



Annual Consolidated Financial Statements

For the years ended December 31, 2016, 2015 and 2014

(Expressed in thousands of Canadian dollars, unless otherwise stated)



KPMG LLP
Chartered Professional Accountants
PO Box 10426 777 Dunsmuir Street
Vancouver BC V7Y 1K3
Canada

Telephone (604) 691-3000
Fax (604) 691-3031
Internet www.kpmg.ca

INDEPENDENT AUDITORS' REPORT OF REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Directors of Canadian Zinc Corporation

We have audited the accompanying consolidated financial statements of Canadian Zinc Corporation, which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015, the consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising 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 as issued by the International Accounting Standards Board, 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 and the standards of the Public Company Accounting Oversight Board (United States). 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 our 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, we consider 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. 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, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Canadian Zinc Corporation as at December 31, 2016 and December 31, 2015, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes that Canadian Zinc Corporation has no current sources of revenue and its ability to carry out its planned business objectives is dependent on its ability to raise adequate financing to continue the development of the Prairie Creek Mine. These conditions, along with other matters as set forth in Note 1, indicate the existence of material uncertainties that cast substantial doubt about Canadian Zinc Corporation's ability to continue as a going concern.

Comparative Information

The consolidated financial statements of Canadian Zinc Corporation for the year ended December 31, 2014 were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements on March 31, 2015.

Other Matter

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canadian Zinc Corporation's internal control over financial reporting as of December 31, 2016, based on the criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2017 expressed an unqualified opinion on the effectiveness of Canadian Zinc Corporation's internal control over financial reporting.

KPMG LLP (signed)

Chartered Professional Accountants

March 15, 2017
Vancouver, Canada



KPMG LLP
Chartered Professional Accountants
PO Box 10426 777 Dunsmuir Street
Vancouver BC V7Y 1K3
Canada

Telephone (604) 691-3000
Fax (604) 691-3031
Internet www.kpmg.ca

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Directors of Canadian Zinc Corporation

We have audited Canadian Zinc Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Canadian Zinc Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying report titled "Management's Report on Internal Controls over Financial Reporting". Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



In our opinion, Canadian Zinc Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial position of Canadian Zinc Corporation as of December 31, 2016 and 2015, and the related consolidated statements of comprehensive loss, shareholders' equity, and cash flows for the years then ended and our report dated March 15, 2017 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP (signed)

Chartered Professional Accountants

March 15, 2017
Vancouver, Canada

CANADIAN ZINC CORPORATION
Consolidated Statements of Financial Position
(Expressed in thousands of Canadian dollars, unless otherwise stated)

	As at December 31, 2016	As at December 31, 2015
ASSETS		
Current		
Cash and cash equivalents (Note 3)	\$ 9,817	\$ 1,674
Short-term investments (Note 4)	28	28
Marketable securities (Note 5)	-	936
Other receivables and prepaid expenses	469	295
Total Current Assets	10,314	2,933
Restricted cash (Note 6)	2,075	2,075
Property, plant and equipment (Note 7)	710	777
Exploration and evaluation assets (Note 8)	5,398	5,398
Total Assets	\$ 18,497	\$ 11,183
LIABILITIES		
Current		
Accounts payable	\$ 328	\$ 298
Accrued and other liabilities (Note 10(a)(ii))	473	153
Total Current Liabilities	801	451
Decommissioning provision (Note 9)	1,797	1,825
Total Liabilities	2,598	2,276
SHAREHOLDERS' EQUITY		
Share capital (Note 10)	114,618	104,028
Reserves (Note 11)	15,873	14,394
Deficit	(114,592)	(109,515)
Total Shareholders' Equity	15,899	8,907
Total Liabilities and Shareholders' Equity	\$ 18,497	\$ 11,183

Nature of Operations and Going Concern (Note 1)
Commitments (Note 19)

Approved by the Board of Directors:

“John F. Kearney”

Director

“John M. Warwick”

Director

CANADIAN ZINC CORPORATION**Consolidated Statements of Comprehensive Loss**

(Expressed in thousands of Canadian dollars, except for share information)

	Years ended December 31,		
	2016	2015	2014
Income			
Investment income	\$ 60	\$ 107	\$ 169
Expenses			
Depreciation	12	10	8
Exploration and evaluation (Note 12)	2,428	7,650	9,996
Listing and regulatory	70	85	58
Management and directors	650	690	850
Office and general	462	531	604
Professional	216	189	298
Shareholder and investor communications	223	245	416
Share-based compensation (Note 11)	1,104	124	23
	5,165	9,524	12,253
Other income (expense)			
Gain (loss) on marketable securities (Note 5)	-	486	(878)
Finance costs (Note 9)	(36)	(48)	(60)
Gain on change in decommissioning provision (Note 9)	64	246	-
Tax deduction recovery (Note 13)	-	471	588
	28	1,155	(350)
Net loss for the year	(5,077)	(8,262)	(12,434)
Other comprehensive income (loss)	-	-	-
Comprehensive loss for the year	\$ (5,077)	\$ (8,262)	\$ (12,434)
Net loss per share - basic and diluted	\$ (0.02)	\$ (0.04)	\$ (0.06)
Weighted average number of shares outstanding			
Basic and diluted	238,480,985	218,047,709	192,465,968

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

CANADIAN ZINC CORPORATION
Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars, unless otherwise stated)

		Years ended December 31,	
	2016	2015	2014
Operating Activities			
Net loss for the year	\$ (5,077)	\$ (8,262)	\$ (12,434)
Adjustments for items not involving cash:			
Accretion and depreciation expense (Notes 7 and 9)	103	129	154
Loss (gain) on marketable securities (Note 5)	-	(486)	878
Share-based compensation (Note 11)	1,104	124	23
Gain on changes to decommissioning provision (Note 9)	(64)	(246)	-
Tax deduction recovery (Note 13)	-	(471)	(588)
Change in non-cash working capital items:			
Other receivables and prepaid expenses	(176)	401	24
Accounts payable and accrued liabilities	85	(1,681)	540
	(4,025)	(10,492)	(11,403)
Financing Activities			
Capital stock issued, net of share issue costs (Note 10)	11,090	-	14,473
Proceeds from exercise of warrants (Note 11)	142	-	357
	11,232	-	14,830
Investing Activities			
Redemption (purchase) of short-term investments (Note 4)	-	5,000	(2,995)
Sale of marketable securities (Note 5)	936	-	-
Payment of reclamation security deposits (Note 6)	-	(1,550)	-
Additions to property, plant and equipment (Note 7)	-	(76)	(16)
	936	3,374	(3,011)
Net change in cash and cash equivalents	\$ 8,143	\$ (7,118)	\$ 416
Cash and cash equivalents, beginning of year	\$ 1,674	\$ 8,792	\$ 8,376
Net change in cash and cash equivalents	8,143	(7,118)	416
Cash and cash equivalents, end of year	\$ 9,817	\$ 1,674	\$ 8,792

