

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, 2005 and 2004, 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, 2005 and 2004 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 2, 2006

DARNLEY BAY RESOURCES LIMITED
FINANCIAL STATEMENTS

4TH QUARTERS (unaudited) and YEARS (audited) ENDED DECEMBER 31, 2005 and 2004

BALANCE SHEET	December 31	
	2005	2004
	\$	\$
Cash	3,808	2,099
Goods and services taxes (GST) recoverable	1,986	11,348
Current assets	5,794	13,447
Deposits	233,468	233,468
Mineral property and related expenditures	1	6,401,310
Total assets	239,263	6,648,225
Accounts payable and accrued liabilities	2,476,915	2,077,359
Future income taxes (note 6)		867,145
Capital stock (note 5)	18,006,510	18,006,510
Stock options (note 5)	199,030	
Deficit	(20,443,192)	(14,302,789)
Shareholders' equity (deficit)	(2,237,652)	3,703,721
Liabilities and shareholders' (deficit) equity	239,263	6,648,225

GOING CONCERN BASIS (note 1)

STATEMENT OF MINERAL PROPERTIES AND RELATED EXPENDITURES	4th Quarter		Year		Cumulative
	2005	2004	2005	2004	December 31,
	\$	\$	\$	\$	2005 *
Concession and permit fees to Inuvialuit and other agencies (note 3)	(67,784)	18,191		85,520	3,841,146
Professional and technical services provided by geophysicists, geologists and others	4,843	1,172	11,016	42,983	2,275,056
Technical services provided by management	14,667	19,391	58,667	83,341	1,240,130
Legal fees applicable to exploration agreements		19,018		(7,500)	225,071
Travel and project presentations				2,675	289,796
Wages and accomodation facilities					992,958
Geophysical surveys					2,090,663
Site administration					205,165
Equipment and supplies		2,287	3,750	1,360	864,129
Drilling contracts					890,186
Environmental surveys					249,530
Total expenditures for period	(48,274)	60,059	73,433	208,379	13,163,830
Adjustment prior years expenditures	(7,631)		(7,631)		
Write down on mineral properties expenditures	(6,467,110)	(196,718)	(6,467,111)	(196,718)	(13,163,829)
Cumulative expenditures beginning of period	6,523,016	6,537,969	6,401,310	6,389,649	
Cumulative expenditures at end of period	1	6,401,310	1	6,401,310	1

The accompanying notes are an integral part of these financial statements

* Cumulative amounts are from commencement of operations in 1993

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, 2005 and 2004

	4th QUARTER		YEAR	
	2005	2004	2005	2004
	\$	\$	\$	\$
STATEMENT OF LOSS AND DEFICIT				
Management and administrative services	28,793	36,058	129,753	178,434
Stock option compensation	120,330		199,030	
Legal and audit	7,599	1,018	45,724	66,730
Promotion			118	2,145
Communications	602	2,526	2,971	8,429
Rent	14,341	32,640	46,364	126,627
Stock transfer and shareholders' expenses	738	16,819	23,168	39,736
Office supplies and miscellaneous	5,763	2,511	14,206	17,281
Interest and other financial expenses	90,023	14,495	99,819	23,997
Adjustment previous years expenses	(20,716)		(20,716)	
Write down on mineral properties expenditures	6,467,111	196,718	6,467,111	196,718
LOSS BEFORE INCOME TAXES	6,714,584	302,785	7,007,548	660,097
Future income tax recovery	(867,145)	(86,556)	(867,145)	(86,556)
NET LOSS FOR THE PERIOD	5,847,439	216,229	6,140,403	573,541
Deficit at beginning of the period	14,595,753	14,086,560	14,302,789	13,729,248
DEFICIT AT END OF THE PERIOD	20,443,192	14,302,789	20,443,192	14,302,789
LOSS PER SHARE (cents)	0.001	0.006	0.165	0.016
STATEMENT OF CASH FLOWS				
Net loss for the period	(5,847,439)	(216,229)	(6,140,403)	(573,541)
Stock based compensation	120,330		199,030	
Write down mineral properties net of taxes	6,467,111	196,718	6,467,111	196,718
Future income tax recovery	(867,145)	(86,556)	(867,145)	(86,556)
Advance from (repayment to) joint venture partner				(203,725)
(Increase) decrease in GST recoverable	5,671	(8,256)	9,362	15,037
Increase in accounts payable	65,146	174,802	399,556	322,394
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(56,326)	60,479	67,511	(329,673)
Decrease permits and security deposits				203,725
(Increase) decrease in mineral property expenditures	55,905	(60,059)	(65,802)	(208,379)
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	55,905	(60,059)	(65,802)	(4,654)
Issue of common shares				335,673
CASH FROM FINANCING ACTIVITIES				335,673
INCREASE (DECREASE) IN CASH	(421)	420	1,709	1,346
Cash at beginning of the period	4,229	1,679	2,099	753
CASH AT END OF THE PERIOD	3,808	2,099	3,808	2,099

