

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, 2003 and 2002, 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, 2003 and 2002 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, March 31, 2004

DARNLEY BAY RESOURCES LIMITED
FINANCIAL STATEMENTS
4TH QUARTERS (unaudited) and YEARS (audited) ENDED DECEMBER 31, 2003 and 2002

BALANCE SHEET	December 31	
	2003	2002
	\$	\$
Cash	753	27,373
Goods and services taxes (GST) recoverable	26,386	8,815
Current assets	27,139	36,188
Deposits	437,193	170,601
Mineral property and related expenditures	6,389,649	12,353,706
Total assets	6,853,981	12,560,495
Accounts payable and accrued liabilities	1,668,691	1,214,111
Advance from joint venture partner	290,000	
Future income taxes (note 6)	1,885,996	3,579,342
Capital stock (note 5)	17,670,837	17,124,881
Deficit	(14,661,543)	(9,357,839)
Shareholders' equity	3,009,294	7,767,042
Liabilities and shareholders' equity	6,853,981	12,560,495

STATEMENT OF MINERAL PROPERTIES AND RELATED EXPENDITURES	4th Quarter		Year		Cumulative
	2003	2002	2003	2002	December 31,
	\$	\$	\$	\$	2003
Concession and permit fees to Inuvialuit and other agencies (note 3)	98,052	74,215	300,434	288,146	3,755,626
Professional and technical services provided by geophysicists, geologists and others	58,074	58,274	90,884	114,960	2,228,148
Technical services provided by management	22,683	21,342	87,158	84,175	1,098,122
Legal fees applicable to exploration agreements	7,500	22,500	27,500	22,500	232,570
Travel and project presentations			55	2,224	287,122
Wages and accomodation facilities	5,250	2,080	3,270	(6,127)	992,958
Air charters and fuel					2,090,663
Site administration		(399)	119	8,508	205,705
Equipment and supplies	25,870		26,523	(2,855)	859,019
Drilling contracts				(21,390)	890,186
Environmental surveys					249,530
Total expenditures for period	217,429	178,012	535,943	490,141	12,889,649
Write down on mineral properties expenditures	(6,500,000)		(6,500,000)		(6,500,000)
Cumulative expenditures beginning of period	12,672,220	12,175,694	12,353,706	11,863,565	
Cumulative expenditures at end of period	6,389,649	12,353,706	6,389,649	12,353,706	6,389,649

The accompanying notes are an integral part of these financial statements

Approved by the Board:

