

DARNLEY BAY RESOURCES LIMITED

(A Development Stage Company)

FINANCIAL STATEMENTS

DECEMBER 31, 2006 and 2005

DARNLEY BAY RESOURCES LIMITED

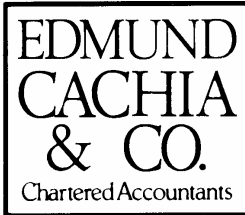
(A Development Stage Company)

FINANCIAL STATEMENTS

DECEMBER 31, 2006 and 2005

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AUDITORS' REPORT

To the Shareholders of
Darnley Bay Resources Limited:
(A Development Stage Company)

We have audited the balance sheets of Darnley Bay Resources Limited (A Development Stage Company) as at December 31, 2006 and 2005 and the statements of 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. Those 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, 2006 and 2005, the results of its operations and the cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) "Edmund Cachia & Co."

Toronto, March 30, 2007

CHARTERED ACCOUNTANTS

DARNLEY BAY RESOURCES LIMITED
(A Development Stage Company)

BALANCE SHEETS

DECEMBER 31

	ASSETS	
	2006	2005
CURRENT		
Cash	\$ 35,655	\$ 3,808
Accounts receivable	<u>2,682</u>	<u>1,986</u>
	38,337	5,794
DEPOSITS	-	233,468
MINERAL PROPERTY (note 1 and 3)	<u>1</u>	<u>1</u>
	<u>\$ 38,338</u>	<u>\$ 239,263</u>

LIABILITIES

CURRENT		
Accounts payable and accrued liabilities (note 4)	\$ 2,440,678	2,476,915

SHAREHOLDERS' DEFICENCY

CAPITAL STOCK (notes 5)	18,147,232	18,006,510
CONTRIBUTED SURPLUS (note 5c)	199,030	199,030
DEFICIT	(<u>20,748,602</u>)	(<u>20,443,192</u>)
	(<u>2,402,340</u>)	(<u>2,237,652</u>)
	<u>\$ 38,338</u>	<u>\$ 239,263</u>

Subsequent events (note 9)
Going concern basis (note 1)

Approved by the Board:
(Signed) "Leon La Prairie" _____, Director
(Signed) "Patricia Mannard" _____, Director

The accompanying notes are an integral part of the financial statements.
DARNLEY BAY RESOURCES LIMITED
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STATEMENTS OF LOSS AND DEFICIT

FOR THE YEAR ENDED DECEMBER 31

	2006	2005
EXPENSES		
Office administration services	\$ 121,865	\$ 115,214
Project evaluation costs (note 3)	113,864	22,000
Professional fees	122,206	45,724
Premises rent	46,307	25,648
Shareholder communication	40,870	33,003
Stock option compensation cost	-	199,030
Interest	53,533	99,818
Other general	1,068	-
Write down of mineral property cost	<u>-</u>	<u>6,467,111</u>
Loss before the under noted	(499,713)	(7,007,548)
Write down of payables	<u>194,303</u>	<u>-</u>
	(305,410)	(7,007,548)
Future income tax recovery (note 6b)	<u>-</u>	<u>867,145</u>
NET LOSS FOR THE YEAR	(305,410)	(6,140,403)
DEFICIT AT BEGINNING OF THE YEAR	(20,443,192)	(14,302,789)
DEFICIT AT END OF THE YEAR	(<u>\$ 20,748,602</u>)	(<u>\$ 20,443,192</u>)
Basic and diluted loss per share (note 2)	<u>\$ 0.01</u>	<u>\$ 0.165</u>
Weighted average number of common shares outstanding	<u>37,594,897</u>	<u>37,116,606</u>

The accompanying notes are an integral part of the financial statements.
DARNLEY BAY RESOURCES LIMITED
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STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31