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, 2005 and 2004

1 -NATURE OF OPERATIONS AND GOING CONCERN CONSIDERATIONS

The objective of Darnley Bay Resources Limited (the "Company") is to explore for base metals and diamonds in the Northwest Territories, Canada. The Company is considered to be in the development stage. The recovery of amounts capitalized as Mineral Property and Related Expenditures depends on 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. The Company has no source of operating cash flow and could possibly be considered to be in arrears in meeting some property access commitments (see note 3). However, in order for the property access grantor to exercise default mechanisms, the access grantor must issue a default notice in writing, the date from which the Company has six months to satisfy the commitments that are in arrears. To date, the property access grantor has not issued a default notice. The Company, as at December 31, 2005, had a working capital deficit of \$2,471,121 (2004-\$ 2,063,912).

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 mineral rights 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

The Company has a stock option plan, which is described in note 5. The company accounts for stock-based compensation using the fair-value method. Under the fair value method, stock-based payments are measured at the fair value of equity instruments and are amortized over the vesting period. The offset to the recorded cost is stock options in shareholder's equity.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, including property and equipment and other assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

LOSS PER SHARE

Basic loss per share is computed by dividing loss available to common shareholders by the weighted average number of common shares outstanding during the year. The treasury stock method is used to calculate diluted loss per share. Diluted loss per share is similar to basic loss per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding assuming that options with an average market price for the year greater than their exercise price are exercised and the proceeds used to repurchase common shares. As a result of the loss for each of the reporting years, the potential effect of exercising stock options has not been included in the calculation of diluted loss per share as to do so would be anti-dilutive.

ASSET RETIREMENT OBLIGATION

On January 1, 2005, the Company adopted the new CICA accounting standard for asset retirement obligations. Under this new standard, the Company recognizes fair value of a future asset retirement obligation as a liability in the year in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. The Company concurrently recognizes a corresponding increase in the carrying amount of the related long-lived asset that is depreciated over the life of the asset. The fair value of the asset retirement obligation is estimated using the expected cash flow approach that reflects a range of possible outcomes discounted at a credit-adjusted risk-free interest rate. Subsequent to the initial measurement, the asset retirement obligation is adjusted at the end of each year to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. Changes in the obligation due to changes in estimated cash flows are recognized as an adjustment of the carrying amount of the long-lived asset that is depreciated over the remaining life of the asset. The impact of this change in accounting policy was not material.

USE OF ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Significant areas requiring the use of management estimates relate to the determination of carrying value of mining interests. Actual results could differ from these estimates.

