose in 2011, which will drive further growth in Fortuna's silver production.

For financing of this project, refer to Liquidity and Capital Resources (page 15).

Trinidad Resource Estimation

On October 26, 2009, the Company released an updated NI 43-101 resource estimation for San Jose, with the full NI 43-101 released on December 10, 2009. Highlights are as follows:

Indicated Resources have increased 83% to 2.69 million tonnes with contained silver equivalent ounces increasing 112% to 37.6 million Ag Equivalent[1] ounces. Silver and gold grades in the Indicated Resource category have increased by 12% to 295 g/t and 4% to 2.27 g/t, respectively. The new resource estimate will serve as the basis for pre-feasibility level engineering studies projected for the first quarter of 2010.

(Dollar amounts expressed in US dollars, unless otherwise indicated)

At a cut-off grade of 150 g/t Ag Equivalent, the Indicated and Inferred Mineral Resources for the Trinidad Zone at San Jose are estimated at:

Indicated Mineral Resource:	2.69 million tonnes grading 295 g/t Ag and 2.27 g/t Au containing 37.6 million Ag Equivalent[1] ounces
Inferred Mineral Resource:	2.41 million tonnes grading 262 g/t Ag and 2.11 g/t Au containing 30.4 million Ag Equivalent[1] ounces.

[1]Silver equivalency estimates were derived using metal prices of US$13.75/oz for silver and US$856.16/oz for gold (36-month average + 24 month future metal prices as of July 31, 2009). Metallurgical recoveries were estimated at 92.5% for silver and 91.5% for gold based on metallurgical testing completed by Metcon Research of Tucson, Arizona as of March 2009.

The resource estimate incorporates data from 196 core drill holes totaling 64,204 meters and 908 underground channel samples. Previously reported NI 43-101 compliant resources for San Jose were estimated at 1.47 million tonnes grading 263 g/t Ag and 2.19 g/t Au in the Indicated category and 3.9 million tonnes grading 261 g/t Ag and 2.57 g/t Au in the Inferred category (see March 31, 2007 Technical Report available on the company website (www.fortunasilver.com) and on SEDAR).

Approval of Environmental Impact Study

On October 23rd, 2009, the "Secretaria de Medio Ambiente y Recursos Naturales" (Mexican Environmental Agency) delivered the approval of the Environmental Impact Study for full mine and mill construction and operation at the San Jose silver-gold project, located in the southern State of Oaxaca, Mexico.

The October 23rd, 2009 government approval authorizes the construction and future operation of the San Jose Mine, including the underground workings, processing plant, tailings facility and other surface infrastructure for a 1,500 tonne per day operation within an area of ninety-two hectares.

The permit contemplates a processing plant that will use conventional flotation for production of high grade silver- and gold- bearing concentrates, without the use of cyanide. The primary source of industrial water for the project will be from a gray-water treatment facility located thirteen kilometers from the mine site.

Approval of Change of Land Use

On December 14, 2009, the "Secretaria de Medio Ambiente y Recursos Naturales" (Mexican Environmental Agency) approved the Company's application for a change of land use from agricultural to industrial for the San Jose silver-gold project, located in the southern State of Oaxaca, Mexico.

This is the final permit required to commence construction activities and complements the Environmental Impact Study, which was approved in late October 2009.

Other permits

On April 28, 2009, the "Comision Federal de Electricidad" (Mexican Federal Energy Commission) issued the permit to connect to the national power grid for up to five megawatts; sufficient power to cover the requirements of a 1,500 tonnes per day mine operation. The transformer sub-station site will be located within five hundred meters of the main high voltage power line which runs through the Company´s property.

Project Engineering

The Company has received from its consultants all the engineering design that form up the San Jose Pre-Feasibility Study which include the processing plant, tailings facility, power project, water project, surface infrastructure, mine design, and other matters. The Company´s engineering staff is currently conducting an internal review of the various engineering projects and continues to work towards the delivery of the final feasibility study by the first quarter of 2010.

The Company has engaged North American engineering firm CAM to provide Qualified Person supervision for the project engineering and to author required Technical Reports.

Mexico - Tlacolula Silver Project

The 12,000 ha Tlacolula property is located 14km E-SE of the city of Oaxaca, 20km north of the Taviche District, where high-grade silver has been mined since Spanish colonial times, and is 30km northeast of the Company's 100% owned San Jose silver-gold development project.

