

## **MANAGEMENT DISCUSSION AND ANALYSIS**

### **SEPTEMBER 30, 2011**

*This Management’s Discussion and Analysis (“MD&A”) is prepared as of November 29, 2011 and should be read in conjunction with the audited annual financial statements of Darnley Bay Resources Limited (the “Company”) for the year ended December 31, 2010, and the unaudited interim condensed financial statements of the Company for the three and nine month periods ended September, 30, 2011 and 2010, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”). This MD&A includes certain statements that may be deemed "forward-looking statements". All statements in this discussion, other than statements of historical fact, that address future exploration activities and events or developments that the Company expects, are forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Additional information can be found on SEDAR, [www.sedar.com](http://www.sedar.com). All amounts are in Canadian dollars.*

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## INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)

The Canadian Accounting Standards Board requires publicly accountable enterprises such as the Company to adopt IFRS for fiscal years beginning on or after January 1, 2011. Accordingly, the Company’s condensed interim financial statements for the nine-month period ending September 30, 2011 have been prepared in accordance with IFRS as published by the International Accounting Standards Board.

For each reporting period in 2011, comparative information for 2010 will also be presented, both for interim and annual financial statements, as applicable, on an IFRS basis. The financial statements for the year ending December 31, 2011, will be our first annual financial statements that comply with IFRS. As this will be the Company’s first year of reporting under IFRS, First time Adoption of IFRS (IFRS 1) is applicable.

In accordance with IFRS 1, we have applied IFRS retrospectively as of January 1, 2010 (the Transition Date) for comparative purposes. In preparing our opening balance sheet in accordance with IFRS, we have adjusted amounts reported previously in our financial statements prepared in accordance with pre-conversion Canadian GAAP (for detailed information, see Changes in Accounting Policies).

For further information, please refer to the Company’s Condensed Interim Financial Statements and Notes for the nine months ended September 30, 2011.

## OVERVIEW

Darnley Bay Resources Limited was formed in 1993 to explore for and develop base metal and potentially other deposits related to the 50 km x 80 km, 132 mGal Darnley Bay gravity anomaly near Paulatuk, Northwest Territories, Canada. The source of the anomaly remains unexplained. While continuing its study of and preparation for further exploring and drilling for base metals on its surrounding 4,600 km<sup>2</sup> land holding, it has entered into a Memorandum of understanding regarding partnership with Diadem Resources Ltd. (“the MOU”), explained more fully below, on 33 claims, which encompass thirteen kimberlite pipes (seven proven diamondiferous). For more information see the Company’s website [www.darnleybay.com](http://www.darnleybay.com).

## EXPLORATION ACTIVITIES AND OUTLOOK

The Company is focused on two project areas near Paulatuk, Northwest Territories. It holds 100% of the rights to the mineral concession covering all of the Paulatuk 7(1)(a) lands, and 100%-owned prospecting permits adjacent to the concession in 7(1)(b) lands and Crown lands. The concession and prospecting permits cover an area of 4,557 km<sup>2</sup>, and host base metal and diamond targets. In addition, the Company and Diadem Resources Ltd. jointly hold 33 claims on the Parry Peninsula northeast of Paulatuk in 7(1)(b) lands, where the focus is diamond exploration, now the subject of the MOU referred to above. The land classifications in the Paulatuk area are as follows:

- Inuvialuit 7(1)(a) lands – The Inuvialuit hold the mineral and surface rights.
- Inuvialuit 7(1)(b) lands – The Inuvialuit hold the surface rights and the Crown holds the mineral rights.
- Crown lands – The Crown holds the mineral and surface rights.

The Company reports the following activities in the course of the year in progress:

