

# **Annual Report of the Independent Review Committee of the Sprott Group of Funds**

March 8, 2012

**IRC Annual Report to: Securityholders in the Sprott Group of Funds (the “Funds”) as listed at the end of this report**

Dear Securityholder,

In accordance with **National Instrument 81-107 Independent Review Committee for Investment Funds** (“NI 81-107” or the “Instrument”), the Manager established an Independent Review Committee (the “Committee” or “IRC”) for the Prospectus Funds in April, 2007. The IRC has functioned in accordance with the applicable securities laws and is composed of three individuals, each of whom is independent of the Funds, the Manager and each entity related to the Manager (as defined in the Instrument).

The Manager also manages several onshore and offshore Non-Prospectus Funds that are not reporting issuers and to which NI 81-107 does not apply. The Manager was granted Exemptive Relief Orders by the Ontario Securities Commission (“OSC”) on July 27, August 27 and September 30, 2010 (referred to as the “Collective Reliefs”). By way of the Collective Reliefs granted, the Manager has appointed the Committee to be the Independent Review Committee of the Non-Prospectus Funds. The Manager will deal with the conflicts of interest matters referred to in the Collective Reliefs by referring conflicts of interest to the IRC in accordance with the provisions of such Collective Reliefs and the provisions of Securities legislation referred to therein.

The Prospectus Funds and the Non-Prospectus Funds are listed on page 4.

The IRC is pleased to publish its annual report to Securityholders, covering the period from January 1, 2011 to December 31, 2011 (“the Reporting Period”).

## **Mandate of the IRC**

In accordance with the Instrument, the mandate of the IRC is to consider and provide recommendations to the Manager on conflicts of interest to which the Manager may be subject when managing the Funds. The Manager is required under the Instrument to identify potential conflicts of interest inherent in its management of the Funds, develop written policies and procedures guiding its management of those conflicts and request input from the IRC on those written policies and procedures.

When a conflict matter arises, the Manager must refer its proposed course of action in respect of such conflict to the IRC for its review. While certain matters require the IRC’s prior approval, in most cases the IRC will provide a recommendation to the Manager as to whether or not, in the opinion of the IRC, the Manager’s proposed action provides a fair and reasonable result for the Funds. For recurring conflict of interest matters, the IRC can provide the Manager with Standing Instructions (“SIs”) that enable the Manager to proceed with certain matters without having to refer them to the IRC each time for approval, providing the Manager deals with the conflicts in accordance with the SIs.

The IRC is empowered to represent the best interest of the Funds in any matter where the Manager has referred a conflict of interest matter to it. In those cases, it has sought to ensure that the Manager’s proposed course of action represents a fair and reasonable result for the Funds.

## **Composition of the IRC**

The current members of the IRC, and their principal occupations, are as follows:

<b><i>Name and municipality of residence</i></b>	<b><i>Principal Occupation</i></b>	<b><i>Term of Office</i></b>
Lawrence A. Ward, Chair, Toronto, Ontario	Consultant, retired partner of PricewaterhouseCoopers, LLP	Initial Appointment: April 20, 2007.  Renewed on March 5, 2010 for a period of two years, eight months with effect from April 30, 2010.
Eamonn B.P. McConnell, Toronto, Ontario	Consultant, former Managing Director of Deutsche Bank, Europe and Asia	Initial Appointment: April 20, 2007.  Renewed on December 20, 2010 for a period of two year with effect from January 1, 2011.
W. William Woods, Toronto, Ontario	Consultant, Lawyer, Independent Director, former CEO of the Bermuda Stock Exchange	Initial Appointment: April 20, 2007.  Renewed on April 6, 2009 for a period of two years, eight months with effect from April 30, 2009.  Renewed on December 6, 2011 for a period of three years with effect from January 1, 2012.

The re-appointment of Mr. Woods on December 6, 2011 extended his total years of service beyond the 6 year limit as set out in NI 81-107. However the Manager has provided its consent to an agreement with the re-appointment beyond the 6 year limit in accordance with the provisions of the Instrument.

There were no other changes in the composition of the IRC during the Reporting Period.