In September 2009, the Company, through its wholly owned subsidiary, Cuzcatlan, was granted an option (the "Option") to acquire a 60% interest (the "Interest") in the Tlacolula silver project ("property") located in the State of Oaxaca, Mexico from Radius Gold Inc.'s wholly owned subsidiary, Radius (Cayman) Inc. ("Radius") (a related party by way of directors in common with the Company). The Company can earn the Interest by spending $2 million, which includes a commitment to drill 1,500 meters within three years, and making staged annual payments of $0.25 million cash and $0.25 million in common stock of the Company to Radius according to the following schedule:

- $0.02 million cash and $0.02 million cash equivalent in shares upon stock exchange approval;
- $0.03 million cash and $0.03 million cash equivalent in shares by the first year anniversary;
- $0.05 million cash and $0.05 million cash equivalent in shares by the second year anniversary;
- $0.05 million cash and $0.05 million cash equivalent in shares by the third year anniversary; and,
- $0.10 million cash and $0.10 million cash equivalent in shares by the fourth year anniversary.

Upon completion of the cash payments and share issuances, and incurring the exploration expenditures as set forth above, the Company will be deemed to have exercised the Option and acquired a 60% interest in the property, whereupon a joint venture will be formed to further develop the property on the basis of the Company owning 60% and Radius 40%.

On January 15, 2010, the transaction was approved by the TSX Venture Exchange, The Company has issued 7,813 common shares of the Company at a fair market value of $2.56 per share and paid $0.02 million cash according to the terms of the option agreement.

Cash cost per silver ounce and cash cost per tonne (non-GAAP measures)

Cash cost per ounce and cash cost per tonne are key performance measures that management uses to monitor performance. In addition, cash costs are presented as they represent an industry standard method of comparing certain costs on a per unit basis and management believes that certain investors use these non-GAAP measures to evaluate the Company's performance. These performance measures have no meaning within Canadian Generally Accepted Accounting Principles ("Canadian GAAP"), and, therefore, amounts presented may not be comparable to similar data presented by other mining companies.

The following table presents a reconciliation of cash costs per tonne of processed ore and cash cost per ounce of payable silver to the cost of sales in the consolidated statement of operations for the years ended December 31, 2009 and 2008.

	$'000's Years ended December 31, 2009	2008
Cost of sales	**23,699**	20,968
Add / (Subtract)		
Change in inventory (ore and concentrate stock piles)	**442**	(225)
Depletion, depreciation, and accretion	**(5,944)**	(5,363)
Cash cost	**18,197**	15,380
Total processed ore (tonnes)	**395,561**	331,380
Cash cost per tonne of processed ore ($/t)	**46.00**	46.41
Cash cost	**18,197**	15,380
Add / (Subtract)		
By-product credits [1]	**(27,318)**	(18,879)
Refining charges	**1,416**	659
Cash cost applicable per payable ounce	**(7,705)**	(2,840)
Payable silver ounces	**1,563,775**	750,822
Cash cost per ounce of payable silver ($/oz)	**(4.93)**	(3.78)

[1] **By-product credits are included in the provisional liquidation**

Liquidity and Capital Resources

The Company's cash as at December 31, 2009 was $30.76 million (2008: $29.45 million) and $6.03 million (2008: $nil) in short term investments.

During 2009, cash generated by operating activities before changes in working capital was $15.91 million. Further liquidity consumed by changes in working capital amounted to $2.22 million, for total cash generated by operating activities of $13.69 million.

During 2009, the Company invested a total amount of $11.02 million in mineral properties, $3.10 million in plant and equipment, and $5.99 million in short term investments. Additionally, the Company collected a net amount of value added tax refundable credit from the Mexican Government of $2.90 million. This is net of value added tax disbursements on local expenses during the period.

As at December 31, 2009, the Company's working capital amounted to $36.14 million compared to working capital of $34.06 million at December 31, 2008.

On January 6, 2010, the Company signed a commitment letter to enter into a $20 million senior secured revolving credit facility with The Bank of Nova Scotia. The facility has a 2.5 year maturity. The proceeds of the facility may be used for general corporate purposes, including the development of the San Jose Project in Mexico. The facility is intended to complement Fortuna's strong cash position and provide additional financing flexibility during the construction stage at San Jose. No funds have been drawn under this facility.

On March 2, 2010 and the Company issued 15,007,500 common shares at a price of CAD$2.30 per shares, under the bought deal financing for gross proceeds of CAD$34.5 million. Net proceeds of CAD$32.8 million after underwriting fees of CAD$1.7 million were raised from the bought deal financing.

Management believes the Company's cash position as well as its ongoing operation in Caylloma is sufficient to support the Company's operating and capital requirements on an ongoing basis. Actual funding requirements may vary from those planned due to further acquisition opportunities. Management believes it will be able to raise equity capital or access debt facilities as required in both the short and long term, but recognizes the uncertainty attached thereto.

