

DARNLEY BAY RESOURCES LIMITED
(An Exploration Stage Enterprise)

INTERIM CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

FOR THE NINE MONTH PERIODS ENDED SEPTEMBER 30, 2011 AND 2010

Notice to Reader – From Darnley Bay Resources Limited

The interim condensed unaudited financial statements of Darnley Bay Resources Limited (the “Company” or “Darnley Bay”) including the accompanying statements of financial position as at September 30, 2011 and December 31, 2010, the statements of comprehensive loss for the three and nine month periods ended September 30, 2011 and 2010, the statements of changes in equity for the nine month periods ended September 30, 2011 and 2010 and year ended December 31, 2010, and statements of cash flows for the nine month periods ended September 30, 2011 and 2010 are the responsibility of the Company’s management. The interim condensed unaudited financial statements have been prepared by management and include the selection of appropriate accounting policies, judgments and estimates necessary to prepare these financial statements in accordance with International Financial Reporting Standards for interim financial statements.

The interim condensed unaudited financial statements as at and for the nine month period ended September 30, 2011 have not been reviewed by the Company's auditors.

DARNLEY BAY RESOURCES LIMITED
(An Exploration Stage Enterprise)

INTERIM CONDENSED STATEMENTS OF FINANCIAL POSITION
(UNAUDITED)

| | As at | |
|---|-----------------------|----------------------------------|
| | September 30, 2011 | December 31, 2010 (Note 4) |
| ASSETS | | |
| CURRENT | | |
| Cash | \$ 243,145 | \$ 1,214,083 |
| Accounts receivable (note 14) | 95,859 | 594,344 |
| Advances (note 13) | - | 221,949 |
| Prepaid expenses and deposits | 157,989 | 133,973 |
| | 496,993 | 2,164,349 |
| MINERAL PROPERTY (note 7) | 6,674,002 | 5,709,011 |
| | \$ 7,170,995 | \$ 7,873,360 |
| LIABILITIES | | |
| CURRENT | | |
| Accounts payable and accrued liabilities (notes 8 and 15) | \$ 597,987 | \$ 978,198 |
| SHAREHOLDERS' EQUITY | | |
| CAPITAL STOCK (note 9(a)) | 26,875,028 | 26,617,908 |
| RESERVE FOR WARRANTS (note 9(b)) | 2,525,759 | 2,525,759 |
| RESERVE FOR SHARE BASED PAYMENTS (notes 9(c) and 9(d)) | 1,635,337 | 1,743,597 |
| DEFICIT | (24,463,116) | (23,992,102) |
| | 6,573,008 | 6,895,162 |
| | \$ 7,170,995 | \$ 7,873,360 |
| Commitments (note 11) | | |
| Going concern basis (note 1) | | |
| Subsequent event (note 12) | | |

(signed) "Stephen Reford", Director

(signed) "Patricia Mannard", Director

See the accompanying notes to the financial statements
The external auditors have not reviewed these interim statements

DARNLEY BAY RESOURCES LIMITED
(An Exploration Stage Enterprise)

INTERIM CONDENSED STATEMENTS OF COMPREHENSIVE LOSS
(UNAUDITED)

| | Three months ended | | Nine months ended | |
|---|-----------------------|-----------------------------------|-----------------------|-----------------------------------|
| | September 30, 2011 | September 30, 2010 (Note 4) | September 30, 2011 | September 30, 2010 (Note 4) |
| EXPENSES | | | | |
| Office, general and administration services | \$ 106,191 | \$ 108,390 | \$ 301,596 | \$ 293,480 |
| Professional fees | 15,875 | 49,056 | 75,605 | 116,685 |
| Stock-based compensation (note 9(d)) | - | 540,400 | 49,560 | 540,400 |
| Premises rent | 15,000 | 15,000 | 45,000 | 45,196 |
| Shareholder communication | 4,806 | 23,590 | 61,144 | 76,437 |
| Net loss before the undernoted | (141,872) | (736,436) | (532,905) | (1,072,198) |
| Interest earned | 9 | - | 1,191 | - |
| NET LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD | (\$ 141,863) | (\$ 736,436) | (\$ 531,714) | (\$ 1,072,198) |
| Loss per share: | | | | |
| Basic and diluted loss per share (note 10) | \$ 0.001 | \$ 0.007 | \$ 0.005 | \$ 0.011 |
| Weighted average number of common shares outstanding | 104,575,949 | 97,126,174 | 103,918,711 | 92,596,657 |

See the accompanying notes to the financial statements
The external auditors have not reviewed these interim statements

DARNLEY BAY RESOURCES LIMITED
(An Exploration Stage Enterprise)

INTERIM CONDENSED STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)

