

DARNLEY BAY RESOURCES LIMITED

ANNUAL REPORT 2008

Darnley Bay Resources Limited's main focus is exploration for base metals and diamonds in an area surrounding the Hamlet of Paulatuk, located along the shores of Darnley Bay, in the Inuvialuit Settlement Region, NWT, Canada - the site of the strongest isolated gravity anomaly in North America.

Board of Directors: John S. Dowsett, P.Eng.,
Leon F. La Prairie, P.Eng., Patricia G. Mannard, B.A. (hons.),
Stephen Reford, P. Eng., Peter G. Telford, Ph.D., Donald Yamkowy

1103 - 4 King Street West, Toronto, Ontario Canada M5H 1B6
T: 416 862-7885 F: 416 862-7889 E: dbr@darnleybay.com
www.darnleybay.com TSX Venture Exchange: DBL

May 11, 2009

Letter to Shareholders of Darnley Bay Resources Limited

It is no surprise that your Company has been impacted by the financial crisis over the last year, as have all junior mining companies, both in terms of share price and ability to finance. However, positive sentiment appears to be growing in recent weeks, and several shareholders have supported the current financing. This will allow the Company to undertake an exploration program for metals and diamonds in 2009.

The Concession Agreement with the Inuvialuit Regional Corporation, that provides for exploration and development on the 7(1)(a) lands (185,320 hectares), was negotiated and ratified prior to last year's AGM. Subsequently, additional improvements were made to the agreement to satisfy potential partners. The agreement covers the central and western parts of the Darnley Bay Anomaly, as well as diamond targets located previously by the Company. It will come into force once the Company pays historical access fees.

The Company expanded its landholdings in February 2009, by acquiring two prospecting permits (28,390 hectares) in the 7(1)(b) lands, over the southern end of the Darnley Bay Anomaly south of Paulatuk, Northwest Territories. They are located over one of the highest priority gravity targets. We were informed that these were the only prospecting permits taken out in 2009 by any company in the Northwest Territories.

Diamond exploration on the Parry Peninsula is ongoing, through our agreement with Diadem Resources Ltd. It completed a ground magnetic survey, and filed the results for assessment so that all claims held by the two companies remain in good standing. A drill program is planned over new and existing kimberlite pipe targets. The Company awaits the completion of Diadem's financing efforts, so that a new agreement on the property can be negotiated.

George Kent decided to stand down as a Director of the Company at the end of 2008. We thank George for his many years of service as a Director.

This past year has been particularly challenging for Darnley Bay Resources Limited and for me in my first year as an officer of the Company. The upcoming year promises an increased level of activity and excitement, as we devote our efforts to exploration towards the ultimate objective, the development of a new mining camp in the Paulatuk area. We look forward to getting back on the land with our Inuvialuit colleagues in 2009.

With Kind Regards and Best Wishes,

Stephen Reford, President and CEO

April 30, 2009

DARNLEY BAY RESOURCES LIMITED - Management's Discussion and Analysis
for the year ended December 31, 2008.

GENERAL

Darnley Bay Resources Limited was formed in 1993 to explore and develop an area of geophysical significance in the Northwest Territories of Canada, located within the Inuvialuit Settlement Region. Base metal exploration resulted in the discovery of diamonds and the area is now host to two distinct interests. The Company's objective is to secure and maintain successful financing partnerships so as to continue exploration for base/precious metals and diamonds, resulting in the development of a profitable mining camp.

SELECTED ANNUAL INFORMATION

	2008	2007	2006
Net loss (in thousands)	632	1,268	305
Loss per common share	0.01	0.03	0.01
Total assets (in thousands)	638	526	38
Shareholders' equity (in thousands)	(1,432)	(1,373)	(2,402)

BALANCE SHEET AND OPERATIONS

At December 31, 2008 assets totaled \$637,511 compared to \$526,565 at the 2007 year-end. This amount includes a cumulative mineral property expense at the year end of \$439,475 (\$192,500 in 2007). The current liability increased to \$2,069,745 from \$1,899,675 at the 2007 year-end. The share capital increased to \$20,624,796 from \$19,930,636 in 2007 through the private placement of 1,025,000 common shares (4,994,309 in 2007) for \$380,000 (\$835,100 in 2007), the exercise of 400,000 options (3,305,770 in 2007) for \$52,000 (\$449,750 in 2007), a debt conversion for 142,500 shares (93,750 in 2007) valued at \$57,000 (\$22,500 in 2007) and the addition of the fair value of options granted of \$205,160 (\$293,004 in 2007). There was no share issue cost in 2008 (\$9,450 in 2007). The existing stock options resulted in a year-end stock-based compensation expense of \$nil and \$807,186 in 2007. The Company reported a net loss at December 31, 2008 of \$632,254 compared to \$1,268,356 in 2007. The ongoing corporate and general expenses required to run a public company continue to be monitored closely.

LIQUIDITY AND CAPITAL RESOURCES

The Company is an exploration and development company and has no revenue. At December 31, 2008, the Company had cash resources of \$64,588 compared to \$217,372 at the 2007 year-end. There were 1,425,000 shares issued for \$432,000 during the year and 8,300,079 shares issued for \$1,284,850 in 2007. The Company has a working capital deficit of \$1,871,709 compared to \$1,565,611 at year-end 2007 and an accumulated deficit of \$22,649,212 (\$22,016,958 at the 2007 year-end). The Company is actively working to reduce liabilities through ongoing negotiations with primary creditors. During the year, a \$57,000 debt was converted to shares (\$22,500 in 2007). Further debt settlement is planned where allowable. On April 20, 2009, an amount of \$141,996 was received through private placements of 1,378,300 common shares.