Guarantees and Indemnifications

The Company may provide guarantees and indemnifications in conjunction with transactions in the normal course of operations. These are recorded as liabilities when reasonable estimates of the obligations can be made. Indemnifications that the Company has provided include obligation to indemnify:

- directors and officers of the Company and its subsidiaries for potential liability while acting as a director or officer of the Company, together with various expenses associated with defending and settling such suits or actions due to association with the Company;
- certain vendors of acquired company for obligations that may or may not have been known at the date of the transaction.

The Company acts as a guarantor to capital lease obligations held by two of its mining contractors. These capital lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements or commitments that are expected to have a current or future effect on our financial condition, results of operations, liquidity, capital expenditures, or capital resources that is material to investors, other than those disclosed in this MD&A and the consolidated financial statements and the related notes.

Related Party Transactions (expressed in $'000's)

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

Transactions with related parties	Expressed in $'000's Years ended December 31, 2009	2008
Consulting fees [1]	**$ 145**	$ 62
Salaries and wages [2,3]	**122**	104
Other general and administrative expenses [3]	**159**	74
	$ 426	$ 240

[1]Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Szotlender.

[2] Salaries and wages includes employees' salaries and benefits charged to the Company based on an estimated percentage of the actual hours worked for the Company.

[2, 3] Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for various general and administrative costs incurred on behalf of the Company.

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius. Refer to Notes to the Consolidated Financial Statements Note 10. c).

Amounts due to/(from) related parties	Expressed in $'000's December 31, 2009	December 31, 2008
Owing (from)/to a director and officer[4]	**$ (1)**	$ -
Owing to a company with common directors [3]	**$ 50**	$ 38
	$ 49	$ 38

[4] Owing from a director includes a non-interest bearing loan to Jorge A. Ganoza Durant with no specific terms of repayments.

The transactions with related parties are measured at the agreed upon exchange amount, which is the amount of consideration established and agreed upon by the parties. The balances with related parties are unsecured, non-interest bearing, and payable in the normal course of business.

Critical Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions are based on established industry standards, historical experience, and are reviewed on an ongoing basis to confirm their continued applicability.

Depletion and Mineral Properties Cost

Mineral property costs are comprised of acquisition costs and capitalized exploration, construction and development costs. Upon initiating production, the asset is depleted over its estimated useful life on a units-of-production basis. The Company estimates reserves and resources and the economic life of its mines and utilizes this information to calculate depletion expense. Depletion charges are adjusted prospectively based on periodic re-assessments of the Company's mineral reserves.

The estimate of mineral reserves is prepared by Qualified Persons in accordance with industry standards defined under NI 43-101 of the Canadian Securities regulatory authorities. Mineral reserve estimates can change over time as a result of numerous factors, including changes in metal prices, production costs, or the re-evaluation of geological, engineering and economic data of a deposit. A significant reduction in mineral reserves would have a negative impact on the calculation of the depletion of this asset.

Asset Retirement Obligations

Fortuna's determination for asset retirement obligations involves estimation of timing and amounts of future costs relating to ongoing environmental and mine closure activities required under applicable law or the Company's own remediation plans. These estimates are subject to significant uncertainties because many of these costs will not be incurred for a number of years, the nature of the reclamation activities might change and the assumptions regarding the rate of inflation and credit risk-adjusted interest rate used in the calculation may vary over time. Therefore, actual costs and their timing might differ from current estimates.

Impairment of Long-lived Assets

Management reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Examples of such events or circumstances are changes in metal prices, sudden physical deterioration of the asset, legal circumstances or political risks in the countries Fortuna operates, or other external factors which could have a significant impact on the operations of the Company. Impairment is considered to exist if total estimated future cash flows or probability-weighted cash flows on an undiscounted basis are less than the carrying amount of the assets, including mineral property, plant and equipment and non-producing property. An impairment loss is measured and recorded based on discounted estimated future cash flows or the application of an expected present value technique to estimate fair value in the absence of a market price. Future cash flows include recoverable proven and probable reserves and a portion of recoverable resources, silver, zinc, copper, lead and gold prices (considering current and historical prices, price trends and related factors), production levels, capital and reclamation costs, all based on detailed engineering life-of-mine plans. Assumptions underlying future cash flow estimates are subject to risks and uncertainties. Any differences between significant assumptions and market conditions and/or the Company's performance could have a material effect on any impairment provision, and on the Company's financial position and results of operations.

Income Taxes

The estimation of the Company's future tax liabilities and assets involves significant judgment around a number of assumptions. Judgement must be used to determine the Company's future earning potential, and the expected timing of the reversal of future tax assets and liabilities. Further uncertainties are the result of interpretation of tax legislation in a number of jurisdictions which might differ from the ultimate assessment of the tax authorities. These differences may affect the final amount or the timing of the payment of taxes.

