

DARNLEY BAY RESOURCES LIMITED
REPORT TO SHAREHOLDERS
YEAR 2002

This report to the shareholders for the year 2002 is distributed along with that of the first quarter of 2003.

Our operations, centred around Darnley Bay in the Northwest Territories, is at an early stage of exploration and has the potential to become a new diamond corridor like the Lac de Gras diamond corridor, also in the Northwest Territories, with an additional possible base metal camp similar to the Sudbury basin in Northern Ontario..

During 2002 and 2003 to date, project development was mainly directed towards diamond potential. For this purpose, local and regional geological and structural features were examined looking for similarities to the Lac de Gras corridor and other world wide diamond deposits. In addition, chemical and microprobe analyses of project samples were plotted for indicator minerals and compared with producing diamond deposits. Based upon current information, the Darnley Bay area appears to be an offset of and within the same diamond stability field as the Lac de Gras deposits, which supports two new producing mines and another under development.

For continued exploration, a corridor of 3.1 million acres (140 x 40 miles) has been selected and divided into five separate project areas. Within the corridor, diamonds have been found in till and drill core samples while kimberlite indicator mineral are found throughout..The known diamond bearing kimberlites are probably only a few of those in the area.

For the first stage of the continuing program, \$5 million is needed and management is confident that discussions and negotiations now underway for a joint venture will be successful, with funding expected to be in place shortly.

In the year 2002 and the first quarter of 2003, the company was successful in obtaining additional share capital, of approximately \$900,000, which covered the cost of the development program and the company's administrative obligations. Unfortunately, the market for venture capital continued in the doldrums and consequently financing for continuation of on-site exploration was not available.

For additional information on our continuing program, see the Company's web page as indicated below.

On behalf of the directors

Leon F. La Prairie
President
May 21, 2003

DIRECTORS

William P.G. Allen, B.A., L.L.M. John S. Dowsett, B.A.Sc, P.Eng. Leon F. La Prairie, B.A.Sc., P.Eng.
Richard T. La Prairie, B.Comm., C.A., Patricia Mannard, B.A.(hons.)

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AUDITORS' REPORT

TO THE SHAREHOLDERS OF
DARNLEY BAY RESOURCES LIMITED

We have audited the balance sheets of Darnley Bay Resources Limited as at December 31, 2002 and 2001, and the statements of mineral properties and related expenditures, loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended, in accordance with Canadian generally accepted accounting principles.

(Signed) Edmund Cachia & Co.
CHARTERED ACCOUNTANTS

Toronto, May 16, 2003

DARNLEY BAY RESOURCES LIMITED
FINANCIAL STATEMENTS

4TH QUARTERS (unaudited) and YEARS (audited) ENDED DECEMBER 31, 2002 and 2001

BALANCE SHEET	December 31	
	2002	2001
	\$	\$
Cash	27,373	9,231
Goods and services taxes (GST) recoverable	8,815	50,571
Prepaid expenses		230,518
Current assets	36,188	290,320
Deposits	170,601	170,601
Mineral property and related expenditures	12,353,706	11,863,565
Total assets	12,560,495	12,324,486
Accounts payable and accrued liabilities	1,214,111	997,617
Future income taxes (note 6)	3,579,342	3,348,304
Capital stock (note 5)	17,124,881	16,492,881
Deficit	(9,357,839)	(8,514,316)
Shareholders' equity	7,767,042	7,978,565
Liabilities and shareholders' equity	12,560,495	12,324,486

STATEMENT OF MINERAL PROPERTIES AND RELATED EXPENDITURES	4th Quarter		Year		Cumulative December 31, 2002
	2002	2001	2002	2001	2002
	\$	\$	\$	\$	\$
Concession and permit fees to Inuvialuit and other agencies (note 3)	74,215	348,188	288,146	361,917	3,455,191
Professional and technical services provided by geophysicists, geologists and others	58,274	14,646	114,960	291,592	2,137,260
Technical services provided by management	21,342	21,166	84,175	94,662	1,010,964
Legal fees applicable to exploration agreements	22,500	30,000	22,500	30,000	205,071
Travel and project presentations			2,224	4,639	287,066
Wages and accomodation facilities	2,080	29,523	(6,127)	245,619	989,690
Air charters and fuel		500		86,401	2,090,663
Site administration	(399)	253	8,508	9,964	205,587
Equipment and supplies		8,300	(2,855)	150,828	832,496
Drilling contracts		74,281	(21,390)	100,200	890,187
Environmental surveys				3,015	249,531
Total expenditures for period	178,012	526,857	490,141	1,378,837	12,353,706
Cumulative expenditures beginning of period	12,175,694	11,336,708	11,863,565	10,484,728	
Cumulative expenditures at end of period	12,353,706	11,863,565	12,353,706	11,863,565	