| | Capital stock | | Reserves for | | | Total |
|--|---------------|--------------|--------------|----------------------|---------------------|--------------|
| | Shares | Amount | Warrants | Share based payments | Accumulated deficit | |
| Balance, January 1, 2011 | 103,584,645 | \$26,617,908 | \$ 2,525,759 | \$ 1,743,597 | (\$23,992,102) | \$ 6,895,162 |
| Proceeds on exercise of options | 1,600,000 | 160,000 | - | - | - | 160,000 |
| Fair value of exercised options | - | 97,120 | - | (97,120) | - | - |
| Fair value of options granted | - | - | - | 49,560 | - | 49,560 |
| Fair value of options expired | - | - | - | (60,700) | 60,700 | - |
| Net loss | - | - | - | - | (531,714) | (531,714) |
| Balance, September 30, 2011 | 105,184,645 | \$26,875,028 | \$ 2,525,759 | \$ 1,635,337 | (\$24,463,116) | \$ 6,573,008 |
| Balance, January 1, 2010 | 88,738,714 | \$23,648,307 | \$ 1,691,100 | \$ 1,157,992 | (\$23,597,244) | \$ 2,900,155 |
| Issued for cash under private placement | 10,625,000 | 4,250,000 | - | - | - | 4,250,000 |
| Proceeds on exercise of options | 100,000 | 10,000 | - | - | - | 10,000 |
| Fair value of exercised options | - | 6,070 | - | (6,070) | - | - |
| Proceeds on exercise of warrants | 328,417 | 79,188 | - | - | - | 79,188 |
| Fair value of exercised warrants | - | 20,940 | (20,940) | - | - | - |
| Proceeds on exercise of compensation options | 751,153 | 112,673 | - | - | - | 112,673 |
| Fair value of exercised compensation options | - | 95,096 | - | (95,096) | - | - |
| Fair value ascribed to warrants issued on exercise of compensation options | - | (69,943) | 69,943 | - | - | - |
| Fair value ascribed to warrants issued in private placements | - | (744,613) | 744,613 | - | - | - |
| Share issue costs | - | (489,023) | - | - | - | (489,023) |
| Share issue costs – compensation options | - | (164,581) | - | 164,581 | - | - |
| Premium on flow-through shares | - | (808,542) | - | - | - | (808,542) |
| Fair value of options granted | - | - | - | 540,400 | - | 540,400 |
| Fair value of options expired | - | - | - | (18,210) | 18,210 | - |
| Shares issued on debt conversion | 3,041,361 | 718,466 | - | - | - | 718,466 |
| Debt conversion reclassification | - | 8,710 | - | - | - | 8,710 |
| Net loss | - | - | - | - | (1,072,198) | (1,072,198) |
| Balance, September 30, 2010 | 103,584,645 | \$26,672,748 | \$ 2,484,716 | \$ 1,743,597 | (\$24,651,232) | \$ 6,249,829 |
| Balance, January 1, 2010 | 88,738,714 | \$23,648,307 | \$ 1,691,100 | \$ 1,157,992 | (\$23,597,244) | \$ 2,900,155 |
| Issued for cash under private placement | 10,625,000 | 4,250,000 | - | - | - | 4,250,000 |
| Proceeds on exercise of options | 100,000 | 10,000 | - | - | - | 10,000 |
| Fair value of exercised options | - | 6,070 | - | (6,070) | - | - |
| Proceeds on exercise of warrants | 328,417 | 79,188 | - | - | - | 79,188 |
| Fair value of exercised warrants | - | 20,940 | (20,940) | - | - | - |
| Proceeds on exercise of compensation options | 751,153 | 112,673 | - | - | - | 112,673 |
| Fair value of exercised compensation options | - | 95,096 | - | (95,096) | - | - |
| Fair value ascribed to warrants issued on exercise of compensation options | - | (81,568) | 81,568 | - | - | - |
| Shares issued on debt conversion | 3,041,361 | 718,466 | - | - | - | 718,466 |
| Fair value ascribed to warrants issued in private placement | - | (774,031) | 774,031 | - | - | - |
| Share issue costs – cash | - | (494,110) | - | - | - | (494,110) |
| Share issue costs – compensation options | - | (164,581) | - | 164,581 | - | - |
| Premium on flow-through shares | - | (808,542) | - | - | - | (808,542) |
| Fair value of options granted | - | - | - | 540,400 | - | 540,400 |
| Fair value of options expired | - | - | - | (18,210) | 18,210 | - |
| Net loss | - | - | - | - | (413,068) | (413,068) |
| Balance, December 31, 2010 | 103,584,645 | \$26,617,908 | \$ 2,525,759 | \$ 1,743,597 | (\$23,992,102) | \$ 6,895,162 |

See the accompanying notes to the financial statements
The external auditors have not reviewed these interim statements

DARNLEY BAY RESOURCES LIMITED
(An Exploration Stage Enterprise)

INTERIM CONDENSED STATEMENTS OF CASH FLOWS
UNAUDITED

| | Nine months ended | |
|--|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 |
| CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES: | | |
| Net loss for the period | (\$ 531,714) | (\$ 1,072,198) |
| Add: item not affecting cash | | |
| Stock-based compensation | 49,560 | 540,400 |
| Net changes in non-cash working capital balances: | | |
| Decrease in accounts receivable | 498,485 | 105,811 |
| Increase in prepaid expenses and deposits | (24,016) | (91,473) |
| Decrease in advances | 221,949 | - |
| (Decrease) increase in accounts payable and accrued liabilities | (380,211) | 698,795 |
| Cash (used in) provided by operations | (165,947) | 181,335 |
| CASH (USED IN) INVESTING ACTIVITIES: | | |
| Increase in mineral property | (964,991) | (4,340,533) |
| Cash (used in) investing | (964,991) | (4,340,533) |
| CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES: | | |
| Shares issued in private placement | - | 4,250,000 |
| Shares issued on exercise of stock options | 160,000 | 10,000 |
| Shares issued on exercise of warrants | - | 79,188 |
| Shares issued on exercise of compensation options | - | 112,673 |
| Share issue cost | - | (489,023) |
| Cash provided by financing | 160,000 | 3,962,838 |
| DECREASE IN CASH POSITION | (970,938) | (196,360) |
| CASH POSITION AT BEGINNING OF PERIOD | 1,214,083 | 3,965,696 |
| CASH AT END OF PERIOD | \$ 243,145 | \$ 3,769,336 |
| Supplementary cash flow information: | | |
| Fair value of stock options exercised | \$ 97,120 | \$ 6,070 |
| Fair value of warrants exercised | \$ - | \$ 20,940 |
| Fair value of compensation options exercised | \$ - | \$ 95,096 |
| Fair value ascribed to warrants issued on exercise of compensation options | \$ - | \$ 69,943 |
| Fair value ascribed to warrants issued in private placements | \$ - | \$ 744,613 |
| Interest received | \$ 1,191 | \$ - |
| Interest paid | \$ 7 | \$ 3,728 |
| Income taxes received | \$ - | \$ - |
| Income taxes paid | \$ - | \$ - |

See the accompanying notes to the financial statements
The external auditors have not reviewed these interim statements

DARNLEY BAY RESOURCES LIMITED
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NOTES TO INTERIM CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

1. NATURE OF OPERATIONS AND GOING CONCERN CONSIDERATIONS:

The Company was incorporated under the laws of the Province of Ontario, Canada. Its principle business activities are the exploration 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 exploration stage. The Company's shares are listed on the TSX Venture Exchange.

The recovery of amounts capitalized as Mineral Property 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 may be considered unrecoverable and written down in the future due to uncertainties in financing.

As at September 30, 2011, the Company has a working capital deficiency of \$100,994 compared to a working capital of \$1,186,151 at December 31, 2010 and an accumulated deficit of \$24,463,116 (December 31, 2010 - \$23,992,102). Management is currently pursuing several financing alternatives to raise additional capital. It is not possible to determine with any certainty, the success or adequacy of these initiatives.

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 and would be significant if the Company is unable to continue as a going concern.

2. BASIS OF PRESENTATION:

In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effectively for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in the interim financial statements for the three months ended March 31, 2011. In these interim financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS. These interim condensed financial Statements do not conform in all respects with Darnley Bay Resources' Canadian GAAP annual financial statements for the year ended December 31, 2010 as Canadian GAAP differs in some areas from IFRS. The disclosures concerning the transition from Canadian GAAP to IFRS are included in note 4.

Statement of Compliance

These interim condensed financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 *Interim Financial Reporting*, and IFRS 1 *First time Adoption of International Financial Reporting Standards*. The accounting policies followed in these interim financial statements are the same as those applied in the Company's interim financial statements for the periods ended March 31 and June 30, 2011. The Company has consistently applied the same accounting policies throughout all periods presented, as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the Company's statement of financial position as at September 30, 2010 and statements of comprehensive loss for the three and nine months ended September 30, 2010, including the nature and effect of significant changes in accounting policies from those used in the Company's annual audited financial statements for the year ended December 31, 2010.

