


(Formerly Prophecy Coal Corp.)

# Annual Consolidated Financial Statements

## For the years ended December 31, 2014 and 2013

(Expressed in Canadian Dollars)

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# MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The annual audited consolidated financial statements (the "**Annual Financial Statements**"), the notes thereto, and other financial information contained in the accompanying Management's Discussion and Analysis ("**MD&A**") have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and are the responsibility of the management of Prophecy Development Corp. The financial information presented elsewhere in the MD&A is consistent with the data that is contained in the Annual Financial Statements. The Annual Financial Statements, where necessary, include amounts which are based on the best estimates and judgment of management.

In order to discharge management's responsibility for the integrity of the Annual Financial Statements, the Company maintains a system of internal accounting controls. These controls are designed to provide reasonable assurance that the Company's assets are safeguarded, transactions are executed and recorded in accordance with management's authorization, proper records are maintained and relevant and reliable financial information is produced. These controls include maintaining quality standards in hiring and training of employees, policies and procedures manuals, a corporate code of conduct and ethics and ensuring that there is proper accountability for performance within appropriate and well-defined areas of responsibility. The system of internal controls is further supported by a compliance function, which is designed to ensure that we and our employees comply with securities legislation and conflict of interest rules.

The Board of Directors is responsible for overseeing management's performance of its responsibilities for financial reporting and internal control. The Audit Committee, which is composed of non-executive directors, meets with management as well as the external auditors to ensure that management is properly fulfilling its financial reporting responsibilities to the Board who approve the Annual Financial Statements. The external auditors have full and unrestricted access to the Audit Committee to discuss the scope of their audits and the adequacy of the system of internal controls, and to review financial reporting issues.

The external auditors, Davidson & Company LLP, have been appointed by the Company's shareholders to render their opinion on the Annual Financial Statements and their report is included herein.

*"John Lee"*
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John Lee, Interim Chief Executive Officer
Vancouver, British Columbia

"*Irina Plavutska*"
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Irina Plavutska, Chief Financial Officer

March 31, 2015

# INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Prophecy Development Corp.

We have audited the accompanying consolidated financial statements of Prophecy Development Corp., which comprise the consolidated statements of financial position as at December 31, 2014 and 2013 and the consolidated statements of operations and comprehensive loss, changes in equity, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

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

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

***Auditors' Responsibility***

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

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

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

***Opinion***

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Prophecy Development Corp. as at December 31, 2014 and 2013 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

***Emphasis of Matter***

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes conditions and matters that indicate the existence of a material uncertainty that may cast significant doubt about Prophecy Development Corp.'s ability to continue as a going concern.

**"DAVIDSON & COMPANY LLP"**

Vancouver, Canada — Chartered Accountants

March 31, 2015

**PROPHECY DEVELOPMENT CORP.**
**(formerly Prophecy Coal Corp.)**
**Consolidated Statements of Financial Position**
(Expressed in Canadian Dollars)

| As at | Notes | December 31, 2014 | December 31, 2013 |
|---|---|---|---|
| **Assets** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 8 | $ 200,994 | $ 507,996 |
| Receivables | 9 | 737,434 | 2,648,993 |
| Amount due from related party | 23 | - | 78,364 |
| Prepaid expenses | 10 | 732,082 | 1,278,914 |
| Inventory | 11 | 1,499,231 | 1,758,310 |
| Available-for-sale investments | 12 | - | 2,295,810 |
| | | 3,169,741 | 8,568,387 |
| **Non-current assets** | | | |
| Restricted cash equivalents | 8 | 34,500 | 34,500 |
| Reclamation deposits | | 27,554 | 27,554 |
| Property and equipment | 13 | 4,361,982 | 10,758,586 |
| Mineral properties | 14 | 13,710,520 | 15,053,773 |
| | | $ 21,304,297 | $ 34,442,800 |
| **Liabilities and Equity** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | 15 | $ 2,778,368 | $ 1,432,238 |
| Line of credit facility, current portion | 16 | 1,288,218 | 1,069,400 |
| | | 4,066,586 | 2,501,638 |
| **Non-current liabilities** | | | |
| Provision for closure and reclamation | 17 | 173,363 | 129,552 |
| Line of credit facility | 16 | - | 631,925 |
| | | 4,239,949 | 3,263,115 |
| **Equity** | | | |
| Share capital | 19 | 147,947,292 | 147,680,113 |
| Reserves | | 20,502,885 | 19,790,089 |
| Accumulated other comprehensive gain | | - | 399,271 |
| Deficit | | (151,385,829) | (136,689,788) |
| | | 17,064,348 | 31,179,685 |
| | | $ 21,304,297 | $ 34,442,800 |

Approved on behalf of the Board:

***"John Lee"***
John Lee, Director

***"Greg Hall"***
Greg Hall, Director

**Nature of operations and going concern** (Note 1)
**Commitments** (Note 27)
**Contingencies** (Note 28)
**Events after the reporting date** (Note 29)

See accompanying notes to the consolidated financial statements.

**PROPHECY DEVELOPMENT CORP.**
**(formerly Prophecy Coal Corp.)**
**Consolidated Statements of Operations and Comprehensive Loss**
(Expressed in Canadian Dollars)

| | Notes | Years Ended December 31 2014 | 2013 |
|---|---|---|---|
| **General and Administrative Expenses** | | | |
| Advertising and promotion | | $ 73,552 | $ 132,779 |
| Consulting and management fees | | 197,940 | 198,156 |
| Depreciation | | 87,434 | 137,535 |
| Director fees | | 151,823 | 247,655 |
| Insurance | | 98,324 | 186,128 |
| Office and administration | | 151,532 | 141,949 |
| Professional fees | | 319,509 | 974,010 |
| Salaries and benefits | | 373,994 | 531,355 |
| Share-based payments | 19 | 617,362 | 1,304,486 |
| Stock exchange and shareholder services | | 130,098 | 121,617 |
| Travel and accommodation | | 262,017 | 118,778 |
| | | (2,463,585) | (4,094,448) |
| **Other Items** | | | |
| Deemed disposal loss of investment in associate | | - | (1,264,472) |
| Equipment rental revenue | | - | 1,338,003 |
| Finance and transaction costs | | - | (765,000) |
| Foreign exchange gain | | 663,523 | 251,254 |
| Gain on sale of available-for-sale investments | 12 | 2,654,882 | 237,137 |
| Interest expense | | - | (2,314,438) |
| Interest income | | 16,480 | 28,890 |
| Impairment of inventory | 11 | (484,288) | - |
| Impairment of mineral property | 14 | (2,252,610) | - |
| Impairment of property and equipment | 13 | (11,151,346) | (3,694,446) |
| Impairment of receivables | 9 | (1,679,097) | - |
| Loss on debt settlement | | - | (174,959) |
| Loss on disposal of investment in associate | | - | (12,399,523) |
| Share of net loss of associate | | - | (1,397,252) |
| | | (12,232,456) | (20,154,806) |
| **Loss Before Deferred Tax Recovery** | | (14,696,041) | (24,249,254) |
| Deferred income tax recovery | 18 | - | 953,100 |
| **Net Loss for Year** | | (14,696,041) | (23,296,154) |
| Fair value gain on available-for-sale investments | 12 | - | 399,271 |
| **Comprehensive Loss for Year** | | $ (14,696,041) | $ (22,896,883) |
| **Loss Per Common Share,** basic and diluted | | $ (0.06) | $ (0.10) |
| **Weighted Average Number of Common Shares Outstanding** | | 251,399,255 | 236,480,098 |

See accompanying notes to the consolidated financial statements.

**PROPHECY DEVELOPMENT CORP.**
**(formerly Prophecy Coal Corp.**
**Consolidated Statements of Changes in Equity**
(Expressed in Canadian Dollars)

| | Numbers of shares | Share Capital | Reserves | Accumulated Other Comprehensive Gain (Loss) | Deficit | Total |
|---|---|---|---|---|---|---|
| **Balance, December 31, 2012** | 228,400,956 | $ 145,796,591 | $ 18,577,859 | $ - | $ (113,393,634) | $ 50,980,816 |
| Private placement, net of share issue costs | 12,525,428 | 989,597 | - | - | - | 989,597 |
| Shares issued as financing fees | 2,000,000 | 280,000 | - | - | - | 280,000 |
| Warrants exercised | 4,175,143 | 438,390 | | | | 438,390 |
| Share-based payments | - | - | 1,070,305 | - | - | 1,070,305 |
| Share bonus to personnel | 1,272,292 | 175,535 | 141,925 | - | - | 317,460 |
| Loss for the year | - | - | - | - | (23,296,154) | (23,296,154) |
| Fair value gain on available for-sale investments | - | - | - | 399,271 | - | 399,271 |
| **Balance, December 31, 2013** | 248,373,819 | $ 147,680,113 | $ 19,790,089 | $ 399,271 | $ (136,689,788) | $ 31,179,685 |
| **Balance, December 31, 2013** | 248,373,819 | $ 147,680,113 | $ 19,790,089 | $ 399,271 | $ (136,689,788) | $ 31,179,685 |
| Share-based payments | - | - | 712,796 | - | - | 712,796 |
| Share bonus to personnel | 1,013,750 | 81,100 | - | - | - | 81,100 |
| Debt settlement | 2,541,065 | 190,580 | - | - | - | 190,580 |
| Return to treasury | (50,000) | (4,501) | - | - | - | (4,501) |
| Loss for the year | - | - | - | - | (14,696,041) | (14,696,041) |
| Sale of available-for-sale investments | - | - | - | (399,271) | - | (399,271) |
| **Balance, December 31, 2014** | 251,878,634 | $ 147,947,292 | $ 20,502,885 | $ - | $ (151,385,829) | $ 17,064,348 |

See accompanying notes to the consolidated financial statements

**PROPHECY DEVELOPMENT CORP.**
**(formerly Prophecy Coal Corp.**
**Consolidated Statements of Cash Flows**
(Expressed in Canadian Dollars)

| | Years Ended December 31 | |
|---|---|---|
| | **2014** | **2013** |
| **Operating Activities** | | |
| Net loss for the year | $ (14,696,041) | $ (23,296,154) |
| Adjustments to reconcile net loss to net cash flows: | | |
| Depreciation | 87,434 | 137,535 |
| Deferred income taxes | - | (953,100) |
| Deemed loss on investment in associate | - | 1,264,472 |
| Equipment rental revenue | - | (1,338,003) |
| Share-based payments | 617,362 | 1,304,486 |
| Share of loss of an associate | - | 1,397,252 |
| Gain on sale of available-for-sale investments | (2,654,882) | (237,137) |
| Loss on disposal of investment in associate | - | 12,399,523 |
| Finance costs | - | 390,000 |
| Impairment of inventory | 484,288 | - |
| Impairment of mineral property | 2,252,610 | - |
| Impairment of property and equipment | 11,151,346 | 3,694,446 |
| Impairment of receivables | 1,679,097 | - |
| Interest costs | 11,387 | 2,314,438 |
| Interest income | (16,480) | (28,890) |
| Unrealized foreign exchange | - | 219 |
| | (1,083,879) | (2,950,913) |
| Working capital adjustments | | |
| Receivables | 310,826 | (1,509,084) |
| Prepaid expenses | 214,804 | 164,368 |
| Inventory | (225,209) | 678,224 |
| Accounts payable and accrued liabilities | 229,280 | 425,593 |
| | 529,701 | (240,899) |
| **Cash Used in Operating Activities** | (554,178) | (3,191,812) |
| **Investing Activities** | | |
| Acquisition of property and equipment | (3,163,902) | (651,554) |
| Mineral property expenditures | (517,167) | (1,383,594) |
| Interest received from short term investment | - | 28,890 |
| Proceeds from sale of available-for-sale investments | 4,567,901 | 865,325 |
| Proceeds from disposal of investment in associate | - | 7,824,715 |
| Restricted cash | - | (34,500) |
| Short term investment | - | 5,107,500 |
| **Cash Provided by Investing Activities** | 886,832 | 11,756,782 |
| **Financing Activities** | | |
| Credit facility paid | (639,656) | - |
| Interest paid | - | (1,026,181) |
| Mongolian credit facility proceeds | - | 1,701,325 |
| Repayment of loan | - | (10,398,936) |
| Restructuring fees | - | (390,000) |
| Shares issued, net of share issuance costs | - | 1,287,987 |
| **Cash Used in Financing Activities** | (639,656) | (8,825,805) |
| Net Decrease in cash and cash equivalents | (307,002) | (260,835) |
| Cash and Cash Equivalents - beginning of year | 507,996 | 768,831 |
| Cash and Cash Equivalents - end of year | $ 200,994 | $ 507,996 |

**Supplemental cash flow information** (Note 26)

See accompanying notes to the consolidated financial statements.