The Company's current funding objective is to support a base metal exploration program and fulfil its obligations to the Inuvialuit Regional Corporation as agreed upon in principle. The Company has completed a full review and evaluation of the exploration history of the area in support of the current direction for geophysical analysis and a drilling program. At the same time, the Company is working to ensure the continuation of diamond exploration. The ability to raise the capital resources to undertake these projects is dependent upon the venture capital market and metal prices.

SUMMARY OF QUARTERLY RESULTS

<i>For the three month period ended</i>	<i>Dec. 31</i>	<i>Sep. 30</i>	<i>Jun. 30</i>	<i>Mar. 31</i>
	<i>2008</i>	<i>2008</i>	<i>2008</i>	<i>2008</i>
Net loss (in thousands)	141	116	219	172
Loss per common share	0.01	0.01	0.01	0.01
Total assets (in thousands)	658	523	542	426
Shareholders' equity (deficiency) (in thousands)	(1,448)	(1,457)	(1,382)	(1,545)
<i>For the three month period ended</i>	<i>Dec. 31</i>	<i>Sep. 30</i>	<i>Jun. 30</i>	<i>Mar. 31</i>
	<i>2007</i>	<i>2007</i>	<i>2007</i>	<i>2007</i>
Net loss (in thousands)	992	150	152	(26)
Loss per common share	0.03	0.01	0.01	0.01
Total assets (in thousands)	526	469	621	671
Shareholders' equity (deficiency) (in thousands)	(1,373)	(1,590)	(1,536)	(2,340)

ANALYSIS OF MINERAL PROPERTY EXPENDITURES

	<i>2008</i>	<i>2007</i>
Project management	60,885	-
Project consulting fees	22,191	-
Licences and permits	163,899	
Property access and agreement costs	<u>-</u>	<u>192,500</u>
	246,975	192,500

ANALYSIS OF CORPORATE AND GENERAL EXPENSES

	<i>2008</i>	<i>2007</i>
Project evaluation and management services	157,862	167,653
Stock based compensation	-	807,186
Administration services	102,000	103,520
Accounting services	45,750	44,125
Premises rent	59,121	75,807
Legal fees	63,049	65,076
Audit fees	35,800	32,150
Office support services & supplies	73,226	39,798
Stock transfer/exchange fees	40,774	41,050
Shareholder communication	19,411	18,747
Interest	45,129	7,476
Miscellaneous	<u>-</u>	<u>-</u>
	642,122	1,402,588

COMMON SHARES ISSUED

Common shares issued at the year-end 2008 were 48,751,081 (47,183,581 at the year-end 2007). During the year, there were 825,000 shares issued through private placements at \$0.40 per share with an option to purchase an additional share at \$1.00 after the first year and \$2.00 in a second year up to April 14, 2010. There were an additional 200,000 units sold at \$0.25 with a two year warrant exercisable up to October 2, 2010 for \$0.40. There were also 534,000 units purchased at \$0.12 with a two-year \$0.24 warrant exercisable up to January 20, 2011 and 133,666 flow through units purchased at \$0.15 with a two year warrant to purchase a flow through share exercisable at \$0.30 up to January 20, 2011 in 2008 and issued on January 20, 2009 (in 2007, there were 4,560,672 shares issued at \$0.15 per share, 250,000 at \$0.20 and 183,637 at \$0.55). There was a debt conversion resulting in the further issue of 142,500 shares at \$0.40 (in 2007, there were 93,750 shares issued at \$0.24 through the conversion of debt).

At December 31, 2008, there were outstanding share purchase options granted to directors, officers and consultants including 300,000 at \$0.45 (expiring on October 16, 2009), 800,000 at \$0.35 (expiring on June 12, 2009), 1,500,000 and 225,000 at \$0.25 (expiring on March 20 and May 31, 2009) and 269,230 at \$0.13 (expiring on November 4, 2009) in accordance with the Company's Stock Option Plan (see note 6c of the annual financial statements). During the year, there were 400,000 options exercised at \$0.13 (in

COMMON SHARES ISSUED continued

2007, there were 2,830,770 options exercised at \$0.13, 100,000 at \$0.10, 220,000 at \$0.15 and 155,000 at \$0.25). At the year-end there were 3,094,230 options (3,494,230 at the end of 2007) granted at a weighted average price of \$0.28 (\$0.25 in 2007). The Company issued 500,000 shares to Carnarvon Capital Corporation on October 3, 2007 at \$0.385 per share when the Darnley Bay/Diadem diamond joint venture met a \$2 million exploration expenditure target. The Company has 41,866 shares in escrow.

On March 20, 2009, there were 1,500,000 options at \$0.25 that expired. On April 20, 2009, an additional 1,170,000 units for one share and one share purchase warrant were purchased through unbrokered private placements at \$0.10 per unit. The warrants are exercisable up to April 19, 2013 for \$0.20. On the same date, there were 208,300 flow through units sold at \$0.12 per share with an option to purchase an extra flow through share for four years up to April 19, 2013 for \$0.24.

ACCOUNTING POLICIES

The Company's accounting is based upon Canadian Generally Accepted Accounting Principles (GAAP) applicable to resource issuers, which are applied on a consistent basis.

These are outlined in full detail in note 2 of Company's audited financial statements for the year ended December 31, 2008.

The recovery of amounts capitalized as Mineral Property expenditures 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. The carrying value of the mineral exploration property was considered unrecoverable and written down to \$1 due to uncertainties in financing at the end of 2005.

The Company continues to retain interest in its property and looks to future funding opportunities and ongoing exploration for both base/precious metals and diamonds.