(Signed) Leon La Prairie, Director (Signed) William Allen, Director

	4th Quarter		Year		Cumulative
	2003	2002	2003	2002	December 31, 2003
	\$	\$	\$	\$	\$
STATEMENT OF LOSS AND DEFICIT					
Management and administrative services	50,627	58,659	215,891	232,505	1,667,539
Consultants					606,269
Legal and audit	22,675	42,500	46,275	83,879	656,029
Promotion	287	5,872	2,926	32,595	408,208
Communications	2,757	3,015	9,960	14,047	146,079
Rent	40,473	26,648	161,903	140,777	714,181
Stock transfer and shareholders' expenses	1,550	4,252	36,575	53,773	310,378
Office supplies and miscellaneous	1,551	3,387	8,331	18,740	252,947
Depreciation office equipment					30,736
Insurance		3,968		3,824	17,748
Capital tax		10,392	6,342	37,737	70,751
Provision for uncollected receivable					55,295
Interest and other financial expenses	2,429	1,714	11,070	8,805	59,394
Write down on mineral properties expenditures	6,500,000		6,500,000		6,500,000
NET LOSS FOR THE PERIOD	6,622,349	160,407	6,999,273	626,682	11,495,554
Deficit at beginning of the period	9,959,194	9,133,336	9,357,839	8,514,316	
Cost (recovered) of issuing shares (note 6)	(1,920,000)	64,096	(1,695,569)	216,841	3,165,989
DEFICIT AT END OF THE PERIOD	14,661,543	9,357,839	14,661,543	9,357,839	14,661,543
LOSS PER SHARE (cents)	0.187	0.005	0.211	0.021	
STATEMENT OF CASH FLOWS					
Net loss for the period	(6,622,349)	(160,407)	(6,999,273)	(626,682)	(11,495,554)
Depreciation					30,736
(Increase) decrease prepaid expenses	13,491	162,097		228,328	0
Advance from joint venture partner	290,000		290,000		290,000
(Increase) decrease in GST recoverable	(12,397)	150	(17,571)	41,756	(26,386)
Increase (decrease) in accounts payable	335,311	52,228	454,580	218,684	1,668,691
CASH USED IN OPERATING ACTIVITIES	(5,995,944)	54,068	(6,272,264)	(137,914)	(9,532,513)
Purchase of fixed assets					(30,736)
(Increase) decrease permits and security deposits	(287,193)		(266,592)		(437,193)
Increase mineral property expenditures	(217,429)	(178,012)	(535,943)	(490,141)	(12,889,649)
Write down on mineral properties expenditures	6,500,000		6,500,000		6,500,000
CASH USED IN INVESTING ACTIVITIES	5,995,378	(178,012)	5,697,465	(490,141)	(6,857,578)
Issue of common shares, net of cost of issue		145,675	545,956	632,000	17,670,837
Cost of issuing shares and warrants		(64,096)	(224,431)	(216,841)	(1,279,993)
Tax-effect of flow-through shares		64,096	226,654	231,038	
CASH FROM FINANCING ACTIVITIES		145,675	548,179	646,197	16,390,844
INCREASE (DECREASE) IN CASH	(566)	21,731	(26,620)	18,142	753
Cash at beginning of the period	1,319	5,642	27,373	9,231	
CASH AT END OF THE PERIOD	753	27,373	753	27,373	

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, 2003 and 2002

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 Company has a working capital deficiency of \$1,641,552. 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. These financial statements have been prepared on a going concern basis which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business.

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.

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.

STOCK OPTION COMPENSATION

Effective January 1, 2003, the Company has adopted, on a prospective basis, the fair value method of accounting for

all stock option awards. Applying this method, the Company recognizes compensation expense for all stock options awarded subsequent to December 31, 2002, based on the fair value of the options on the date of grant which is determined using the Black Scholes option pricing model. The fair value of the options is expensed over the vesting period of the option. The Company recognized no compensation for stock options issued before January 1, 2003.

3 - AGREEMENTS & MINERAL PROPERTY AND RELATED EXPENDITURES

AGREEMENTS WITH INUVIALUIT LAND CORPORATION (“INUVIALUIT”)

Prior Agreements with the Inuvialuit

The Company has had two prior agreements, dated March 16, 2001, with the Inuvialuit. One dealt with base metals, the other with diamonds. The agreements covered an area of about 14,000,000 acres from latitude 68' north to 70' north and longitudes 120' 40 minutes west to 128' west. Of this area, the Inuvialuit own the mineral rights in 450,000 acres centered around Paulatuk (the “Concession Land”). The rest of the area was termed the Area of Mutual Interest. The Company’s rights in the Concession Lands have ended, and certain of the lands in the area of mutual interest have been abandoned and accordingly, the Company has written down the mineral properties interest by \$6,500,000 in 2003. In the Area of Mutual Interest, the Company can acquire and hold prospecting permits and mining claims which are issued by the Crown. Except where the Company enters into new agreements with the Inuvialuit, the rights of the Inuvialuit in the Area of Mutual Interest are to continue under certain circumstances. Under the agreements, in the Area of Mutual Interest, the Inuvialuit are entitled to a 2% royalty, where the 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).