## 1. NATURE OF OPERATIONS AND GOING CONCERN

Prophecy Development Corp. ("**Prophecy**" or the "**Company**") is incorporated under the laws of the province of British Columbia, Canada and is engaged in exploring and developing mining properties and energy projects in Canada and Mongolia. The Company's principal assets are its 100% interest in mining licenses in the Ulaan Ovoo property and Chandgana properties in Mongolia.

The Company maintains its head office at 2nd floor, 342 Water Street, Vancouver, B.C., Canada, V6B 1B6.

These consolidated audited annual financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. The Company incurred a net loss of $14.7 million for the year ended December 31, 2014 (December 31, 2013 - $23.3 million) and has a deficit of $151 million (December 31, 2013 - $137 million).

The business of mineral exploration involves a high degree of risk and there can be no assurance that the Company's current operations, including exploration programs, will result in profitable mining operations. The recoverability of the carrying value of mineral properties, and property and equipment interests and the Company's continued on going existence is dependent upon the preservation of its interest in the underlying properties, the discovery of economically recoverable reserves, the achievement of profitable operations, the ability of the Company to raise additional sources of funding, and/or, alternatively, upon the Company's ability to dispose of some or all of its interests on an advantageous basis. These conditions may cast significant doubt upon the Company's ability to continue as a going concern.

Additional sources of funding, which may not be available at favourable terms, if at all, include: equity and debt financings; coal sales; equipment rentals; equity, debt or property level joint ventures with power project and coal property developers; and sales of interests in existing assets. In the event that the Company is not able to obtain adequate additional funding to continue as a going concern, material adjustments would be required to be made to both the carrying value and classification of assets and liabilities on the statement of financial position.

## 2. BASIS OF PRESENTATION

(a) Statement of compliance

These Annual Financial Statements have been prepared in accordance with International Financial Reporting Standards, ("**IFRS**") as issued by the International Accounting Standards Board ("**IASB**").

The preparation of financial statements in compliance with IFRS requires the use of certain critical accounting estimates. It also requires the Company's management to exercise judgment in applying the Company's accounting policies. The areas where significant judgments and estimates have been made in preparing these Annual Financial Statements and their effect are disclosed in Note 5.

## 2. BASIS OF PRESENTATION (cont'd…)

These Annual Financial Statements have been prepared on a historical cost basis, except for financial instruments classified as available-for-sale and fair value through profit or loss ("**FVTPL**"), which are stated at their fair values. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting except for cash flow information.

The accounting policies set out in Note 6 have been applied consistently by the Company and its subsidiaries to all years presented.

(b) Approval of the financial statements

The Annual Consolidated Financial Statements were approved and authorized for issue by the Board of Directors on March 24, 2015.

(c) Functional Currency

The presentation currency is the Canadian dollar and the functional currency of the Company and its subsidiaries is the Canadian dollar, as this is the principal currency of the economic environment in which it operates.

## 3. BASIS OF CONSOLIDATION

(a) Subsidiaries

The Annual Financial Statements comprise the financial statements of the Company and its wholly owned subsidiaries as at December 31, 2014. Subsidiaries are consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date when such control ceases. Effects of transactions between related companies are eliminated on consolidation. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company. Accounting policies of the subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

Prophecy's subsidiaries at December 31, 2014 are as follows:

| | Principal | Place of incorporation | Ownership |
|---|---|---|---|
| 0912603 B.C. Ltd. | Exploration/Development | Canada | 100% |
| 0912601 B.C. Ltd. | Exploration/Development | Canada | 100% |
| Chandgana Coal LLC | Exploration/Development | Mongolia | 100% |
| Prophecy Power Generation LLC | Exploration/Development | Mongolia | 100% |
| Red Hill Mongolia LLC | Exploration/Development | Mongolia | 100% |
| UGL Enterprises LLC | Inactive | Mongolia | 100% |
| 1420 PSR PTE. LTD | Holding | Singapore | 100% |

## 4. CHANGES IN ACCOUNTING POLICIES

The Company has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of January 1, 2014:

IFRS 10, IFRS 12 and IAS 27

| | |
|---|---|
| (2011) Amendments | Amendments to IFRS 10, IFRS 12 and IAS 27 (2011) – Investment Entities |
| IAS 32 Amendments | Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities |
| IAS 39 Amendments | Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting |
| IFRIC 21 | Levies |
| IAS 36 Amendments | The amendments to IAS 36 relate to disclosure changes, specifically: (i) removing the requirement to disclose the recoverable value of a CGU when the CGU contains goodwill or long lived intangible assets not currently subject to impairment, (ii) adding a requirement to disclose the recoverable amount of an asset or CGU when an impairment loss is recognized or reversed, and (iii) adding a requirement to disclose how fair value less disposal costs are measured when an impairment loss is recognized or reversed. |

These adoptions did not have a material impact on the Company's Annual Financial Statements.

The following standards have been published and are mandatory for the Company's annual accounting periods no earlier than January 1, 2017:

• IFRS 9 *'Financial Instruments'* – This standard was published in July 2014 and replaces the existing guidance in IAS39, '*Financial Instruments: Recognition and Measurement'*. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted. The Company is currently evaluating the extent of the impact of the adoption of this standard.

• IFRS 15 *'Revenue from Contracts with Customers'* – This standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

## 4. CHANGES IN ACCOUNTING POLICIES (cont'd…)

This standard is effective for fiscal years beginning on or after January 1, 2017, with early adoption permitted. The Company does not expect this standard to have a material impact on its financial statements.

There are other new standards, amendments to standards and interpretations that have been published and are not yet effective. The Company believes they will have no material impact to its consolidated financial statements.

## 5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of a company's financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from these estimates.

### 5.1 Significant Judgments

The significant judgments that the Company's management has made in the process of applying the Company's accounting policies, apart from those involving estimation uncertainties (Annual financial statements 5.1.2), that have the most significant effect on the amounts recognized in the Annual Financial Statements include, but are not limited to:

(a) Functional currency determination

The functional currency for each of the Company's subsidiaries and investment in an associate is the currency of the primary economic environment and the Company reconsiders the functional currency of its entities if there is a change in events and conditions which determined the primary economic environment.

(b) Operating levels intended by management and valuation of property and equipment

Prior to reaching operating levels intended by management, costs incurred are capitalized as part of the costs of the related mineral property and proceeds from coal sales are offset against capitalized costs. Depletion of capitalized costs for a mineral property begins when operating levels intended by management have been reached. Management considers several factors in determining when a mineral property has reached the operating levels intended by management. The results of operations of the Company during the year ended December 31, 2014, presented in these Annual Financial Statements, have been impacted by management's determination that its Ulaan Ovoo mineral property, classified within property and equipment on the statement of financial position, did not reach the operating levels intended by management. The Company is unable to determine with certainty the extent of project changes and operational modifications that would be required to more fully realize on the potential value of the existing coal resources (Note 13).

**5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS** (cont'd...)

(c) Economic recoverability and probability of future economic benefits of exploration, evaluation and development costs

Management has determined that exploratory drilling, evaluation, development and related costs incurred which have been capitalized are economically recoverable. Management uses several criteria in its assessments of economic recoverability and probability of future economic benefit including geologic and metallurgic information, history of conversion of mineral deposits to proven and probable reserves, scoping, prefeasibility and feasibility studies, assessable facilities, existing permits and life of mine plans.

(d) Impairment assessment of deferred exploration interests

The Company considers both external and internal sources of information in assessing whether there are any indications that mineral property interests are impaired. External sources of information the Company considers include changes in the market, economic and legal environment in which the Company operates that are not within its control and affect the recoverable amount of mineral property interest. Internal sources of information the Company considers include the manner in which mineral properties and plant and equipment are being used or are expected to be used and indications of economic performance of the assets.

During the year ended December 31, 2014, the Company wrote-off as a non-cash charge the Titan, Okeover, and Kanichee properties. Due to current market conditions and the difficulty to raise additional financing, as well as Prophecy's inactivity on these properties in recent years, management impaired their values at the year ended December 31, 2014. The Company recognized a total impairment of mineral property loss of $2,252,610 on its consolidated statement of operations and comprehensive loss.

**5.2 Estimates and Assumptions**

The Company bases its estimates and assumptions on current and various other factors that it believes to be reasonable under the circumstances. Management believes the estimates are reasonable; however, actual results could differ from those estimates and could impact future results of operations and cash flows.

The areas which require management to make significant estimates and assumptions in determining carrying values include, but are not limited to:

(a) Mineral reserves

The recoverability of the carrying value of the exploration and evaluation assets and mineral properties is dependent on successful development and commercial exploitation, or alternatively, sale of the respective areas of interest;

(b) Depreciation

Significant judgment is involved in the determination of useful life and residual values for the computation of depreciation, depletion and amortization and no assurance can be given that actual useful lives and residual values will not differ significantly from current assumptions.

**5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS** (cont'd...)

(c) Impairment

The carrying value of property and equipment is reviewed each reporting period to determine whether there is any indication of impairment. If the carrying amount of an asset exceeds its recoverable amount, the asset is impaired and an impairment loss is recognized in the consolidated statement of operations. The assessment of fair values, including those of the cash generating units (the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflow from other assets or groups of assets) ("**CGUs**") for purposes of testing goodwill, require the use of estimates and assumptions for recoverable production, long-term commodity prices, discount rates, foreign exchange rates, future capital requirements and operating performance. Changes in any of the assumptions or estimates used in determining the fair value of goodwill or other assets could impact the impairment analysis.

Due to indications of impairment at December 31, 2014 an impairment analysis was completed on the Company's Ulaan Ovoo property CGU's and an impairment charge of $11,151,346 was taken as at that date and was reflected in the Company's Annual Financial Statements (Note 13).

(d) Inventories

Coal stockpiles are valued at the lower of production cost and net realizable value. The costs of inventories are determined on a weighted average basis. Production cost includes direct and indirect labour, operating materials and supplies, transportation costs, and an applicable portion of operating overhead. Net realizable value is the expected average selling price of the finished product less the costs to get the product into saleable form and to the selling location.

Stockpile tonnages are verified by surveys. The allocation of costs to stockpiles and in-process inventories and the determination of net realizable value involve the use of estimates. There can be no assurance that actual results will not differ significantly from estimates used in the determination of the carrying value of inventories.

(e) Allowance for doubtful accounts, and the recoverability of receivables and prepaid expense amounts.