Stock-based Compensation

The determination of the value of stock-based compensation is estimated using the Black-Scholes option pricing model. Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Other assumptions include the expected life of the options and the risk-free interest rate at the time of the grant. Changes in these assumptions can materially affect the fair value estimated.

Financial Instruments

The carrying value of cash, accounts receivable, accounts payable and accrued liabilities, due to related parties, net approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The Company enters into derivative contracts to manage its exposure to fluctuations in base metal prices. These contracts are marked-to-market at the end of each period, and the changes in estimated fair value are recorded as an unrealized gain (loss) on commodity contracts in the statement of operations. As at December 31, 2009 the Company estimated the fair value of the outstanding contracts to constitute a liability of $3.06 million, and recorded a loss in the consolidated statements of operations for the year of $7.36 million. The estimated fair value was determined based on using applicable valuation techniques for commodity options with reference to the published market prices for underlying commodities quoted at the London Metal Exchange.

The long term investments in marketable securities are classified as available-for-sale and are measured at fair value at the end of each period. Fair value of these investments is determined based on published market prices of underlying securities. Change in fair values of available-for-sale marketable securities is recognized in other comprehensive income. At December 31, 2008 the Company had an investment in 3,706,250 shares of Continuum. These shares were de-recognized upon the Company's acquisition of Continuum on March 6, 2009 and a loss of $0.46 million was recorded in the statement of operations to reflect the realization of the loss.
The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk, and metal price risk.

(a) Fair value of financial instruments

The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3862 "Financial Instruments - Disclosure" requires disclosure of a three-level-hierarchy for fair value measurements based upon transparency of inputs to the valuation of financial instrument carried on the balance sheet at fair value. The three levels are defined as follows:

- Level 1 - inputs to the valuation methodology are quoted (unadjusted) for identical assets or liabilities in active markets.

- Level 2 - inputs to valuation methodology include quoted market prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value of measurement.

The carrying value of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, due to related parties, net, approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments.

Fair value estimates are made a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The Company has classified the determination of fair value of accounts receivable, and derivatives as level 2, as the valuation method used by the Company includes an assessment of assets in quoted markets with significant observable inputs.

Expressed in '000's

Financial assets (liabilities) at fair value as at December 31, 2009				
	Level 1	Level 2	Level 3	Total
Short term investments	**$ 6,034**	**$ -**	**$ -**	**$ 6,034**
Accounts receivable	**-**	**8,322**	**-**	**8,322**
Derivatives	**-**	**(3,055)**	**-**	**(3,055)**
	$ 6,034	**$ 5,267**	**$ -**	**$ 11,301**

[1] Comparative information has not been presented in the table because this information is not required in the year of adoption. For periods subsequent to the year of adoption, comparative information would be necessary.

Accounts receivable includes accounts receivable from provisional sales. The fair value of accounts receivable resulting from provisional pricing reflect observable market commodity prices. Resulting fair value changes accounts receivable are through sales. Transactions involving accounts receivable are with counterparties the Company believes are creditworthy.

Derivatives are carried at their fair value, which is determined based on internal valuation models that reflect observable forward market commodity prices. Resulting fair value changes to derivatives are through net gain(loss) on commodity contracts. Transactions involving derivatives are with counterparties the Company believes to be creditworthy.

(b) Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico, and Barbados and a portion of its expenses are incurred in Canadian dollars, Nuevo Soles, and Mexican Pesos. A significant change in the currency exchange rates between the United

States dollar relative to the other currencies could have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

At December 31, 2009, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, Nuevo Soles and Mexican Pesos (all amounts are expressed in thousands of Canadian dollars, thousands of Nuevo Soles or thousands of Mexican Pesos):

	Expressed in '000's					
	December 31, 2009			December 31, 2008		
	Canadian Dollars	**Nuevo Soles**	**Mexican Pesos**	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash	**$ 21,283**	**S/. 302**	**$ 1,283**	$29,748	S/. 629	$ 3,864
Short term investments	**560**	**-**	**-**	-	-	-
Accounts receivable	**5**	**880**	**6,565**	13	10,400	46,460
Accounts payable and accrued liabilities	**(194)**	**(17,150)**	**(623)**	(172)	(5,281)	(10,259)

Based on the above net exposure as at December 31, 2009, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, expressed in US dollars, as follows:

Impact to other comprehensive income (loss)	$ 2,293		
Impact to net income (loss)		$ (614)	$ 65

(c) 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 equivalents and short term investments are held through large Canadian, international and foreign national financial institutions. These investments mature at various dates within one year. All of the Company's trade accounts receivables are held with large international metals trading companies.

The Company holds derivative contracts with financial institutions and in this regard is exposed to counterparty risk. The Company mitigates this risk by transacting only with reputable financial institutions to minimize credit risk.