- A drill crew and support personnel were mobilized to its base metals property on March 22, 2011. It commenced drilling target G-09-01A on March 30 and reached a depth of 242 meters, with the transition from semi-consolidated clay to vuggy dolomite occurring at 157 meters. Voids in excess of 3 meters and infiltration of sand and clay prevented further drilling. The crew demobilized on April 20.
- The thick and loose nature of the cover material overlying difficult bedrock is proving to be a challenge for drilling, despite the new measures taken that proved more efficient than in 2010. The Company is reviewing its strategies with external consultants and is considering a number of options to move the base metals program forward. It is highly likely that a reverse circulation drill will be required to case its drillholes to stable bedrock at depths on the order of 250-300 m, and then continue the holes with a diamond drill to the target depths.
- A reflection seismic survey was considered to assess overburden conditions prior to drilling, but was deferred due to cost and logistical reasons. Seismic may be incorporated in future drill programs.
- Throughout 2010 and early 2011, the Company worked with officials of the Government of Canada (Canadian Northern Economic Development Agency), the Northwest Territories Government (Industry, Tourism & Investment), the Inuvialuit Regional Corporation (IRC) and the Paulatuk Development Corporation (PDC) to purchase an exploration camp for operation by the PDC. As a result, PDC received grants of \$485,000 and \$25,000 from the federal and territorial governments respectively, of which \$330,098 was allocated for the camp purchase and transport to Paulatuk. IRC provided additional resources for training and administration. The Company facilitated the process by purchasing the camp and additional equipment (including snow machines and ATVs). It also provided hands-on training in camp management and operation to Inuvialuit residents of Paulatuk. The Company has now been reimbursed fully for the camp purchase and intends to rent usage of the camp from PDC in the future.
- The preparation of a National Instrument 43-101 technical report on the base metals project, chronicling the historical and recent work, and the interpretation of the geophysical and drill results is nearing completion.

The Company is committed to pursuing equity financing and seeking joint venture partnerships to enable the current exploration and development program to continue. Following the Annual General Meeting of the Company held on June 30, 2011, Mr. Jay Richardson was appointed by the Board of Directors as Interim Chief Executive Officer and President of the Corporation. Mr. Stephen Reford continues with the Company in a new capacity as Chief Technical Officer. Mr. Richardson is now reviewing past programs including those with respect to the diamond exploration and assessing the Corporation's alternatives for raising additional financing and advancing its exploration efforts.

### OVERALL PERFORMANCE

As at September 30, 2011 the Company's cash position decreased to \$243,145 from \$1,214,083 at the year end, as a result of base metal exploration activities and operating expenses. Significant amounts were dedicated to the conclusion of the spring drill program that began in March 2011. The Company will continue to focus on its base metal exploration program.

## RESULTS OF OPERATIONS

The Company's operations involve exploration on its property in the Northwest Territories. The Company has no income from mining operations. For the nine-month period ended September 30, 2011, the Company had net losses of \$531,713, or \$0.005 per share, compared to a net loss of \$1,072,198, or \$0.011 per share for the same period in 2010. The increased loss over the comparable period is due to general and administrative costs associated with an active exploration period.

### *OFFICE, GENERAL AND ADMINISTRATIVE EXPENSES*

	<i>Nine months ended</i>	
	<i>September 30,</i>	<i>September 30,</i>
	<i>2011</i>	<i>2010</i>
Project evaluation and management services	90,874	105,399
Administration services	155,230	131,267
Professional fees	75,605	116,685
Office services, supplies	44,719	38,994
Premises rent	45,000	45,196
Insurance	10,773	17,820
Stock-based compensation	49,560	540,400
Public company fees and shareholder communication	61,144	76,437
	<u>532,905</u>	<u>1,072,198</u>

### *EXPLORATION EXPENDITURES*

	<i>Nine months ended</i>	
	<i>September 30,</i>	<i>September 30,</i>
	<i>2011</i>	<i>2010</i>
Project management	62,380	100,657
Project consulting fees	20,402	235,538
Property access and exploration expense	880,659	4,004,236
Licenses and permits	1,550	102
	<u>964,991</u>	<u>4,340,533</u>

The Company's policy is to capitalize drilling and other exploration expenditures.

## SUMMARY OF QUARTERLY RESULTS

The following quarterly results are presented in compliance with the IFRS. See note 4 in Condensed Interim Financial Statements for the period ended March 31, June 30 and period ended September 30, 2011 for reconciliation of the presented information to the previously disclosed information under Canadian GAAP.

	<i>For the three month periods ended</i>			
	<i>Sep. 30</i>	<i>Jun. 30</i>	<i>Mar. 31</i>	<i>Dec. 31</i>
	<i>2011</i>	<i>2011</i>	<i>2011</i>	<i>2010</i>
Net loss (profit) (in thousands)	142	250	140	(631)
Net loss per share	0.00	0.00	0.00	(0.01)
Total assets (in thousands)	7,171	7,526	7,322	7,873
Shareholders' equity (in thousands)	6,573	6,555	6,755	6,895

	<i>For the three month periods ended</i>			
	<i>Sept. 30</i>	<i>June 30</i>	<i>Mar. 31</i>	<i>Dec. 31</i>
	<i>2010</i>	<i>2010</i>	<i>2010</i>	<i>2009</i>
Net loss (profit) (in thousands)	736	209	126	(36)
Loss per common share	0.01	0.00	0.00	0.00
Total assets (in thousands)	8,907	4,316	4,371	4,777
Shareholders' equity (in thousands)	6,249	3,377	3,511	2,900

## CHANGES IN ACCOUNTING POLICIES

The Company's financial statements for the year ending December 31, 2011 will be the first annual financial statements that comply with IFRS. The condensed interim financial statements for the nine months ended September 30, 2011 were prepared in accordance with IFRS as described in note 2 to those financial statements, 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 and has prepared and issued these interim financial statements with that end in view and consistent with that aim.