CANADIAN ZINC CORPORATION

Consolidated Statements of Changes in Shareholders' Equity

(Expressed in thousands of Canadian dollars, except for share information)

	Share Capital		Reserves	Deficit	Total
	Number	Amount			
Balance, December 31, 2013	172,828,575	\$ 91,823	\$ 12,681	\$ (88,819)	\$ 15,685
Issue of shares at \$0.35 per share (Note 10)	28,572,000	10,000	-	-	10,000
Issue of shares at \$0.38 per share (Note 10)	15,134,000	4,692	-	-	4,692
Share issuance costs (Note 10)	-	(1,278)	-	-	(1,278)
Share purchase warrants (Note 11 (c))	-	(1,723)	1,723	-	-
Exercise of options at \$0.23 per share (Note 10)	1,513,134	514	(157)	-	357
Share-based compensation (Note 11 (a))	-	-	23	-	23
Net loss for the year	-	-	-	(12,434)	(12,434)
Balance, December 31, 2014	218,047,709	\$ 104,028	\$ 14,270	\$ (101,253)	\$ 17,045
Share-based compensation (Note 11 (b))	-	-	124	-	124
Net loss for the year	-	-	-	(8,262)	(8,262)
Balance, December 31, 2015	218,047,709	104,028	14,394	(109,515)	8,907
Issue of shares at \$0.25 per share (Note 10)	40,800,000	10,200	-	-	10,200
Issue of shares at \$0.30 per share (Note 10)	6,666,664	1,733	-	-	1,733
Share issuance costs (Note 10)	-	(1,110)	-	-	(1,110)
Share purchase warrants (Note 11 (c))	-	(440)	440	-	-
Exercise of deferred share units (Note 10)	190,970	24	(24)	-	-
Exercise of warrants at \$0.35 per share (Note 10)	406,200	183	(41)	-	142
Share-based compensation (Notes 11 (a) and 11 (b))	-	-	1,104	-	1,104
Net loss for the year	-	-	-	(5,077)	(5,077)
Balance, December 31, 2016	266,111,543	\$ 114,618	\$ 15,873	\$ (114,592)	\$ 15,899

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

1. Nature of Operations and Going Concern

Canadian Zinc Corporation (the “Company” or “Canadian Zinc”) is incorporated under the laws of the Province of British Columbia, Canada, and its principal business activity is the exploration and development of natural resource properties. The address of the Company’s registered office is Suite 1710, 650 West Georgia Street, PO Box 11644, Vancouver, British Columbia, Canada, V6B 4N9. The Company currently exists under the *Business Corporations Act* (British Columbia) and its common shares are listed on the Toronto Stock Exchange (“TSX”) under the symbol “CZN” and on the OTCQB under the symbol “CZICF”.

The Company is primarily engaged in the exploration, development and permitting of its mineral properties. The Company is considered to be in the exploration and development stage given that its mineral properties are not yet in production and, to date, have not earned any significant revenues. The recoverability of amounts shown for exploration and evaluation assets is dependent on the existence of economically recoverable reserves, obtaining and maintaining the necessary permits to operate a mine, obtaining the financing to complete development and future profitable production.

These audited consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern which assumes that the Company will realize its assets and discharge its liabilities in the normal course of business. There are however material uncertainties that cast significant doubt upon the Company’s ability to continue as a going concern which are discussed below.

The Company has a history of losses with no operating revenue other than interest income, and has working capital of \$9,513,000 as at December 31, 2016. The ability of the Company to carry out its planned business objectives is dependent on its ability to raise adequate financing from lenders, shareholders and other investors. Additional financing will be required in the short term to continue the development of the Prairie Creek Project and in the longer term to put the Prairie Creek Mine into production. There is no assurance that such financing will be available on a timely basis or on acceptable terms. If the Company is unable to obtain adequate additional financing, the Company will be required to curtail operations, exploration and development activities. The Company is currently evaluating various opportunities and seeking additional sources of financing. These conditions indicate the existence of material uncertainties which cast significant doubt about the Company’s ability to continue as a going concern.

These audited consolidated financial statements do not give effect to any adjustments, which could be material, and which would be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different than those reflected in the audited consolidated financial statements.

2. Significant Accounting Policies

(a) Statement of Compliance

These audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and were approved and authorized for issue by the Board of Directors on March 15, 2017.

(b) Basis of Preparation and Consolidation

These audited consolidated financial statements have been prepared on a historical cost basis except for financial instruments classified as fair value through profit or loss which are stated at their fair value. These audited consolidated financial statements are presented in Canadian dollars and have been prepared on the basis of IFRS standards that are effective on December 31, 2016. The accounting policies adopted by the Company have been applied consistently to all periods presented. These audited consolidated financial statements are presented in the Company’s, and its subsidiaries, functional currency of Canadian dollars.

These audited consolidated financial statements include the accounts of Canadian Zinc Corporation and its wholly-owned subsidiaries Paragon Minerals Corporation (“Paragon”) and Messina Minerals Inc. (“Messina”), collectively the Group. 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. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. All intra-group balances, transactions, unrealized gains and losses resulting from intra-group transactions and dividends are eliminated in full upon consolidation.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

2. Significant Accounting Policies (continued)

(c) Significant Accounting Judgments, Estimates and Assumptions

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities at the reporting date and the reported amounts of income and expenses during the reporting year. Actual results may differ from these estimates.

- i. The assessment of the Company's ability to continue as a going concern involves judgment regarding future funding available for the development of the Prairie Creek mine and exploration of the Newfoundland properties and for working capital requirements. In concluding the Company is a going concern, management considers funds on hand at year end, planned expenditures for at least 12 months from the balance sheet date and strategic objectives in its assessment. Due to the nature of its business, management increases or decreases administrative and exploration expenditures based on available working capital. Judgments must also be made with regard to events or conditions which might give rise to significant uncertainty.
- ii. Valuation of exploration and evaluation assets: Significant judgment is required when determining whether facts and circumstances suggest that the carrying amount of exploration and evaluation assets may exceed its recoverable amount. Significant judgment must be exercised in determining when a project of the Company moves from the exploration and evaluation phase and into the development phase. The existence and extent of proven or probable mineral reserves; retention of regulatory permits and licences; the availability of development financing; current and future metal prices; and market sentiment are all factors considered by the Company. Accordingly, the Company having not secured development financing has deemed all projects to be in the exploration and evaluation phase.
- iii. Decommissioning provision: Decommissioning provisions are recognized in the period in which they arise and are stated at the best estimate of the present value of estimated future costs. These estimates require significant judgment about the nature, cost and timing of the work to be completed, and may change with future changes to costs, environmental laws, regulations and remediation practices and the expected timing of remediation work.
- iv. Share-based compensation: The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value of share-based payment transactions requires determination of the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determination of the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating the fair value of share-based payment transactions are disclosed in Note 11.