The accompanying notes are an integral part of these financial statements

Approved by the Board:
(Signed) Leon La Prairie, Director (Signed) William Allen, Director

DARNLEY BAY RESOURCES LIMITED
FINANCIAL STATEMENTS

4TH QUARTERS (unaudited) and YEARS (audited) ENDED DECEMBER 31, 2002 and 2001

	4th Quarter 2002	2001	Year 2002	2001	Cumulative December 31, 2002
	\$	\$	\$	\$	\$
STATEMENT OF LOSS AND DEFICIT					
Management and administrative services	58,659	59,003	232,505	270,786	1,451,647
Consultants		10,000		40,600	606,269
Legal and audit	42,500	38,000	83,879	35,334	609,754
Promotion	5,872	6,567	32,595	38,115	405,282
Communications	3,015	4,077	14,047	24,227	136,119
Rent	26,648	20,278	140,777	116,597	552,278
Stock transfer and shareholders' expenses	4,252	34,886	53,773	74,399	273,803
Office supplies and miscellaneous	3,387	7,856	18,740	35,971	244,616
Depreciation office equipment				6,923	30,736
Insurance	3,968	253	3,824	4,049	17,748
Capital tax	10,392	10,000	37,737	10,000	64,409
Provision for uncollected receivable					55,295
Interest and other financial expenses	1,714	1,681	8,805	(5,101)	48,324
NET LOSS FOR THE PERIOD	160,407	192,601	626,682	651,900	4,496,280
Deficit at beginning of the period	9,133,526	8,239,616	8,514,316	7,261,186	
Cost of issuing shares	64,103	82,099	216,841	601,230	4,861,559
DEFICIT AT END OF THE PERIOD	9,358,036	8,514,316	9,357,839	8,514,316	9,357,839
LOSS PER SHARE (cents)	0.005	0.007	0.021	0.025	
STATEMENT OF CASH FLOWS					
Net loss for the period	(160,407)	(192,601)	(626,682)	(651,900)	(4,496,280)
Depreciation				6,923	30,736
(Increase) decrease prepaid expenses	162,097	(172,706)	228,328	(164,443)	(2,190)
(Increase) decrease in GST recoverable	150	(19,918)	41,756	78,075	(8,815)
Increase (decrease) in accounts payable	52,228	725,138	218,684	676,719	1,216,301
CASH USED IN OPERATING ACTIVITIES	54,068	339,913	(137,914)	(54,626)	(3,260,248)
Purchase of fixed assets					(30,736)
(Increase) decrease permits and security deposits				22,543	(170,601)
Increase mineral property expenditures	(178,012)	(526,857)	(490,141)	(1,378,837)	(12,353,706)
CASH USED IN INVESTING ACTIVITIES	(178,012)	(526,857)	(490,141)	(1,356,294)	(12,555,043)
Issue of common shares, net of cost of issue	145,675	187,063	632,000	1,258,687	17,124,881
Cost of issuing shares and warrants	(64,103)	(82,099)	(216,841)	(601,230)	(4,861,559)
Tax-effect of flow-through shares	64,103	82,099	231,038	552,416	3,579,342
CASH FROM FINANCING ACTIVITIES	145,675	104,964	646,197	1,209,873	15,842,664
INCREASE (DECREASE) IN CASH	21,731	(81,980)	18,142	(201,047)	27,373
Cash at beginning of the period	5,642	9,112	9,231	210,278	
CASH AT END OF THE PERIOD	27,373	(72,868)	27,373	9,231	

The accompanying notes are an integral part of these financial statements

DARNLEY BAY RESOURCES LIMITED
NOTES TO FINANCIAL STATEMENTS
For the Fourth Quarters (unaudited) and Years (audited)
ended December 31, 2002 and 2001

1 -NATURE OF OPERATIONS

The objective of Darnley Bay Resources Limited is to explore for nickel, copper and platinum/palladium group elements and diamond deposits within and surrounding the geophysical anomaly centred on the Hamlet of Paulatuk in the Inuvialuit Settlement Region on the coast of the Arctic Ocean in the Northwest Territories of Canada. The recovery of amounts capitalized as Mineral Property and Related Expenditures is dependent upon the discovery of economically recoverable ore reserves, the ability of the Company to obtain financing to complete the necessary exploration and development, and obtaining future profitable production or proceeds from the disposition thereof.

2 -SIGNIFICANT ACCOUNTING POLICIES:

MINERAL PROPERTY AND RELATED EXPENDITURES

Mineral Property and Related Expenditures consist of costs of acquiring claims and exploratory expenditures. These costs are deferred, or capitalized, until commencement of commercial mining operations, when the deferred costs applicable to the specific property will be amortized on the unit of production basis. If in any year, the interests in specific properties are disposed of, or abandoned, the applicable deferred expenditures will be written off in that year.