Significant estimates are involved in the determination of recoverability of receivables and no assurance can be given that actual proceeds will not differ significantly from current estimations. Similarly, significant estimates are involved in the determination of the recoverability of services and/or goods related to the prepaid expense amounts, and actual results could differ significantly from current estimations.

Management has made significant assumptions about the recoverability of Mongolian VAT receivable. Management uses all relevant facts available, such as the development of VAT policies in Mongolia, past collectability, and the general economic environment of Mongolia to determine if the VAT is impaired. During the year ended December 31, 2014, the Company recorded an impairment on VAT receivable in the amount of $1,679,097 (Note 9).

**5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS** (cont'd...)

(f) Provision for closure and reclamation

The Company assesses its mineral properties' rehabilitation provision at each reporting date or when new material information becomes available. Exploration, development and mining activities are subject to various laws and regulations governing the protection of the environment. In general, these laws and regulations are continually changing and the Company has made, and intends to make in the future, expenditures to comply with such laws and regulations. Accounting for reclamation obligations requires management to make estimates of the future costs that the Company will incur to complete the reclamation work required to comply with existing laws and regulations at each location. Actual costs incurred may differ from those amounts estimated. Also, future changes to environmental laws and regulations could increase the extent of reclamation and remediation work required to be performed by the Company. Increases in future costs could materially impact the amounts charged to operations for reclamation and remediation. The provision represents management's best estimate of the present value of the future reclamation and remediation obligation. The actual future expenditures may differ from the amounts currently provided.

(g) Share-based payments

Management uses valuation techniques in measuring the fair value of share purchase options granted. The fair value is determined using the Black Scholes option pricing model which requires management to make certain estimates, judgement, and assumptions in relation to the expected life of the share purchase options and share purchase warrants, expected volatility, expected risk-free rate, and expected forfeiture rate. Changes to these assumptions could have a material impact on the Annual Financial Statements.

(h) Contingencies

The assessment of contingencies involves the exercise of significant judgment and estimates of the outcome of future events. In assessing loss contingencies related to legal proceedings that are pending against the Company and that may result in regulatory or government actions that may negatively impact the Company's business or operations, the Company and its legal counsel evaluate the perceived merits of the legal proceeding or unasserted claim or action as well as the perceived merits of the nature and amount of relief sought or expected to be sought, when determining the amount, if any, to recognize as a contingent liability or when assessing the impact on the carrying value of the Company's assets. Contingent assets are not recognized in the Annual Financial Statements.

**5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS** (cont'd...)

(i) Deferred Tax Liability

Judgement is required to determine which types of arrangements are considered to be a tax on income in contrast to an operating cost. Judgement is also required in determining whether deferred tax liabilities are recognised in the statement of financial position. Deferred tax liabilities, including those arising from un-utilised tax gains, require management to assess the likelihood that the Company will generate sufficient taxable losses in future periods, in order to offset recognised deferred tax liabilities.

Assumptions about the generation of future taxable losses depend on management's estimates of future cash flows. These estimates of future taxable losses are based on forecast cash flows from operations (which are impacted by production and sales volumes, commodity prices, reserves, operating costs, closure and rehabilitation costs, capital expenditure, and other capital management transactions) and judgement about the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable losses differ significantly from estimates, the ability of the Company to offset the net deferred tax liabilities recorded at the reporting date could be impacted.

(j) Fair value measurement

The Company measures financial instruments at fair value at each reporting date. The fair values of financial instruments measured at amortized cost are disclosed in Note 21.Also, from time to time, the fair values of non-financial assets and liabilities are required to be determined, e.g., when the entity acquires a business, or where an entity measures the recoverable amount of an asset or cash-generating unit at fair value less costs of disposal. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Changes in estimates and assumptions about these inputs could affect the reported fair value.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Associates

Associates are entities, including unincorporated entities such as partnerships, over which the Company has significant influence and that are neither subsidiaries nor interests in joint ventures. Significant influence is the ability to participate in the financial and operating policy decisions of the investee without having control or joint control over those policies.

In general, significant influence is presumed to exist when the Company has between 20% and 50% of voting power. Significant influence may also be evidenced by factors such as the Company's representation on the board of directors, participation in policy-making of the investee, material transactions with the investee, interchange of managerial personnel, or the provision of essential technical information. Associates are equity accounted for from the effective date of commencement of significant influence to the date that the company ceases to have significant influence.

Results of associates are equity accounted for using the results of their most recent annual financial statements or interim financial statements, as applicable. Losses from associates are recognized in the consolidated financial statements until the interest in the associate is written down to $nil. Thereafter, losses are recognized only to the extent that the Company is committed to providing financial support to such associates.

The carrying value of the investment in an associate represents the cost of the investment, including goodwill, a share of the post-acquisition retained earnings and losses accumulated other comprehensive income ("**AOCI**") and any impairment losses. At the end of each reporting period, the Company assesses whether there is any objective evidence that its investments in associates are impaired.

(b) Cash equivalents

Cash equivalents consist of highly liquid, short-term investments with original maturities of three months or less when purchased and are readily convertible to known amounts of cash.

(c) Short term investment

Short-term investments consist of certificates of deposit and money market instruments, including cashable guaranteed investment certificates, bearer deposit notes and commercial paper with original terms of three months or more, but less than one year.

(d) Available-for-sale investments

Available-for-sale equity investments are recorded at fair value with unrealized gains and losses recorded in Other Comprehensive Income ("**OCI**"). Realized gains and losses are recorded in the consolidated statement of operations when investments are sold and are calculated using the weighted average carrying amount of securities sold.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(e) Impairment of financial assets

The Company assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of investments classified as available-for-sale, an evaluation is made as to whether a decline in fair value is significant or prolonged based on an analysis of indicators such as market price of the investment and significant adverse changes in the technological, market, economic or legal environment in which the investee operates.

If an available-for-sale financial asset is impaired, an amount equal to the difference between its carrying value and its current fair value is transferred from AOCI and recognized in the consolidated statement of operations. Reversals of impairment charges in respect of equity instruments classified as available-for-sale are not recognized in the consolidated statement of operations.

(f) Mineral properties

Costs directly related to the exploration and evaluation of resource properties are capitalized to mineral properties once the legal rights to explore the resource properties are acquired or obtained. When the technical and commercial viability of a mineral resource have been demonstrated and a development decision has been made, the capitalized costs of the related property are transferred to property and equipment assets and depreciated using the units of production method on commencement of commercial production.

If it is determined that capitalized acquisition, exploration and evaluation costs are not recoverable, or the property is abandoned or management has determined an impairment in value, the property is written down to its recoverable amount. Mineral properties are reviewed for impairment when facts and circumstances suggest that the carrying amount may exceed its recoverable amount.

From time to time, the Company acquires or disposes of properties pursuant to the terms of option agreements. Options are exercisable entirely at the discretion of the optionee and, accordingly, are recorded as mineral property costs or recoveries when the payments are made or received. After costs are recovered, the balances of the payments received are recorded as a gain on option or disposition of mineral property.

(i) Title to mineral properties

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title, nor has the Company insured title. Property title may be subject to unregistered prior agreements and non-compliance with regulatory requirements.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(f) Mineral properties (cont'd…)

(ii) Realization of mineral property assets

The investment in and expenditures on mineral property interests comprise a significant portion of the Company's assets. Realization of the Company's investment in these assets is dependent upon the establishment of legal ownership, and the attainment of successful production from properties or from the proceeds of their disposal. Resource exploration and development is highly speculative and involves inherent risks. While the rewards if an ore body is discovered can be substantial, few properties that are explored are ultimately developed into profitable producing mines. There can be no assurance that current exploration programs will result in the discovery of economically viable quantities of ore. The amounts shown for acquisition costs and deferred exploration expenditures represent costs incurred to date and do not necessarily reflect present or future values.

(iii) Environmental

The Company is subject to the laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. The Company may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest. The Company conducts its mineral exploration activities in compliance with applicable environmental protection legislation. The Company is not aware of any existing environmental issues related to any of its current or former properties that may result in material liability to the Company.

Environmental legislation is becoming increasingly stringent and costs and expenses of regulatory compliance are increasing. The impact of new and future environmental legislation on the Company's operations may cause additional expenses and restrictions. If the restrictions adversely affect the scope of exploration and development on the mineral properties, the potential for production on the property may be diminished or negated.

(g) Property and equipment

(i) Development

When economically viable reserves have been determined and the decision to proceed with development has been approved, the expenditures related to development and construction are capitalized as construction-in-progress and, in addition, any pre-commercial production is also capitalized, all of which is classified as a component of property and equipment.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(g) Property and equipment (cont'd...)

During the development of a mine, prior to the commencement of production, costs incurred to remove overburden and other mine waste materials in order to access the resource body ("**stripping costs**") are classified as a component of property and equipment, and are capitalized to the related property and depleted over the productive life of the mine using the unit-of-production method. During the production phase of a mine, stripping costs are accounted for as variable production costs and included in the cost of inventory produced during the period except for stripping costs incurred to provide access to reserves that will be produced in future periods and would not otherwise have been accessible, which are capitalized to the cost of mineral property interests and depleted on a unit-of-production method over the reserves that directly benefit from the stripping activity.

Road and bridges, classified within mine development and deferred exploration costs, are amortized on a declining balance basis at an annual rate of 20%.

(ii) Equipment

Equipment is stated at cost less accumulated depreciation and accumulated impairment losses, if any. The cost of an item of property and equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use, and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Depreciation of equipment is recorded on a declining-balance basis at the following annual rates:

| | |
|---|---|
| Computer equipment | 45% |
| Computer software | 100% |
| Exploration equipment | 20% |
| Furniture and equipment | 20% |
| Leasehold improvements | Straight line/5yrs |
| Mining equipment | 20% |
| Vehicles | 30% |

When parts of major components of equipment have different useful lives, they are accounted for as a separate item of equipment.

The cost of major overhauls of part of equipment is recognized in the carrying amount of the item if is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of equipment are recognized in profit or loss as incurred.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(g) Property and equipment (cont'd...)

Leasehold improvements are amortized on a straight-line basis over the term of the lease. Additions during the year are amortized at one-half the annual rates.

(h) Impairment of non-current assets and Cash Generating Units ("**CGU**")

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the CGU, where the recoverable amount of the CGU is the greater of the CGU's fair value less costs to sell and its value in use to which the assets belong.

In assessing value in use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of comprehensive loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Each project or group of claims or licenses is treated as a CGU. The Company uses its best efforts to fully understand all of the aforementioned to make an informed decision based upon historical and current facts surrounding the projects. Discounted cash flow techniques often require management to make estimates and assumptions concerning reserves and expected future production revenues and expenses, which can vary from actual. Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or CGU) in prior years.

(i) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of that asset. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(i) Borrowing costs (cont'd...)

Where funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs incurred. Where surplus funds are available for a short-term from funds borrowed specifically to finance a project, the income generated from the temporary investment of such amounts is also capitalized and deducted from the total capitalized borrowing cost. Where the funds used to finance a project are from part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

(j) Foreign currency translation

Transactions in currencies other than the functional currency are recorded at the prevailing exchange rates on the dates of the transactions. At each financial position reporting date, monetary assets and liabilities denominated in foreign currencies are translated at the prevailing exchange rates at the date of the consolidated statement of financial position. Non-monetary items measured in terms of historical cost in a foreign currency are not retranslated.

Gains and losses arising from this translation are included in the determination of net loss for the year.

(k) Revenue recognition

The Company recognizes interest income on its cash and cash equivalents on an accrual basis at the stated rates over the term to maturity.