	2006	2005
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net loss for the year	(\$ 305,410)	(\$ 6,140,403)
Non-cash items:		
Decrease in deposits	233,468	-
Stock option cost	-	199,030
Write down of payables	194,303	-
Write down of mineral property cost net of taxes	-	6,467,111
Future income tax recovery	-	(867,145)
Net changes in working capital balances:		
(Increase) decrease in accounts receivable	(696)	9,362
Increase (decrease) in accounts payable and accrued liabilities	(160,318)	399,556
Cash provided by (used in) operations	(38,653)	67,511
CASH USED IN INVESTING ACTIVITIES:		
Increase in deferred mineral property costs	(-)	(65,802)
Cash used in investing activities	(-)	(65,802)
CASH PROVIDED BY FINANCING ACTIVITIES:		
Issue of common shares	70,500	-
Cash provided by financing	70,500	-
INCREASE IN CASH POSITION	31,847	1,709
CASH POSITION AT BEGINNING OF THE YEAR	3,808	2,099
CASH POSITION AT END OF THE YEAR	<u>\$ 35,655</u>	<u>\$ 3,808</u>
Supplementary disclosure of non-cash items		
Shares issued for non-cash consideration:		
Issuance of common shares for debt	\$ 70,222	\$ -

The accompanying notes are an integral part of the financial statements.
DARNLEY BAY RESOURCES LIMITED
(A Development Stage Company)

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

1 - NATURE OF OPERATIONS AND GOING CONCERN CONSIDERATIONS:

The Company is in the business of exploring for base metals and diamonds in the Northwest Territories, Canada. To date, the Company has not earned significant revenues and still is considered to be in the development stage. The Company's shares are listed on the TSX Venture Exchange.

The recovery of amounts capitalized as Mineral Property Costs is dependent upon the discovery of economically recoverable ore reserves, the ability of the Company to obtain necessary financing to explore and develop potential ore reserves, future profitable production, or alternatively, upon the Company's ability to dispose of its interests on an advantageous basis. At the 2005 year end, the carrying value of the mineral exploration property was considered unrecoverable and written down to \$1 due to uncertainties in financing. The Company continues to retain interest in its property and looks to future funding opportunities and ongoing exploration for both base metals and diamonds.

As at December 31, 2006, the Company has a working capital deficiency of \$2,402,341 (2005 - \$2,471,121). Management is currently pursuing several financing alternatives to raise capital. It is not possible to determine with any certainty, the success or adequacy of these initiatives. The Company could possibly be considered to be in arrears in meeting some property access commitments (see note 3). However, in order for the property 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.

The financial statements of the Company have been prepared on the basis that the Company will continue as a going concern, which presumes that it will be able to realize its assets and discharge its liabilities in the normal course of business. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

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.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

2 - SIGNIFICANT ACCOUNTING POLICIES (continued):

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 tax assets also arise from unused tax 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 and is reviewed annually and adjusted, if necessary, by use of a valuation allowance.

LOSS PER SHARE

Basic loss per share is computed by using the weighted average number of common shares outstanding during the year. Diluted loss per share is calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares using the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to redeem common shares at the prevailing market value.

STOCK OPTION COMPENSATION

The Company has a stock option plan, which is described in note 5c). 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 contributed surplus in shareholder's equity.

ESTIMATES

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles of Canada. Precise determination of amounts of some assets and liabilities is dependent on future events. This requires that management make estimates in the preparation of financial statements. Actual results could vary from the estimates.

ASSET RETIREMENT OBLIGATIONS

The Company has adopted the CICA accounting standard for asset retirement obligations. Under this

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-

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

2 - SIGNIFICANT ACCOUNTING POLICIES (continued):

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 the passage of time are recognized in income as an operating expense using the interest method. 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.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived 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.