The Company uses the fair value method of accounting for all stock options awarded. Compensation expense is recognized based on the fair value of the option on the date of the grant and is expensed over the vesting period of the option (see note 6c of the 2008 audited year end statement).

ADOPTION OF NEW ACCOUNTING POLICY

Effective October 1, 2006, the Company adopted the new recommendations of CICA Handbook Section 1530, "Comprehensive Income" and Section 3251, "Equity". These sections establish standards for reporting and presenting certain gains and losses normally not included in net earnings or losses, such as unrealized gains and losses related to available-for-sale investments in a statement of comprehensive income. There was no impact on the financial statements in the current period.

ADOPTION OF NEW ACCOUNTING POLICY continued

On January 1, 2008, the Company introduced policy to disclose management of capital as recommended in CICA Handbook Section 1535 and the nature and extent of risk arising from financial instruments and management of that risk from Sections 3862 and 3863.

RELATED PARTY TRANSACTIONS

Technical and administrative support is received from directors and officers of the Company. In the absence of financial resources to pay for these services, the allowable issuance of common shares for debt is undertaken.

During the year, amounts charged for management fees by La Prairie Ltd. (controlled by Leon La Prairie, Chairman/director) were \$48,000 (\$48,000 in 2007), rent and office services amounts were \$57,821 (\$74,525 in 2007) and \$9,323 (\$9,039 in 2007) respectively. Mr. La Prairie charged \$77,000 for consulting services (2007 - \$77,000) as CEO up to June 26, 2008 and then as Chairman. Reimbursable expenses including travel, office and meeting costs for 2008 totaled \$15,454 (\$10,175 in 2007).

On June 26, 2008, Stephen Reford became a director and was appointed CEO of the Company. He charged \$9,675 in professional fees and \$37,125 in services related to deferred project development in the second half of the year. Reimbursable travel expenses amounted to \$2,086 in the same period. On October 3, 2008, Mr. Reford participated in the purchase of 200,000 share purchase units for \$0.25 consisting of one common share and a warrant to purchase an additional share for \$0.40 up to October 2, 2010. On December 19, 2008, he purchased an additional 84,000 units at \$0.12 with a two year warrant at \$0.24 and 67,000 flow through units at \$0.15 with a two year \$0.30 flow through warrant.

William Allen provided legal services to the Company until he retired as a director of the Company on June 26, 2008. Legal fees were \$42,907 in the six month period (\$65,076 in 2007). Patricia Mannard was appointed Chief Financial Officer on June 26, 2008 and provided corporate maintenance and accounting management services in the amount of \$45,750 in 2008 and \$44,125 in 2007. The former CFO, Richard La Prairie, received 93,750 shares through a debt conversion at \$0.24 in 2007. Additional shares or cash will be issued to eliminate a balance of \$94,035 owing to R. La Prairie. John Dowsett, a director, provided geophysical and project development services in the amount of \$2,950 (\$9,825 in 2007). George Kent, a director, provided geological consulting services in the amount of \$5,837 (\$5,821 in 2007) up to December 31, 2008 when he resigned as a director. Mr. Kent exercised 400,000 options at \$0.13 during the year. Peter Telford charged \$4,000 for professional services in 2008 (nil in 2007). On June 26, 2008, Donald Yamkowy was elected as a director and, during the second six months of the year, invoiced the Company for \$4,297 in consulting fees related to project development. As at December 31, 2008, accounts payable to the above total \$623,436 (2007 - \$465,687).

RELATED PARTY TRANSACTIONS continued

At December 31, 2008, the above-related parties held share purchase options. L. La Prairie holds 1,000,000 options exercisable at \$0.25 up to March 20, 2009 and Mannard has 500,000 options with the same terms. Dowsett has 269,230 options for \$0.13 exercisable up to November 4, 2009 and Peter Telford has an option to purchase 300,000 shares at \$0.45 up to October 16, 2009. Stephen Reford and Donald Yamkowy (former consultants to the Company and now directors) each hold options (500,000 and 300,000 at \$0.35) expiring on June 12, 2009.

COMMITMENTS

Notes 4 and 11 of the financial statements for the year ended December 31, 2008 cover the status of agreements with the Inuvialuit Land Corporation and Diadem Resources Ltd. (“Diadem”) for exploration of base metals, diamonds and other commitments.

Effective November 26, 2003, the Company entered into an agreement to form a joint venture with Diadem, formerly an agreement held with Carnarvon Capital Corporation, to operate diamond exploration in an area near Paulatuk in the Northwest Territories. On November 29, 2007, the agreement was revised to reset the deadlines for earn-in (June 30, 2008) and other requirements including a loan repayment (March 31, 2008). On June 30, 2008, all the terms of the agreement and its amendments had not been met and the companies continue to negotiate a future relationship favourable for their shareholders.

The Company and Diadem entered into a letter agreement with the Inuvialuit Regional Corporation allowing access to the property that lies within the Inuvialuit Settlement Region. The agreement expired on January 1, 2009.

In addition, the Company has a number of Finder’s Fee agreements and an Agent’s Agreement with varying terms and conditions outlined in Note 9 of the Interim Financial Statements for the period ended December 31, 2008 and to date.

RISKS AND UNCERTAINTIES

The inherent risks which most profoundly affect the Company’s activities are metal prices, market demand and the ability of the Company to obtain venture capital necessary to establish a resource and, in the case that an economic ore reserve is determined, to develop the prospect. Further, the Company is relying on the Inuvialuit Regional Corporation to allow property access for both projects.

CORPORATE GOVERNANCE

On February 22, 2007, the Company filed its Corporate Governance Policy document with the TSX Venture Exchange and on www.sedar.com. The Company maintains its commitment to achieve full compliance with the policy.