3 - AGREEMENTS & MINERAL PROPERTY AND RELATED EXPENDITURES

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

Under an agreement (originally, June 24, 2003) with Carnarvon Capital Corporation (“Carnarvon”) and Diadem Resources Limited (“Diadem”) the Company agreed for joint venture diamond exploration in a corridor near Paulatuk in the Inuvialuit Settlement Region (“Inuvialuit”) in the Northwest Territories. The principal terms, as amended from time to time, are as follows:

- Carnarvon/Diadem agreed to raise and spend funds to explore for diamonds in the corridor. The earn-in amount is now a further \$2,100,000 covering a period commencing with the 2005 calendar year and up to December 31, 2007.
- When the funds are spent, Diadem is entitled to select up to 2.5 million acres of the corridor for further exploration, and Diadem will have earned an undivided 50% participating interest in the selected lands, with the Company holding the other 50%. The interests of Diadem and the Company will be subject to such equity rights as may be held by the Inuvialuit, and by such third parties as they may retain if land is acquired from third parties. If there is a

- decision to carry out a feasibility study on the lands selected by Diadem, it will have the right to fund the feasibility study, and if the property is placed into commercial production Diadem's interest will increase to 75% and the Company's interest will decrease to 25%
- Under the agreement, when Carnarvon/Diadem arranges the first \$2 million, the Company will issue 500,000 common shares to Carnarvon.

AGREEMENT WITH THE INUVIALUIT LAND CORPORATION ("INUVIALUIT")

On February 4, 2004, the Company/Diadem joint venture entered into an agreement with the Inuvialuit under which the Company/Diadem joint venture will enter into a Cooperation and Benefits Agreement with the Inuvialuit. The principal terms are as follows:

- The 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 Company/Diadem 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 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 September 30, 2005. All costs to be expended under the terms of the agreement have been committed to be expended by Diadem under the terms of the Joint Venture Agreement. Diadem has not to date provided sufficient information to the company in order to assess the quantification of expenditures made by Diadem under the terms of the Agreement. However Diadem, in its quarterly reporting for its three months ended February 28, 2006 had indicated that it had expended approximately 1.7 million to February 28, 2006. The Company has not received a notice of default from the Inuvialuit to date (see note 1).
- 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 and can obtain a 15 year deferral of Crown royalties. If the Inuvialuit do so, 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.

Although the Company intends on pursuing further work programs on the properties in accordance with the above agreements, due to uncertainty regarding the Company meeting its mineral property commitments, the Company has written down its investment in mineral properties during the year (see note 1).

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. The lack of available funds restricts cash compensation on a regular basis and settlement of arrears has been made from time to time, in the past, by the issue of common shares, issued at prevailing market values or greater. The Company's accounts includes the following compensation to the related parties for 2005 and 2004 and the balances remaining unpaid to them, for compensation and expenses, as at December 31, 2005.

Chief executive officer / director	2005	\$108,000	2004	\$100,000	\$329,250 unpaid
Chief financial officer	2005	\$ 79,500	2004	\$78,000	\$178,498 unpaid
Corporate secretary / director	2005	\$ 10,920	2004	\$31,725	\$ 42,843 .unpaid
Director (geophysicist)	2005	\$ 20,400	2004	\$13,571	\$ 20,954 unpaid
Director (lawyer)	2005	\$ 75,000	2004	\$52,425	\$ 84,335 unpaid
Director (geologist)	2005	\$ 4,187	(appointed 2005)		\$ 7,400 unpaid

5 - CAPITAL STOCK

(a) Authorized:

An unlimited number of common shares

(b) Issued and outstanding

	Number	\$
Balance, December 31, 2003	35,324,107	17,670,837
Issued in 2004		
Private placements	<u>1,792,499</u>	<u>335,673</u>
Balance, December 31, 2004	37,116,606	18,006,510
Issued in 2005	<u>Nil</u>	<u>Nil</u>
Balance, December 31, 2005	<u>37,116,606</u>	<u>18,006,510</u>

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No shares were issued in 2005. The subscription prices for 1,792,499 shares issued in 2004 were; 296,000 at \$0.14, 499,999 at \$0.15 and 996,500 at \$0.22.