The accounting policies applied in these interim condensed financial statements are based on IFRS effective for the year ended December 31, 2011, as issued and outstanding as of November 28, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual financial statements for the year ending December 31, 2011 could result in restatement of these interim financial statements, including transition adjustments recognized on changeover to IFRS.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO INTERIM CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

2. BASIS OF PRESENTATION (continued):

Statement of Compliance (continued)

The interim condensed financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010, and the Company's interim financial statements for the quarters ended March 31 and June 30, 2011 prepared in accordance with IFRS applicable to interim financial statements.

Basis of Measurement

These interim condensed financial statements have been prepared on the historical cost basis.

Functional and Presentation Currency

These interim condensed financial statements are presented in Canadian dollars, which is the functional currency of the Company.

Use of Estimates and Judgement

The preparation of interim financial statements in conformity with IFRS requires that management make estimates and assumptions about future events that affect the amounts reported in the interim financial statements and related notes to the financial statements. Actual results may differ from those estimates.

In preparing these interim financial statements, the significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty are expected to be the same as those to be applied in the first annual IFRS financial statements.

Significant estimates used in the preparation of these interim financial statements include, but are not limited to, the recoverability of exploration and evaluation ("E&E") assets, share-based compensation, income taxes, the recording of liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenditures during the reporting period. Actual results could differ from management's best estimates.

3. FUTURE ACCOUNTING CHANGES:

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the IASB or IFRIC that are mandatory for accounting periods beginning after January 1, 2011 or later periods. Updates are not applicable or are not consequential to the Company have been excluded thereof.

IAS 1 *Presentation of Financial Statements* was amended to require entities to group items within other comprehensive income that may be reclassified to profit or loss. This standard is effective for annual periods beginning on or after July 1, 2012. The Company is currently evaluating the impact of IAS 1 amendments.

IFRS 9 *Financial Instruments – Classification and Measurement* ("IFRS 9") was issued November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with early adoption permitted, introduces new requirements for the classification and measurement of financial instruments. Management anticipates that this standard will be adopted in the Company's financial statements for the period beginning January 1, 2013, with early adoption permitted. The Company has not yet determined the potential impact of the amendments to IFRS 9 on its financial statements.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO INTERIM CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

3. FUTURE ACCOUNTING CHANGES (continued):

IFRS 7 *Financial Instruments – Disclosures* (“IFRS 7”) was amended by the IASB in October 2010 and provides guidance on identifying transfers of financial assets and continuing involvement in transferred assets for disclosure purposes. The amendments introduce new disclosure requirements for transfers of financial assets including disclosures for financial assets that are not derecognized in their entirety, and for financial assets that are derecognized in their entirety but for which continuing involvement is retained. The amendments to IFRS 7 are effective for annual periods beginning on or after July 1, 2011. The Company has not yet determined the impact of the amendments to IFRS 7 on its financial statements.

IFRS 11 *Joint Arrangements* (“IFRS 11”) requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operative. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers*. This standard is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet determined the impact, if any, of the IFRS 11 on its financial statements.

IFRS 13 *Fair Value Measurement* (“IFRS 13”) is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. This standard is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company is currently evaluating the impact of IFRS 13.

4. TRANSITION TO IFRS:

The Company's financial statements for the year ending December 31, 2011 will be the first annual financial statements that comply with IFRS and these interim condensed financial statements were prepared as described in note 2, including the application of IFRS 1. IFRS 1 requires an entity to adopt IFRS in its first annual financial statements prepared under IFRS by making an explicit and unreserved statement in those financial statements of compliance with IFRS. The Company will make this statement when it issues its 2011 annual financial statements.

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which the Company has applied IFRS was January 1, 2010 (the “Transition Date”). IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company will be December 31, 2011. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

Initial elections upon adoption

Set forth below are the IFRS 1 applicable exemptions and exceptions applied in the conversion from Canadian GAAP to IFRS.

IFRS Exemption Options

Share-based payments - IFRS 2, Share-based Payments, encourages application of its provisions to equity instruments granted on or before November 7, 2002, but permits the application only to equity instruments granted after November 7, 2002 that had not vested by the Transition Date. The Company elected to avail itself of the exemption provided under IFRS 1 and applied IFRS 2 for all equity instruments granted after November 7, 2002 that had not vested by its Transition Date.

DARNLEY BAY RESOURCES LIMITED
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NOTES TO INTERIM CONDENSED FINANCIAL STATEMENTS
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4. TRANSITION TO IFRS (continued):

IFRS Exemption Options (continued)

Mineral property – IFRS 6 - Upon transition to IFRS, the Company retained its accounting policies and practices it has applied previously under Canadian GAAP, relating to the recognition of mineral property. The Company elected to use the cost model for its mineral property which is consistent with its policy under Canadian GAAP. The Company did not elect to measure mineral property at its deemed cost equivalent to fair value as at January 1, 2010 or revalue amounts previously determined under Canadian GAAP. Accordingly, the Company used the carrying values of its mineral properties and deferred exploration costs as the IFRS balances as at January 1, 2010.

IFRS Mandatory Exceptions

Estimates - Hindsight is not used to create or revise estimates. The estimates previously made by the Company under Canadian GAAP were not revised for application of IFRS except where necessary to reflect any difference in accounting policies.

Reconciliations of Canadian GAAP to IFRS

IFRS 1 requires an entity to reconcile equity, comprehensive loss and cash flows for prior periods. The changes made to the statements of financial position and statements of comprehensive loss as shown below have resulted in reclassifications of various amounts on the statements of cash flows, however as there have been no material adjustments to the net cash flows, no reconciliation of the statement of cash flows has been prepared.

Changes in accounting policies:

The following narratives explain the significant differences between the previous historical Canadian GAAP accounting policies and the current IFRS policies applied by the Company. Please refer to the Company's March 31, 2011 interim condensed financial statements for a complete description of the accounting policies used.

a) Share-based compensation

IFRS 2 is effective for the Company as of January 1, 2010 and is applicable to stock options and grants that are unvested at that date. The transition rules in IFRS 1 and IFRS 2 as applied by the Company result in the following:

- Stock options and share grants prior to November 7, 2002 are not taken into account for IFRS 2;
- Stock options and share grants subsequent to November 7, 2002 are only taken into account if they have not vested as at January 1, 2010; and,
- From January 1, 2010, all stock options, share grants and other share-based payments will be expensed in accordance with the Company's accounting policy stated in note 3 in the Company's interim condensed financial statements for the period ended March 31, 2011.

Forfeitures

Canadian GAAP - Forfeitures of awards are recognized as they occur.

IFRS – An estimate is required of the number of awards expected to vest, which is revised if subsequent information indicates that actual forfeitures are likely to differ from the estimate. No material difference was determined and consequently no adjustment was made.