FIXED ASSETS

The fixed assets of the Company, consisting of furniture, fixtures and office equipment, were fully depreciated in the Company's accounts by the year 2001.

FINANCIAL INSTRUMENTS

Financial instruments, consisting of current assets and liabilities, are stated at cost. Due to the short-term nature of these instruments, cost approximates fair market value.

INCOME TAXES

Future income tax assets and liabilities are determined based on differences between the financial statements carrying values and their respective income tax basis generally using the enacted income tax rates at each balance sheet date. Future income assets also arise from unused loss carry forwards and other deductions. The amount of the future income tax asset recognized is limited to the amount that is more likely than not to be realized. The estimated realizable amount is reviewed annually and adjusted, if necessary, by use of a valuation allowance.

3 - AGREEMENTS & MINERAL PROPERTY AND RELATED EXPENDITURES

Under the date of March 16, 2001, the Company entered into two new agreements with the Inuvialuit Land Corporation and associated companies (the "Inuvialuit"). These agreements replaced the previous agreement of October 5, 1995 with the Inuvialuit. One agreement covers base metals and the other deals with diamonds. The agreements cover an area of about 14 million acres (about 60,000 square kilometres) from latitude 68 degrees north to 70 degrees north and longitudes 120 degrees 40 minutes west to 128 degrees west. The Inuvialuit own the mineral rights in 450,000 acres centred around Paulatuk, referred to as "the Concession Lands". The rest of the area is termed "the Area of Mutual Interest". The agreements also provides the Inuvialuit, at their option, with a 10% participation in any mine development, subject to pro rata cost sharing.

In the base metals agreement, the Company's rights in the Concession Lands are in three phases; an exploration phase, a development phase and a production phase. The exploration phase commenced on October 6, 1995 and runs for 10 years, during which time the Company can designate specific areas ("Project Areas") for more intensive work. Each Project Area runs for 10 years during which time the Company is entitled to acquire mining leases. The production phase runs for 10 years and for as long thereafter as commercial or reclamation work continues. During the exploration phase, the Company is committed to undertake \$2 million of work in each 2 year period. During the development phase, the Company is committed to undertake \$10 work per acre per year for the first 5 years and \$20 per acre for each year thereafter with a minimum of \$1 million per year for all Project Areas.

The diamond agreement is identical to the base metals agreement except that it commences on January 1, 2001 and Project Areas run for 6 years instead of 10.

The Inuvialuit are entitled to a 6% NSR royalty (or its equivalent for diamonds) in the Concession Lands and a 2% royalty in the Area of Mutual Interest, where Crown royalties apply. The Inuvialuit can hold certain claims in the Area of Mutual Interest in which there is a 15 year deferral of Crown royalties. In such cases, the Inuvialuit will receive an additional 4% royalty while the deferral applies. Also, in the exploration phase, the Company is obligated to pay certain administration and land access fees to the Inuvialuit. The administration fee is \$250,000 annually, \$125,000 for each of the base metals and diamond agreements, adjusted annually for inflation based on the Consumers' Price Index from October 6, 2000. The Company is currently in arrears in amounts due to the Inuvialuit under the terms of these agreements amounting to \$693,705 (2001 - \$613,936).

In addition to the Inuvialuit agreements, the Company has an agreement with Falconbridge Limited ("Falconbridge") which entitles it to participate in the exploration and drilling for specific Project Areas on a shared cost basis. Falconbridge may select a specific Project Area for which it will be entitled to an overall 51 % interest, with 49% for the Company, or 39% if the Inuvialuit - as described above - decides to participate in the Project Area. Thereafter Falconbridge can retain 50% of the Company's interest in all subsequent Project Areas, subject to pro rata cost sharing.

4 - RELATED PARTY TRANSACTIONS

Related party transactions consist of compensation paid, or payable, to the company's senior officers and directors for management and professional services; to its chief executive officer / director and a company owned by him of \$10,527 and 250,000 common shares of the company at a recorded value of \$50,000 (\$0.20 per share) for year 2002 and \$117,000 for the year 2001; to the chief financial officer / director of \$24,050 and 321,601 common shares for a recorded value of \$67,900 (\$0.21 per share) for the year 2002 and \$58,000 and 78,755 common shares at a recorded value of \$28,129 (\$0.36 per share) for year 2001; to the corporate secretary (appointed a director in 2002) of \$38,104 and 25,000 common shares for a recorded value of \$7,500 (\$0.30 per

share) for the year 2002; to an independent director (appointed a director in 2002) of 110,000 common shares for a recorded value of \$24,500 (\$0.22 per share) for the year 2002; to a legal firm, of which a director is a partner, of 410,000 common shares at a recorded value of \$90,000 (\$0.22 per share) for the year 2002 and \$42,800 and 160,000 common shares at a recorded value of \$40,000 (\$0.25 per share) for the year 2001. The company's accounts payable as at December 31, 2002 includes \$138,729 and as at December 31, 2001 \$52,395 owing to these parties for unpaid compensation and expenses.