(c) Options and commitment for issue of shares

The Company maintains a Stock Option Plan for the benefit of directors, officers, employees, consultants and other service providers of the Company in order to assist the Company in attracting, retaining, and motivating such persons by providing them with the opportunity, through stock options to acquire an increased proprietary interest in the Company. Under the plan, options are non-assignable and may be granted for a term not exceeding five years. The number of common shares that may be reserved for issue under the plan shall not exceed 10% of the common shares outstanding with no more than 5% applicable to any one optionee in any 12 month period. The exercise price of an option may not be lower than the closing price of the common shares on the TSX Venture Exchange, subject to applicable discounts, on the business day immediately preceding the date the option is granted. The options are non-transferable. Outstanding options may be adjusted by the Board of Directors in certain events, as to exercise price and number of common shares, to prevent dilution or enlargement. Pursuant to the stock option plan, the Company has granted options to its directors and officers to purchase up to a total of 3,600,000 shares at an issue price of \$0.13 per share and 100,000 at an issue price of \$0.10 per share. These options expire on November 4, 2009 and none of the options have been exercised to date.

The following summarizes the employee and director stock options that have been granted, exercised or forfeited during the years ended December 31, 2005 and 2004:

	Options	Value	Weighed average exercise price
Balance, January 1, 2004 and December 31, 2004	\$ -	\$ -	\$ -
Granted	3,700,000	199,030	0.13
Forfeited	-	-	-
Exercised	<u>-</u>	<u>-</u>	<u>-</u>
Balance, December 31, 2005	<u>\$3,700,000</u>	<u>\$ 199,030</u>	<u>\$ 0.13</u>

The Company provides compensation to directors, employees and consultants in the form of stock options. The fair value of the options granted are estimated on the dates of grant using a Black-Scholes option pricing model with the following assumptions:

	2005	2004
Risk-free interest rate	4.0%	-
Expected life	5.0 years	-
Estimated volatility in the market price of the common shares	80%	-
Weighted average grant date fair value per share of options granted during the year	\$0.05	-
Dividend yield	Nil	-

During 2005, the Company granted 3,700,000 (2004- nil) options at a weighted average exercise price of \$0.13 (2004- \$nil). The stock-based compensation expense related to these options for the year ended December 31, 2005 is \$199,030 (2004- \$nil).

Under its 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 exploration for diamonds, subject to regulatory approval, the Company will grant Carnarvon 500,000 common shares. Diadem's financial statements as at February 28, 2006 indicates that approximately \$1.7 million has expended to date.

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, 2005, the Company has non-capital losses of \$5,760,078 that can be used to reduce future taxable income. These losses expire as follows:

2006	\$843,934	2007	\$723,032	2008	\$1,059,842
2009	\$941,564	2010	\$809,149	2011	\$ 559,902
2012	\$494,417	2013	\$328,238		

(b) As at December 31, 2005 the tax effects of temporary timing differences that give rise to significant components of the future tax asset (liability) computed at current rates were as follows:

Future Tax Asset	
Non-capital loss carry forward	\$2,080,540
Mining interests	1,626,829
Less Valuation allowance	<u>(3,707,369)</u>
Tax benefit recognized	Nil

(c) The Company's provision for current income taxes differ from the amounts computed by applying current rates to the loss for the year before taxes, as shown in the following table:

	2005	2004
Statutory rate applied to loss for the year before income taxes (\$2,217,914)		(\$290,442)
Increase in taxes resulting from:		
Non-deductible stock-based compensation	71,890	-
Other items	(187,047)	88,550
Share issue cost	(2,850)	(16,150)
Tax loss not benefitted	2,335,921	218,042
Tax benefit recovered on mining interest	<u>(867,145)</u>	<u>(86,556)</u>
Future income tax recovery	<u>(867,145)</u>	<u>(86,556)</u>

(d) Future income taxes as presented in the Balance Sheet, \$nil (2004-\$867,145) as at December 31 2005, result from exploration expenditures renounced to shareholders on the issue of flow-through shares. The future income tax balance was reduced in 2003, 2004 and 2005 due to the write down of mineral property expenditures. The applicable income taxes have been calculated by applying current rates to the amounts renounced to flow-through shareholders.

7. INTEREST RECEIVED AND PAID

During the year 2005 interest of \$99,819 was recorded which was net of \$946 interest income. For the year 2004 the total was \$23,977 without any interest income..