OUTLOOK

The global financial crisis of 2008-09 commenced in earnest during the reporting period, and has continued unabated. The freeze-up of the credit markets and concurrent downturn in commodity prices has severely impacted junior exploration companies in Canada with respect to financing. The Company has implemented a series of cost-saving measures to preserve capital while maintaining its regulatory obligations. Nevertheless, the Company perseveres with financing so as to carry out its planned exploration and drilling activities in 2009. The ongoing support from the Inuvialuit Regional Corporation (IRC), the community of Paulatuk and other local participants is encouraging. The purpose of the exploration is to locate metal and diamond targets for a comprehensive drilling program. The exploration program is contingent upon the receipt of funds through equity financing or joint venture partnerships on terms most favourable for our shareholders.

Some of the highlights from the 2008 reporting period include:

- The Company completed negotiations with the IRC for a new Letter Agreement that governs exploration and development in the 7(1)(a) lands, totaling 185,320 hectares. These lands cover the majority of the Darnley Bay gravity and magnetic anomaly that is available for exploration. Signature of the agreement is contingent on payment of outstanding access and environmental fees to the IRC.
- The Company applied to the Mining Recorder in Yellowknife NT for two prospecting permits, totaling 28,390 hectares. They cover the remainder of the Darnley Bay gravity and magnetic anomaly that is available for exploration, including half of a high-priority gravity target and shallow magnetic targets. The permits were awarded to the Company in February 2009.
- The Company and its consultants developed an alternative model for the source of the Darnley Bay Anomaly, which is traditionally thought to be a mafic to ultramafic intrusive with associated Ni-Cu-PGE deposits. The alternative is an iron oxide-copper-gold (IOCG) deposit model, developed due to the Anomaly's tectonic setting, age relationships and geophysical signatures that resemble Olympic Dam in Australia, considered the world's richest metal deposit.
- A permit to carry out exploration on the 7(1)(a) and selected portions of the 7(1)(b) lands near Paulatuk, NT was granted to the Company on September 4, 2008, after submission of its permit application to the Environmental Impact Screening Committee of the Inuvialuit Land Administration in June 2008. The permit incorporated the execution of airborne geophysical surveys, geological prospecting and sampling, and studies of water sources for winter drilling. To date, the work has not been carried out due to lack of funds.
- Diadem Resources Ltd. provided the Company with the report on ground magnetic surveys carried out over claims on the Parry Peninsula in April 2008, as part of its earn-in obligations towards a 50/50 joint venture on diamond exploration for the Franklin Project northwest of Paulatuk NT. The report delineated new kimberlite targets for drilling. Diadem filed the necessary paperwork and fees with the Mining Recorder's Office in Yellowknife, to maintain all claims on the Parry Peninsula in good standing.

OUTLOOK continued

- The Company and Diadem discussed the next phase of exploration on the Franklin Project, pursuant to the agreements previously executed by the two companies. If a joint venture is concluded between the two companies, Diadem is obligated to expend the first \$2 million on the planned drill program. It is pursuing financing for that purpose.
- Stephen Reford was introduced as the Company's new CEO & President at the Annual Meeting in June 2008. Leon La Prairie remains with the Company as Chairman of the Board of Directors. Patricia Mannard was appointed CFO. Donald Yamkowy was appointed to the Board of Directors.
- William Allen and George Kent resigned from the Board of Directors.
- The Company raised \$464,130 through private placements, including \$45,046 in flow-through funds, and \$52,000 through the exercise of options by a director.

Subsequent to the reporting period, the Company reports the following activities:

- The Company raised \$141,996 through private placements, including \$24,996 in flow-through funds, between April 6 and April 28, 2009.
- The President took advantage of a personal trip to Australia to visit BHP-Billiton's Olympic Dam IOCG deposit, meeting with the mine geologists, touring the surface workings and collecting samples underground.

The Company is committed to pursue equity financing and seek joint venture partnerships to enable the current exploration and development program to continue.

This MD&A contains certain forward-looking statements related but not limited to the Company's operations, anticipated financial performance, business prospects and strategies. Forward-looking information typically contains statements with words such as "anticipate", "believe", "expect", "plan" or similar words suggesting future outcomes. Readers are cautioned to not place undue reliance on forward-looking information because it is possible that the Company will not achieve predictions, forecasts, projections and other forms of forward-looking information.

THE MANAGEMENT'S DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH THE COMPANY'S AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2008 WHICH ACCOMPANY THIS ANALYSIS AND, ALTERNATELY, ARE AVAILABLE ALONG WITH ALL THE COMPANY'S PUBLIC DOCUMENTS ON WWW.SEDAR.COM

www.darnleybay.com TSX Venture Exchange Symbol DBL

DARNLEY BAY RESOURCES LIMITED

(A Development Stage Company)

FINANCIAL STATEMENTS

DECEMBER 31, 2008 and 2007

DARNLEY BAY RESOURCES LIMITED

(A Development Stage Company)

FINANCIAL STATEMENTS

DECEMBER 31, 2008 and 2007

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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 (The "Company", A Development Stage Company) as at December 31, 2008 and 2007 and the statements of loss, comprehensive 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, 2008 and 2007, 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, April 30, 2009

CHARTERED ACCOUNTANTS
Licensed Public Accountants

DARNLEY BAY RESOURCES LIMITED
(A Development Stage Company)

BALANCE SHEETS

DECEMBER 31

	ASSETS	
CURRENT	2008	2007
Cash	\$ 64,588	\$ 217,372
Accounts receivable	<u>133,448</u>	<u>116,692</u>
	198,036	334,064
MINERAL PROPERTY (notes 1 and 3)	<u>439,475</u>	<u>192,501</u>
	<u>\$ 637,511</u>	<u>\$ 526,565</u>