Sales of coal are recognized when the risks and rewards of ownership pass to the customer and the price can be measured reliably. Sales contracts and revenue is recognized based on the terms of the contract. Revenue is measured at the fair value of the consideration received, excluding discounts and rebates. Royalties related to production are recorded in cost of sales.

Revenue from coal sales is credited against construction when generated during commissioning of the plant; to mineral properties or property and equipment when generated from pre-commercial production; and to operations when generated from commercial production.

(l) Unit offerings

Proceeds received on the issuance of units, consisting of common shares and warrants, are allocated first to common shares based on the market trading price of the common shares at the time the units are priced, and any excess is allocated to warrants.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(m) Inventories

Net realisable value tests are performed at each year end reporting date and represent the estimated future sales price of the product the entity expects to realise when the product is processed and sold, less estimated costs to complete production and bring the product to sale. This value is compared to the cost of producing coal, with the lower of the net realisable value or the cost being recorded.

Stockpile tonnages are verified by surveys.

(n) Share-based payments

The Company has a share purchase option plan that is described in Note 20. The Company accounts for share-based payments using a fair value based method with respect to all share-based payments to directors, officers, employees, and service providers. Share-based payments to employees are measured at the fair value of the instruments issued and amortized over the vesting periods. Share-based payments to non-employees are measured at the fair value of the goods or services received or if such fair value is not reliably measurable, at the fair value of the equity instruments issued. The fair value is recognized as an expense or capitalized to mineral properties or property and equipment with a corresponding increase in option reserve. This includes a forfeiture estimate, which is revised for actual forfeitures in subsequent periods.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of the options, measured immediately before and after the modification, is also charged to the consolidated statement of comprehensive income over the remaining vesting period.

Upon the exercise of the share purchase option, the consideration received and the related amount transferred from option reserve are recorded as share capital.

(o) Loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. The Company uses the treasury stock method to compute the dilutive effect of options and warrants. Under this method the dilutive effect on earnings per share is calculated presuming the exercise of outstanding options and warrants. It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the period. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(p) Income taxes

The Company uses the asset and liability method to account for income taxes. Deferred income taxes are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax basis on the statement of financial position date. Deferred income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on deferred income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantively enacted. The amount of deferred income tax assets recognized is limited to the amount of the benefit that is probable upon recovery.

(q) Provision for closure and reclamation

The Company assesses its property, equipment and mineral property rehabilitation provision at each reporting date. Changes to estimated future costs are recognized in the statement of financial position by either increasing or decreasing the rehabilitation liability and asset to which it relates if the initial estimate was originally recognized as part of an asset measured in accordance with IAS 16*Property, Plant and Equipment*.

The Company records the present value of estimated costs of legal and constructive obligations required to restore operations in the period in which the obligation is incurred. The nature of these restoration activities includes dismantling and removing structures; rehabilitating mineral properties; dismantling operating facilities; closure of plant and waste sites; and restoration, reclamation and vegetation of affected areas.

Present value is used where the effect of the time value of money is material. The related liability is adjusted each period for the unwinding of the discount rate and for changes in estimates, changes to the current market-based discount rate, and the amount or timing of the underlying cash flows needed to settle the obligation.

(r) Financial instruments

(i) Financial assets

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held-to-maturity, available-for-sale, loans and receivables or at FVTPL. This category comprises derivatives and financial assets acquired principally for the purpose of selling or repurchasing in the near term. They are carried at fair value with changes in fair value recognized in profit or loss.

The Company's cash and cash equivalents, and restricted cash equivalents are classified as FVTPL.

Loans and receivables: These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at amortized cost using the effective interest method less any provision for impairment.

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(r) Financial instruments (cont'd...)

The Company's receivables and amount due from related party are classified as loans and receivables.

Held-to-maturity investments: These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's Management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest method less any provision for impairment.

The Company does not have any held-to-maturity investments.

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

As at December 31, 2014, the Company does not have any available-for-sale investments.

All financial assets except those measured at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is objective evidence of impairment as a result of one or more events that have occurred after initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset or the group of financial assets.

Transactions costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

(ii) Financial liabilities

All financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or other financial liabilities. Financial liabilities classified as other financial liabilities are initially recognized at fair value less directly attributable transaction costs. The Company's accounts payable and accrued liabilities, loan payable and line of credit facility are classified as other financial liabilities.

Financial liabilities classified as FVTPL include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments.

Fair value changes on financial liabilities classified as FVTPL are recognized through the statement of comprehensive income. The Company has no financial liabilities classified as FVTPL.

Please refer to Note 21 for relevant fair value measurement disclosures.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

(s) Comparative figures

Certain comparative figures from the year ended December 31, 2013 have been re-classified during the year ended December 31, 2014. Equipment rental revenue of $1,338,003 has been re-classified in the consolidated statement of operations and comprehensive loss as a separate line and the property and equipment impairment expense adjusted accordingly to reflect the re-classification.

## 7. SEGMENTED INFORMATION

The Company operates in one operating segment, being the acquisition, exploration and development of mineral properties. Geographic segmentation of Prophecy's assets is as follows:

| | December 31, 2014 | | |
|---|---|---|---|
| | Canada | Mongolia | Total |
| Reclamation deposits | $ 6,500 | $ 21,054 | $ 27,554 |
| Property and equipment | 131,863 | 4,230,119 | 4,361,982 |
| Mineral properties | - | 13,710,520 | 13,710,520 |
| | $ 138,363 | $ 17,961,693 | $ 18,100,056 |

| | December 31, 2013 | | |
|---|---|---|---|
| | Canada | Mongolia | Total |
| Reclamation deposits | $ 6,500 | $ 21,054 | $ 27,554 |
| Property and equipment | 190,135 | 10,568,451 | 10,758,586 |
| Mineral properties | 2,203,794 | 12,849,979 | 15,053,773 |
| | $ 2,400,429 | $ 23,439,484 | $ 25,839,913 |

## 8. CASH AND CASH EQUIVALENTS

Cash and cash equivalents of Prophecy are comprised of bank balances and short-term money market instruments with original maturities of three months or less. The carrying amounts of cash and cash equivalents approximate fair value. Prophecy's cash and cash equivalents are denominated in the following currencies:

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| Denominated in Canadian dollars | $ 154,592 | $ 259,411 |
| Denominated in US dollars | 3,642 | 1,777 |
| Denominated in Mongolian tugriks | 42,760 | 246,808 |
| | $ 200,994 | $ 507,996 |

## 8. CASH AND CASH EQUIVALENTS (cont'd...)

**Restricted Cash Equivalents**

A guaranteed investment certificate of $34,500 has been pledged as collateral for the Company's credit card.

## 9. RECEIVABLES

Trade receivables are non-interest-bearing and are generally on terms of 30 to 90 days. The Company anticipates full recovery of its outstanding trade and other receivables, net of any allowances.

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| Current assets | | |
| Input tax recoverable | $ 5,987 | $ 1,838,683 |
| Trade receivable | 652,675 | 679,738 |
| Other receivable | 78,772 | 130,572 |
| | $ 737,434 | $ 2,648,993 |

During the year ended December 31, 2014 the Company determined that the Mongolian VAT receivable was not collectible and has recorded an impairment charge of $1,679,097 on the consolidated statement of operations and comprehensive loss.

## 10. PREPAID EXPENSES

Prepaid expenses correspond to expenses paid during the year that relate to the subsequent year are as follows:

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| Advertising and promotion | $ - | $ 2,902 |
| Mining and exploration | 385,538 | 251,255 |
| Business acquisition | 125,000 | - |
| General | 7,949 | 113,946 |
| Insurance | 43,489 | 11,825 |
| Capital expenses | 27,577 | 335,657 |
| Power plant application | - | 398,650 |
| Environmental and taxes | 72,967 | 46,904 |
| Listing fees | - | 15,715 |
| Transportation and fuel | 8,370 | 32,094 |
| Rent | 61,192 | 69,966 |
| | $ 732,082 | $ 1,278,914 |

## 10. PREPAID EXPENSES (cont'd...)

The Company anticipates full recovery of its outstanding prepaid expense amounts in the form of goods and services.

## 11. INVENTORY

| | | December 31, 2014 | | December 31, 2013 |
|---|---|---|---|---|
| Coal Inventory | $ | 1,499,231 | $ | 1,758,310 |
| | $ | 1,499,231 | $ | 1,758,310 |

As at December 31, 2014, the Company determined inventory was impaired and recorded an impairment charge of $484,288 on the consolidated statement of operations and comprehensive loss.

## 12. AVAILABLE FOR SALE INVESTMENTS

As of December 31, 2014 the Company does not hold available-for sale investment (December 31, 2013 – $2,295,810).

Pursuant to the plan of arrangement and consolidation in share capital in the acquisition of Wellgreen Platinum Ltd. shares ("**Wellgreen Platinum**") in June 2011, the Company acquired 22,500,000 and reserved 4,417,643 Wellgreen Platinum's issued and outstanding common shares for distribution to option and warrant holders of the Company. Pursuant to the plan of arrangement each option and warrant holder of Prophecy Development as at June 9, 2011 will, upon the exercise of their Prophecy Development options and warrants, ("**June 9, 2011 Options and Warrants**") receive 0.094758 of a Wellgreen Platinum common share, in addition to one common share of the Company for each whole option or warrant of the Company held and exercised. Any Wellgreen Platinum shares held in-trust, but not delivered, due to the expiry of unexercised June 9, 2011 Options and Warrants, shall be returned to the Company.

During the year ended December 31, 2014, a total of 1,981,368 of Wellgreen Platinum's reserved held in-trust common shares were released back to the Company due to the forfeiture and expiry of applicable June 9, 2011 Options and Warrants. During the year ended December 31, 2014, the Company sold a total of 5,308,629 Wellgreen Platinum's common shares for gross proceeds of $4,567,901 and a realized gain of $2,654,882.

As at December 31, 2014, the Company held reserved in-trust, 335,265 (December 31, 2013-2,316,634) Wellgreen Platinum common shares contingent upon exercise of these June 9, 2011 Options and Warrants.