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.

*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 acquisition and exploration costs. The Company elected to use the cost model for its mineral property that 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.

### **Changes in accounting policies:**

In addition to the exemptions and exceptions discussed above, the following narratives explain the significant differences between the previous historical Canadian GAAP accounting policies and the current IFRS policies applied by the Company.

#### **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 policy stated in note 3.

#### **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.

#### **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 and warrants allocated to contributed surplus.

#### **Expiration of share-based compensation**

**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 condensed interim 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.

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.

### FUTURE ACCOUNTING PRONOUNCEMENTS

Standards and interpretations issued but not yet effective:

- 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 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 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.
- 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.

Overall, the Company anticipates that the adoption of these standards and interpretations in future periods will have no material impact on the financial statements of the Company except for the additional disclosures.

## LIQUIDITY

The Company’s mineral exploration activities have been funded to date primarily through the issuance of common shares, and the Company expects that it will continue to be able to utilize this source of financing until it develops cash flow from mining operations. Other than as discussed herein, the Company is not aware of any trends, demands, commitments, events or uncertainties that may result in its liquidity either materially increasing or decreasing at present or in the foreseeable future other than general market conditions which have recently become more difficult for junior exploration companies. Material increases or decreases in the Company’s liquidity will be substantially determined by the success or failure of its exploration programs as well as its continued ability to raise capital. The Company has not recently been actively attempting to raise additional capital, however during the reporting period ended September 30, 2011, the Company added \$160,000 to working capital from funds received for the issue of shares pursuant to the exercise of stock options expiring August 5, 2011, as reported in its press release of August 18, 2011.

Cash as at September 30, 2011 was \$243,145 (December 31, 2010 - \$1,214,083). The Company has no long-term debt. Accounts payable and accrued liabilities at September 30, 2011 were \$597,987 (December 31, 2010 - \$978,198). Currently the Company’s only material source of funds is through the sale of shares by way of private offerings.

Cash used in operating activities during the nine-month period ended September 30, 2011 was \$165,947 (December 31, 2010 - \$1,671,693).

Cash used for investing activities during the nine-month period ended September 30, 2011 totalled \$964,991 (December 31, 2010 - \$5,037,671), which have been exclusively spent on exploration activities.

Cash generated from financing activities during the nine-month period September 30, 2011 totalled \$160,000 (December 31, 2010 - \$3,957,751) resulting from the exercise of options for the issue of common shares of \$160,000 (December 31, 2010 - \$4,451,861). Funds raised in private placement have been partially offset by share issue costs in the amount of \$nil (December 31, 2010 - \$494,110).

The Company's current funding objective is to support its continuing metal exploration program and fulfill its obligations to the Inuvialuit Regional Corporation as agreed upon. Current funding will be used for general and administrative expenses while additional funds are sought for continuation of the exploration program. The ability to raise the capital resources to undertake these projects is dependent upon the capital markets especially related to junior exploration companies.

At present, the Company's operations do not generate cash flow and its financial success is dependent on management's ability to discover economically viable mineral deposits. The mineral exploration process can take many years and is subject to factors that are beyond the Company's control. In order to finance the Company's exploration programs and to cover administrative and overhead expenses, the Company raises money through equity financings. Many factors influence the Company's ability to raise funds, including the health of the resource market, the climate for mineral exploration investment, the Company's track record, and the experience and caliber of its management. Actual funding requirements may vary from those planned due to a number of factors, including the progress of exploration activities. Management believes it will be able to raise equity capital as required in the long term, but recognizes there will be risks involved that may be beyond their control. If the Company is unable to raise sufficient financing it may need to scale back its intended exploration program and its other expenses.

## CAPITAL RESOURCES

The Company relies primarily on the issuance of common shares to fund working capital. The Company anticipates seeking capital for an infusion from private investors to continue to fund exploration and corporate administrative activities when market conditions are appropriate.