As at December 31, 2009, the Company has a Mexican value added tax of $0.42 million and Peruvian value added tax of $0.18 million. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

(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 by continuing to monitor forecasted and actual cash flows. The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its development plans. The Company strives to maintain sufficient liquidity to meet its short term business requirements, taking into account its anticipated cash flows from operations, its holdings of cash, short term investments, and its committed liabilities.

The Company expects the following maturities of its financial liabilities (including interest), operating leases, and other contractual commitments:

	Expressed in '000's				
	Expected payments due by period as at December 31, 2009				
	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years	Total
Accounts payable and accrued liabilities	$ 8,083	$ -	$ -	$ -	$ 8,083
Due to related parties, net	49	-	-	-	49
Derivatives	3,055	-	-	-	3,055
Long term liability	1,038	1,454	-	-	2,492
Total [1]	$ 12,225	$ 1,454	$ -	$ -	$ 13,679

[1] Amounts above do not include payments related to the following: (i) the Company's anticipated asset retirement obligation of $2,529 associated with mine closure, land reclamation, and other environmental matters.

(e) 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 is limited because the balances are generally held with major financial institutions in demand deposit accounts.

(f) Metal price risk

The Company is exposed to metals price risk with respect to silver, gold, zinc, and lead sold through its mineral concentrate products. The Company mitigates this risk by implementing price protection programs for some of its zinc and lead production through the use of derivative instruments. As a matter of policy, the Company does not hedge its silver production.

<u>Other Data</u>

Additional information related to the Company is available for viewing at www.sedar.com and the Company's website at www.fortunasilver.com.

(Dollar amounts expressed in US dollars, unless otherwise indicated)

Share Position and Outstanding Warrants and Options

The Company's outstanding share position at March 11, 2010 is 110,062,465 common shares. In addition, a total of 8,150,500 incentive stock options, with 2,665,000 subject to shareholder approval, are currently outstanding as follows:

Type of Security	No. of Shares	Exercise Price CAD$	Expiry Date
Incentive Stock Options:	30,000	$0.80	July 24, 2010
	270,000	$1.35	February 5, 2016
	250,000	$2.29	March 30, 2016
	60,000	$1.75	May 8, 2016
	200,000	$1.75	May 22, 2016
	7,500	$0.85	July 5, 2016
	225,000	$1.55	July 5, 2016
	860,000	$1.66	July 10, 2016
	225,000	$1.61	September 13, 2016
	95,000	$0.85	January 11, 2017
	700,000	$2.22	January 11, 2017
	50,000	$2.75	February 6, 2017
	15,000	$0.85	April 22, 2017
	5,000	$0.85	May 31, 2017
	38,000	$0.85	June 27, 2017
	30,000	$0.85	July 2, 2017
	25,000	$0.85	October 24, 2017
	250,000	$2.52	February 5, 2018
	150,000	$1.25	August 25, 2018
	1,100,000	$0.85	October 5, 2018
	650,000	$0.85	November 5, 2018
	250,000	$0.83	July 6, 2019
	2,150,000	$1.60	October 27, 2019
	490,000	$1.70	November 8, 2019
	25,000	$2.23	November 23, 2019
TOTAL OUTSTANDING OPTIONS:	**8,150,500**		

Change in Accounting Policy

Change in Reporting Currency

Effective January 1, 2009, the Company changed its reporting currency to the US dollar. The change in reporting currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the mining industry. Prior to January 1, 2009, the Company reported its annual and quarterly consolidated balance sheets and the related consolidated statements of operations and cash flows in Canadian dollar (CAD).

In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants ("CICA"), set out in EIC-130, "Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency". In accordance with EIC-130, the financial statements for all years and periods presented have been translated in to the new reporting currency using the current rate method. Under this method, the statements of operations and cash flows statements items for each year and period have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the consolidated balance sheets dates. All resulting exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US dollars.

Adoption of New Accounting Standards

Goodwill and Intangible Assets (Section 3064)

In February 2008, the CICA issued the following Handbook Sections : Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs", and amended Section 1000, "Financial Statement Concepts". The standard intends to reduce the differences with International Financial Reporting Standards ("IFRS") in the accounting for intangible assets and results in closer alignment with U.S. GAAP. Under previous Canadian standards, more items are recognized as assets than under IFRS or U.S. GAAP. The objectives of Section 3064 are to reinforce the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition; and clarify the application of the concept of matching revenues and expenses such that the current practice of recognizing assets that do not meet the definition and recognition criteria are eliminated. The standard also provides guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. This standard is effective for fiscal years beginning on or after October 1, 2008. The Company has evaluated the new section and determined that adoption of these new requirements did not have a material impact on the Company's consolidated financial statements.

Credit risk and fair value of financial assets and financial liabilities

In January 2009, the Emerging Issues Committee of the CICA issued EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments, for presentation and disclosure purposes.