(d) Financial Assets

Financial assets are initially recorded at fair value and designated upon initial recognition into one of the following four categories: held-to-maturity, available-for-sale, loans and receivables or at fair value through profit or loss ("FVTPL").

Financial assets classified as loans and receivables are measured at amortized cost less impairment, if any. The Company has classified its other receivables as loans and receivables.

Financial assets classified as FVTPL are measured at fair value with unrealized gains and losses recognized through net earnings. The Company has classified its cash and cash equivalents, short-term investments, and restricted cash as FVTPL. The Company previously designated its marketable securities as FVTPL upon initial recognition in accordance with an investment strategy that management uses to evaluate performance on a fair value basis.

Financial assets classified as held-to-maturity are measured at amortized cost. The Company has no financial assets classified as held-to-maturity.

Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) except for losses in value that are considered other than temporary, which are recorded in profit or loss. The Company has no financial assets classified as available-for-sale.

Transaction 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 value of the asset.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

2. Significant Accounting Policies (continued)

(e) Impairment of Non-Financial Assets

The Company assesses at each reporting date the carrying amounts of non-financial assets to determine whether there is an indication of impairment. If such an indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount of an asset or cash-generating unit is the greater of fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks specific to the asset. In determining fair value less costs to sell, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used. For the purpose of impairment testing, assets are grouped at lowest levels that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

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

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment charge is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. A previously recognized impairment loss is reversed only if there has been a significant change in or reversal of the circumstances or events that gave rise to the previously recognize impairment loss.

(f) Cash and Cash Equivalents

Cash and cash equivalents consist of cash and liquid investments which are readily convertible into cash with maturities of three months or less from the date of purchase.

(g) Short-term Investments

Short-term investments, which consist primarily of investments in Bankers Acceptances and Guaranteed Investment Certificates, are investments with maturities of more than three months and less than one year from the date of purchase.

(h) Marketable Securities

Marketable securities are recorded at their fair market value on the date of acquisition and are classified as FVTPL. The carrying value of the marketable securities is adjusted at each subsequent reporting period to their estimated fair value (based upon the market bid price and the Bank of Canada quoted exchange rate, if applicable) with the resulting unrealized gains or losses recognized in comprehensive income or loss for the year. Transaction costs relating to the purchase of marketable securities are expensed directly to profit or loss.

(i) Foreign Currency Transactions

The Company's reporting currency and the functional currency of its subsidiaries is the Canadian dollar as this is the principal currency of the economic environment in which the Company operates. Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate in effect at the financial statement date. Foreign exchange gains or losses arising from translation are recognized in profit and loss for the reporting year.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

2. Significant Accounting Policies (continued)

(j) Property, Plant and Equipment ("PPE")

Items of PPE are carried at acquisition cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Depreciation is provided on a declining-balance basis, less the estimated residual value, at the following annual rates:

Mining equipment	30%
Office equipment	20%

Buildings and leasehold improvements are recorded at cost, net of accumulated depreciation. Depreciation on buildings and leasehold improvements are provided on a straight-line basis over the life of the asset.

Depreciation methods, material residual value estimates and estimates of useful lives are reviewed at each reporting date and updated as required. Gains or losses arising on the disposal of PPE are determined as the difference between the proceeds on disposition and the carrying value of the assets and are recognized in profit or loss at the time of the disposal. Amortization of the Prairie Creek plant and mill will be based on the unit-of-production method using estimated proven and probable reserves.

(k) Exploration and Evaluation Assets

Exploration and evaluation assets include acquired mineral use rights for mineral properties held by the Company. The amount of consideration paid (in cash or share value) for mineral use rights is capitalized. The amounts shown for exploration and evaluation assets represent costs of acquisition incurred to date, less recoveries and impairments, if any, and do not necessarily reflect present or future values. Amounts received for the sale of mineral properties and for option payments are treated as reductions of the cost of the property, with payments in excess of capitalized costs recognized in income.

The recoverability of the amounts capitalized for the undeveloped mineral properties is dependent upon the determination of economically recoverable ore reserves, confirmation of the Company's interest in the underlying mineral claims, the ability to obtain the necessary financing to complete their development, and future profitable production or proceeds from the disposition thereof. Subsequent recovery of the resulting carrying value depends on successful development or sale of the mineral property. If a mineral property does not prove viable, all unrecoverable costs associated with the project net of any impairment provisions are written off.

Exploration and evaluation assets will be amortized to profit or loss once commercial production has been achieved or written off if the exploration and evaluation assets are abandoned or sold. Depletion of costs capitalized on projects put into commercial production will be recorded using the unit-of-production method based upon estimated proven and probable reserves.

Included in the cost of exploration and evaluation assets is the cost of the estimated decommissioning provision.

Ownership in exploration and evaluation assets involves certain inherent risks, including geological, fluctuation in metal prices, operating costs, and permitting risks. Many of these risks are outside the Company's control. The ultimate recoverability of the amounts capitalized for the exploration and evaluation assets is dependent upon the delineation of economically recoverable ore reserves, obtaining the necessary financing to complete their development, obtaining and retaining the necessary permits to operate a mine, and realizing profitable production or proceeds from the disposition thereof. Estimates of the recoverability of the Company's investment in exploration and evaluation assets have been based on current and expected conditions. However, it is possible that changes could occur which may adversely affect management's estimates and may result in future write downs of exploration and evaluation assets carrying values.

Title to mineral properties involves inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently unreliable conveyance history characteristics of many mineral properties.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

2. Significant Accounting Policies (continued)

(l) Financial Liabilities

Financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or classified as other financial liabilities.

Financial liabilities classified as other financial liabilities are initially recognized at fair value less directly attributable transaction costs. Subsequently, they are measured at amortized cost using the effective interest method. The Company has classified its accounts payable and accrued liabilities as other financial liabilities.

Financial liabilities classified as FVTPL include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as FVTPL. Fair value changes on financial liabilities classified as FVTPL are recognized through profit or loss. The Company has no financial liabilities classified as FVTPL.