As at September 30, 2011, the Company's share capital was \$26,875,028 (December 31, 2010 - \$26,617,908) representing 105,184,645 (December 31, 2010 - 103,584,645) issued and outstanding common shares without par value. As at September 30, 2011, the Company had 23,567,977 warrants outstanding compared to 23,567,977 warrants outstanding as at December 31, 2010 exercisable at varying prices. As at September 30, 2011, the Company had 3,644,680 Agent's options outstanding compared to 3,644,680 Agent's options outstanding as at December 31, 2010. Agent's option entitles the holder to purchase one unit of securities in the Company (the "Agent Units") at \$0.15 and \$0.40 exercisable until December 29, 2012 and August 25, 2012 respectively. Each Agent Unit consists of one common share and one half common share purchase warrant.

The Company's deficit was \$24,463,116 as at September 30, 2011 (December 31, 2010 - \$23,992,102).

## OUTSTANDING SHARE DATA

	September 30, 2011	December 31, 2010	September 30, 2010
Common shares	105,184,645	103,584,645	103,584,645
Warrants	23,567,977	23,567,977	24,926,476
Stock options	3,350,000	5,250,000	5,250,000
Agent's options	3,644,680	3,644,680	3,644,680

Options are issued in accordance with the Company's Stock Option Plan. On August 5, 2011, there were 1,600,000 options exercised at \$0.10 resulting in the issue of 1,600,000 common shares and 1,000,000 options that expired. There are 41,866 shares in escrow.

## CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

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.

On September 27, 2011, the Company signed the MOU 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 supercedes the MOU dated July 7, 2010.

The Company is periodically issuing flow-through shares as part of its program targeted towards obtaining required financing for the Company. The Company has indemnified the subscribers of current and previous flow-through share offerings against any tax related amounts that become payable by the shareholder as a result of the Company not meeting its expenditure commitments.

The Company's exploration activities are subject to various law and regulations governing the protection of the environment. These law and regulations are continually changing and generally becoming more restrictive. The Company believes its operations are materially in compliance with all applicable laws and regulations. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations.

### RELATED PARTY TRANSACTIONS

Technical and administrative support is received from directors and officers of the Company and paid for at rates representative of fair market value.

In the nine month period ended September 30, 2011, amounts charged for management fees, office services and rent by La Prairie Ltd. (controlled by Leon La Prairie, Chair/director) were \$86,400 and \$86,671 in the same nine month period in 2010. Mr. La Prairie charged \$57,750 for consulting services (2010 - \$57,750) and \$525 in reimbursable meeting expense. Stephen Reford, CEO and President of the Company during the period to June 30, 2011 and Chief Technical Officer during three month ended September 30, 2011, charged \$55,000 (\$85,540 in 2010) in project management, \$10,700 in executive administration (\$28,850 in 2010) and \$11,773 in reimbursable project expenses (\$27,360 in 2010). President and CEO since June 30, 2011, Jay Richardson, charged the company \$24,000 in executive management services. Accounting and corporate maintenance services were provided by the Company's CFO, Patricia Mannard, in the amount of \$68,000 (\$52,450 in 2010). Greg O'Halloran, appointed an officer of the Company in 2010, charged \$75,000 in consulting fees and \$3,105 in meeting expense (nil in 2010). In addition, Don Yamkowy, director, charged for consulting services of \$13,140 in the nine month period, incurred \$5,032 in reimbursable project expenses (\$4,740 and \$5,353 in 2010) and \$1,572 in travel expense (\$1,305 in 2010). As at September 30, 2011, accounts payable to the above total \$4,924 (\$115,292 in 2010).

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.

On June 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. On August 5, 2011, options at \$0.10 were exercised by La Prairie (600,000), Reford (600,000), Mannard (100,000) and Yamkowy (300,000) and 1,000,000 expired. At the time of this report, an additional 300,000 options at \$0.15 expired (November 12, 2011) and 300,000 at \$0.32 expired (November 27, 2011). On July 27, 2010, there were 300,000 two year options granted to Richardson exercisable at \$0.27. On September 1, 2010, Reford and La Prairie were granted 400,000 options exercisable at \$0.37 for five years. Mannard and O'Halloran were granted 200,000 options each and the remaining five directors were granted 100,000 each with the same terms. There are a total of 2,700,000 options granted to the related parties mentioned above.

## RISKS AND UNCERTAINTIES

The operations of the Company are speculative due to the high-risk nature of its business, which is the acquisition, financing, exploration and development of mining properties. These risk factors could materially affect the Company's future operating results and could cause actual events to differ materially from those described in forward-looking information relating to the Company.