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NOTES TO INTERIM CONDENSED FINANCIAL STATEMENTS
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4. TRANSITION TO IFRS (continued):

Changes in accounting policies (continued):

a) Share-based compensation (continued)

Expiration of share-based compensation

Canadian GAAP – Under Canadian GAAP, the Company's policy was to leave the value recorded for expired, unexercised stock options to contributed surplus, and to record the value of expired, unexercised warrants to contributed surplus.

IFRS – The Company has changed its policy regarding expired share-based compensation whereby amounts recorded for expired, unexercised stock options and warrants are transferred to retained earnings/(deficit) on expiry. The impact of this change was to decrease contributed surplus and decreased deficit by \$18,210 at December 31, 2010 (September 30, 2010 – \$18,210).

b) Reserves

Canadian GAAP – Under Canadian GAAP – Prior to 2011, the Company recorded the value of share based payments and warrants issued to contributed surplus.

IFRS – IFRS requires an entity to present for each component of equity, a reconciliation between the carrying amount at the beginning and end of the period, separately disclosing each change. IFRS requires a separate disclosure of the value that relates to "Reserves for warrants", "Reserves for share based payments" and any other component of equity.

c) Impairment of (non-financial) assets

IFRS requires a write-down of assets if the higher of the fair market value and the value in use of a group of assets is less than its carrying value. Value in use is determined using discounted estimated future cash flows. Canadian GAAP requires a write-down to estimated value only if the undiscounted estimated future cash flows of a group of assets are less than its carrying value.

The Company's accounting policies related to impairment of non-financial assets have been changed to reflect these differences. There is no impact on the unaudited interim condensed financial statements.

d) Flow-through shares

According to Canadian GAAP, the resource expenditure deduction for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. The deferred income taxes relating to the temporary difference that arise when the qualifying expenditures are incurred were recorded at the time of filing the renunciation with the tax authorities. The recognition of the deferred income tax liability results in a corresponding reduction to the carrying value of the shares issued.

Under IFRS, the proceeds from issuing flow-through shares are allocated between the offering of shares and the sale of tax benefits. The allocation is based on the difference ("premium") between the quoted price of the Company's existing shares, at the date of closing, and the amount the investor pays for the actual flow-through shares. A liability is recognized for the premium, in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets, and is extinguished when the tax effect of the temporary differences, resulting from the renunciation, is recorded. The difference between the liability and the value of the tax assets renounced is recorded as a deferred tax expense. There is no subsequent reduction in share capital. If the flow-through shares are not issued at a premium, a liability is not established and on renunciation the full value of the tax assets renounced is recorded as a deferred tax expense.

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4. TRANSITION TO IFRS (continued):

Changes in accounting policies (continued):

d) Flow-through shares (continued)

As at December 31, 2010, \$878,227 (September 30, 2010 - \$1,092,540) was credited to share capital, \$455,569 (September 30, 2010 - \$1,901,082) was debited to deficit, \$nil (September 30, 2010 - \$808,542) was credited to other liability and \$422,658 (September 30, 2010 - \$1,445,513) was debited to future income tax recovery.

e) Presentation

The presentation in accordance with IFRS differs from the presentation in accordance with Canadian GAAP. Please refer to the interim statements of financial position and interim statements of comprehensive loss, and changes in equity for the impact of the specific IFRS changes noted above.

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4. TRANSITION TO IFRS (continued):

Reconciliation of Statement of Financial Position as at September 30, 2010

| | Canadian GAAP | IFRS Adjustments | Ref. | IFRS |
|--|---------------------|---------------------|------------|---------------------|
| ASSETS | | | | |
| CURRENT | | | | |
| Cash | \$ 3,769,336 | - | | \$ 3,769,336 |
| Accounts receivable | 26,013 | - | | 26,013 |
| Deposits | 100,000 | - | | 100,000 |
| | <u>3,895,349</u> | <u>-</u> | | <u>3,895,349</u> |
| Mineral property | 5,011,873 | - | | 5,011,873 |
| | <u>\$ 8,907,222</u> | <u>-</u> | | <u>\$ 8,907,222</u> |
| LIABILITIES | | | | |
| CURRENT | | | | |
| Accounts payable and accrued liabilities | \$ 1,848,851 | - | | \$ 1,848,851 |
| Other liabilities | - | 808,542 | 4(d) | 808,542 |
| Total liabilities | <u>1,848,851</u> | <u>808,542</u> | | <u>2,657,393</u> |
| SHAREHOLDERS' EQUITY | | | | |
| Capital stock | 25,580,208 | 1,092,540 | 4(d) | 26,672,748 |
| Reserve for warrants | 2,484,716 | - | | 2,484,716 |
| Reserve for share based payments | 1,761,807 | (18,210) | 4(a) | 1,743,597 |
| Deficit | (22,768,360) | (1,882,872) | 4(a), 4(d) | (24,651,232) |
| | <u>7,058,371</u> | <u>(808,542)</u> | | <u>6,249,829</u> |
| | <u>\$ 8,907,222</u> | <u>-</u> | | <u>\$ 8,907,222</u> |

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4. TRANSITION TO IFRS (continued):

Reconciliation of the Statement of Comprehensive Income (Loss) for the nine months ended September 30, 2010

| | Canadian GAAP | IFRS Adjustments | Reference | IFRS |
|--|-------------------|---------------------|-----------|----------------------|
| EXPENSES | | | | |
| Office, general and administration services | \$ 293,480 | - | | \$ 293,480 |
| Professional fees | 116,685 | - | | 116,685 |
| Premises rent | 45,196 | - | | 45,196 |
| Shareholder communication | 76,437 | - | | 76,437 |
| Stock option compensation cost | <u>540,400</u> | <u>-</u> | | <u>540,400</u> |
| Net loss before the undernoted | (1,072,198) | - | | (1,072,198) |
| Future income tax recovery | 1,445,513 | (1,445,513) | 4(d) | - |
| NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) | <u>\$ 373,315</u> | <u>(1,445,513)</u> | | <u>(\$1,072,198)</u> |

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4. TRANSITION TO IFRS (continued):

Reconciliation of the Statement of Comprehensive Income (Loss) for the three months ended September 30, 2010

| | Canadian GAAP | IFRS Adjustments | Reference | IFRS |
|--|-------------------|---------------------|-----------|---------------------|
| EXPENSES | | | | |
| Office, general and administration services | \$ 108,390 | - | | \$ 108,390 |
| Professional fees | 49,056 | - | | 49,056 |
| Premises rent | 15,000 | - | | 15,000 |
| Shareholder communication | 23,590 | - | | 23,590 |
| Stock option compensation cost | <u>540,400</u> | | | <u>540,400</u> |
| Net loss before the undernoted | (736,436) | - | | (736,436) |
| | | | | |
| Future income tax recovery | 1,445,513 | (1,445,513) | 4(d) | - |
| | | | | |
| NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) | <u>\$ 709,077</u> | <u>(1,445,513)</u> | | <u>(\$ 736,436)</u> |

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5. CAPITAL MANAGEMENT:

The Company manages its capital structure and makes adjustments to it, based on the funds required and available to the Company, in order to support the acquisition, exploration and development of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for this management, but rather relies on the expertise of the Company's management to sustain future development of the business. In this relatively formative stage of the Company's existence, it is likely that primary emphasis will continue to be placed on equity instruments as funded debt is unlikely to be available to the Company.