New Agreement with the Inuvialuit

The Company/Diadem joint venture, (outlined below) entered into a letter agreement of November 24, 2003 with the Inuvialuit under which the Company and Diadem will enter into a Cooperation and Benefits Agreement with the Inuvialuit. This agreement covers an area in the Inuvialuit Settlement Region around Paulatuk of about 57,000 square kilometers (excluding the area around Paulatuk in which the Inuvialuit own the mineral rights and excluding the Tukut Nogait National Park).

The agreement is for 5 years from January 1, 2004 with provisions for renewal and termination consistent with the joint venture’s mining rights in the area. The joint venture will be granted access to the Inuvialuit lands to conduct exploration, development and extraction operations for rough diamonds. The joint venture will be required to obtain all necessary Inuvialuit permits and approvals, and will pay the fees and charges under the Inuvialuit Rules with a minimum amount payable each year of \$50,000. The joint venture is to incur at least \$2 million of work by June 30, 2005. The Inuvialuit will receive a 2% diamond royalty on mining rights exploited by the joint venture. (The Inuvialuit can hold certain claims in the area 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.) If the joint venture completes a positive feasibility, the Inuvialuit have the right to acquire up to a 10% participating interest by paying the corresponding percentage of the cost of the feasibility study.

JOINT VENTURE AGREEMENT WITH DIADEM RESOURCES LTD (“DIADEM”)

On June 24, 2003, the Company entered into a letter agreement with Carnarvon Capital Corporation (“Carnarvon”) for joint venture diamond exploration in a corridor measuring 150 miles by 95 miles (approximately 8 million acres) near Paulatuk in the Inuvialuit Settlement Region in the Northwest Territories. The principal terms are as follows:

- Carnarvon is to raise \$5 million to explore for diamonds. The funds are to be spent by June 30, 2006. When that is done, Carnarvon will be entitled to select up to 2.5 million acres of the corridor for further exploration, and Carnarvon will have earned an undivided 50% participating interest in the selected lands, with the Company holding the other 50%. The interests of Carnarvon and the Company will be subject to such equity rights as may be held by the Inuvialuit, and by such third parties as may receive

rights if land is acquired from third parties.

- If there is a decision to carry out a feasibility study on the lands selected by Carnarvon, it will have the right to fund the feasibility study, and if the property is placed into commercial production Carnarvon's interest will increase to 75% and the Company's interest will decrease to 25%.
- When the \$5 million is spent, the parties will allocate at least \$2.5 million of the \$5 million to the selected lands. As to the portion of the \$5 million that is not allocated to the selected lands, Carnarvon will be entitled either to convert that amount to common shares of the Company at the then market price, subject to regulatory approval, or to convert that amount (in amounts of at least \$1 million) into a diamond royalty equal to 1% for each full \$1 million spent and not allocated to the select lands. The Company will have the right to purchase such a royalty for \$1.5 million for each 1% of royalty if the purchase is made within 90 days of a bankable feasibility study, or thereafter for \$2.5 million if the purchase is within 90 days of the start of commercial production.
- When Carnarvon arranges the first \$2 million of the \$5 million, the Company will issue 500,000 common shares to Carnarvon subject to regulatory approval

Subsequently the Company agreed to the transfer by Carnarvon of its interest in the agreement to Diadem and to change the time by which the \$5 million exploration costs are to be incurred from June 30, 2006 to December 31, 2006 and as the original agreement involved only the area north of the 68th parallel, the joint venture was extended south of the 68th parallel. In this expanded joint venture area, the Company and Diadem each have a 50% interest (with Diadem having the right to go to a 75% interest by financing a feasibility study for a diamond mine). In the area of the expanded joint venture, the Company and Diadem are to finance exploration costs equally.