## 12. AVAILABLE FOR SALE INVESTMENTS (cont'd...)

The Company's activity in itsavailable-for-sale investment for the year ending December 31, 2014 and December 31, 2013 was as follows:

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| Investment in Wellgreen Platinum Ltd. | | |
| Opening balance | $ 2,295,810 | $ 25,118,910 |
| Deemed disposal loss of associate | - | (1,264,472) |
| Share of net loss of associate | - | (1,397,252) |
| Acquisitions | 411,825 | 140,000 |
| Disposals to market | (2,308,364) | (625,222) |
| Settlement of debt | - | (474,699) |
| Private sale | - | (19,596,976) |
| Fair value loss on available-for-sale investments of an associate | - | (3,750) |
| Net gain/(loss) transferred to/from equity | (399,271) | 399,271 |
| | $ - | $ 2,295,810 |

## 13. PROPERTY AND EQUIPMENT

| | Computer Equipment | Furniture & Equipment | Vehicles | Computer Software | Leasehold Improvements | Ulaan Ovoo Mining Equipment | Ulaan Ovoo Deferred Exploration | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| Balance, December 31, 2012 | $ 176,192 | $ 377,701 | $ 786,946 | $ 196,707 | $ 172,818 | $ 14,459,112 | $ 2,000,000 | $ 18,169,476 |
| Additions/(disposals) | (4,642) | (5,156) | 11,653 | (153) | - | 612,388 | - | 614,090 |
| Sale of coal | - | - | - | - | - | - | (3,253,283) | (3,253,283) |
| Cost of coal production | - | - | - | - | - | - | 7,347,729 | 7,347,729 |
| Impairment charge | - | - | - | - | - | - | (4,094,446) | (4,094,446) |
| Balance, December 31, 2013 | $ 171,550 | $ 372,545 | $ 798,599 | $ 196,554 | $ 172,818 | $ 15,071,500 | $ 2,000,000 | $ 18,783,566 |
| **Accumulated depreciation** | | | | | | | | |
| Balance, December 31, 2012 | $ 80,515 | $ 135,451 | $ 288,488 | $ 120,433 | $ 58,145 | $ 4,557,103 | $ - | $ 5,240,135 |
| Depreciation for year | 19,357 | 38,564 | 116,099 | 10,895 | 34,564 | 2,565,366 | 400,000 | 3,184,845 |
| Impairment charge | - | - | - | - | - | - | (400,000) | (400,000) |
| Balance, December 31, 2013 | $ 99,872 | $ 174,015 | $ 404,587 | $ 131,328 | $ 92,709 | $ 7,122,469 | $ - | $ 8,024,980 |
| **Carrying amount** | | | | | | | | |
| At December 31, 2012 | $ 95,677 | $ 242,250 | $ 498,458 | $ 76,274 | $ 114,673 | $ 9,902,009 | $ 2,000,000 | $ 12,929,342 |
| At December 31, 2013 | $ 71,678 | $ 198,530 | $ 394,012 | $ 65,226 | $ 80,109 | $ 7,949,031 | $ 2,000,000 | $ 10,758,586 |
| | | | | | | | | |
| **Cost** | | | | | | | | |
| Balance, December 31, 2013 | $ 171,550 | $ 372,545 | $ 798,599 | $ 196,554 | $ 172,818 | $ 15,071,500 | $ 2,000,000 | $ 18,783,566 |
| Additions | 4,411 | 672 | - | 1,259 | - | 927,423 | - | 933,765 |
| Disposals | (20,124) | - | (11,291) | - | - | - | (33,899) | (65,314) |
| Sale of coal | - | - | - | - | - | - | (3,935,612) | (3,935,612) |
| Cost of coal production | - | - | - | - | - | - | 10,045,848 | 10,045,848 |
| Impairment charge | - | - | - | - | - | (9,750,533) | (8,076,337) | (17,826,870) |
| Balance, December 31, 2014 | $ 155,837 | $ 373,217 | $ 787,308 | $ 197,813 | $ 172,818 | $ 6,248,390 | $ - | $ 7,935,383 |
| **Accumulated depreciation** | | | | | | | | |
| Balance, December 31, 2013 | $ 99,872 | $ 174,015 | $ 404,587 | $ 131,328 | $ 92,709 | $ 7,122,469 | $ - | $ 8,024,980 |
| Depreciation for year | 15,338 | 33,288 | 73,428 | 4,356 | 32,944 | 1,664,591 | 400,000 | 2,223,945 |
| Impairment charge | - | - | - | - | - | (6,275,524) | (400,000) | (6,675,524) |
| Balance, December 31, 2014 | $ 115,210 | $ 207,303 | $ 478,015 | $ 135,684 | $ 125,653 | $ 2,511,536 | $ - | $ 3,573,401 |
| **Carrying amount** | | | | | | | | |
| At December 31, 2013 | $ 71,678 | $ 198,530 | $ 394,012 | $ 65,226 | $ 80,109 | $ 7,949,031 | $ 2,000,000 | $ 10,758,586 |
| At December 31, 2014 | $ 40,627 | $ 165,914 | $ 309,293 | $ 62,129 | $ 47,165 | $ 3,736,854 | $ - | $ 4,361,982 |

**13. PROPERTY AND EQUIPMENT** (cont'd...)

**Ulaan Ovoo Property**

In November 2005, Prophecy entered into a letter of intent with Ochir LLC that set out the terms to acquire a 100% interest in the Ulaan Ovoo coal property. The Ulaan Ovoo property is located in Selenge province, Mongolia. It is held by Ochir LLC under a transferable, 55-year mining license with a 45-year option for extension granted by the Government of Mongolia. The purchase price for the 100% interest, together with all equipment, buildings, and other facilities assembled and constructed at the property, was US$9,600,000. Under the terms of the agreement, Ochir LLC retained a 2% net smelter return royalty ("**NSR**").

In November 2006, Prophecy entered into an agreement with a private Mongolian corporation to purchase 100% title and interest in five mineral licenses including licenses that are contiguous and entirely surrounding the Ulaan Ovoo property. The aggregate purchase price for the licenses was US$400,000. Under the terms of the agreement the vendor retained a 2% NSR. A finder's fee of 58,500 common shares of Prophecy was issued to a third party on the acquisition.

In March 2010, Prophecy was granted an option to purchase a 2% NSR on the Ulaan Ovoo property from Dunview Services Ltd., a private British Virgin Islands company, with a cash payment of US$130,000 and issuance of 2,000,000 common shares of Prophecy. In April 2010, Prophecy exercised the option and a total of $1,570,000 was capitalized as acquisition costs of the property.

On November 9, 2010, Prophecy received a mining permit from the Mongolian Ministry of Mineral Resources and Energy ("**MMMRE**") for the Ulaan Ovoo coal property. During the year ended December 31, 2010, Prophecy had reached technical feasibility, commenced development, and achieved some pre-commercial production, and accordingly reclassified mineral property costs to Property and Equipment.

Pre-commercial operations for the period from commencement in November 2010 until December 31, 2014, along with project exploration and development costs were capitalized to Ulaan Ovoo deferred exploration costs within property and equipment. Modest coal sales revenue and associated costs to deliver the coal during the fiscal 2014 have been recorded against deferred exploration, within property and equipment.

**Impairment**

During the year ended December 31, 2014, the Company determined there were several indicators of potential impairment of the carrying value of the Company's long-lived assets. The indicators of potential impairment were as follows:

(i) The book value of the Company's net assets exceeded the market capitalization of the Company;

(ii) The Ulaan Ovoo property re-commenced pre-commercial productions during the year ended December 31, 2013. During the year ended December 31, 2014, production targets were not met;

**13. PROPERTY AND EQUIPMENT** (cont'd...)

**Impairment** (cont'd...)

(iii) Coal prices have been volatile and have experienced declines throughout the year ended December 31, 2014; and

(iv) The Company's history of operating losses, combined with current losses and the inability to reduce operating costs to an acceptable level relating to the Ulaan Ovoo property.

As result, in accordance with *IFRS 6, Exploration for and Evaluation of Mineral Resources* and *IAS 36, Impairment of Assets,*at December 31, 2014, the Company assessed the recoverable amount of the Ulaan Ovoo property, which consists of the deferred development costs and the mine equipment, which have both been identified as separate CGU's.

*Mining Equipment*

The recoverable amount of the mining equipment was determined as Fair Value Less Costs to Sell ("**FVLCTS**") because the FVLCTS is considered to be the higher amount between Value-in-Use and FVLCTS, which is based upon the equipment's estimated replacement cost, less a discount for costs to sell. Under the premise of continuous use, replacement cost is determined on the basis of the current market value of the assets if they are to be re-acquired and commissioned. Through an on-site inspection and technical analysis, a residual amount is determined which is used in calculating the estimated value. Management's estimate of the FVLCTS is classified as level 3 in the fair value hierarchy. At December 31, 2014, the recoverable amount of $3,736,854 was lower than the carrying value of the CGU and therefore the Company recorded an impairment charge of $3,475,009 against the value of the mining equipment.

*Deferred development costs*

The Company determined the recoverable amount of the deferred development cost based on its expected value-in-use. As a result of the Company not meeting its production targets, as well as negative net cash flows realized from the Ulaan Ovoo property, there are no expected net cash flows from the project, resulting in a value in use of $nil. As at December 31, 2014, the recoverable amount of $nil resulted in an impairment charge of $ 7,676,337 against the value of the deferred development costs.

## 14. MINERAL PROPERTIES

| | Chandgana Tal | Khavtgai Uul | Titan | Okeover, others | Total |
|---|---|---|---|---|---|
| **Balance, December 31, 2012** | $ 8,624,130 | $ 2,603,986 | $ 750,628 | $ 1,409,138 | $ 13,387,882 |
| *Additions:* | | | | | |
| Acquisition cost | - | - | - | - | - |
| Deferred exploration costs: | | | | | |
| Licenses, leases, and power plant application | 792,392 | 161,226 | - | 4,852 | 958,470 |
| Geological core, engineering, and consulting | 271,683 | 515 | - | 30,580 | 302,778 |
| Camp and general | 285,967 | 110,081 | - | 8,595 | 404,643 |
| | 1,350,042 | 271,822 | - | 44,027 | 1,665,891 |
| **Balance, December 31, 2013** | $ 9,974,172 | $ 2,875,808 | $ 750,628 | $ 1,453,165 | $ 15,053,773 |
| *Additions:* | | | | | |
| Acquisition cost | $ - | $ - | $ - | $ - | $ - |
| Deferred exploration costs: | | | | | |
| Licenses, leases, and power plant application | 664,437 | 41,299 | 1,049 | 5,864 | 712,649 |
| Geological core, engineering, and consulting | 23,560 | - | 7,705 | 30,910 | 62,175 |
| Camp and general | 112,464 | 18,780 | 1,500 | 1,789 | 134,533 |
| *Impairment of mineral property* | - | - | - 760,882 | (1,491,728) | (2,252,610) |
| | 800,461 | 60,079 | (750,628) | (1,453,165) | (1,343,253) |
| **Balance, December 31, 2014** | $ 10,774,633 | $ 2,935,887 | $ - | $ - | $ 13,710,520 |

**14. MINERAL PROPERTIES** (cont'd...)

(a) Chandgana Tal Property, Mongolia

In March 2006, the Company acquired a 100% interest in the Chandgana Tal property, a coal exploration property consisting of two exploration licenses located in the northeast part of the Nyalga coal basin, approximately 290 kilometers east of Ulaan Bataar, Mongolia, by cash payment of US$400,000 and the issuance of 250,000 shares of the Company valued at $1.20 per share. A total of $814,334, which included a finder's fee of 50,000 shares of the Company issued to a third party, was capitalized as acquisition costs of the Chandgana Tal property.

In March 2011, the Company obtained a mine permit from Ministry of Mineral Resources and Energy for the Chandgana Tal coal project.

(b) Khavtgai Uul Property, Mongolia

In 2007, the Company acquired a 100% interest in the Chandgana Khavtgai property, a coal exploration property consisting of one license located in the northeast part of the Nyalga coal basin by cash payment of US$570,000. A total of $589,053 was capitalized as acquisition costs of the Chandgana Khavtgai property.

(c) Titan Property, Ontario, Canada

The Company has an 80% interest in the Titan property, a vanadium-titanium-iron project located in Ontario, Canada.

In January 2010, the Company entered into an option agreement with Randsburg International Gold Corp. ("**Randsburg**") whereby Prophecy Resource Corp. had the right to acquire an 80% interest in the Titan property by paying Randsburg an aggregate of $500,000 (paid), and by incurring exploration expenditures of $200,000 by December 31, 2010. Pursuant to the option agreement, Randsburg has the option to sell the remaining 20% interest in the Titan property to the Company for $150,000 cash or 400,000 shares of the Company. The Titan property is subject to a 3% NSR that may be purchased for $20,000.

On June 30, 2011, the Company paid Randsburg the balance of unexpended amount of $114,742 according to the terms of an amended agreement with Randsburg signed on June 30, 2011.