The properties in which the Company currently has an interest are in the exploration stage; as such the Company is dependent on external financing to fund its activities. In order to carry out the planned exploration and pay for administrative costs, the Company intends on raising additional amounts of working capital. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so.

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 nine month period ended September 30, 2011. The Company is not subject to externally imposed capital requirements.

6. FINANCIAL INSTRUMENTS:

The Company manages its exposure to a number of different financial risks arising from operations as well as from the use of financial instruments including market risks (commodity prices, foreign currency exchange rate and interest rate), credit risk and liquidity risk through its risk management strategy. The objective of the strategy is to support the delivery of the Company's financial targets while protecting its future financial security and flexibility.

Financial risks are primarily managed and monitored through operating and financing activities. The Company does not use derivative financial instruments. The financial risks are evaluated regularly with due consideration to changes in key economic indicators and to up-to-date market information.

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

Credit risk

The Company's credit risk is primarily attributable to short-term investment and receivables included in other assets. The Company has no significant concentration of credit risk arising from operations.

Cash consist of bank deposits which have been invested with reputable financial institution (being Canadian Schedule A Chartered Bank), from which management believes the risk of loss to be remote. Management believes that the credit risk concentration with respect to financial instruments included in other assets is remote.

Liquidity risk

Liquidity risk encompasses the risk that a company cannot meet its financial obligations in full. The Company's main source of liquidity is its cash. These funds are primarily used to finance working capital, exploration expenditures, capital expenditures, and acquisitions.

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6. FINANCIAL INSTRUMENTS (continued):

Liquidity risk (continued)

The Company manages its liquidity risk by regularly monitoring its cash flows from operating activities and holding adequate amounts of cash and cash equivalents. Accounts payable and accrued liabilities are current financial instruments expected to be settled in the normal course of operations.

As at September 30, 2011, the Company held cash of \$243,145.

Market risk

Market risk is the risk of uncertainty arising primarily from possible commodity market price movements and their impact on the future economic viability of the Company's projects and ability of the Company to raise capital. These market risks are evaluated by monitoring changes in key economic indicators and market information on an on-going basis and adjusting operating and exploration budgets accordingly.

a) Interest rate risk

Interest rate risk is the risk borne by an interest-bearing asset or liability as a result of fluctuations in interest rates.

Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's investment policy is to invest excess cash in highly liquid investments that earn interest at market rates. The Company does not have any interest bearing liabilities.

Although the Company endeavours to maximize the interest income earned on excess funds, the Company's policy focuses on cash preservation, while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Company's policy limits the investing of excess funds to liquid term deposits, treasury bills and banker's acceptances.

Fluctuations in market interest rates have not had a significant impact on the Company's results of operations due to the short term maturity of the investments held.

b) Commodity price risk

The value of the Company's mineral resource properties are related to the prices for mineral resources, and their outlook. Adverse changes in the prices for mineral resources can significantly impair the economic viability of the Company's projects, along with the ability to obtain future financing.

Prices for mineral resources historically have fluctuated widely and are affected by numerous factors outside of the Company's control, including, but not limited to, industrial and retail demand, levels of worldwide production, short-term changes in supply and demand due to speculative hedging activities, macro-economic variables and various other factors.

A protracted period of depressed prices could impair the Company's operations and exploration opportunities, and significantly erode shareholder value.

Fair value

The Company has designated its cash as held-for-trading, which is measured at fair value. Accounts receivable and advances 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.

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7. MINERAL PROPERTY:

The following table shows changes in the mineral property balance for the year ended December 31, 2010. The balance of additions is presented net of the reimbursements that are being received from the Diadem Resources Ltd. ("Diadem") under the memorandum of understanding in existence between the Company and Diadem (see note 11(e) for additional information):

| | Cumulative to December 31, 2009 | 2010 additions (net of reimbursements) | Cumulative to December 31, 2010 |
|--|------------------------------------|---|------------------------------------|
| Project management | \$ 121,505 | \$ 91,640 | \$ 213,145 |
| Consultants | 38,540 | 137,943 | 176,483 |
| Licenses and permits | 228,643 | 39,888 | 268,531 |
| Property access and exploration costs | 282,652 | 4,768,200 | 5,050,852 |
| | <u>\$ 671,340</u> | <u>\$ 5,037,671</u> | <u>\$ 5,709,011</u> |

The following table shows changes in the mineral property balance for the nine month period ended September 30, 2011:

| | Cumulative to December 31, 2010 | Nine month ended September 30, 2011 additions (net of reimbursements) | Cumulative to September 30, 2011 |
|--|------------------------------------|--|-------------------------------------|
| Project management | \$ 213,145 | \$ 62,380 | \$ 275,525 |
| Consultants | 176,483 | 20,402 | 196,885 |
| Licenses and permits | 268,531 | 1,550 | 270,081 |
| Property access and exploration costs | 5,050,852 | 880,659 | 5,931,511 |
| | <u>\$ 5,709,011</u> | <u>\$ 964,991</u> | <u>\$ 6,674,002</u> |

For the three month ended September 30, 2011 and 2010, the Company has incurred the following expenditures on its mineral property:

| | Three month ended September 30 | |
|--|--------------------------------|---------------------|
| | 2011 | 2010 |
| Project management | \$ 6,000 | \$ 17,600 |
| Consultants | 2,000 | 31,491 |
| Licenses and permits | - | 18 |
| Property access and exploration costs | 12,104 | 2,892,530 |
| | <u>20,104</u> | <u>2,941,639</u> |
| Reimbursements received | (68,711) | - |
| Total additions (net of reimbursements) | <u>(\$ 48,607)</u> | <u>\$ 2,941,639</u> |

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8. RELATED PARTY TRANSACTIONS:

During the nine-month period ended September 30, 2011, La Prairie Ltd., a company controlled by a director and officer of the Company, charged the Company \$86,400 (\$86,671 in the same period 2010) for management services, office administration and premises rent. Executive management and accounting fees of \$150,500 and exploration project management fees of \$69,640 were charged in the nine-month period by directors and officers (\$139,050 and \$99,015 in the same nine-month period in 2010). Reimbursable exploration expenses in the nine-month period (includes travel to the property) totalled \$15,230 (\$42,826 in the same period in 2010). Office, meeting and travel expenses of \$7,195 for the period (\$9,751 in the same period in 2010) were also charged by the related parties.