The guidance is to be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after the date of issuance of this Abstract. Retrospective application with restatement of prior periods is permitted but not required.

The Company has evaluated the new section and determined that adoption of these new requirements did not have a material impact on the Company's consolidated financial statements.

Mining Exploration Costs

On March 27, 2009, the Emerging Issues Committee of the CICA issued EIC-174 "Mining Exploration Costs" which applies to interim and annual financial statements for periods ending on or after January 20, 2009. This guidance clarified that an entity that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

The Company has adopted this new standard in its December 31, 2009 annual financial statements with no impact on the Company's consolidated financial statements.

Foreign currency translation

Fortuna Silver Mines Inc.'s functional currency is the Canadian dollar. Effective January 1, 2009, the Company changed its reporting currency to the US dollar.

All subsidiaries, except its wholly owned subsidiary, Minera Bateas S.A.C. ("Bateas"), are considered to be self sustaining operations. Bateas's integrated foreign operations and their financial statements are translated to US dollars under the temporal method. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at historical exchange rates. Revenues and expenses are translated at the average exchange rate in effect during the period. Realized and unrealized foreign exchange gains and losses are included in earnings.

Commencing January 1, 2009, Bateas is an integrated foreign operation because Bateas translates its financial statements denominated in Peruvian Soles to US dollars using the temporal method.

All other subsidiaries' financial statements are translated using the current rate method. Assets and are translated into US dollars using the current rate method at period-end exchange rates and resulting translation adjustments are reflected in comprehensive income. Revenues and expenses are translated at average exchange rates for the period.

Recent released Canadian Accounting Standards

The Company has assessed new and revised accounting pronouncements that have been issued and determined that the following may have an impact on the Company:

Convergence with International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will begin reporting its financial statements in accordance with IFRS on January 1, 2011, with comparative figures for 2010.

The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

During 2009, the Company began planning its transition to IFRS. The process will consist of three phases: Scoping and Diagnostics, Analysis and Development, and Implementation and Review.

During the third quarter of 2009, the Company, with the assistance of external advisors, completed an initial scoping and diagnostic assessment. This assessment identified, at a high level, the key areas for more detailed consideration and that may give rise to potential difference upon conversion. As part of this phase, preliminary recommendations were made in respect of transitional elections available under IFRS 1, "First-Time Adoption of International Reporting Standards". At the present time the company is planning to apply two of the 17 exemptions which include:

- IFRS 3 "Business Combinations" which allows an entity that has conducted prior business combinations to apply IFRS 3 on a prospective basis only from the date of transition. This avoids the requirement to restate prior business combinations, although some adjustments may still be necessary. Currently, the Company has three prior business transactions that meet the criteria of a business combination under IFRS.
- IFRS 2 "Share-Based Payment Transactions" which allows full retrospective application to be avoided for certain share-based instruments depending on the grant date, vesting terms and settlement of any related liabilities. The Company has not disclosed the value of the share options historically and therefore cannot apply IFRS 2 retrospectively.

Following the completion of the scoping and diagnostic assessment, the Company engaged external advisors to assist with detailed technical reviews of the identified potential high impact areas. These reviews include the identification of IFRS - Canadian GAAP differences, accounting policy considerations, and preliminary implementation plans. The high impact areas relating to conversion include foreign currency; property, plant and equipment; income taxes; and provisions (including asset retirement obligations). The technical review aspects of these assessments have been completed for foreign currency; property, plant and equipment; and income taxes. A summary of the potential impacts in these areas are as follows:

a) Foreign Currency

Under International Accounting Standard ("IAS") 21, it is necessary to assess the functional currency of all the Company's entities based on the primary economic environment in which the entity operates. In addition, secondary factors may also provide evidence of an entity's functional currency. Once the functional currency is determined, it does not change unless there is a change in the underlying nature of the transactions and relevant conditions and events.

All entities that have a Canadian GAAP measurement currency that is different than the functional currency under IFRS will need to translate their balance sheets to the functional currency at the transition date. The Company will need to update its consolidation model for foreign currency translation.

The Company's preliminary analysis is the functional currency of all the group's entities is U.S. dollars, the same as the presentation currency. As a result, the Company is planning to take the IFRS 1 exemption that resets the cumulative translation adjustment balance to zero, to reduce the conversion effort.

b) Property, Plant and Equipment

Under IAS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total costs of an item is depreciated separately. This is commonly referred to as component depreciation. Each separate part is depreciated over its useful economic life to the residual value. Under IFRS, the assessment of the useful economic life and the residual value of each part of the asset are determined on an annual basis. The Company is currently completing a detailed review of fixed assets to determine if additional component depreciation will be necessary.