LIABILITIES

CURRENT		
Accounts payable and accrued liabilities (note 5)	\$ 2,069,745	\$ 1,899,675

SHAREHOLDERS' DEFICENCY

CAPITAL STOCK (note 6(b))	20,624,796	19,930,636
SHARES TO BE ISSUED (note 11 (f))	84,130	-
CONTRIBUTED SURPLUS (note 8)	508,052	713,212
DEFICIT	(<u>22,649,212</u>)	(<u>22,016,958</u>)
	(<u>1,432,234</u>)	(<u>1,373,110</u>)
	<u>\$ 637,511</u>	<u>\$ 526,565</u>

Subsequent events and commitments (note 11)
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
(A Development Stage Company)

STATEMENTS OF LOSS, COMPREHENSIVE LOSS AND DEFICIT
FOR THE YEAR ENDED DECEMBER 31

	2008	2007
EXPENSES		
Office administration services	\$ 218,195	\$ 185,378
Project evaluation costs	157,862	167,653
Professional fees	98,849	97,226
Premises rent	59,121	75,807
Shareholder communication	62,966	61,862
Stock option compensation cost	-	807,186
Interest expense	<u>45,129</u>	<u>7,476</u>
Loss before the under noted	(642,122)	(1,402,588)
Interest income	9,868	-
Write-down of payables	<u>-</u>	<u>134,232</u>
NET LOSS AND COMPREHENSIVE LOSS FOR THE YEAR	(632,254)	(1,268,356)
DEFICIT AT BEGINNING OF THE YEAR	<u>(22,016,958)</u>	<u>(20,748,602)</u>
DEFICIT AT END OF THE YEAR	<u>(\$ 22,649,212)</u>	<u>(\$ 22,016,958)</u>
Basic and diluted loss per share (note 2)	<u>\$ 0.01</u>	<u>\$ 0.03</u>
Weighted average number of common shares outstanding	<u>48,134,381</u>	<u>44,790,604</u>

The accompanying notes are an integral part of the financial statements.

DARNLEY BAY RESOURCES LIMITED
(A Development Stage Company)

STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31

	2008	2007
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net loss for the year	(\$ 632,254)	(\$ 1,268,356)
Non-cash items:		
Stock option cost	-	807,186
Write down of payables	-	134,232
Net changes in working capital balances:		
Increase in accounts receivable	(16,755)	(114,010)
Increase (decrease) in accounts payable and accrued liabilities	<u>227,069</u>	<u>(652,736)</u>
Cash used in operations	<u>(421,940)</u>	<u>(1,093,684)</u>
CASH USED IN INVESTING ACTIVITIES:		
Increase in mineral property expense	<u>(246,974)</u>	-
Cash used in investments	<u>(246,974)</u>	-
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES:		
Issue of common shares	432,000	1,284,851
Common shares to be issued	84,130	-
Share issue cost	<u>-</u>	<u>(9,450)</u>
Cash provided by financing	<u>516,130</u>	<u>1,275,401</u>
INCREASE (DECREASE) IN CASH POSITION	(152,784)	181,717
CASH POSITION AT BEGINNING OF THE YEAR	<u>217,372</u>	<u>35,655</u>
CASH POSITION AT END OF THE YEAR	<u>\$ 64,588</u>	<u>\$ 217,372</u>
Supplementary disclosure of non-cash items:		
Shares issued for non-cash consideration:		
Issuance of common shares for mineral interests	\$ -	\$ 192,500
Issuance of common shares for debt	\$ 57,000	\$ 22,500

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, 2008 AND 2007

1 - NATURE OF OPERATIONS AND GOING CONCERN CONSIDERATIONS:

The Company is in the business of exploring for 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 metals and diamonds.

As at December 31, 2008, the Company has a working capital deficiency of \$1,871,710 (2007 - \$1,565,611). 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 4). 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
(A Development Stage Company)

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

2 - SIGNIFICANT ACCOUNTING POLICIES (continued):

MINERAL PROPERTY AND RELATED EXPENDITURES (continued)

The Company reviews its exploration properties to determine if events or changes in circumstances have transpired which indicate that the carrying value of its assets may not be recoverable. The recoverability of costs incurred on the exploration properties is dependant upon numerous factors including exploration results, environmental risks, community risks, political risks, and the Company's ability to attain profitable production. An impairment loss is recognized when the carrying amount of the exploration properties is not recoverable and exceeds its fair value. It is possible, based on existing knowledge, that changes in future conditions in the near-term could require a change in the determination of the need for and amount of any write-down.

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 6d). 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.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

2 - SIGNIFICANT ACCOUNTING POLICIES (continued):

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 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 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. At December 31, 2008, the Company has not incurred or committed any asset retirement obligations relating to its exploration properties.

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.

FINANCIAL ASSETS AND LIABILITIES

Assets or liabilities held-for-trading :

Financial instruments classified as assets or liabilities held for trading are reported at fair value at each balance sheet date, and any change in fair value is recognized in net income (loss) in the period which the change occurs.

DARNLEY BAY RESOURCES LIMITED
(A Development Stage Company)

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

2 - SIGNIFICANT ACCOUNTING POLICIES (continued):

FINANCIAL ASSETS AND LIABILITIES (continued)

Held-to-maturity investments, loans and receivables and other financial liabilities :

Financial instruments classified as loans and receivables, held-to-maturity investments and other financial liabilities are carried at amortized costs using the effective interest method. Interest income or expenses is included in net income (loss) over the expected life of the instrument.