In the nine-month period ended September 30, 2010 there was \$521,049 in debt converted to shares and issued to officers, directors, and a company controlled by a director of the Company (see note 9(a)(v) for additional information).

During the nine-month period ended September 30, 2011, the CEO received 700,000 stock options exercisable for five years at \$0.10. The fair value of these options has been estimated at \$49,560.

As at September 30, 2011, accounts payable include \$4,924 (2010 - \$115,292) due 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 being fair market value in the circumstances.

9. CAPITAL STOCK:

a) Common shares:

Authorized:

An unlimited number of common shares

Issued and outstanding:

| | Number of shares | Amount |
|---|------------------|--------------|
| Balance, January 1, 2010 | 88,738,714 | \$23,648,307 |
| Issued for cash under private placement (9(a)(i)) | 10,625,000 | 4,250,000 |
| Proceeds on exercise of options (9(a)(ii)) | 100,000 | 10,000 |
| Fair value of exercised options | - | 6,070 |
| Proceeds on exercise of warrants (9(a)(iii)) | 328,417 | 79,188 |
| Fair value of exercised warrants | - | 20,940 |
| Proceeds on exercise of compensation options (9(a)(iv)) | 751,153 | 112,673 |
| Fair value of exercised compensation options | - | 95,096 |
| Fair value ascribed to warrants issued on exercise of compensation options (9(b)) | - | (81,568) |
| Shares issued on debt conversion (9(a)(v)) | 3,041,361 | 718,466 |
| Fair value ascribed to warrants issued in private placement (9(b)) | - | (774,031) |
| Share issue costs – cash | - | (494,110) |
| Share issue costs – compensation options (9(c)) | - | (164,581) |
| Premium on flow-through shares | - | (808,542) |
| Balance, December 31, 2010 | 103,584,645 | \$26,617,908 |
| Proceeds on exercise of options (9(a)(vi)) | 1,600,000 | 160,000 |
| Fair value of exercised options | - | 97,120 |
| Balance, September 30, 2011 | 105,184,645 | \$26,875,028 |

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9. CAPITAL STOCK (continued):

a) Common shares (continued):

Issued and outstanding (continued):

Year ended December 31, 2010:

(i) Shares issued for cash

On August 25, 2011, the Company has closed a private placement financing of 10,625,000 flow-through units of the Company (the "flow-through units") at a price of \$0.40 per flow-through unit for total gross proceeds to the Company of \$4,250,000. Each flow-through unit consisted of one flow-through share and one half of one common share purchase warrant of the Company. Each whole warrant entitles the holder to acquire one non-flow-through common share at an exercise price of \$0.45 for a period of 24 months from the closing date of the private placement. The Company has paid agent a cash commission in relation to the private placement in the amount of 8% of the gross proceeds as well as paid various legal and regulatory fees for a total cash share issue costs of \$494,110. The Company has also issued to an agent 1,062,500 compensation options, each valued at \$0.1549 per compensation option for gross non-cash share issue costs of 164,581. Each compensation option entitled an agent to purchase a unit consisting of one common share and one half of one common share purchase warrant for \$0.40 up to August 25, 2012. Warrants received upon exercise of the agent's option are exercisable at \$0.45 until August 25, 2012.

(ii) Shares issued on exercise of stock options

On March 11, 2010, a consultant of the Company exercised 100,000 of his stock options and acquired 100,000 common shares of the Company at \$0.10 per share.

(iii) Shares issued on exercise of warrants

On May 17, 2010, the Company has issued 20,000 common shares at \$0.25 per share upon exercise of warrants issued as part of December 2009 financing completed by the Company.

On June 17, 2010, the Company has issued 291,667 flow-through common shares at \$0.24 per share upon exercise of flow-through warrants issued as part of May 2009 private placement undertaken by the Company.

On August 31, 2010, the Company has issued 16,750 common shares at \$0.25 per share upon exercise of warrants issued as part of December 2009 financing completed by the Company.

(iv) Shares issued on exercise of compensation options

On April 27, 2010, the Company has issued 4,175 units of the Company at \$0.15 per unit upon exercise of equivalent number of compensation options which have been issued to an agent in relation to December 2009 financing. Each unit consisted of one common share and one half of one common share purchase warrant of the Company. Each whole warrant entitles the holder to acquire one common share at an exercise price of \$0.25 until December 29, 2012.

On May 13, 2010, the Company has issued 25,000 units of the Company at \$0.15 per unit upon exercise of equivalent number of compensation options which have been issued to an agent in relation to December 2009 financing. Each unit consisted of one common share and one half of one common share purchase warrant of the Company. Each whole warrant entitles the holder to acquire one common share at an exercise price of \$0.25 until December 29, 2012.

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9. CAPITAL STOCK (continued):

a) Common shares (continued):

Issued and outstanding (continued):

Year ended December 31, 2010 (continued):

(iv) Shares issued on exercise of compensation options (continued)

On May 21, 2010, the Company has issued 516,670 units of the Company at \$0.15 per unit upon exercise of equivalent number of compensation options which have been issued to an agent in relation to December 2009 financing. Each unit consisted of one common share and one half of one common share purchase warrant of the Company. Each whole warrant entitles the holder to acquire one common share at an exercise price of \$0.25 until December 29, 2012.

On August 31, 2010, the Company has issued 205,308 units of the Company at \$0.15 per unit upon exercise of equivalent number of compensation options which have been issued to an agent in relation to December 2009 financing. Each unit consisted of one common share and one half of one common share purchase warrant of the Company. Each whole warrant entitles the holder to acquire one common share at an exercise price of \$0.25 until December 29, 2012.

(v) Shares issued on debt conversion

On April 8, 2010, the TSX Venture exchange approved debt conversion agreements that have been signed by the Company with some of its creditors. The total amount of debt outstanding of \$718,466 has been converted into 3,041,361 common shares of the Company. \$521,049 of the aforementioned debt conversion was with officers, directors, and a company controlled by a director of the Company.

Nine months ended September 30, 2011:

(vi) Shares issued on exercise of stock options

On August 5, 2011, the Company has issue 1,600,000 common shares upon exercise of equivalent number of stock options by certain consultants of the Company. Common shares have been issued at \$0.10 per share.

b) Warrants:

On August 25, 2011, the Company issued 5,312,500 warrants as part of a private placement. Each warrant entitles the holder to acquire one common share at an exercise price of \$0.45 for a period of 24 months from the closing date of the private placement (see note 9(a)(i) for additional information).

During the year ended December 31, 2010, the Company had issued 375,577 warrants upon exercise of compensation options previously issued as a commission to brokers. Each whole warrant entitles the holder to acquire one common share at an exercise price of \$0.25 until December 29, 2012 (see note 9(a)(iv) for additional information).