3 - MINERAL PROPERTY:

	Cumulative to December 31, 2004	2005 Additions	Cumulative to December 31, 2005	2006 Addition	Cumulative to December 31, 2006
Project management	1,181,463	58,667	1,240,130	-	-
Consultants	2,264,040	11,016	2,275,056	-	-
Licenses and permits	3,841,146	-	3,841,146	-	-
Property access and expense	<u>5,811,379</u>	<u>3,750</u>	<u>5,815,129</u>	<u>-</u>	<u>-</u>
Total expenditure for the period	\$13,098,028	\$ 73,433	\$13,171,461	\$ -	\$ -
Adjustment to prior years	-	(7,631)	(7,631)	-	-
Write down prior years	-	-	(6,696,718)	-	-
Write down current year	<u>(6,696,718)</u>	<u>(6,467,111)</u>	<u>(6,467,111)</u>	<u>-</u>	<u>-</u>

Balance, beginning of period	_____ -	<u>6,401,310</u>	_____ -	_____ 1	_____ 1
Balance, end of period (Also see note 1)	<u>\$ 6,401,310</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 1</u>

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

3 - AGREEMENTS:

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 Tuktut 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 enough 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 six months ended November 30, 2006 had indicated that it had

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

3 - AGREEMENTS (continued):

expended approximately 1.9 million. Accordingly, there is a deficiency of expended amounts in accordance with the agreement with the Inuvialuit. However, the joint venture has not received a notice of default from the Inuvialuit to date (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 wrote down its investment in the mineral properties during fiscal 2005. During 2006, the Company incurred a continuing evaluation cost of future involvement in the project.

4 - RELATED PARTY TRANSACTIONS:

During the year, a company controlled by the Chief Executive Officer and director of the Company, charged \$48,000 (2005 - \$46,000) for management fees. The company was issued 605,000 shares through a private placement. Project evaluation cost fees in the amount of \$63,500 (2005 - \$52,000) were charged by the CEO and director directly and the individual subscribed for 100,000 shares through a private placement.

Accounting services provided to April 30, 2006, in the amount of \$25,500 (\$79,500 in 2005), were provided by the former Chief Financial Officer of the Company. The CFO received 468,146 shares through a debt conversion at \$0.15 per share (note 5b).

Legal fees amounting to \$97,731 (2005 - \$21,964) were charged by a law firm of which a director of the Company is a partner.

Corporate maintenance and accounting management fees amounting to \$23,620 (2005 - \$12,520) were charged by a director and officer of the Company.

Consulting fees amounting to \$17,035 (2005 - \$11,017) were charged by directors of the Company.

A director was granted 400,000 options at \$0.13.

As at December 31, 2006, accounts payable include \$753,502 (2005 - \$663,280) payable to the related parties mentioned above.

Management believes these transactions are in the normal course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the parties.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

5 - CAPITAL STOCK:

a) Authorized:

An unlimited number of common shares

b) Common shares issued:

	2006		2005	
	Shares	Amount	Shares	Amount
Balance, beginning of the year	37,116,606	\$ 18,006,510	37,116,606	\$ 18,006,510
Issued for cash (note 4)	705,000	70,500	-	-
Issued for debt conversion (note 4)	468,146	70,222	-	-
Balance, end of the year	38,289,752	\$18,147,232	37,116,606	\$ 18,006,510

Under the Company's joint venture agreement with Diadem Resources Ltd. (previously with Carnarvon Capital Corp.), upon the completion by Diadem if 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 November 30, 2006 indicate that approximately \$1.9 million has been expended to date.

c) Stock option plan

Under the Company's Incentive Stock Option Plan (the plan), the Company has granted options to its directors, officers and consultants, to purchase up to a total of 3,820,000 shares. The exercise price of the options is \$0.13 for 3,500,000, \$0.10 for 100,000 and \$0.15 for 220,000, all expire on November 4, 2009. The Company maintains the plan for the benefit of directors, officers, consultants and other services providers 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 total number of common shares that may be reserved for issuance may not exceed 10% of outstanding common shares and may not exceed 5% for any one person. The exercise price of an option may not be lower than the discounted market price of the common shares on the TSX Venture Exchange. The options are non-transferable. Outstanding options may be adjusted by the Board in certain events, as to exercise price and number of common shares, to prevent dilution or enlargement. At the year end, the Company has reserved 3,828,975 common shares to be granted under the plan. Options were exercised after the year end (note 9a).