Available-for-sale :

Financial instruments classified as available for sale are recorded at fair value at each balance sheet date and any change in fair value is recognized in other comprehensive income in the period in which these changes occur. Securities classified as available for sale and with no quoted market price in an active market are carried at cost. Available-for-sale securities are written down to fair value (impairment recognized in income) when it is necessary to reflect an other-than-temporary impairment. Upon derecognition, any accrued gains or losses in accumulated other comprehensive income are then recognized in net income (loss).

CHANGES IN ACCOUNTING POLICIES

The Company has adopted two new accounting standards related to financial instruments that were issued by the Canadian Institute of Chartered Accountants. These new standards were adopted on a prospective basis with no restatement of prior period financial statements. The new standards are as follows:

FINANCIAL INSTRUMENTS – RECOGNITION AND MEASUREMENT (Section 3855)

In accordance with the new standard, all financial assets, except those classified as held-to-maturity, and derivative financial instruments, must be measured at fair value. All financial liabilities must be measured at fair value when they are classified as held-for-trading; otherwise, they are measured at amortized cost. Investments classified as available-for-sale are reported at fair market value based on quoted market prices with unrealized gains or losses excluded from earnings and reported as other comprehensive income or loss.

Upon adoption of this new standard, the Company has designated its cash as held-for-trading, which

is measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities which are measured at amortized cost.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

2 - SIGNIFICANT ACCOUNTING POLICIES (continued):

CHANGES IN ACCOUNTING POLICIES (continued)

COMPREHENSIVE INCOME (Section 1530)

Comprehensive income is the change in shareholder's equity during a period from transactions and other events and circumstances from non-owner sources. In accordance with this new standard, the Company now reports a statement of comprehensive income and a new category, accumulated other comprehensive income, in the shareholder's equity section of the balance sheet. The components of this new category will include unrealized gains and losses on financial assets classified as available-for-sale.

Effective January 1, 2008, the Company adopted the following accounting policies as recommended by the CICA handbook:

Capital Disclosures – Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such noncompliance. The Company has included disclosures recommended by the new Handbook section in note 10 to these consolidated financial statements.

Financial Instruments – Sections 3862 and 3863 replace Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The Company has included disclosures recommended by the new section in note 9 to these financial statements.

Assessing going concern - the Corporation adopted the amended CICA Handbook Section 1400 "General Standards of Financial Statement Presentation". This amended section includes requirements for management to assess and disclose an entity's ability to continue as a going concern, and if applicable, management's plans to address any going concern issues. The adoption of this standard has no material impact on the Corporation's consolidated financial statements.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

2 - SIGNIFICANT ACCOUNTING POLICIES (continued):

FUTURE ACCOUNTING AND REPORTING CHANGES

a) Goodwill and intangible assets:

The CICA issued the new Handbook Section 3064, "Goodwill and Intangible Assets", which will replace Section 3062, "Goodwill and Other Intangible Assets". The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Management is currently assessing the impact of this new accounting standard on its consolidated financial statements.

b) International Financial Reporting Standards ("IFRS"):

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company is currently assessing the impact of IFRS on its consolidated financial statements.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

3 - MINERAL PROPERTY:

	Cumulative to December 31, 2006	2007 Additions	Cumulative to December 31, 2007	2008 Additions	Cumulative to December 31, 2008
Project management	-	-	-	60,885	60,885
Consultants	-	-	-	22,191	22,191
Licenses and permits	-	-	-	163,899	163,899
Property access and expense	<u>-</u>	<u>192,500</u>	<u>192,500</u>	<u>-</u>	<u>192,500</u>
Total expenditure for the year	\$ -	\$ 192,500	\$ 192,500	\$ 246,975	\$ 439,475
Adjustment to prior years	-	-	-	-	-
Write down prior years	-	-	-	-	-
Write down current year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance, beginning of year	<u>1</u>	<u>1</u>	<u>1</u>	<u>-</u>	<u>1</u>
Balance, end of period (Also see note 1)	<u>\$ 1</u>	<u>\$ 192,501</u>	<u>\$ 192,501</u>	<u>\$ 246,975</u>	<u>\$ 439,476</u>

4 - 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 to a joint venture diamond exploration program 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:

On November 29, 2007, Diadem agreed to raise and spend funds to explore for diamonds in the area north of 69 degrees 25 minutes latitude. The earn-in amount now includes an additional \$1,000,000 for the extended period from September 1, 2007 to June 30, 2008 (previously December 31, 2007) and further to the approximately \$3.2 million that has been reported as expended by Diadem commencing with the 2005 calendar year. At June 30, 2008, Diadem had not met all the requirements of the agreement (note 11).

When the funds are spent, Diadem will have earned a 50% participating interest in the selected lands, with the Company holding the other 50%. Under the amended agreement, once Diadem has earned its interest, it will advance \$1 million toward the continuing joint venture on behalf of the Company that may be repaid, without interest, out of the Company's share of production from a diamond mine. 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

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

4 - AGREEMENTS:

JOINT VENTURE AGREEMENT WITH DIADEM RESOURCES LTD ("DIADEM") (continued)

increase to 75% and the Company's interest will decrease to 25%. As outlined in the agreement, Carnarvon was issued 500,000 shares of the Company on October 3, 2007 after Diadem's first \$2 million in exploration expenditures.

AGREEMENTS 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. On April 23, 2007, the Company paid \$100,000 to the Inuvialuit on behalf of Diadem. Repayment terms are outlined in the revised joint venture agreement of November 29, 2007. On July 13, 2007, the Inuvialuit confirmed that the Company remained in good standing with respect to the agreement.

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 2007, the Company incurred a continuing evaluation cost of future involvement in the project.