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. Compensation to senior officers consist of; \$125,000 to the chief executive officer / director and a company owned by him of which \$33,700 was paid for the year 2003 (\$99,000 of which \$53,695 was paid for the year 2002), \$79,500 to the chief financial officer of which \$11,500 was paid for the year 2003 (\$76,500 of which \$24,050 was paid for the year 2002) and \$48,510 to the corporate secretary / director of which \$17,250 was paid for the year 2003 (\$46,560 of which \$35,600 was paid for the year 2002.. The lack of available funds from time to time restricts cash compensation on a regular basis and settlement of arrears is made, from time to time, by the issue of common shares, issued at prevailing market values or greater. As at September 30, 2003 the Company owed these officers \$152,688 collectively for unpaid compensation and expenses.

In addition a director, who is a geophysicist provided service for \$60,025 and another director, a lawyer, for \$38,500 all of which were settled for the issue of shares

5 - CAPITAL STOCK AND SUBSEQUENT EVENTS

(a) Authorized:

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

(b) Issued and outstanding

	Number	\$
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	31,017,447	17,124,881

Issued in 2003

Exercise of common share purchase warrants	969,000	199,690
Private placements	<u>3,337,660</u>	<u>346,266</u>
Balance, December 31, 2003	<u>35,324,107</u>	<u>17,670,837</u>

The subscription prices for 4,306,660 shares issued in 2003 were; 3,012,660 at \$0.10, 125,000 at \$0.12, 342,000 at \$0.15, 267,000 at \$0.17, 140,000 at \$0.20 and 420,000 at \$0.250. For the 3,418,866 shares issued in 2002, the subscription prices 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.

Subsequent to December 31, 2003 an additional 795,999 shares were issued for settlement of debts, 296,000 shares at \$0.14 and 499,999 shares at \$0.15 plus warrants to purchase 148,000 shares at an exercise price of \$0.30 per share with an expiry date of June 30, 2004..

Under a joint venture agreement with Diadem Resources Ltd. (previously with Carnarvon Capital Corporation), upon the completion by Diadem of the first \$2,000,000 of its commitment for \$5,000,000 of financing, subject to regulatory approval, the Company will grant Diadem 500,000 common shares. There are no other options or share purchase warrants outstanding and as of the date of release of these financial statements, 41,866 shares were held in escrow.

6. INCOME TAXES

- (a) At December 31, 2003, the Company has non-capital losses of \$6,009,000 that can be used to reduce future taxable income. These losses expire as follows:

2004	1,094,000	2008	931,000
2005	844,000	2009	770,000
2006	719,000	2010	563,000
2007	1,049,000	2011/14	39,000

- (b) As at December 31, 2003 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	\$2,645,000
Share issue costs	<u>17,000</u>
	2,662,000
Less Valuation allowance	<u>(2,662,000)</u>
Net asset	-

- (c) 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:

	2003	2002
Statutory rate applied to loss for the year before income taxes	\$ 3,080,000	\$276,000
Non-deductible items	(2,860,000)	(6,000)
Share issue cost	30,000	86,000
Tax benefit not recognized on current year's losses	<u>(250,000)</u>	<u>(356,000)</u>
	Nil	Nil

- (d) Future income taxes of \$1,885,996 as disclosed in the Balance Sheet, are applicable to \$8,649,990 of exploration expenditures renounced to shareholders on the issue of flow-through shares. The future income tax balance was reduced in 2003 by \$1,920,000 resulting from the write down of mineral properties. The applicable income taxes have been calculated by applying a combined rate (both federal and provincial) of 44% to the amounts renounced to flow-through shareholders. In the Statement of Loss and Deficit, the 'Cost of issuing shares', accumulated to December 31, 2003 of \$3,165,989, in addition to the \$1,885,996 applicable to flow-through shares, includes \$1,279,993

of commissions and other expenses disbursed on the issue of shares.

7. INTEREST RECEIVED AND PAID

During the year 2003 interest of \$123,023 was recorded of which \$11,076 was applicable to administration and \$111,947 to mineral properties. For the year 2002 the total was \$35,281 of which \$8,805 was applicable to administration and \$26,476 to mineral properties. No interest was received for either year.