## **Compensation and Indemnification**

### **Review of Compensation**

At least annually, the IRC reviews its compensation giving consideration to the following:

- the nature and extent of the workload of each member of the IRC, including the commitment of time and energy expected from each member;
- the number of meetings required by the IRC including special meetings to consider conflict issues brought to the Committee;
- industry best practices, including industry averages and surveys on IRC compensation; and
- the complexity of the conflict issues brought to the IRC.

### **Members' Fees**

In aggregate the IRC members were paid \$95,000 in 2011, plus applicable taxes.

### **Indemnities Granted**

The Funds and the Manager have provided each IRC Member with a contractual indemnity in keeping with NI 81-107. No payments were paid to the IRC Members pursuant to this indemnity by the Funds or the Manager during the Reporting Period.

### **Disclosure of IRC Members' Holdings**

As at December 31, 2011, the IRC Members did not beneficially own, directly or indirectly:

- any interest in any of the Funds;
- any interests in the Manager; or
- any interests in a company or person that provides services to the Manager or any Fund.

### **Recommendations and Approvals**

On April 5, 2011, the Manager requested approval from the IRC regarding an exemptive relief application. The Manager was seeking relief from the Canadian Securities Administrators ("CSA") to permit the Manager to:

- i. Allow its mutual funds to participate in private placements of equity securities where Sprott Private Wealth LP ("SPW") is the underwriter. These would only involve securities that are listed on an exchange.
- ii. Allow its mutual funds to participate in private placements of debt securities where SPW is the underwriter. There are several additional restrictions set out in the application.

After reviewing the Application for Exemptive Relief, the draft decision and the previous decisions of the CSA on similar applications, and making reasonable enquiry the IRC **RESOLVED** that the Manager's proposed course of action to make the application for exemptive relief if granted, would achieve a fair and reasonable result for the Funds. The application was subsequently granted.

On June 28, 2011, the Manager requested approval from the IRC regarding the merger of the Growth Fund (the "Terminating Fund") into the Small Cap Fund (the "Continuing Fund"). After making reasonable enquiry the IRC **RESOLVED** that the Manager's proposed course of action to merge the funds, if approved by the unitholders and completed, would achieve a fair and reasonable result for each of the Funds. The unitholders subsequently approved the merger.

The IRC is not aware of any instance in which the Manager acted in a Conflict Of Interest Matter ("COIM") referred to the IRC for which the IRC did not give a positive recommendation or approval during the Reporting Period.

### **Standing Instructions Approved**

The IRC has approved five Standing Instructions ("Sis"), which constitute a written approval or recommendation from the IRC that permit the Manager to proceed with the specific action(s) set out in the SI on an ongoing basis, without having to refer the conflict of interest matter or its proposed action to the IRC, provided that the Manager complies with the terms and conditions of the SI. In each case, the SI required the Manager to comply with its related policy and procedures and to report periodically to the IRC. The Manager relied on Sis No. 1, 2, 3 and 5 during the Reporting Period.

On February 8, 2011 the IRC approved SI No 5: *Related Party Issues: Inter Fund Trades –Pooled/Hedge Funds*.

**Standing Instruction No. 1: Omnibus** deals with a number of conflict of interest matters including:

1. Expenses charged to the Funds policy

2. Expense allocations policy between prospectus funds
3. Expense allocations policy between prospectus and non-prospectus funds
4. Short-term trading and late trading policy
5. Trade allocations policy
6. Net asset value error correction policy
7. Other material transaction error policy
8. Best execution policy
9. Soft dollar policy
10. Favouritism policy
11. Proxy voting policy
12. Changing service providers policy
13. Employee Personal Trading Policy
14. Sub-advisors personal trading policy
15. Short term trading policy
16. Complaint handling policy
17. Service providers related to the Manager policy
18. Affiliate dealer policy

**Standing Instruction No. 2:** Portfolio Pricing Issues: Fair Valuing Securities

**Standing Instruction No. 3:** Related Party Issues: Inter Fund Trades

**Standing Instruction No. 4:** Related Party Issues: A Fund Purchases Securities (Whether Debt or Equity) Issued by a Company Related to a Sub-Advisor