5 - CAPITAL STOCK

(a) Authorized:

The Company's authorized capital consists of an unlimited number of common shares

(b) Issued and outstanding Amount

Common shares	Number	\$
Balance, December 31, 2000	25,323,446	15,234,194
Issued in 2001		
Exercise of common share purchase warrants	1,521,296	1,071,624
Issued under rights offering	61,139	13,888
Private placements	<u>692,700</u>	<u>173,175</u>
Balance, December 31, 2001	27,598,581	16,492,881
Issued in 2002		
Exercise of common share purchase warrants	515,150	120,956
Issued under rights offerings	909,716	181,943
Private placements	1,244,000	179,101
Exercise of options	<u>750,000</u>	<u>150,000</u>
Balance, December 31, 2002	<u>31,017,447</u>	<u>17,124,881</u>

The subscription prices for 3,418,866 shares issued in 2002 were; 200,000 at \$0.10, 1,016,000 at \$0.15, 128,000 at \$0.17, 1,659,716 at \$0.20, 372,700 at \$0.25, 42,220 at \$0.30 and 230 at \$0.50. For the 2,275,135 shares issued in 2001, the subscription prices were; 52,839 at \$0.20, 692,700 at \$0.25, 8,300 at \$0.40 and 1,521,296 at \$0.70/0.71.

(c) Share purchase warrants

As at December 31, 2002, a total of 969,000 common shares were reserved for exercise of share purchase, on the basis of one share for each warrant, all with an expiry date of June 30, 2003. These warrants are exercisable as follows; 142,000 at \$0.15 per share, 267,000 at \$0.17 per share, 140,000 at \$0.20 per share and 420,000 at \$0.25 per share. The following summarizes warrants that have been issued, exercised and expired:

	Number of warrants	
	<u>2002</u>	<u>2001</u>
Balance, beginning of year	692,700	2,228,093
Issued on issuance of shares for cash	1,808,716	692,700
Exercised	(565,150)	(1,521,296)
Expired	<u>(967,266)</u>	<u>(706,797)</u>
Balance, end of year	<u>969,000</u>	<u>692,700</u>

(d) Options

Presently the Company does not maintain an Incentive Stock Option Plan, and no options are outstanding. In the year 2001, options on 2,520,000 shares were granted at a weighted average exercise price of \$0.92 per share. These options were not exercised and expired in the year 2002. In 2002 options on 750,000 shares were granted and exercise at \$0.20 per share during the year.

(e) Subsequent issue of shares

Subsequent to December 31, 2002, a total of 2,662,660 additional shares were issued under private placements at a subscription price of \$0.10 per share.

6. INCOME TAXES

(a) At December 31, 2002, the Company has non-capital losses of \$5,653,000 that can be used to reduce future taxable income. These losses expire as follows:

2003	\$ 140,000	2004	1,094,000
2005	844,000	2006	719,000
2007	1,049,000	2008	931,000
2009/12	876,000		

As at December 31, 2002 the tax effects of temporary timing differences that give rise to significant components of the future tax asset computed at a federal and provincial aggregate rate of 44%, were as follows:

Non-capital loss carry forward	\$2,487,000
Share issue costs	<u>47,000</u>
	2,534,000
Less Valuation allowance	<u>(2,534,000)</u>
Net asset	-

(b) The Company's provision for income taxes differ from the amounts computed by applying the basic aggregate federal and provincial rate of 44% to the loss for the year before taxes, as shown in the following table:

	2002	2001
Statutory rate applied to loss for the year before income taxes	\$276,000	\$287,000
Non-deductible items	(6,000)	(10,000)
Share issue cost	86,000	138,000
Tax benefit not recognized on current year's losses	<u>(356,000)</u>	<u>(415,000)</u>

(c) The Company has recognized future income taxes of \$231,038 (2001 - \$3,348,304) by applying a combined rate (both federal and provincial) of 44% to the amounts renounced to the flow-through shareholders. These amounts are treated as "Cost of issuing shares" in the Statement of Loss and Deficit.

7. INTEREST RECEIVED AND PAID

During the year 2002 interest paid was \$35,281, with no interest received and in the year 2001, interest paid of \$1,886 and interest received of \$6,987.

8. COMPARATIVE FIGURES

The comparative figures on the Balance Sheet for "Future income tax" and "Deficit" and on the Statement of Loss and Deficit for "Cost of issuing shares" have been restated to reflect the future income taxes as described in note 6(c) above. This information was previously disclosed in a note to the annual financial statements, alternative to actual recording in the accounts of the Company.