During the year ended December 31, 2010, the Company issued 291,667 flow-through common shares and 36,750 non-flow-through common shares upon exercise, at \$0.24 and \$0.25 respectively, of corresponding number of flow-through and non-flow-through common share purchase warrants (see note 9(a)(iii) for additional information).

During the year ended December 31, 2010, 1,559,000 non-flow-through common share purchase warrants and 133,666 flow-through common share purchase warrants have expired.

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9. CAPITAL STOCK (continued):

b) Warrants (continued):

There were no capital transactions with relations to warrants of the Company during the nine month period ended September 30, 2011.

The following table summarizes warrants that have been issued, exercised or have expired during the year ended December 31, 2010 and for the nine months ended September 30, 2011:

| | Number of warrants | Exercise price | Expiry date |
|--|--------------------|----------------|-------------------|
| Outstanding, January 1, 2010 | 19,900,983 | | |
| Warrants expired during the year | (825,000) | \$ 2.00 | October 14, 2010 |
| | (200,000) | \$ 0.40 | October 2, 2010 |
| | (534,000) | \$ 0.24 | January 20, 2010 |
| | (133,666) | \$ 0.30 | January 20, 2010 |
| Warrants exercised during the year | (291,667) | \$ 0.24 | May 20, 2013 |
| | (36,750) | \$ 0.25 | December 29, 2012 |
| Warrants issued during the year | 375,577 | \$ 0.25 | December 29, 2012 |
| | 5,312,500 | \$ 0.45 | August 25, 2012 |
| Outstanding, December 31, 2010 and September 30, 2011 | <u>23,567,977</u> | | |

At September 30, 2011, the following warrants were outstanding. The warrants entitle the holders to purchase the stated number of shares at the exercise price on or before the expiry date:

| | Number of warrants | Exercise price | Expiry date |
|--|--------------------|----------------|-------------------|
| | 1,170,000 | \$ 0.20 | April 19, 2013 |
| | 208,300 | \$ 0.24 | April 19, 2013 |
| | 1,550,000 | \$ 0.20 | May 20, 2013 |
| | 291,666 | \$ 0.24 | May 20, 2013 |
| | 2,475,000 | \$ 0.20 | July 23, 2013 |
| | 12,560,511 | \$ 0.25 | December 29, 2012 |
| | 5,312,500 | \$ 0.45 | August 25, 2012 |
| | <u>23,567,977</u> | | |

The fair value of each warrant was estimated on the date of measurement. Under Black-Scholes, the warrants issued in 2010 were valued at \$855,599 (\$81,568 attributable to warrants issued upon exercise of compensation options and \$774,031 attributable to warrants issued as part of the private placement) and recorded as share purchase warrants using the following assumptions at the measurement date:

| | April 27, 2010 | May 13, 2010 | May 21, 2010 | August 25, 2010 | September 1, 2010 | Total |
|-----------------------------|----------------|--------------|--------------|-----------------|-------------------|------------|
| Number of warrants | 2,088 | 12,500 | 258,335 | 5,312,500 | 102,654 | 5,688,077 |
| Exercise price (\$) | 0.250 | 0.250 | 0.250 | 0.450 | 0.250 | |
| Market Price (\$) | 0.320 | 0.335 | 0.340 | 0.325 | 0.350 | |
| Expected volatility (%) | 100 | 100 | 100 | 100 | 100 | |
| Risk-free interest rate (%) | 1.82 | 1.72 | 1.51 | 1.60 | 1.25 | |
| Expected life (years) | 2.68 | 2.63 | 2.61 | 2.00 | 2.33 | |
| Dividend yield (%) | - | - | - | - | - | |
| Fair value of warrants | \$ 453 | \$ 2,727 | \$ 56,360 | \$ 774,031 | \$ 22,028 | \$ 855,599 |

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9. CAPITAL STOCK (continued):

b) Warrants (continued):

The following table summarizes fair value attributable to warrants that have been issued, exercised or have expired during the year ended December 31, 2010, there were no warrants issued in the nine-month period ended September 30, 2011:

| | | |
|-----------------------------|----|-------------------------|
| Balance, December 31, 2009 | \$ | 1,691,100 |
| Issued | | 855,599 |
| Expired | | - |
| Exercised | (| 20,940) |
| Balance, December 31, 2010 | \$ | <u>2,525,759</u> |
| Issued | | - |
| Expired | | - |
| Exercised | | - |
| Balance, September 30, 2011 | \$ | <u><u>2,525,759</u></u> |

c) Agent's compensation options:

On August 25, 2010, the Company has issued 1,062,500 agent's compensation options ("compensation options" or "agent's options") (see note 9(a)(i) for additional information). Each option entitles the agent to purchase a unit consisting of one common share and one half of one common share purchase warrant for \$0.40 up to August 25, 2012. Warrants received upon exercise of the agent's option are exercisable at \$0.45 until August 25, 2012.

On December 29, 2009, there were 3,333,333 agent's options granted. Each option entitles the agent to purchase a unit consisting of one common share and one half of one common share purchase warrant for \$0.15 up to December 29, 2012. Warrants received upon exercise of the agent's option are exercisable for three years at \$0.25. During 2010, 751,153 of these agent's options have been exercised (see note 9(a)(iv) for additional information).

The fair value of each agent's option was estimated on the date of grant. Under Black-Scholes, the agent's options issued in 2010 were valued at \$164,581 and capitalized to share issue costs using the following assumptions at the measurement date:

| | August 25, 2010 | Total |
|-------------------------------|-----------------|------------|
| Number of agent's options | 1,062,500 | 1,062,500 |
| Exercise price (\$) | 0.400 | |
| Market Price (\$) | 0.325 | |
| Expected volatility (%) | 100 | |
| Risk-free interest rate (%) | 1.60 | |
| Expected life (years) | 2.00 | |
| Dividend yield (%) | - | |
| Fair value of agent's options | \$ 164,581 | \$ 164,581 |

At September 30, 2011, the following agent's options were outstanding. The agent's options entitle the holders to purchase the stated number of units of the Company at the exercise price on or before the expiry date:

| Number of agent's options | Exercise price | Expiry date |
|------------------------------|----------------|-------------------|
| 2,582,180 | \$ 0.15 | December 29, 2012 |
| <u>1,062,500</u> | \$ 0.40 | August 25, 2012 |
| <u><u>3,644,680</u></u> | | |

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9. 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 5,250,000 shares. On August 5, 2011, there were 1,600,000 options exercised at \$0.10 for gross proceeds of \$160,000 and 1,000,000 options expired. The remaining stock options outstanding are exercisable at the following prices – \$0.15 for 300,000 (expiring on November 12, 2011), \$0.32 for 300,000 (expiring on November 27, 2011), \$0.27 for 300,000 (expiring July 26, 2012) and \$0.37 for 1,750,000 (expiring August 31, 2015) (see note 12 for additional information). On June 30, 2011, the Company granted 700,000 options to an officer and director to purchase common shares at \$0.10 for a period of five years.