(m) Decommissioning, Restoration and Other Provisions

The Company recognizes provisions for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of exploration and evaluation assets and PPE, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a decommissioning provision is recognized at its present value in the period in which it is incurred, which is generally when an environmental disturbance occurs or a constructive obligation is determined. Upon initial recognition of the provision, a corresponding amount is added to the carrying amount of the related asset and the cost is amortized as an expense over the economic life of the asset using the unit-of-production method. Subsequent to initial recognition the carrying value of the provision is increased for the passage of time and adjusted for changes to the current market-based discount rate and the amount or timing of the underlying cash flows needed to settle the obligation. This accretion expense is recognized in profit or loss as finance costs. Changes to estimated future decommissioning costs are recognized in the consolidated statement of financial position by either increasing or decreasing the decommissioning provision and the related asset.

(n) Flow-Through Shares

Current Canadian tax legislation permits mining entities to issue flow-through shares to investors. Flow-through shares are securities issued to investors whereby the deductions for tax purposes related to exploration and evaluation expenditures may be claimed by investors instead of the entity. The issue of flow-through shares is in substance an issue of ordinary shares and the sale of tax deductions. At the time the Company issues flow-through shares, the sale of tax deductions is deferred and presented as other liabilities in the consolidated statement of financial position to recognize the obligation to incur and renounce eligible resource exploration and evaluation expenditures. The tax deduction is measured as the difference between the current market price of the Company's common shares and the issue price of the flow-through share. Upon incurring and renouncing eligible resource exploration and evaluation expenditures, the Company recognizes the sale of tax deductions as a tax deduction recovery on the consolidated statement of comprehensive income or loss and accordingly reduces the liability for flow-through shares premium.

(o) Investment Income

Investment income on cash and cash equivalents and short-term investments is recognized as it is earned.

(p) Exploration and Evaluation Expenditures

Exploration and evaluation expenditures, other than those described in Note 2(k), are recognized in profit and loss. Expenditures incurred before the company has obtained legal rights to explore areas of interest are also recognized in profit and loss. Expenditures incurred by the Company in connection with the development of mineral resources after such time as mineral reserves are proven or probable; permits to operate the mineral resource property are received; financing to complete development has been obtained; and approval of the Board of Directors to commence mining development and operations are capitalized as deferred development expenditures within the exploration and evaluation asset (see Note 2(k)).

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

2. Significant Accounting Policies (continued)

(q) Share-based Compensation

The Company follows the fair value method of accounting for the stock option awards granted to employees, directors and consultants. The fair value of stock options is determined by the Black-Scholes Option Pricing Model with assumptions for risk-free interest rates, dividend yields, volatility of the expected market price of the Company's common shares and the expected life of the options. The number of stock option awards expected to vest are estimated using a forfeiture rate based on historical experience and future expectations. The fair value of direct awards of stock is determined by the quoted market price of the Company's stock. Share-based compensation is amortized to earnings over the vesting period of the related option. The Company uses graded or accelerated amortization which specifies that each vesting tranche must be accounted for as a separate arrangement with a unique fair value measurement. Each vesting tranche is subsequently amortized separately and in parallel from the grant date.

Option-pricing models require the use of highly subjective estimates and assumptions including the expected stock price volatility. Changes in the underlying assumptions can materially affect the fair value estimates and, therefore, existing models do not necessarily provide reliable measurement of the fair value of the Company's stock options.

Share-based compensation for deferred share units granted to directors is determined based on estimated fair values of the units at the time of grant using quoted market prices and recognized immediately. Share-based compensation for restricted share units granted to employees and consultants is determined based on estimated fair values of the units at the time of grant using quoted market prices and recognized over the vesting period of the respective units.

(r) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Deferred income tax assets and liabilities are recognized in the period for temporary differences between the tax and accounting bases of assets and liabilities as well as for the potential benefit of income tax losses and other deductions carried forward to future years.

Deferred income tax assets and liabilities are measured using substantively enacted tax rates and laws expected to apply in the years in which temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred income tax assets and liabilities is recognized in the year that includes the substantive enactment date. The value of deferred income tax assets is reviewed annually and adjusted, if necessary, to reflect the amount probable of being realized.

(s) Earnings (Loss) Per Common Share

Earnings (loss) per share calculations are based on the net income (loss) attributable to common shareholders for the year divided by the weighted average number of common shares issued and outstanding during the year.

Diluted earnings per share calculations are based on the net income attributable to common shareholders for the year divided by the weighted average number of common shares outstanding during the year plus the effects of dilutive common share equivalents. This method requires that the dilutive effect of outstanding options and warrants issued be calculated using the treasury stock method. This method assumes that all common share equivalents have been exercised at the beginning of the year (or at the time of issuance, if later), and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of common shares during the year. The incremental number of common shares that would be issued is included in the calculation of diluted earnings (loss) per share.

Diluted loss per share calculations are based on the net loss attributable to common shareholders for the year divided by the weighted average number of common shares issued and outstanding during the year. Stock options and share purchase warrants are not included in the computation of loss per share as such inclusion would be anti-dilutive.

(t) Government Grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the Company has complied with all conditions necessary to receive the grants and collectability is reasonably assured. Government grants relating to costs are accrued as receivable and recognized in the consolidated statement of comprehensive income or loss as a reduction of the related expense. Government grants relating to property, plant and equipment are accrued as receivable and recognized in the consolidated statement of financial position as a reduction of the carrying value of the related asset.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

2. Significant Accounting Policies (continued)

(u) IFRS Standards Adopted

As of January 1, 2016, the Company adopted the new and amended IFRS pronouncements in accordance with transitional provisions outlined in the respective standards. The adoption of these standards did not have a material impact on the consolidated results and financial position of the Company.

(v) IFRS Standards Issued But Not Yet Effective

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2016, and have not been applied in preparing these consolidated financial statements. The following pronouncements are those that the Company considers most significant and are not intended to be a complete list of new pronouncements that may impact the financial statements.

IFRS 9, Financial Instruments (“IFRS 9”)

In July 2014, the IASB issued the final version of IFRS 9 to replace IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on an entity's business model and the contractual cash flows of the financial asset. Classification is made at the time the financial asset is initially recognized, namely when the entity becomes a party to the contractual provisions of the instrument. The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 with early adoption permitted. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018 and does not expect the adoption of IFRS 9 to have a material effect on its consolidated financial statements based on its current holding of financial instruments.

IFRS 16, Leases (“IFRS 16”)

On January 13, 2016, the International Accounting Standards Board published a new standard, IFRS 16, *Leases*, eliminating the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Under the new standard, a lease becomes an on-balance sheet liability that attracts interest, together with a new right-of-use asset. There are optional exemptions for short-term leases and leases of low value items. In addition, lessees will recognize a front-loaded pattern of expense for most leases, even when cash rentals are constant. IFRS 16 replaces existing leases guidance including IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases—Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2018. The Company has started an initial assessment of the potential impact on its consolidated financial statements. Based on the analysis to date, the most significant impact identified is that the Group will recognize new assets and liabilities for its operating leases of office facilities. In addition, the nature of expenses related to those leases will now change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities. The Company intends to use the optional exemption for short-term leases and leases for which the underlying asset is of low value.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

3. Cash and Cash Equivalents

The Company's cash and cash equivalents at December 31, 2016 consisted of cash of \$191,000 and cash equivalents of \$9,626,000 (December 31, 2015 - cash of \$301,000 and cash equivalents of \$1,373,000).