Canadian GAAP does not specifically state how to treat borrowing costs related to the construction of an asset, whereas IFRS states that borrowing costs that are directly attributable to the acquisition or construction of a qualifying asset shall be capitalized as part of the cost of that asset on a net basis.

Under IFRS, there is an option to use either the cost method or the revaluation model for subsequent measurement of classes of assets. The Company plans to continue to use the cost method.

For impairment, Canadian GAAP generally uses a two-step approach to testing: first comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists, and then measuring any impairment by comparing asset carrying values with fair values. IAS 36, "Impairment of Assets", uses a one-step approach for both testing for and measurement of impairment, with carrying values compared directly with the higher of fair value less costs to sell and value in use (which uses discounted future cash flows). This may potentially result in more write downs when carrying values of assets are supported under Canadian GAAP on an undiscounted cash flow basis, but could not be supported on a discounted cash flow basis.

However, the extent of any new writedowns may be partially offset by the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

c) Income Taxes

The analysis completed to date has identified two significant relevant differences in the area of accounting for income taxes.

Canadian GAAP has a specific exemption for future income taxes related to non-monetary assets or liabilities of integrated foreign operations. Future income taxes cannot be recognized for a temporary difference arising from the difference between the historical exchange rate and the current exchange rate translation of the cost of non-monetary assets or liabilities of integrated foreign operations. Under IFRS, deferred tax is recognized on the difference between: the accounting basis of all items, which is accounted for as specified under IFRS. For foreign currency non-monetary assets or liabilities, this is the local or tax basis currency translated into the functional currency at the historical rate; and the tax basis, which is the local or tax basis currency amount translated to the functional currency at the spot exchange rate at the balance sheet date. The result of this calculation difference will be added volatility in the tax expense as foreign exchange swings will have an impact on the tax expense.

IFRS 12 does not permit recognition of a temporary difference on initial recognition, except if the transaction is a business combination or if the transaction affects accounting or taxable profit or loss. Under Canadian GAAP, assets acquired in other than in a business combination, may have a tax basis different than the carrying amount on acquisition. The associated FIT assets (subject to the more likely than not test) or liability is recognized at the time of acquisition and added to the cost of the asset. The amount of the FIT is calculated using a simultaneous equation; this method of tax calculation is referred to as the 'gross up' method. Under IAS 12, any temporary differences arising on subsequent asset acquisitions, other than in a business combination, would be ignored. On adoption of IFRS, the temporary differences arising from the 'gross up' method under Canadian GAAP will be reversed.

Following the completion of the 2009 year-end filings, the Company will commence quantification of the identified technical differences.

Concurrent with the technical analysis, we have prepared draft pro forma consolidated annual IFRS financial statements to help understand the disclosure impact of the change to IFRS. These will be presented to the Audit Committee at the end of the first quarter of 2010.

The Company will continue to monitor changes in IFRS leading up to the changeover date, and will update the conversion plan as required.

Business Combinations

In January 2009, the CICA issued the following Handbook Sections: Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests". These new standards are harmonized with International Financial Reporting Standards (IFRS). Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 specifies that non-controlling interests be treated as a separate component of equity, not as a liability or other item outside of equity. The new standards will become effective in 2011 but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

Comprehensive revaluation of assets and liabilities and Equity

In August 2009, the CICA amended Section 1625, "Comprehensive revaluation of assets and liabilities" as a result of issuing "Business Combinations, Section 1582, "Consolidated Financial Statements", Section 1601, and Non-Controlling Interests", Section 1602, in January 2009.

In August 2009, the CICA amended Section 3251, "Equity" as a result of issuing Section 1602, "Non-controlling Interests". These amendments only apply to entities that have adopted Section 1602.

These amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011, but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

Financial Instruments and Impaired Loans

In August 2009, the CICA issued amendments to Section 3855, "Financial Instruments: Recognition and Measurement". These amendments will permit (or require in certain circumstances) entities to reclassify certain investments in debt instruments, will amend the guidance regarding impairment measurement for Held-to-Maturity debt instruments and will require reversals of impairment losses for Available for Sale debt instruments when conditions have changed. These amendments apply only to investments in debt instruments and do not apply to investments in equity investments or to debt instruments that have been designated at orgination as Held-for-Trading.

In August 2009, the CICA amended Section 3025, "Impaired loans" to conform with the definition of a loan to that in amended Section 3855 and to include held-to-maturity investments within the scope of this Section.

These amendments are effective for annual financial statements relating to fiscal years beginning on or after November 1, 2008 with early adoption permitted for interim financial statements issued on or after August 20, 2009. The Company has evaluated the new section and determined that adoption of these new requirements, for fiscal year end December 31, 2009, did not have a material impact on the Company's consolidated financial statements.