Due to current market conditions and the difficulty to raise additional financing, as well as Prophecy's inactivity on the Titan property in recent years, management impaired the value at the year ended December 31, 2014. Prophecy continues to retain its 80% interest and management will continue to evaluate appropriate financing and strategic alternatives to move the project forward. The Company recognized an impairment loss $760,882 on its consolidated statement of operations and comprehensive loss

(d) Okeover Property, British Columbia, Canada

The Company has a 60% interest in the Okeover property, a copper-molybdenum project in the Vancouver Mining Division of southwestern British Columbia, Canada.

## 14. MINERAL PROPERTIES (cont'd...)

Due to current market conditions and the difficulty to raise additional financing, as well as Prophecy's inactivity on the Okeover property in recent years, management impaired the value at the year ended December 31, 2014. Prophecy continues to retain its 60% interest and management will continue to evaluate appropriate financing and strategic alternatives to move the project forward. The Company recognized an impairment loss $1,453,897 on its consolidated statement of operations and comprehensive loss.

(e) Kanichee Property, Ontario, Canada

During the year ended December 31, 2014, the Company wrote-off as a non-cash charge the Kanichee property since management determined that the property does not fit the Company's core strategy. The Company recognized an impairment loss of $37,832 on its consolidated statement of operations and comprehensive loss.

## 15. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities of the Company consist of amounts outstanding for trade and other purchases relating to development and exploration, along with administrative activities. The usual credit period taken for trade purchases is between 30 to 90 days.

| | | December 31, 2014 | | December 31, 2013 |
|---|---|---|---|---|
| Trade accounts payable | $ | 2,347,888 | $ | 992,253 |
| Accrued liabilities | | 430,480 | | 439,985 |
| | $ | 2,778,368 | $ | 1,432,238 |

## 16. LINE OF CREDIT FACILITY

In October 2013, Prophecy Coal's wholly-owned Mongolian subsidiary, Red Hill Mongolia LLC ("**Red Hill**") arranged a line of credit for US $1,500,000 ("**LOC**") with the Trade and Development Bank. The line of credit has a 1.5 year term, with the option of extending it, and bears interest at 15% per annum and a commitment rate of 2% per annum payable monthly. The funds will be used for working capital. The credit facility is collateralized by certain equipment and certain mineral and exploration licences. Pursuant to the LOC agreement, Red Hill was scheduled to pay a fixed amount of US $125,000 monthly against the principal starting May 2014. Interest expense related to the LOC is capitalized to the Ulaan Ovoo asset totaling $226,549.

On June 30, 2014, Red Hill amended the line of credit agreement by extending the maturity date by four months and the repayment schedule of the remaining principal of US $1,250,000 commencing November 2, 2014, broken down as follows:

| | |
|---|---|
| November and December 2014 | Monthly payment of US $150,000 |
| January 2015 to March 2015 | Monthly payment of US $150,000 |
| April 2015 to August 2015 | Monthly payment of US $100,000 |

As at December 31, 2014, Red Hill had drawn down $1,288,218 of the LOC. For the year ended December 31, 2014, Red Hill recorded an interest expense of $226,549, interest paid of $224,871 and interest payable of $16,391. The Company is currently not in compliance with the above payment schedule.

## 17. PROVISION OF CLOSURE AND RECLAMATION

| | | December 31, 2014 | | December 31, 2013 |
|---|---|---|---|---|
| Balance, beginning of year | $ | 129,552 | $ | 294,263 |
| Additions (reductions) | | 32,424 | | (193,460) |
| Accretion | | 11,387 | | 28,749 |
| Balance, end of year | $ | 173,363 | $ | 129,552 |

The Company's closure and reclamation costs consists of costs accrued based on the current best estimate of mine closure and reclamation activities that will be required at the Ulaan Ovoo site upon completion of mining activity. These activities include costs for earthworks, including land re-contouring and re-vegetation, water treatment and demolition. The Company's provision for future site closure and reclamation costs is based on the level of known disturbance at the reporting date, known legal requirements and estimates prepared by a third party specialist.

It is not currently possible to estimate the impact on operating results, if any, of future legislative or regulatory developments.

Management used a risk-free interest rate of 1.79% and a risk premium of 7% in preparing the Company's provision for closure and reclamation. Although the ultimate amount of reclamation costs to be incurred cannot be predicted with certainty, the total undiscounted amount of estimated cash flows required to settle the Company's estimated obligations is $2,000,000 over the next 9.7 years. The cash expenditures are expected to occur over a period of time extending several years after the projected mine closure of the mineral properties. The decrease from the prior year is due to revised figures used to calculate the volume of the disturbed pit area relative to the prior year.

## 18. DEFERRED INCOME TAXES

Prophecy's operations are, in part, subject to foreign tax laws where interpretations, regulations and legislation are complex and continually changing. As a result, there are usually some tax matters in question that may, upon resolution in the future, result in adjustments to the amount of deferred income tax assets and liabilities, and those adjustments may be material to the Company's financial position and results of operations.

## 18. DEFERRED INCOME TAXES (cont'd...)

A reconciliation of income taxes at statutory rates with the reported taxes is as follows:

| | | 2014 | | 2013 |
|---|---|---|---|---|
| Earnings (loss) for the year | $ | (14,696,041) | $ | (24,249,254) |
| Expected income tax (recovery) | $ | (3,821,000) | $ | (6,244,000) |
| Change in statutory, foreign tax, foreign exchange rates and other | | 217,000 | | (41,100) |
| Permanent Difference | | 3,528,000 | | 5,160,000 |
| Share issue cost | | - | | (84,000) |
| Adjustment to prior years provision versus statutory tax returns and | | (1,819,000) | | (518,000) |
| Change in unrecognized deductible temporary differences | | 1,895,000 | | 774,000 |
| **Total income tax expense (recovery)** | **$** | **-** | **$** | **(953,100)** |

The Canadian income tax rate declined/increased during the year due to changes in the law that reduced/increased corporate income tax rates in Canada/British Columbia.

Significant components of deductible and taxable temporary differences, unused tax losses and unused tax credits that have not been included on the consolidated statements of financial position are as follows:

| | | 2014 | Expiry dates | | 2013 | Expiry dates |
|---|---|---|---|---|---|---|
| Share issue costs | **$** | **768,000** | 2035 to 2037 | $ | 1,531,000 | 2034 to 2037 |
| Allowable Capital losses | **$** | **4,943,000** | No expiry | $ | 538,000 | No expiry |
| Non-Capital losses | **$** | **14,491,000** | 2030 to 2034 | $ | 8,524,000 | 2030 to 2033 |
| Property and equipment | **$** | **1,047,000** | No expiry | $ | 995,000 | No expiry |
| Exploration and evaluation assets | **$** | **140,000** | No expiry | $ | 104,000 | No expiry |
| Investment tax credits | **$** | **23,000** | 2029 | $ | 22,000 | 2029 |
| Asset retirement obligation | **$** | **173,000** | No expiry | $ | 294,000 | No expiry |

## 19. SHARE CAPITAL

(a) Authorized

The authorized share capital consists of an unlimited number of common shares without par value. There are no authorized preferred shares. At December 31, 2014, the Company had 251,878,634 (December 31, 2013 – 248,373,819) common shares issued and outstanding.

(b) Equity issuances

During the year ended December 31, 2014, Prophecy had the following common share capital transactions:

**19. SHARE CAPITAL** (cont'd...)

On January 7, 2014, the Company issued a second tranche of 1,013,750 common shares at a value of $0.08 related to its 2012 share bonus to certain employees, directors, officers, and consultants of the Company. The Company recorded $81,100 as share bonus expense to personnel. On July 3, 2014, 50,000 common shares (at value of $4,501) of the Company were returned to treasury at no cost to the Company.

On June 19, 2014, the Company issued 2,541,065 units ("**Debt Settlement Units**") as payment for outstanding debt owing by the Company to some of the Company's directors, officers, employees and consultants at a value of $0.075 per Debt Settlement Unit. Each Debt Settlement Unit is comprised of one common share of the Company and one share purchase warrant of the Company entitling the holder thereof to purchase, upon exercise of a warrant, one additional common share at a price of $0.10 per common share for a period of two years from the date of issuance of the Debt Settlement Units.

During the year ended December 31, 2013, Prophecy had the following common share capital transactions:

On March 15, 2013, Prophecy issued 2,000,000 shares to Waterton at a value of $0.14 per share, amounting to $280,000, as a financing fee pursuant to $10 million loan and related waiver.

On April 12, 2013, the Company closed the first tranche of a non-brokered private placement announced on February 7, 2013 (the "**Private Placement**"), issuing 4,382,571 units (each a "Unit") of the Company, of which each Unit consists of one common share (a "**Share**") and 0.75 common share purchase warrant (a "**Warrant**"), at a purchase price of $0.14 per Unit for aggregate consideration of $613,560. Each whole Warrant is exercisable into one common share of Prophecy at a price of $0.18, expiring two years from the date of issue. Each Unit sold in the first tranche also included, subject to shareholder approval, which was obtained at the AGM on July 30, 2013, an adjustment warrant ("**Adjustment Warrant**") entitling the holder to acquire additional common shares of the Company. Finder's fees of 6% were paid in connection with a portion of the first tranche of the private placement.

On June 6, 2013, the Company closed a second and final tranche of the Private Placement with the issuance of 8,142,857 units (each a "**Unit**") of the Company for aggregate consideration of $1,140,000. Each Unit consists of one common share and $0.75 of a common share purchase Warrant at a purchase price of $0.14 per Unit. Each whole Warrant is exercisable for one common share of Prophecy at a price of $0.18, expiring two years from the date of issue. Each Unit sold in the second tranche also included an Adjustment Warrant entitling the holder to acquire additional common shares of the Company. Finder's fees of 6% were paid on the second tranche of the Private Placement.

The Company amended the first and second tranche of the Private Placement to include an additional Adjustment Warrant in each Unit sold in the Private Placement. Each Adjustment Warrant may be exercised for no additional consideration for a period of 12 months following the closing of the final tranche of the private placement, for a fraction of a common share of Prophecy. The fraction will be calculated by first dividing the Unit subscription price of $0.14 by the market price (subject to a floor market price of $0.105) at the time of exercise, then subtracting one (1) from that resulting number to determine the fraction. Market price is defined as the 20 day moving average price for the Company's common shares. The Adjustment Warrants must be exercised in their entirety and may not be exercised in part, and the holder of

**19. SHARE CAPITAL** (cont'd...)

Adjustment Warrants may not sell any securities of the Company within 20 days prior to exercise. Adjustment Warrants may also only be exercised to the extent that the holder continues to hold the shares and warrants comprising the Units of which the Adjustment Warrants were attached.

A total of 12,525,428 Adjustment warrants were issued and subsequently exercised resulting in the Company issuing 4,175,143 common shares on October 4, 2013.

On January 24, 2013, the Board of Directors approved the grant of 2,027,500 bonus shares to employees, consultants and directors. Pursuant to shareholder approval granted at the Company's 2013 Annual General Meeting held on July 30, 2013, the Company issued a first tranche of 1,013,750 Prophecy common shares on October 4, 2013. On July 3, 2013, the Company issued 258,542 common shares as the second tranche of 2011 stock bonus. As at December 31, 2013, the Company recorded $317,460 stock bonus expense.

(c) Equity-based compensation plans

The Company has two equity-based compensation plans in place: (i) a 20% rolling stock option plan that was approved by the Company's shareholders on July 30, 2013 (the "**2013 Option Plan**"); and (ii) a share-based compensation plan ("**Share-Based Compensation Plan**") which provides for the granting of stock options, bonus shares and stock appreciation rights and which was approved by the Company's disinterested shareholders on June 19, 2014. Since the implementation of the Share-Based Compensation Plan, the 2013 Option Plan has remained in force and effect solely to govern the stock options previously granted under the 2013 Option Plan. All stock options and other share-based awards granted by the Company, or to be granted by the Company, since the implementation of the Share-Based Compensation Plan will be issued under, and governed by, the terms and conditions of the Share-Based Compensation Plan.