4. Short-term Investments

Short-term investments, which consist primarily of investments in Banker's Acceptances and Guaranteed Investment Certificates, are investments with maturities of more than three months and less than one year from the date of purchase. At December 31, 2016, short-term investments had a carrying value of \$28,000, earning income at a rate of 0.60% (December 31, 2015 - \$28,000, earning income at a rate of 0.75%). The carrying values of short-term investments approximate their fair values due to the relatively short period to maturity.

5. Marketable Securities

In January 2016, the Company liquidated its marketable securities and sold 12,573,380 shares of Vatukoula Gold Mines plc ("Vatukoula") to Zhongrun International Mining Co. Ltd., the major shareholder of Vatukoula, for cash of \$936,000.

6. Restricted Cash

As at December 31, 2016, restricted cash comprised reclamation security deposits totaling \$2,075,000 (December 31, 2015 - \$2,075,000) held by government agencies as financial assurance in respect of certain reclamation obligations at the Prairie Creek Property.

7. Property, Plant and Equipment

	Land	Prairie Creek Plant & Mill	Mining Equipment	Office Equipment	Buildings and Leasehold Improvements	Total
Cost						
December 31, 2014	\$ 40	\$ 500	\$ 1,689	\$ 164	\$ 80	\$ 2,473
Additions during the year	-	-	53	23	-	76
December 31, 2015	40	500	1,742	187	80	2,549
Additions during the year	-	-	-	-	-	-
December 31, 2016	40	\$ 500	\$ 1,742	\$ 187	\$ 80	\$ 2,549
Accumulated Depreciation						
December 31, 2014	\$ -	\$ -	\$ 1,482	\$ 147	\$ 62	\$ 1,691
Depreciation for the year	-	-	71	7	3	81
December 31, 2015	-	-	1,553	154	65	1,772
Depreciation for the year	-	-	55	10	2	67
December 31, 2016	\$ -	\$ -	\$ 1,608	\$ 164	\$ 67	\$ 1,839
Net Book Value						
December 31, 2014	\$ 40	\$ 500	\$ 207	\$ 17	\$ 18	\$ 782
December 31, 2015	40	500	189	33	15	777
December 31, 2016	40	500	134	23	13	710

CANADIAN ZINC CORPORATION
Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

8. Exploration and Evaluation Assets

The Company holds a 100% interest in the Prairie Creek Mine property located in the Northwest Territories, Canada. The Prairie Creek Property is subject to a 1.2% net smelter return royalty. It also holds, through the Company's wholly-owned subsidiaries Paragon and Messina, a 100% interest in the South Tally Pond, Tulks South and Long Lake properties in Newfoundland and Labrador.

	December 31, 2016	December 31, 2015
Prairie Creek Mine	\$ -	\$ -
Central Newfoundland properties	5,398	5,398
	\$ 5,398	\$ 5,398

Reclamation and closure costs and any subsequent changes in estimates are capitalized into exploration and evaluation assets (see Note 9). The Company has incurred historical exploration and evaluation costs of \$78,508,000 on the Prairie Creek Mine asset and \$4,167,000 on exploration properties in central Newfoundland (see Note 12) and has expensed these costs pursuant to its accounting policy.

9. Decommissioning Provision

Reclamation and closure costs for the Prairie Creek Property have been estimated based on an Abandonment and Restoration Plan agreed to by the Mackenzie Valley Land and Water Board and the Company based upon current obligations under existing surface leases, land use permits and a class "B" Water Licence for reclamation and closure of the Prairie Creek Mine site as it now exists with the current infrastructure and assuming a mine life of 17 years. These reclamation and closure costs have been measured based on the net present value of the best estimate of future cash expenditures. These reclamation and closure costs and any subsequent changes in estimates are capitalized into exploration and evaluation assets and amortized over the life of the related asset (see Note 8). The accretion expense is included in finance costs in the consolidated statement of comprehensive income or loss.

The Company's undiscounted decommissioning provision for the Prairie Creek site, as it currently exists, is \$2,728,000 (December 31, 2015 - \$2,728,000), being the estimated future net cash outflows of the reclamation and closure costs, including a 25% contingency and inflation rate of 2% per annum, required to satisfy the obligations, settlement of which will occur subsequent to closure of the mine estimated to be 2036. The decommissioning provision is discounted using a risk free rate of 2.21% (December 31, 2015 – 2.03%).

Reclamation and closure costs are capitalized into exploration and evaluation assets and amortized over the life of the Prairie Creek Mine asset. Changes in the reclamation and closure costs resulting from changes in the timing, estimated cost or discount rate requires an offsetting change in the carrying value of the corresponding exploration and evaluation asset. Decreases in the decommissioning provision result in a corresponding decrease to the asset until the corresponding asset is reduced to nil, after which a decrease in the decommissioning provision is recognized as a gain in the consolidated statement of comprehensive loss.

For the year ended December 31, 2016, a change in timing of estimated costs reduced the decommissioning provision by \$64,000, resulting in a gain on change in estimate of the decommissioning provision (2015 - \$246,000 and 2014 - \$nil) and which is included in other income on the consolidated statement of comprehensive loss.

	December 31, 2016	December 31, 2015	December 31, 2014
Balance – beginning of year	\$ 1,825	\$ 2,243	\$ 1,963
Accretion expense	36	48	60
Change in estimates	(64)	(466)	220
Balance – end of year	\$ 1,797	\$ 1,825	\$ 2,243

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

10. Share Capital

Issued and outstanding: 266,111,543 common shares (December 31, 2015 – 218,047,709). Authorized: Unlimited common shares with no par value (2015 – unlimited).