Risks and Uncertainties

Metal price risk

One of the most significant risks affecting the profitability and viability of the Company's mining operations is the fluctuation of metal prices. Volatility of metal prices is high by historic measures and strong downturns on these prices can have significant adverse effects on the continuity of the Company's operations. In order to mitigate this risk in the medium term, the Company put in place price protection strategies for approximately 59% and 60% of its zinc and lead metal production, respectively, for the six month period between January 2010 and June 2010. For the six month period between July 2010 and December 31, 2010, the Company put in place price protection strategies for 59% and 57% of its zinc and lead metal production, respectively.

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 equivalents and short term investments are held through large Canadian and international financial institutions. These investments mature at various dates within one year.

The Company is subject to credit risk through its trade receivables. The Company enters into one year contracts to sell its concentrate products at Caylloma and transacts only with credit worthy costumers to minimize credit risk. The Company awarded its full production of 2009 to large international metals trading companies, including Glencore International.

The Company holds derivative contracts with financial institutions and in this regard is exposed to counterparty risk. The Company mitigates this risk by transacting only with reputable financial institutions to minimize credit risk. During 2009, the Company has transacted with Standard Bank PLC, Banco Bilbao Vizcaya Argentaria, S.A., Macquarie Bank Limited, Goldman Sachs, and Scotia Bank. The Company currently holds derivatives contracts with Macquarie Bank Limited and Scotia Bank.

Environmental risk

The Company has recorded an asset retirement obligation of $2.53 million as of December 31, 2009 in relation to the cost of reclamation associated with the Caylloma property. This amount has been estimated by a third party in compliance of local regulations and has been approved by the relevant authorities in November 2009.

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

Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico, and Barbados and a portion of its expenses are incurred in Canadian dollars, Nuevo Soles, and Mexican Pesos. A significant change in the currency exchange rates between the United States dollar relative to the other currencies could have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

Exploration and development

The business of mineral exploration and extraction involves a high degree of risk. Few properties that are in the exploration stage ultimately become producing mines. Major expenses may be required to establish reserves by drilling and to construct mining and processing facilities at a site. It is impossible to ensure that exploration and development programs carried out by the Company will result in profitable commercial mining operations.

Resources and reserves

There is a degree of uncertainty attributable to the estimation of resources and reserves and to expected mineral grades. Mineral Resources and Mineral Reserves may require revision based on actual production experience. Market fluctuations in the price of metals, as well as increased production costs and reduced recovery rates, may render certain mineral reserves uneconomic and may ultimately result in a restatement of resources and/or reserves. Short term operating factors relating to the mineral resources and reserves, such as the need for sequential development of ore bodies may adversely affect the Company's profitability in any accounting period.

Political and country risk

The Company's mineral properties are located in emerging nations and consequently may be subject to a higher level of risk compared to developed countries. Operations, the status of mineral property rights, title to the properties and the recoverability of amounts shown for mineral properties in emerging nations can be affected by changing economic, regulatory, and political situations.

The State of Oaxaca has a history of social conflicts and political agitation which can lead to public demonstrations and blockades that can from time to time affect the Company's operations.

Controls and Procedures

Disclosure Controls and Procedures

The Company evaluated the effectiveness of the design and operation of the disclosure controls and procedures, as of December 31, 2009, under the supervision of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the results of this evaluation the CEO and the CFO have concluded that such disclosure controls are sufficiently effective to provide reasonable assurance that material information relating to the Company is made known to management and disclosed in accordance with the applicable securities laws.

Internal Control Over Financial Reporting

The Company's management, with the participation of its CEO and CFO, are responsible for establishing a system of internal control over financial reporting to provide reasonable assurance regarding the reliability and integrity of the Company's financial information and the preparation of its financial statements in accordance with Canadian generally accepted accounting principles. Management of the Company, with the participation of the CEO and CFO, has evaluated the effectiveness of internal control over financial reporting as of December 31, 2009 and has concluded there are no material weaknesses. Management continues to review and refine its internal controls and procedures.

Management Changes

There were no management changes during the year ended December 31, 2009.

(Dollar amounts expressed in US dollars, unless otherwise indicated)

Outlook

For 2010, the Company expects to sustain silver production at 1,700,000 ounces, with base metal production also remaining level at current rates.

2010 Production Guidance (rounded to whole thousands)

Metal production	**2010 (Forecast)**	2009 (Actual)	2008 (Actual)	2007 (Actual)
Silver (oz)	**1,700,000**	1,683,000	805,000	480,000
Zinc (lbs)	**28,400,000**	28,442,000	23,283,000	13,900,000
Lead (lbs)	**25,200,000**	25,137,000	16,502,000	8,300,000
Copper (lbs)	**1,000,000**	88,000	-	-