Subject to the adjustment provisions provided for in the Share-Based Compensation Plan and the applicable rules of the TSX, the aggregate number of common shares issuable under the Share-Based Compensation Plan, plus the aggregate number of common shares issuable pursuant to the exercise of outstanding stock options granted under the 2013 Option Plan, must not exceed 50,080,263, being 20% of the total issued and outstanding common shares of the Company (as of June 19, 2014). The stock option vesting terms are determined by the Board of Directors on grant with a maximum allowable stock option life of 10 years.

During the year ended December 31, 2014, the Company granted 13,535,000 stock options to directors, officers, employees and consultants with a weighted average exercise price of $0.08 and expiry dates ranging from January 9, 2019 to October 21, 2019.

On June 30, 2014, the Company also modified 2,668,750 stock options granted to various consultants, former directors and former officers of the Company to replace an equivalent number of June 9, 2011 Options and Warrants which they voluntarily surrendered in June 2014. The modified stock options vest immediately and are exercisable at $0.055 per share until December 31, 2015. The incremental fair value of these modified options determined using the Black-Scholes option pricing model was $42,676 and was recorded as share-based payment expense during the year ended December 31, 2014.

**19. SHARE CAPITAL** (cont'd...)

During the year ended December 31, 2013, the Company granted 4,800,000 share purchase options to employees, directors, officers and consultants, with a weighted average exercise price of $0.12 and expiry dates ranging from March 4, 2018 to August 16, 2018.

The following is a summary of the changes in Prophecy's stock options from December 31, 2012 to December 31, 2014:

| | Number of Options | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2012 | 32,485,550 | $0.57 |
| Granted | 4,800,000 | $0.12 |
| Forfeited | (5,720,000) | $0.20 |
| Outstanding, December 31, 2013 | 31,565,550 | $0.26 |
| Granted | 13,535,000 | $0.08 |
| Expired | (1,231,800) | $0.28 |
| Forfeited | (14,980,000) | $0.29 |
| Cancelled | (2,325,000) | $0.23 |
| Outstanding, December 31, 2014 | 26,563,750 | $0.13 |
| Options exercisable on December 31, 2014 | 20,463,750 | $0.14 |

As of December 31, 2014, the following Prophecyshare purchase options were outstanding:

| | | | At December 31, 2014 | |
|---|---|---|---|---|
| Exercise Price | Options Outstanding | Expiry Date | Exercisable | Unvested |
| $ 0.055 | 2,468,750 | December 31, 2015 | 2,468,750 | - |
| $ 0.055 | 100,000 | October 21, 2019 | - | 100,000 |
| $ 0.065 | 7,055,000 | May 1, 2019 | 4,880,000 | 2,175,000 |
| $ 0.08 | 100,000 | January 9, 2019 | 50,000 | 50,000 |
| $ 0.10 | 500,000 | February 3, 2019 | 250,000 | 250,000 |
| $ 0.105 | 5,150,000 | January 27, 2019 | 2,575,000 | 2,575,000 |
| $ 0.12 | 3,450,000 | August 16, 2018 | 2,562,500 | 887,500 |
| $ 0.13 | 250,000 | July 22, 2018 | 187,500 | 62,500 |
| $ 0.18 | 230,000 | August 16, 2017 | 230,000 | - |
| $ 0.18 | 3,654,167 | August 22, 2017 | 3,654,167 | - |
| $ 0.18 | 375,000 | September 24, 2017 | 375,000 | - |
| $ 0.25 | 10,000 | June 1, 2017 | 10,000 | - |
| $ 0.28 | 2,450,000 | June 18, 2017 | 2,450,000 | - |
| $ 0.28 | 25,000 | September 21, 2015 | 25,000 | - |
| $ 0.28 | 50,000 | May 10, 2015 | 50,000 | - |
| $ 0.28 | 445,833 | December 24, 2015 | 445,833 | - |
| $ 0.28 | 50,000 | April 30, 2015 | 50,000 | - |
| $ 0.28 | 100,000 | February 14, 2016 | 100,000 | - |
| $ 0.67 | 100,000 | May 10, 2015 | 100,000 | - |
| | 26,563,750 | | 20,463,750 | 6,100,000 |

**19. SHARE CAPITAL** (cont'd...)

At December 31, 2014, the Company had 20,463,750 exercisable share purchase options outstanding (December 31, 2013– 24,199,717).

Share-based payment expenses resulting from stock options are amortized over the corresponding vesting periods. During the year ended December 31, 2014, the share-based payment expenses were calculated using the following weighted average assumptions:

| | Year ended December 31, 2014 | |
|---|---|---|
| | 2014 | 2013 |
| Risk-free interest rate | 1.62% | 1.85% |
| Expected life of options in years | 4.90 years | 5 years |
| Expected volatility | 84.3% | 74.6% |
| Expected dividend yield | Nil | Nil |

The expected volatility used in the Black-Scholes option pricing model is based on the historical volatility of the Company's shares. The weighted average fair-value of options granted during the year ended December 31, 2014 was $0.05 (December 31, 2013 - $0.07).

Share-based payments charged to operations and assets were allocated between capitalization as property and equipment for Ulaan Ovoo and other deferred mineral properties, and general and administrative expenses. For the year ended December 31, 2014 and 2013, share-based payments were recorded as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Consolidated Statement of Operations | | |
| Share based payments | $ 617,362 | $ 1,304,486 |
| | 617,362 | 1,304,486 |
| | | |
| Consolidated Statement of Financial Position | | |
| Ulaan Ovoo exploration | 112,650 | 68,487 |
| Power Plant application | 59,383 | 14,792 |
| | 172,033 | 83,279 |
| Total share-based payments | $ 789,395 | $ 1,387,765 |

**19. SHARE CAPITAL** (cont'd...)

(d) Share purchase warrants

The following is a summary of the changes in Prophecy's warrants and adjustment warrants from December 31, 2012 to December 31, 2014:

| | Number of Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2012 | 10,339,926 | $0.57 |
| Issued | 9,394,072 | $0.18 |
| Expired | (6,508,415) | $0.80 |
| Outstanding, December 31, 2013 | 13,225,583 | $0.18 |
| Issued | 2,541,065 | $0.10 |
| Outstanding, December 31, 2014 | 15,766,648 | $0.15 |

| | Number of Adjustment Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, January 1, 2013 | - | - |
| Issued adjustment warrants | 12,525,428 | ** |
| Exercised | (12,525,428) | - |
| Outstanding, December 31, 2013 and 2014 | - | - |

** Adjustment warrants see Note 19 (b)

On July 7, 2014 the Company announced an amendment of the terms of 1,064,215 share purchase warrants (the "**Old Warrants**") of the Company held by various investors that were originally issued pursuant to a private placement of 3,831,511 units which closed on October 28, 2010, expiring October 28, 2015 with an exercise price of $0.18 and had a right to purchase a fraction of a share of Wellgreen Platinum attached.

The Old Warrants were voluntarily surrendered by holders in June 2014. The Company replaced the Old Warrants by issuing an equivalent number of new warrants to these holders at an exercise price of $0.055, and no longer have a right to purchase a fraction of Wellgreen Platinum shares attached. The incremental fair value of $14,789 of the modified warrants was included in share based payments expense and determined using the Black-Scholes option pricing model using the following assumptions:1) a risk-free interest rate of 0.99%, 2) warrant expected life of 1.27 years, 3) expected volatility of 109%, 4)dividend yield of nil.

**19. SHARE CAPITAL** (cont'd...)

(d) Share purchase warrants (cont'd…)

On October 4, 2013, the Company issued 4,175,143 common shares pursuant to the exercise of 12,525,420 adjustment warrants accordingly to adjustment warrant terms described in Note 19 (b) at no consideration.

| Exercise price | Number of Warrants | | Expiry date |
|---|---|---|---|
| | At December 31, 2014 | At December 31, 2013 | |
| $0.18 | 3,286,929 | 3,286,929 | April 11, 2015 |
| $0.18 | 6,107,143 | 6,107,143 | June 4, 2015 |
| $0.18 | 2,767,296 | 3,831,511 | October 28, 2015 |
| $0.055 | 1,064,215 | - | October 28, 2015 |
| $0.10 | 2,541,065 | - | June 19, 2016 |
| | 15,766,648 | 13,225,583 | |

**20. CAPITAL RISK MANAGEMENT**

Management considers its capital structure to consist of share capital, share purchase options and warrants. Prophecy manages its capital structure and makes adjustments to it, based on the funds available to, and required by the Company in order to support the acquisition, exploration and development of mineral properties. The Board of Directors does not establish quantitative returns on capital criteria for management. In order to facilitate the management of its capital requirement, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors. The annual and updated budgets are approved by the Board of Directors.

The properties, to which the Company currently has an interest in, are in the development and exploration stage; as such, Prophecy is dependent on external financing to fund its activities. In order to carry out the planned exploration and development and pay for administrative costs, Prophecy will spend its existing working capital and raise additional amounts as needed. There were no changes in managements approach to capital management during the year ended December 31, 2014. Neither Prophecy nor its subsidiaries are subject to externally imposed capital requirements.

**21. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS**

**Fair Value**

Fair value is the price that would be received to sell and asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Prophecy utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or

**21. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS** (cont'd…)

liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts and volatility measurements used to value option contracts), or inputs that are derived principally from or corroborated by observable market data or other means; and

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. The following table sets forth Prophecy's financial assets measured at fair value by level within the fair value hierarchy:

| As at December 31, 2014 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets | | | | |
| Cash and cash equivalents | $ 200,994 | $ - | $ - | $ 200,994 |
| Restricted cash equivalents | 34,500 | - | - | 34,500 |
| Available-for-sale investments | - | - | - | - |
| | $ 235,494 | $ - | $ - | $ 235,494 |

| As at December 31, 2013 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets | | | | |
| Cash and cash equivalents | $ 507,996 | $ - | $ - | $ 507,996 |
| Restricted cash equivalents | 34,500 | - | - | 34,500 |
| Available-for-sale investments | 2,295,810 | - | - | 2,295,810 |
| | $2,838,306 | $ - | $ - | $ 2,838,306 |

The Company considers that the carrying amount of all its financial assets and financial liabilities measure at amortized cost approximates their fair value. The Company does not offset financial assets with financial liabilities. There were no transfers between Level 1, 2 and 3 for the year ended December 31, 2014.

Valuation Techniques

Available-for-sale investments

The fair value of available-for-sale investments is determined based on the closing price of each investment at the date of the statement of financial position. The closing price is a quoted market price obtained from the exchange that is the principal active market for the particular security, and therefore available-for-sale investment are classified within Level 1 of the fair value hierarchy. The fair value of the Company's former investment in the shares of Wellgreen Platinum is determined using this methodology.