**Standing Instruction No. 5:** Related Party Issues: Inter Fund Trades –Pooled/Hedge Funds

### **Funds served by the IRC**

#### Prospectus Funds

Sprott Canadian Equity Fund  
 Sprott Gold and Precious Minerals Fund  
 Sprott Energy Fund  
 Sprott Small Cap Equity Fund  
 Sprott Tactical Balanced Fund  
 Sprott All Cap Fund  
 Sprott Gold Bullion Fund  
 Sprott 2011 Flow-Through Limited Partnership  
 Sprott Physical Gold Trust  
 Sprott Physical Silver Trust  
 Sprott Diversified Yield Fund  
 Sprott Short-Term Bond Fund  
 Sprott Silver Bullion Fund  
 Sprott Strategic Fixed Income Fund

#### **Corporate Class**

Sprott Resource Class  
 Sprott Canadian Equity Class  
 Sprott Diversified Yield Class (Series T and Series FT  
 Shares also available)  
 Sprott Gold and Precious Minerals Class  
 Sprott Energy Class  
 Sprott Short-Term Bond Class  
 Sprott Small Cap Equity Class  
 Sprott Tactical Balanced Class (Series T and Series FT  
 Shares also available)

#### Non-Prospectus Funds

##### **Domestic**

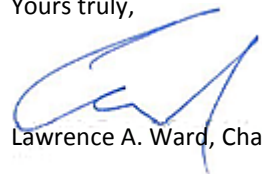
Sprott Hedge Fund LP  
 Sprott Hedge Fund LP II  
 Sprott Bull Bear RSP Fund  
 Sprott Opportunities Fund LP  
 Sprott Opportunities RSP Fund  
 Sprott Small Cap Hedge Fund  
 Sprott Private Credit Fund  
 Sprott Absolute Return Income Fund

##### **Offshore**

Sprott Capital LP  
 Sprott Offshore Fund Ltd.  
 Sprott Capital II LP  
 Sprott Offshore Fund II Ltd.

This report is available on the Manager's website at [www.sprott.com](http://www.sprott.com) or you may request a copy, at no cost to you, by contacting the Sprott Funds at (416) 943 6707 or 1- 866 299 9906 or email the Sprott Funds at [invest@sprott.com](mailto:invest@sprott.com). This document and other information about the Sprott Funds are available on [www.sedar.com](http://www.sedar.com).

Yours truly,

A handwritten signature in blue ink, appearing to read 'LAW', is positioned above the name Lawrence A. Ward.

Lawrence A. Ward, Chair

## Schedule of IRC Members who sit on IRCs for other Fund Families

### **Eamonn McConnell serves as a member of the Independent Review Committees for the following funds:**

Investment funds that are reporting issuers managed by Integra Capital Limited;  
 Investment funds that are reporting issuers managed by Northwest & Ethical Investments L.P.;  
 Investment funds that are reporting issuers managed by O'Leary Funds Management L.P.;  
 Investment funds that are reporting issuers managed by Man Investments Canada Corp.;  
 Investment funds that are reporting issuers managed by Onex Credit Partners, LLC;  
 The Goodwood Capital Fund;  
 Investment funds that are reporting issuers managed by Russell Investments Canada Limited; and  
 Investment funds that are reporting issuers managed by Webb Asset Management Canada Inc.

### **Lawrence A. Ward serves as a member of the Independent Review Committees for the following funds:**

The Acker Finley Canada Focus Fund\*;  
 Investment funds that are reporting issuers managed by Northwest & Ethical Investments L.P.;  
 Investment funds that are reporting issuers managed by Vertex One Asset Management Inc. ;  
 The Goodwood Capital Fund; and  
 Investment funds that are reporting issuers managed by Russell Investments Canada Limited.

### **W. William Woods serves as a member of the Independent Review Committees for the following funds:**

Investment funds that are reporting issuers managed by Integra Capital Limited;  
 The Acker Finley Canada Focus Fund\*;  
 Investment funds that are reporting issuers managed by O'Leary Funds Management L.P.;  
 The Goodwood Capital Fund;  
 Investment funds that are reporting issuers managed by Russell Investments Canada Limited;  
 Investment funds that are reporting issuers managed by The International Scholarship Foundation;  
 Investment funds that are reporting issuers managed by Man Investments Canada Corp.;  
 Investment funds that are reporting issuers managed by Onex Credit Partners, LLC; and  
 Investment funds that are reporting issuers managed by Webb Asset Management Canada Inc.

\*Cease to be a reporting issuer as of December 16, 2011.