(a) During the year ended December 31, 2016

- i. On July 7, 2016, the Company completed an underwritten public offering of common shares and flow-through shares (the "Offering") through a syndicate of underwriters co-led by Paradigm Capital Inc. and Canaccord Genuity Corp. and included Dundee Securities Ltd. (together, the "Underwriters"). The Company issued 34,135,000 common shares at a price of \$0.25 per common share for gross proceeds of \$8,533,750, and 6,665,000 common shares, which qualify as "flow-through" shares (the "FT Shares") at a price of \$0.25 per FT Share for gross proceeds of \$1,666,250. In total, the gross proceeds of the Offering amounted to \$10,200,000. The Underwriters were paid a commission of 6% of the gross proceeds from the offering and received compensation warrants to acquire 2,448,000 non-flow-through shares at any time until July 7, 2018 at a price of \$0.25 per share. Net proceeds from the issuance were \$9,249,000 after issuance costs comprised of the advisor's commission of \$612,000 and other issuance costs of \$339,000. The Company also recognized non-cash costs for the fair value of the warrants granted of \$440,000 and did not recognize a sale of tax deductions as the issue price of the flow-through shares was greater than the market price of the Company's shares at the date of issue.
- ii. On December 14, 2016, the Company completed a non-brokered private placement of flow-through shares. The Company issued 6,666,664 common shares at a price of \$0.30 per common share for gross proceeds of \$2,000,000. A finder's fee equal to 6% of the gross proceeds raised was paid to the advisors. Net proceeds from the issuance were \$1,841,000 after issuance costs comprised of the advisor's fee of \$120,000 and other issuance costs of \$39,000. The sale of tax deductions of \$267,000, being the difference between the market price of the Company's shares at the date of issue and the issue price of the flow-through shares, was deferred and recorded as a current liability in the consolidated statement of financial position and presented within accrued and other liabilities.
- iii. 406,200 common shares were issued upon the exercise of warrants at a price of \$0.35 per common share for proceeds of \$142,000.
- iv. 190,970 common shares were issued upon the conversion of deferred share units following the retirement of a director.

(b) During the year ended December 31, 2015

There were no changes to the Company's share capital in the annual period ended December 31, 2015.

(c) During the year ended December 31, 2014

- i. On July 31, 2014, the Company completed a bought deal public offering of units and flow-through shares (the "Offering") through a syndicate of underwriters led by Dundee Securities Ltd. and included Canaccord Genuity Corp. and Paradigm Capital Inc. (together, the "Underwriters"). The Company issued 28,572,000 units ("Units") at a price of \$0.35 per Unit for gross proceeds of \$10,000,000, and 15,134,000 common shares, which qualify as "flow-through" shares (the "FT Shares") at a price of \$0.38 per FT Share for gross proceeds of \$5,751,000. Each Unit is comprised of one common share and one half of one common share purchase warrant (each full warrant, a "Warrant"). Each Warrant entitles the holder to purchase one common share at an exercise price of \$0.50 on or before July 31, 2017.

In total, the gross proceeds of the Offering amounted to \$15,751,000. The Underwriters were paid a commission of 6% of the gross proceeds from the offering and received compensation warrants to acquire 2,622,360 non-flow-through shares at any time until July 31, 2016 at a price of \$0.35 per share. Net proceeds from the issuance were \$14,473,000 after issuance costs comprised of the advisor's commission of \$945,000 and other issuance costs of \$333,000. The Company also recognized non-cash costs for the fair value of the warrants granted of \$1,723,000. The sale of tax deductions of \$1,059,000, being the difference between the market price of the Company's shares at the date of issue and the issue price of the flow-through shares, was deferred and recorded as a current liability in the consolidated statement of financial position and presented within accrued and other liabilities (See Note 13).

- ii. 1,513,134 stock options were exercised at prices between \$0.23 and \$0.30 per common share for proceeds of \$357,000.

CANADIAN ZINC CORPORATION
Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

11. Reserves

(a) Stock Options

The Company's stock option plan is a fixed share stock option plan pursuant to which options on up to 7,500,000 common shares may be issued to directors, officers, employees and service providers of the Company. Each option granted shall be for a term not exceeding five years from the date of grant and the vesting period is determined at the discretion of the Board. The option exercise price is set at the date of grant and cannot be less than the closing market price of the Company's common shares on the TSX on the day of grant. At December 31, 2016, there were 5,850,000 incentive stock options outstanding. Each stock option is exercisable for one ordinary share of the Company. No amounts are paid or payable by the recipient on receipt of the option. The options carry neither rights to dividends nor voting rights. Options may be exercised at any time from the date of vesting to the date of their expiry.

	December 31, 2016		December 31, 2015		December 31, 2014	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	973,800	\$ 0.55	5,693,800	\$ 0.47	7,247,734	\$ 0.42
Exercised	-	-	-	-	(1,513,134)	0.24
Expired	(323,800)	0.72	(4,060,000)	0.45	(40,800)	1.14
Forfeited	-	-	(660,000)	0.45	-	-
Granted	5,200,000	0.35	-	-	-	-
Outstanding, end of year	5,850,000	\$ 0.36	973,800	\$ 0.55	5,693,800	\$ 0.47

As at December 31, 2016, the Company had outstanding and exercisable stock options, with a weighted average remaining contractual life of 4.2 years, to purchase an aggregate 5,850,000 common shares as follows:

Expiry Date	Options Outstanding		Options Exercisable	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
October 3, 2017	650,000	\$ 0.46	650,000	\$ 0.46
August 10, 2021	5,200,000	0.35	1,300,000	0.35
	5,850,000	\$ 0.36	1,950,000	\$ 0.39

For the year ended December 31, 2016, the Company recorded share-based compensation expense for stock options granted to directors, officers and employees of \$492,000; did not recognize any share-based compensation in the year ended December 31, 2015; and recorded \$23,000 in the year ended December 31, 2014.

The share-based compensation expense was determined using the Black-Scholes option pricing model, based on the following terms and assumptions:

Period of Grant	Year ended December 31, 2016
Dividend Yield	0%
Risk free interest rate	0.54%
Expected life	2.6 to 3.5 years
Expected volatility ⁽¹⁾	92% to 97%
Weighted average grant date fair value of the options granted	\$0.19

⁽¹⁾ Determined based on historical volatility of the Company's share price.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

11. Reserves (continued)

(b) Restricted Share Units (“RSUs”) and Deferred Share Units (“DSUs”)

At the Annual General Meeting held on June 19, 2014, shareholders approved the adoption of a Restricted Share Unit Plan (the “RSU Plan”) and a Deferred Share Unit Plan (the “DSU Plan”). The RSU Plan and the DSU Plan provide for the issuance of shares to eligible employees, directors and consultants, subject to certain vesting and deferral provisions, to a maximum number, equal to 3% and 2% respectively, of the issued and outstanding common shares of the Company. During the year ended December 31, 2016, the Company issued 376,034 DSUs to directors and 1,900,000 RSUs to senior officers (2015 – 276,340 DSUs and 3,650,000 RSUs). Additionally, 190,970 DSUs were redeemed upon the retirement of a director. At December 31, 2016, there were 461,404 DSUs and 5,550,000 RSUs outstanding (December 31, 2015 – 276,340 DSUs and 3,650,000 RSUs).