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

5 - CAPITAL STOCK (continued):

The following summarizes the director and consultant stock options that have been granted, exercised or forfeited during the years ended 2005 and 2006. The forfeited options were those of an optionee who ceased to be a director, officer or consultant to the Company in the period.

Options granted:

Common share options	Number	Value	Weighted average Price
Balance December 31, 2004	-	-	-
Granted	3,700,000	199,030	\$ 0.13
Forfeited	-	-	-
Exercised	-	-	-
Balance December 31, 2005	3,700,000	199,030	\$ 0.13
Granted	620,000	-	-
Forfeited	(500,000)	-	-
Exercised	-	-	-
Balance, December 31, 2006	3,820,000	199,030	\$ 0.13

The stock option grant resulted in a stock-based compensation expense of \$199,030 in 2005 that was based on a fair value estimate according to the Black Scholes option pricing model assuming a risk free rate of 2.98%, an expected remaining life of two years, and an expected volatility rate of 90% on the measured date. The fair value of the options is recorded into contributed surplus over their vesting period. There was no stock option cost incurred in 2006.

6 - INCOME TAXES:

- a) At December 31, 2006, the Company has non-capital losses of \$5,216,454 that can be used to reduce future taxable income. These losses expire as follow:

2007 \$ 723,032

2008	1,059,842
2009	941,564
2010	809,149
2011	559,902
2015	494,417
2016	328,238
2017	<u>300,310</u>

\$ 5,216,454

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

6 - INCOME TAXES (continued):

As at December 31, 2006 the tax effects of temporary timing differences that give rise to significant components of the future tax asset computed at current rates, were as follows:

Non-capital losses carry forward	\$ 1,877,823
Capital assets	11,066
Mining interests	1,618,677
Less: Valuation allowance	<u>(3,507,566)</u>
Net asset	<u>\$ -</u>

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

	2006	2005
Statutory rate applied to loss for the year before income taxes	(\$ 109,948)	(\$2,217,914)
Increase in taxes resulting from:		
Non-deductible stock-based compensation	-	71,890
Other items	1,836	(187,047)
Share issue cost	-	(2,850)
Tax loss not benefited	108,112	2,335,921
Tax benefit recovered on mining interest	<u>-</u>	<u>(867,145)</u>
Future income tax recovery	<u>\$ -</u>	<u>(\$867,145)</u>

7 - FINANCIAL INSTRUMENTS:

Financial instruments are initially recorded at cost. The fair values of cash, accounts receivable and accounts payable and accrued liabilities approximate their recorded amounts because of their short-term nature.

8 - COMPARATIVE FIGURES:

Certain comparative figures have been reclassified to conform to the current year's presentation. These reclassifications did not affect prior year's net losses.

9 - SUBSEQUENT EVENTS:

- a) On February 2, 2007, the Company entered a non-exclusive agency agreement to raise funds in the form of private placements of equity. As compensation, the agent is entitled to a ten percent commission as well as broker's warrants. This agreement has a twelve-month term.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

9 – SUBSEQUENT EVENTS (continued):

- b) On February 6, 2007, the Company entered into a five-year finders fee agreement. Under the terms of this agreement, DBR will pay the finder ten percent of amounts up to \$10 million and six percent of any additional funds raised through introductions to potential investors.
- c) On February 7, 2007, the Company entered into a finder's fee agreement with an individual. The Company has agreed to pay ten percent, in cash, of any amounts paid by qualified investors introduced to the Company by the finder.
- d) On March 8, 2007, there were 2,930,770 common shares issued through the exercise of options at \$0.13 and \$0.10. An amount of \$378,000 was received. In addition, on March 30, 2007, 1,580,000 options were granted to directors and a consultant at an exercise price of \$0.25 and are exercisable for a two year period.
- e) On March 26, 2007, the Company received final approval for private placements of 4,560,672 shares at \$0.15 per share for which gross proceeds of \$684,101 were received. There was a share issue cost of \$9,450.