On May 8, 2007, the Company announced an agreement in principal with the Inuvialuit (subject to the ratification by the members of the Paulatuk Community Corporation) regarding the terms of a new base-metals/diamond concession in the 7(1)(a) lands where the Inuvialuit own the subsurface and surface rights. The agreement includes a two year payment schedule for the liability of approximately \$1,100,000 owed to the Inuvialuit. The new concession follows the terms of the Company's prior

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

4 - AGREEMENTS:

AGREEMENTS WITH THE INUVIALUIT LAND CORPORATION ("INUVIALUIT") (continued)

2001 mineral/diamond agreement, with minimum exploration expenditure of \$6 million for the first three years and \$7 million for the following seven years of the Exploration Phase plus \$1 million for each renewal year.

5 - RELATED PARTY TRANSACTIONS:

During the year, a company controlled by the Chief Executive Officer, Chairman and director of the Company, charged \$48,000 (\$48,000 in 2007) for management fees, \$57,821 for rent (\$74,525 in 2007) and \$9,323 for offices services (\$9,039 in 2007). Executive management fees in the amount of \$77,000 (2007 - \$77,000) were charged by the CEO, Chairman and director directly plus reimbursable travel, office and meeting expenses of \$15,454 (\$10,175 in 2007). The individual stepped down from the position of Chief Executive Officer on June 26, 2008.

Professional fees amounting to \$9,675 were charged by the Chief Executive Officer after June 26, 2008. Fees associated with deferred project development of \$37,125 were charged and there were reimbursable travel expenses of \$2,086 recorded in the same period. On October 3, 2008, the CEO participated in a private placement of 200,000 units comprised of one common share at \$0.25 per share and a warrant for the purchase of an additional common share exercisable up to two years at \$0.40. Consulting fees amounting to \$17,084 (2007 - \$15,646) were charged by directors of the Company. On June 18, 2008, a director and consultant to the Company exercised 400,000 options at \$0.13.

Legal fees amounting to \$42,908 (2007 - \$65,076) were charged by a law firm of which a director of the Company is a partner. The director resigned on June 26, 2008.

Corporate maintenance and accounting management fees amounting to \$45,750 (2007 - \$44,125) were charged by a director and officer of the Company.

In 2007, the former Chief Financial Officer of the Company received 93,750 shares through a debt conversion at \$0.24 per share (note 6(b)).

As at December 31, 2008, accounts payable include \$607,309 (2007 - \$465,687) 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.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

6 - CAPITAL STOCK:

a) Authorized:

An unlimited number of common shares

b) Common shares issued:

	2008		2007	
	Shares	Amount	Shares	Amount
Balance, beginning of the year	47,183,581	\$ 19,930,636	38,289,752	\$ 18,147,232
Issued for cash (note 5)	1,025,000	380,000	4,994,309	835,100
Issued for cash /exercise of options (note 5)	400,000	52,000	3,305,770	449,750
Issued under agreement option (note 4)	-	-	500,000	192,500
Issued for debt conversion	142,500	57,000	93,750	22,500
Fair value of options exercised	-	205,160	-	293,004
Share issue cost		-		(9,450)
Balance, end of the year	<u>48,751,081</u>	<u>\$ 20,624,796</u>	<u>47,183,581</u>	<u>\$ 19,930,636</u>

See note 11 for additional capital stock information.

c) Warrants:

During the year, 1,692,666 warrants were issued as part of private placements. No warrants were outstanding prior to the issue of the aforementioned warrants.

At December 31, 2008, the following warrants were outstanding. The warrants entitle the holders to purchase the stated number of common shares at the exercise price on or before the expiry date:

Number of common shares	Exercise price	Expiry date
825,000	Yr. 1-\$ 1.00 Yr. 2-\$ 2.00	April 14, 2010
200,000	\$ 0.40	October 2, 2010
534,000	\$ 0.24	January 20, 2010
<u>133,666</u>	\$ 0.30	January 20, 2010

1,692,666

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

6 - CAPITAL STOCK (continued):

d) 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 3,094,230 shares. The exercise price of the options is \$0.13 for 269,230 (expiring on November 4, 2009), \$0.25 for 1,500,000 and 225,000 (expiring on March 20, 2009 and May 31, 2009), \$0.35 for 800,000 (expiring on June 12, 2009) and \$0.45 for 300,000 (expiring on October 16, 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 propriety 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 4,941,874 common shares to be granted under the plan.

The following summarizes the director and consultant stock options that have been granted, exercised or forfeited during the years ended 2008 and 2007.

Options granted:

Common share options	Number	Weighted average Price
Balance December 31, 2006	3,820,000	\$ 0.13
Granted	2,980,000	0.30
Forfeited	-	-
Exercised	(3,305,770)	0.13
Balance December 31, 2007	3,494,230	\$ 0.25
Granted	-	-
Forfeited	-	-
Exercised	(400,000)	0.13
Balance, December 31, 2008	3,094,230	\$ 0.28

The fair value of each options are estimated on the date of grant. Under Black-Scholes, the options issued in 2007 were valued at \$807,186 (no options were granted in the year ended December 31, 2008) and expensed to loss, using the following assumptions at the measurement

date:

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

6 - CAPITAL STOCK (continued):

d) Stock option plan

	2008	2007
Risk-free interest rate	nil	3.79 - 4.74%
Expected life	nil	2 -5 years
Price volatility	nil	100%
Dividend yield	nil	nil

See note 11 for additional stock option information.