	Number of DSUs	Weighted average grant date fair value	Number of RSUs	Weighted average grant date fair value
Outstanding, December 31, 2014	-	\$ -	-	\$ -
Granted	276,340	0.09	3,650,000	0.11
Outstanding, December 31, 2015	276,340	0.09	3,650,000	0.11
Redeemed	(190,970)	0.13	-	-
Granted	376,034	0.24	1,900,000	0.33
Outstanding, December 31, 2016	461,404	\$ 0.20	5,550,000	\$ 0.19

The RSUs granted are subject to a ten to eighteen month vesting period; a pay-out date of 2.5 to 3 years; an expiry date of 5 years; and are assigned a fair value based on the share price at time of issuance. Upon issuance, the DSUs are fully vested and are assigned a fair value based on the share price at time of issuance. Subject to the terms and conditions of the DSU Plan, DSUs are paid out upon retirement.

For the year ended December 31, 2016, the Company recognized share-based compensation expense for DSUs granted of \$90,000 (2015 - \$25,000 and 2014 - \$nil) and RSUs granted of \$522,000 (2015 - \$99,000 and 2014 - \$nil).

CANADIAN ZINC CORPORATION
Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

11. Reserves (continued)

(c) Share Purchase Warrants

As at December 31, 2016, the Company has outstanding exercisable warrants to purchase an aggregate 16,734,000 common shares, with a weighted average remaining contractual life of 9 months, as follows:

	December 31, 2016		December 31, 2015		December 31, 2014	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of year	16,908,360	\$ 0.48	17,295,960	\$ 0.48	8,490,200	\$ 1.00
Exercised	(406,200)	0.35	-	-	-	-
Expired	(2,216,160)	0.35	(387,600)	0.63	(8,102,600)	1.01
Issued	2,448,000	0.25	-	-	16,908,360	0.48
Outstanding, end of year	16,734,000	\$ 0.46	16,908,360	\$ 0.48	17,295,960	\$ 0.48

Expiry Date	Warrants Outstanding and Exercisable	
	Number of Warrants	Weighted Average Exercise Price
July 31, 2017	14,286,000	\$ 0.50
July 7, 2018	2,448,000	0.25
	16,734,000	\$ 0.46

The fair value (\$440,000) of warrants, issued during the year ended December 31, 2016, was determined using the Black-Scholes option pricing model, based on the following terms and assumptions:

Year of Grant	Year ended December 31, 2016
Dividend Yield	0%
Risk free interest rate	0.47%
Expected life	2 years
Expected volatility ⁽¹⁾	109%
Weighted average grant date fair value of the warrants issued	\$ 0.18

⁽¹⁾ Determined based on historical volatility of the Company's share price.

CANADIAN ZINC CORPORATION**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

11. Reserves (continued)**(d) Summary**

A summary of the changes to the reserves is summarized below as follows:

	Share Options and Units	Warrants	Unexercised Share Options, Units and Warrants	Normal Course Issuer Bid	Total
Balance, December 31, 2014	\$ 1,286	\$ 1,814	\$ 10,566	\$ 604	\$ 14,270
Share-based compensation	124	-	-	-	124
Stock options expired	(1,022)	-	1,022	-	-
Stock options forfeited	(154)	-	154	-	-
Warrants expired	-	(92)	92	-	-
Balance, December 31, 2015	234	1,722	11,834	604	14,394
Deferred share units exercised	(24)	-	-	-	(24)
Share-based compensation	1,104	-	-	-	1,104
Stock options expired	(114)	-	114	-	-
Warrants exercised	-	(41)	-	-	(41)
Warrants expired	-	(226)	226	-	-
Warrants issued	-	440	-	-	440
Balance, December 31, 2016	\$ 1,200	\$ 1,895	\$ 12,174	\$ 604	\$ 15,873

CANADIAN ZINC CORPORATION**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

12. Exploration and Evaluation Expenditures

Prairie Creek Mine	Years ended December 31,		
	2016	2015	2014
Camp operation and project development	\$ 470	\$ 2,106	\$ 1,881
Diamond drilling	-	3,102	1,163
Mine planning and feasibility studies	331	1,045	3,301
Permitting and environmental	1,001	993	1,551
	1,802	7,246	7,896
Depreciation – mining plant and equipment	55	71	86
Total exploration and evaluation expenditures	\$ 1,857	\$ 7,317	\$ 7,982
Exploration and evaluation expenditures (inception to date), beginning of year	\$ 76,651	\$ 69,334	\$ 61,352
Total exploration and evaluation expenditures	1,857	7,317	7,982
Exploration and evaluation expenditures (inception to date), end of year	\$ 78,508	\$ 76,651	\$ 69,334

Central Newfoundland Properties	Years ended December 31,		
	2016	2015	2014
Camp operation and project development	\$ 370	\$428	\$ 802
Diamond drilling ⁽¹⁾	201	(95)	1,195
Permitting and environmental	-	-	17
Total exploration and evaluation expenditures	\$ 571	\$ 333	\$ 2,014
Exploration and evaluation expenditures (inception to date), beginning of year	\$ 3,596	\$ 3,263	\$ 1,249
Total exploration and evaluation expenditures	571	333	2,014
Exploration and evaluation expenditures (inception to date), end of year	\$ 4,167	\$ 3,596	\$ 3,263

⁽¹⁾ The Company received government grants in 2015 relating to the 2014 drill programs in Newfoundland which are credited to the expense as a recovery.

For the year ended December 31, 2016, employee wages and benefits of \$472,000 were included in exploration and evaluation expenditures (2015 - \$1,314,000 and 2014 - \$1,339,000).

CANADIAN ZINC CORPORATION
Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

13. Tax Deduction Recovery

During the year ended December 31, 2016, the Company did not recognize a tax deduction recovery (2015 - \$471,000 and 2014 - \$588,000) in respect of flow-through shares previously issued (see Note 10).

14. Government Grants

During the year ended December 31, 2016, the Company received government grants in the amount of \$241,000 (2015 - \$398,000 and 2014 - \$170,000). The grants received or receivable were accounted for as a reduction of the related expense or as a reduction of the carrying value of the related asset.

As at December 31, 2015, a prepayment of \$40,000 was recorded, presented within accrued and other liabilities, for work associated with a grant received from the Research and Development Corporation of Newfoundland and Labrador for work to be completed in 2016 with no comparable amount in the current year. As at December 31, 2016, a receivable of \$75,000 (December 31, 2015 - \$170,000) was due from the government of Newfoundland and Labrador and is presented within other receivables and prepaid expenses.