## 21. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS (cont'd…)

### Categories of financial instruments

The Company's financial assets and financial liabilities are categorized as follows:

| | As at December 31, 2014 | As at December 31, 2013 |
|---|---|---|
| Fair value through profit or loss | | |
| Cash and cash equivalents | $ 200,994 | $ 507,996 |
| Restricted cash equivalents | 34,500 | 34,500 |
| Loans and receivables | | |
| Trade receivable and other | 731,447 | 679,738 |
| VAT receivable | 1,679,097 | 1,813,502 |
| Due from related party | - | 78,364 |
| Available-for-sale investments | - | 2,295,810 |
| | $ 2,646,038 | $ 5,409,910 |
| Other financial liabilities | | |
| Accounts payable and accrued liabilities | $ 2,778,368 | $ 1,432,238 |
| Line of credit facility | 1,288,218 | 1,701,325 |
| | $ 4,066,586 | $ 3,133,563 |

## 22. FINANCIAL RISK MANAGEMENT DISCLOSURES

(a) Liquidity risk

Liquidity risk is the risk that an entity will be unable to meet its financial obligations as they fall due. The Company manages liquidity risk by preparing cash flow forecasts of upcoming cash requirements. As at December 31, 2014, the Company had a cash and cash equivalents balance of $200,994 (at December 31, 2013 – cash and cash equivalents and available-for-sale investments of $2,803,806), in order to meet short-term business requirements. At December 31, 2014, the Company had accounts payable and accrued liabilities $2,778,368 (December 31, 2013 - $1,432,238), which have contractual maturities of 90 days or less and short-term line of credit payments of $1,288,218. The Company is seeking financing in order to be in a position to satisfy its current liabilities.

The Company has a planning and budgeting process in place by which it anticipates and determines the funds required to support normal operation requirements as well as the growth and development of its mineral property interests. The Company coordinates this planning and budgeting process with its financing activities through the capital management process in normal circumstances.

**22. FINANCIAL RISK MANAGEMENT DISCLOSURES** (cont'd…)

(a) Liquidity risk (cont'd…)

The following table details the Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods. The table is based on the undiscounted cash flows of financial liabilities.

| | 0 to 6 months | 6 to 12 months | Total |
|---|---|---|---|
| As at December 31, 2014 | | | |
| Trade accounts payable | $ 2,347,888 | $ - | $ 2,347,888 |
| Line of credit facility, current portion | 1,055,678 | 232,540 | 1,288,218 |
| | $ 3,403,566 | $ 232,540 | $ 3,636,106 |
| | | | |
| As at December 31, 2013 | | | |
| Trade accounts payable | $ 992,253 | $ - | $ 992,253 |
| Loans payable | 267,350 | 805,050 | 1,072,400 |
| | $ 1,259,603 | $ 805,050 | $ 2,064,653 |

Additional sources of funding, which may not be available on favourable terms, if at all, include: share equity and debt financings; coal sales from stockpiled inventory; equity, debt or property level joint ventures with power project and coal property developers; and sale of interests in existing assets. In the event that the Company is not able to obtain adequate additional funding to continue as a going concern, material adjustment would be required to both the carrying value and classification of assets and liabilities on the statement of financial position (Note 1).

(b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risk primarily associated to cash and cash equivalents and receivables, net of allowances. The significant concentration of credit risk is situated in Mongolia. The carrying amount of assets included on the statements of financial position represents the maximum credit exposure.

(c) Market risk

The significant market risks to which the Company is exposed are interest rate risk, foreign currency risk, and commodity and equity price risk.

**23. FINANCIAL RISK MANAGEMENT DISCLOSURES** (cont'd...)

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Company's cash equivalents primarily include highly liquid investments that earn interest at market rates that are fixed to maturity or at variable interest rates. The Company also drew down $1,288,218 on its credit facility bearing an annual coupon rate of 15%, with monthly interest payments. Due to the short-term nature of these financial instruments, and that the Company's line of credit beers interest at fixed rate, fluctuations in market rates do not have a significant impact on the fair values or future cash flows of the financial instruments as of December 31, 2014. The Company manages interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity.

(ii) Foreign currency risk

The Company is exposed to foreign currency risk to the extent that monetary assets and liabilities held by the Company are not denominated in Canadian dollars.

The Company has exploration and development projects in Mongolia and undertakes transactions in various foreign currencies. The Company is therefore exposed to foreign currency risk arising from transactions denominated in a foreign currency and the translation of financial instruments denominated in US dollars and Mongolia tugrik into its functional and reporting currency, the Canadian dollar.

Based on the above, net exposures as at December 31, 2014, with other variables unchanged, a 10% (December 31, 2013 - 10%) strengthening (weakening) of the Canadian dollar against the Mongolian tugrik would impact earnings with other variables unchanged by $133,835. A 10% (December 31, 2013 - 10%) strengthening (weakening) of the US dollar against the Canadian dollar would have a trivial impact on net loss. The Company currently does not use any foreign exchange contracts to hedge this currency risk.

(iii) Commodity and equity price risk

Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities.Commodity prices fluctuate on a daily basis and are affected by numerous factors beyond the Company's control. The supply and demand for these commodities, the level of interest rates, the rate of inflation, investment decisions by large holders of commodities including governmental reserves and stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns and monetary systems and political developments. The Company closely monitors commodity prices, individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company. Fluctuations in value may be significant.

## 24. RELATED PARTY DISCLOSURES

Prophecy had related party transactions with the following companies, related by way of directors and key management personnel:

- Linx Partners Ltd., a private company controlled by John Lee, Director, CEO and Executive Chairman of Prophecy, provides management and consulting services to the Company.

- MaKevCo Consulting Inc., a private company 50% owned by Greg Hall, Director of Prophecy, provides consulting services to the Company.

A summary of related party transactions by related party is as follows:

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Related parties | | 2014 | | 2013 |
| Directors and officers | $ | 370,462 | $ | 499,817 |
| Linx Partners Ltd. | | 490,312 | | 525,012 |
| MaKevCo Consulting Inc. | | 54,200 | | 142,200 |
| | $ | 914,974 | $ | 1,167,029 |

A summary of the transactions by nature among the related parties is as follows:

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Related parties | | 2014 | | 2013 |
| Consulting and management fees | $ | 169,312 | $ | 153,948 |
| Directors' fees | | 151,823 | | 246,010 |
| Mineral properties | | 176,750 | | 320,250 |
| Property and equipment | | 150,500 | | 162,750 |
| Salaries and benefits | | 266,589 | | 284,071 |
| | $ | 914,974 | $ | 1,167,029 |

As at December 31, 2014, amounts due to related parties totaled of $463,578 (December 31, 2013 – $413,278) and was comprised of $70,845 (December 31, 2013 - $129,060) for director fees, $198,935 (December 31, 2013 - $84,072) for consulting fees, and $157,312 (December 31, 2013 - $200,146) for managing the Ulaan Ovoo mineral properties and power plant project, and $36,486 (December 31, 2013 - $Nil) for salaries and reimbursable expenses.

The amounts due to related parties are non-interest bearing and are due upon demand.

## 25. KEY MANAGEMENT PERSONNEL COMPENSATION

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, including directors of the Company.

| Key Management Personnel | | Year Ended December 31, 2014 | | 2013 |
|---|---|---|---|---|
| Salaries and short term benefits | $ | 344,970 | $ | 811,321 |
| Share-based payments | | 418,850 | | 829,085 |
| | $ | 763,820 | $ | 1,640,406 |

## 26. SUPPLEMENTAL CASH FLOW INFORMATION

| | | Year Ended December 31, 2014 | | 2013 |
|---|---|---|---|---|
| Supplementary information | | | | |
| Interest paid | $ | 224,871 | $ | 1,052,160 |
| Non-Cash Financing and Investing Activities | | | | |
| Application of prepaid expense to mineral property | $ | 332,028 | $ | - |
| Shares issued as financing fees | $ | - | $ | 280,000 |
| Shares issued as bonus shares | $ | 81,100 | $ | 175,535 |
| Shares returned to treasury | $ | 4,501 | $ | - |
| Shares issued to settle debt | $ | 190,580 | $ | - |
| Shares issued in exchange for Wellgreen shares | $ | - | $ | 140,000 |
| Non-cash disposition of Wellgreen shares to settle debt | $ | - | $ | 474,699 |
| Revision in provision for closure and reclamation | $ | - | $ | (193,460) |
| Capitalized depreciation | $ | 2,136,511 | $ | 3,708,606 |
| Capitalized interest | $ | 226,549 | $ | 42,900 |
| Property & equipment expenditures included in accounts payable | $ | 1,921,741 | $ | 615,090 |
| Mineral property expenditures included in accounts payable | $ | 269,950 | $ | 269,171 |
| Share-based payments capitalized in property and equipment | $ | 112,650 | $ | 68,487 |
| Share-based payments capitalized in mineral properties | $ | 59,383 | $ | 14,792 |

## 27. COMMITMENTS

Commitments, not disclosed elsewhere in these Annual Financial Statements, are as follows:

| Office rental commitments | | |
|---|---|---|
| Year | | Amount |
| 2015 | $ | 63,641 |
| 2016 | | 21,214 |
| | $ | 84,855 |

## 28. CONTINGENCIES

The Company accrues for liabilities when both a liability is probable and the amount payable can be reasonably estimated.

During the year ended December 31, 2014, Red Hill Mongolia LLC was issued a letter from the Sukhbaatar district Tax division discussing the results of VAT inspection of the 2009-2013 tax imposition and payments resulted in an imposed VAT payable of MNT 2,654,175,507

(CAD$1,648,556). Red Hill disagreed with the findings as the tax assessment appeared to be unfounded. The Company has been advised by its legal counsel that it is only possible, but not probable, that the action will succeed. The Company disputes the assessment and submitted a complaint to the Capital City Tax Tribunal. The Tribunal's decision is pending.

In the opinion of Prophecy, at December 31, 2014 a provision for this matter is not required.

## 29. EVENTS AFTER THE REPORTING DATE

The following events occurred subsequent to December 31, 2014:

- On November 4, 2014, the Company announced that it has signed a definitive agreement (the "**Definitive Agreement**") with Apogee Silver Ltd. ("**Apogee**") in connection with the proposed transaction to acquire the Pulacayo-Paca silver-lead-zinc mining project in Bolivia (the "**Pulacayo Project**").

  Under the terms of the transaction, the Company will acquire Apogee's subsidiaries: Apogee Minerals Bolivia S.A. and ASC Bolivia LDC (which in turn, holds ASC Bolivia LDC Sucursal Bolivia, which holds Apogee's joint venture interest in the Pulacayo-Paca project) (collectively, the "**Apogee Subsidiaries**") by paying to Apogee $250,000 in cash and issuing to Apogee 60 million Prophecy common shares (the "**Consideration Shares**").

  On January 2, 2015, the Company successfully completed the acquisition of Apogee Subsidiaries and acquisition of mining joint venture interest in the Pulacayo-Paca Project. In consideration, the Company has paid Apogee $250,000 and issued to Apogee 60 million common shares. The Consideration Shares have been deposited into escrow pursuant to an escrow agreement, which allows for the release of the Consideration Shares over time, when the Company's shares trading on the TSX reach certain price levels or in the face of certain major triggering events. The Company has also agreed to assume all liabilities of the Apogee Subsidiaries. The escrow agreement also provides for a standstill on the voting of the Consideration Shares while they are held in escrow, and the voting of all released Consideration Shares in support of the Company's management so long as Prophecy continues to be engaged in its current business. The transaction has been accounted for as an asset acquisition.

- Subsequent to year end, the Company borrowed by way of a revolving credit facility agreement dated March 12, 2015 (the "**Credit Facility Agreement**") $1,064,280 from Linx Partners Ltd., a personal holding company wholly-owned and controlled by the Company's CEO, in order to meet interim working capital requirements to fund the Company's business operations and financial commitments. The Credit Facility Agreement has a maximum principal amount available for advance of $1.5 million, a one-year term with an option to extend it for any number of subsequent one-year terms, and bears an interest rate of 18% per annum. The Credit Facility Agreement is secured by a promissory note and a general security agreement.