7 - INCOME TAXES:

- a) At December 31, 2008, the Company has non-capital losses of \$4,198,989 that can be used to reduce future taxable income. These losses expire as follows:

2009	\$ 941,564
2010	809,149
2011	559,902
2015	494,417
2016	328,238
2017	300,310
2027	291,017
2028	<u>474,392</u>
	<u>\$ 4,198,989</u>

As at December 31, 2008 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	\$ 1,385,666
Capital assets	10,144
Mining interests	1,628,783
Less: Valuation allowance	<u>(3,024,593)</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:

DARNLEY BAY RESOURCES LIMITED
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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

7 - INCOME TAXES continued:

	2008	2007
Statutory rate applied to loss for the year before income taxes	(\$ 208,644)	(\$ 458,130)
Increase in taxes resulting from:		
Non-deductible stock-based compensation	-	291,556
Other items	-	903
Project evaluation costs	52,094	60,556
Tax loss not benefited	<u>156,550</u>	<u>105,115</u>
Future income tax (recovery)	<u>\$ -</u>	<u>\$ -</u>

8- CONTRIBUTED SURPLUS:

Contributed surplus is comprised of the following:

	2008	2007
Balance, beginning of the year	\$ 713,212	\$ 199,030
Stock-based compensation cost	-	807,186
Exercise of stock options	<u>(205,160)</u>	<u>(293,004)</u>
Balance, end of the year	<u>\$ 508,052</u>	<u>\$ 713,212</u>

9 - FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS:

Fair value

The Company has determined the estimated fair value of its financial instruments based on estimates and assumptions. The actual results may differ from those estimates and the use of different assumptions or methodologies may have a material effect on the estimated fair value amounts.

The fair value of cash, accounts receivable and accounts payable and accrued liabilities are comparable to their carrying value due to the relatively short period to maturity of these instruments.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

9 - FINANCIAL INSTRUMENTS AND FINANCIAL RISK FACTORS (continued):

Credit risk

The Company's credit risk is primarily attributable to receivables included in current assets. The Company has no material concentration of credit risk arising from operations. Cash consist of bank deposits, which have been invested with a Canadian Chartered Bank, from which management believes the risk of loss to be remote. Management believes that credit risk with respect to receivables is minimal.

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2008, the Company has cash of \$64,588 (December 31, 2007- \$217,372) to settle accounts payable and accrued liabilities of \$2,069,745 (December 31, 2007- \$1,899,675). The ability of the Company to continue to pursue its exploration activities is dependant on its ability to secure additional equity or other financing. All of the Company's financial liabilities have contractual maturities of less than 30 days and are subject to normal trade terms.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates and equity prices.

(a) Interest rate risk - The Company has cash and no interest bearing debt. The Company's current policy is to invest excess cash in investment-grade term deposit certificates issued by its banking institution. The Company periodically monitors the investments it makes and is satisfied with the credit of its bank.

(b) Price risk - the Company is exposed to price risk with respect to equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. The Company closely monitors individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company.

(c) Commodity price risk - the Company is exposed to price risk with respect to commodity prices. Changes in commodity prices will impact the economics of development of the Company's mineral properties. The Company closely monitors commodity prices to determine the appropriate course of action to be taken by the Company.

Sensitivity analysis

As at December 31, 2008, the carrying value amounts of the Company's financial instruments approximates their fair value.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

10 - CAPITAL MANAGEMENT:

The Company considers its capital to include components of shareholders' equity.

The Company's objectives in managing its capital are: to maintain adequate levels of funding to support its expenditures arising from the Company's investments; to safeguard the Company's ability to continue as a going concern in order to pursue the exploration of its properties; to maintain a flexible capital structure for its projects for the benefit of its stakeholders; to maintain corporate and administrative functions necessary to support the Company's operations and corporate functions; and to seek out and acquire new projects of merit.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of mineral property. The capability of the Company to carry out planned exploration and pay for administrative costs is dependant on its ability to secure additional equity or other financings. The Company will assess properties and seek to acquire properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so.

The Company's investment policy is to invest excess cash in low risk, highly liquid, short-term interest bearing investments, selected with regards to the expected timing of upcoming expenditures.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the year ended December 31, 2008. The Company is not subject to externally imposed capital requirements.

11 - COMMITMENTS AND 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.
- 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.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2008 AND 2007

11 - COMMITMENTS AND SUBSEQUENT EVENTS continued:

- d) On July 4, 2008, the Company entered into a five-year finder's fee agreement. The Company will pay fees on a downward scale from eight per cent (on the first \$10 million) to three percent (for amounts over \$15 million) on equity financing. In the case of joint venture financing, the fee scale will move from ten per cent (on the first \$300,000) to one and a half percent (for amounts over \$25 million).
- e) On January 1, 2009, the agreement with the Inuvialuit Land Corporation (note 4) expired. The Company is actively seeking renewal and continues to control permitted land in the Inuvialuit Settlement Region.
- f) As at December 31, 2008 the Company is committed to issue 667,666 common shares by way of a subscription agreement. On January 20, 2009, these shares were issued (note 6(b)).
- g) On March 10, 2009, the Company entered into a three-year finder's fee agreement. The Company will pay fees on a downward scale from eight per cent (on the first \$10 million) to three percent (for amounts over \$15 million) on equity financing. In the case of joint venture financing, the fee scale will move from ten per cent (on the first \$300,000) to one and a half percent (for amounts over \$25 million).
- h) On March 20, 2009, there were 1,500,000 options that expired.
- i) On April 20, 2009, the Company concluded a private placement of share purchase units. Each \$0.10 unit consisted of one common share and one four-year share purchase warrant priced at \$0.20. There were 1,170,000 units issued proceeds of \$117,000. In addition 208,300 flow through share purchase units were purchased for \$0.12 with flow through share purchase warrant available for four years at \$0.24 for additional proceeds of \$24,996.
- j) At April 30, 2009, the Company and Diadem Resources Limited are currently negotiating future terms regarding the diamond exploration project (note 4).

12- 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.