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 10,518,465 stock options to be granted under the Plan.

The following table summarizes stock options that have been granted, exercised, expired or cancelled during the years ended 2010 and for the period ended September 30, 2011.

| | Number | Weighted average price |
|-----------------------------|-------------|------------------------|
| Balance, December 31, 2009 | 3,600,000 | \$ 0.12 |
| Granted | 2,050,000 | 0.35 |
| Expired or cancelled | (300,000) | 0.10 |
| Exercised | (100,000) | 0.10 |
| Balance, December 31, 2010 | 5,250,000 | \$ 0.22 |
| Granted | 700,000 | 0.10 |
| Expired or cancelled | (1,000,000) | 0.10 |
| Exercised | (1,600,000) | 0.10 |
| Balance, September 30, 2011 | 3,350,000 | \$ 0.28 |

The fair value of each option is estimated on the date of grant. Under Black-Scholes, the options issued in 2010 were valued at \$540,400 (for the nine month ended September 30, 2011 - \$49,560) and expensed to loss, using the following assumptions at the measurement date:

| | July 26, 2010 | August 31, 2010 | Total |
|-----------------------------|---------------|-----------------|------------|
| Number of stock options | 300,000 | 1,750,000 | 2,050,000 |
| Exercise price (\$) | 0.270 | 0.370 | |
| Market Price (\$) | 0.325 | 0.370 | |
| Expected volatility (%) | 100 | 100 | |
| Risk-free interest rate (%) | 1.60 | 2.05 | |
| Expected life (years) | 2.00 | 5.00 | |
| Dividend yield (%) | - | - | |
| Fair value of stock options | \$ 55,650 | \$ 484,750 | \$ 540,400 |

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9. CAPITAL STOCK (continued):

d) Stock option plan (continued):

| | June 30, 2011 | Total |
|-----------------------------|---------------|-----------|
| Number of stock options | 700,000 | 700,000 |
| Exercise price (\$) | 0.100 | |
| Market Price (\$) | 0.095 | |
| Expected volatility (%) | 100 | |
| Risk-free interest rate (%) | 2.33 | |
| Expected life (years) | 5.00 | |
| Dividend yield (%) | - | |
| Fair value of stock options | \$ 49,560 | \$ 49,560 |

10. BASIC AND DILUTED LOSS PER SHARE:

Basic loss per share has been calculated by dividing the net loss per financial statements by the weighted average number of shares outstanding during the period. The fully diluted loss per share would be calculated using a common share balance increased by the number of common shares that could be issued on the exercise of outstanding warrants and options of the Company. As the Company is in a loss position for the nine months ended September 30, 2011 and 2010, the inclusion of options and warrants would be anti-dilutive.

11. COMMITMENTS AND CONTRACTUAL OBLIGATIONS:

- a) The Company has a combined metals and diamonds concession agreement with the Inuvialuit Land Corporation (the "ILC"). According to the agreement of December 22, 2009, all activities and consequently all payments and required work commitments are divided into three stages: exploration, project definition and production. As the Company is currently in the exploration stage, it has to make the following cash payments and meet work commitments as described below:

| | Cash payments | Work commitment | Work commitments met at September 30, 2011 |
|------|-----------------------|----------------------|---|
| 2010 | \$ 50,000 (fulfilled) | \$ 2,000,000 | \$ 2,000,000 |
| 2011 | 50,000 | 2,000,000 | 2,000,000 |
| 2012 | 50,000 | 2,000,000 | 1,043,735 |
| 2013 | 50,000 | 1,000,000 | - |
| 2014 | 50,000 | 1,000,000 | - |
| 2015 | *125,000 | 1,000,000 | - |
| 2016 | *125,000 | 1,000,000 | - |
| 2017 | *125,000 | 1,000,000 | - |
| 2018 | *125,000 | 1,000,000 | - |
| 2019 | *125,000 | 1,000,000 | - |
| | <u>\$ 875,000</u> | <u>\$ 13,000,000</u> | <u>\$ 5,043,735</u> |

* plus applicable access fees.

In any year, the work commitment is reduced by the percentage of lands that have been designated as project areas and preceded to the second stage of activities. For each renewal period the Company has to incur \$1,000,000 in work commitments per year to maintain its concession rights. Any underperformed amount of work commitment in any year can be paid in cash.

See note 4 of the audited financial statements for the year-ended December 31, 2010 for additional information on the agreement with ILC.

DARNLEY BAY RESOURCES LIMITED
(An Exploration Stage Enterprise)

NOTES TO INTERIM CONDENSED FINANCIAL STATEMENTS
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11. COMMITMENTS AND CONTRACTUAL OBLIGATIONS (continued):

- b) On February 6, 2007, the Company entered into a five-year finder's fee agreement. Under the terms of this agreement, Darnley Bay 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 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).
- d) In conjunction with an agency agreement entered into by the Company on December 29, 2009, the agent has been granted a two year first right of refusal to lead manage future financings.
- e) On September 27, 2011, the Company signed the MOU referred to above to reallocate interests in the Diadem Joint Venture regarding diamond exploration in certain parts of the Companies' lands. The essential terms of the MOU call for the Company's 50% interest in the diamond elements of the Joint Venture to be conveyed to Diadem in exchange for 11,700,000 shares of Diadem, a 2% NSR/Diamond royalty and back-in rights to the former interests in the event of a valuable discovery. The MOU is now in the process of being re-engrossed as definitive agreements and is to be concluded by December 31, 2011. This document supersedes the MOU dated July 7, 2010.

12. SUBSEQUENT EVENT:

- a) On November 12, 2011, there were 300,000 options exercisable at \$0.15 that expired and on November 27, 2011 there were a further 300,000 exercisable at \$0.32 that expired.

13. ADVANCES:

Advances have been made by the Company to the Paulatuk Development Corporation ("PDC") for the purposes of a field camp purchase to be made by PDC. Advances are interest free with no specified terms of repayment.

Certain of the advances will be offset against minimum rent payable to PDC as they become due. During the nine-month period ended September 30, 2011, remaining advances not offset against minimum rent payable to PDC have been fully repaid to the Company.

14. ACCOUNTS RECEIVABLE:

| | September 30, 2011 | December 31, 2010 |
|---|-----------------------|----------------------|
| Amounts receivable from Diadem Resources Ltd. | \$ 18,501 | \$ 266,976 |
| GST receivable | 77,358 | 327,368 |
| | \$ 95,859 | \$ 594,344 |

15. ACCOUNTS PAYABLE:

As at September 30, 2011 and December 31, 2010, accounts payable consisted solely from the trade payable owed for the services provided to the Company.