15. Income Taxes

The Company's current and deferred income tax expense for the year ended December 31, 2016, is \$nil and \$nil (2015 - \$nil and \$nil and 2014 - \$nil and \$nil). A reconciliation of the statutory tax rate to the effective rate for the Company is as follows:

	2016	2015	2014
Statutory tax rate	26.54%	26.74%	26.56%
Income taxes/(recovery) computed at statutory rates	\$ (1,347)	\$ (2,209)	\$ (3,303)
Expired losses	239	-	236
Flow-through share premium recovery	-	(126)	(156)
Income tax rate changes	126	(112)	20
Loss on marketable securities subject to capital gains tax rate	-	(66)	(118)
Non-refundable investment tax credits	-	(1,651)	-
Other	9	(95)	7
Permanent differences	299	40	249
Renunciation of resource expenditures	104	779	1,899
Tax benefits not yet recognized	570	3,440	1,166
	-	-	-

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

16. Income Taxes (continued)

The approximate tax effect of each type of temporary difference that gives rise to the Company's deferred income tax assets and liabilities are as follows:

	2016	2015	2014
Non-capital loss carry forwards	\$ 11,392	\$ 10,942	\$ 9,868
Capital losses	1,260	-	-
Investment tax credits	1,651	1,651	-
Marketable securities	-	1,258	1,314
Plant and equipment	448	433	409
Resource interests	10,599	10,294	9,329
Other	871	776	994
Net unrecognized deferred income tax asset	\$ 26,221	\$ 25,354	\$ 21,914

At December 31, 2016, the Company has approximately \$43,076,000 (2015 - \$41,126,000 and 2014 - \$37,300,000) of non-capital losses for tax purposes available to be carried forward to various dates until 2035 and applied against future income for tax purposes and approximately \$44,659,000 (2015 - \$38,889,000 and 2014 - \$35,422,000) of unused cumulative Canadian exploration and development expenses for tax purposes available to be carried forward indefinitely and applied against future income for tax purposes. The non-capital losses expire as follows:

Year	Total
2026	\$ 1,116
2027	3,511
2028	5,500
2029	3,547
2030	3,605
2031	3,915
2032	6,741
2033	2,272
2034	6,554
2035	3,634
2036	2,681
	\$ 43,076

The non-refundable investment tax credits of \$1.6 million expire between 2025 and 2032.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

16. Capital Management

The Company manages its cash and cash equivalents, short-term investments, marketable securities, common shares, stock options and share purchase warrants as capital. As the Company is in the exploration and evaluation stage, its principal source of funds for its operations is from the issuance of common shares. The issuance of common shares requires approval of the Board of Directors. It is the Company's objective to safeguard its ability to continue as a going concern, so that it can continue to explore its Canadian properties and develop the Prairie Creek project for the benefit of its shareholders.

17. Related Party Transactions

During the year ended December 31, 2016, the Company incurred rent expense in the amount of \$24,000 (2015 - \$24,000 and 2014 - \$24,000) with Buchans Minerals Corporation ("Buchans") a corporation in which the Chairman of the Company John F. Kearney serves as a director and chairman and with which the Company has an office sharing arrangement. These transactions were within the normal course of business and have been recorded at amounts agreed to by the transacting parties. There was not an amount owing to related parties and included in accounts payable and accrued and other liabilities at December 31, 2016 nor was there an amount recorded at the end of the previous year.

The Company recorded a net receivable of \$10,000 at December 31, 2016 due from Buchans representing payments made on behalf of Buchans for work undertaken associated with a grant receivable from the Research and Development Corporation of Newfoundland and Labrador (see Note 14).

During the year ended December 31, 2016, the Company incurred short-term employee remuneration and benefits to officers and directors in the amount of \$650,000 (2015 - \$690,000 and 2014 - \$850,000) and share-based compensation with officers and directors in the amount of \$986,000 (2015 - \$124,000 and 2014 - \$2,000).

18. Financial Instruments

(a) Categories of financial instruments

		Fair Value Hierarchy	December 31, 2016	December 31, 2015
Cash and cash equivalents	FVTPL		\$ 9,817	\$ 1,674
Short-term investments	FVTPL		28	28
Marketable securities	FVTPL	Level 3	-	936
Other receivables	Loans and receivables		199	54
Restricted cash	FVTPL		2,075	2,075
Accounts payable	Other financial liabilities		(328)	(298)
Accrued and other liabilities	Other financial liabilities		(473)	(153)

The carrying value of the Company's financial assets and liabilities reasonably approximate their fair values.

(b) Interest rate risk

In respect of financial assets, the Company's policy is to invest cash at floating rates of interest and cash reserves are to be maintained in cash equivalents in order to maintain liquidity. Fluctuations in interest rates impact the value of cash equivalents. Included in net loss for the year ended December 31, 2016, is investment income on the Company's cash and cash equivalents and short-term investments. As at December 31, 2016, with other variables unchanged, a 1% increase or decrease in the Prime rate would have resulted in a decrease or increase, respectively, to net loss of approximately \$40,000. The Company does not have any debt obligations which expose it to interest rate risk.

CANADIAN ZINC CORPORATION

Notes to the Consolidated Financial Statements

For the years ended December 31, 2016 and 2015

(Tabular amounts expressed in thousands of Canadian dollars, except for shares, price per share and per share amounts)

18. Financial Instruments (continued)

(c) 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 does not currently generate any revenues from sales to customers nor does it hold derivative type instruments that would require a counterparty to fulfil a contractual obligation resulting in credit risk. The Company has never held any asset-backed paper instruments. The Company seeks to hold its cash and cash equivalents, short-term investments and restricted cash with reputable financial institutions. The Company considers the following financial assets to be exposed to credit risk: cash and cash equivalents, short-term investments, and restricted cash. The carrying value of these financial assets at December 31, 2016 is \$11,920,000 (December 31, 2015 - \$4,713,000). At December 31, 2016, the Company's cash and cash equivalents, short-term investments and restricted cash were invested with two Canadian financial institutions.

(d) Liquidity risk

Liquidity risk encompasses the risk that the Company cannot meet its financial obligations as they fall due. The Company ensures that there is sufficient capital in order to meet short-term business requirements. The Company's policy is to invest cash at floating rates of interest, while cash reserves are maintained in cash equivalents in order to maintain liquidity after taking into account the Company's holdings of cash equivalents, money market investments, marketable securities and receivables. As at December 31, 2016, the Company had positive working capital of \$9,513,000 (December 31, 2015 - \$2,482,000). Additional financing will be required in the short term to continue the development of the Prairie Creek Project and in the longer term to put the Prairie Creek Mine into production. Accordingly, there is a risk that the Company may not be able to secure adequate funding on reasonable terms, or at all.

19. Commitments

The Company has entered into certain operating lease agreements for office space and equipment. These agreements require the Company to make the following lease payments:

Year ending December 31,	Total
2017	\$ 155
2018	153
2019	153
2020	152
2021	149
	\$ 762

During the year ended December 31, 2016, the Company recognized lease expense of \$211,000 (2015 - \$209,000 and 2014 - \$207,000).