### *NATURE OF MINERAL EXPLORATION*

Mineral exploration is highly speculative in nature. There is no assurance that exploration efforts will be successful. Even when mineralization is discovered, it may take several years until production is possible, during which time the economic feasibility of production may change. Substantial expenditures are required to establish proven and probable mineral reserves through drilling. Because of these uncertainties, no assurance can be given that exploration programs will result in the establishment or expansion of mineral resources or mineral reserves. There is no certainty that the expenditures made by the Company towards the search for and evaluation of mineral deposits will result in discoveries or development of commercial quantities of base metals.

### *ENVIRONMENTAL RISKS AND HAZARDS*

All phases of the Company's mineral exploration operations are subject to environmental regulations pertaining to the Northwest Territories and Canada. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist on the properties on which the Company holds interests which are unknown to the Company at present and which have been caused by previous or existing owners or operators of the properties. The Company may become liable for such environmental hazards caused by previous owners and operators of the properties even where it has attempted to contractually limit its liability.

### *PERMITS, LAWS AND REGULATIONS*

Government approvals and permits are currently, and may in the future be, required in connection with the Company's operations. To the extent such approvals are required and not obtained, the Company may be curtailed or prohibited from proceeding with planned exploration or development of mineral properties. Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions thereunder, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

### *ADDITIONAL FUNDING REQUIREMENTS*

As discussed, the mineral property of the Company is in the exploration and development stage. The Company has no source of operating cash flow, and will need to raise additional funds to

complete its projects. There is no assurance that the Company will be able to raise additional funds on reasonable terms. The development of ore deposits which may be found on the exploration property of the Company would depend on the ability of the Company to obtain financing through debt financing, equity financing or other means. If the exploration and development programs of the Company are successful, additional funds would be required to develop the property. The only source of future funds presently available to the Company is the sale of equity capital or the sale of an interest in any of its property in whole or in part. The ability of the Company to arrange such financing in the future would depend in part upon the prevailing capital market conditions, as well as on the business performance of the Company. There can be no assurance that the Company would be successful in its efforts to arrange additional financing if needed on satisfactory terms. If additional financing is raised by the issuance of shares from the treasury of the Corporation, control of the Company may change and shareholders may suffer additional dilution. If adequate financing is not available, the Company may be required to delay, reduce its scope, eliminate one or more exploration activities or relinquish rights to certain of its interests. Failure to obtain additional financing on a timely basis could cause the Company to forfeit its interests in some or all of its property and to reduce or terminate its operations.

#### *PRICES FOR MINERAL COMMODITIES*

The profitability of the Company's operations will be dependent upon the market price of mineral commodities. Mineral prices fluctuate widely and are affected by numerous factors beyond the control of the Company. The level of interest rates, the rate of inflation, the world supply of mineral commodities and the stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns, monetary systems and political developments. The price of mineral commodities has fluctuated widely in recent years, and future price declines could cause commercial production to be impracticable, thereby having a material adverse effect on the Company's business, financial condition and result of operations.

#### *TITLE TO PROPERTY*

The acquisition of title to resource property is a very detailed and time-consuming process. The Company holds an interest in its property through mining claims, leases and agreements with relevant authorities. Title to, and the area of, the mining claims may be disputed. There is no guarantee that such title will not be challenged or impaired. There may be challenges to the title of the property in which the Company may have an interest, which, if successful, could result in the loss or reduction of the Company's interest in the property.

#### *DEPENDENCE ON OUTSIDE PARTIES*

The Company has relied upon consultants, engineers and others and intends to rely on these parties for development and operating expertise. Substantial expenditures are required to develop the exploration infrastructure at the site, to establish mineral reserves through drilling, and to carry out environmental and social impact assessments. If such parties' work is deficient or negligent or is not completed in a timely manner, it could have a material adverse effect on the Company.

## *CONFLICTS OF INTEREST*

A number of the Company's directors and officers serve or may agree to serve as directors or officers of other companies and, to the extent that such other companies may participate in ventures in which the Company may participate or that certain directors may have interests in other companies that may be in competition for exploration properties or in other ways, the directors of the Company may have a conflict of interest in negotiating and concluding terms respecting such participation or for the acquisition of exploration properties. Further, certain of the directors and officers are involved in other enterprises involved in mineral exploration. As a result, conflicts of interest may arise and officers and directors cannot devote 100% of their time to the Company.

## *INTERNAL CONTROLS*

The Company has invested resources to document and analyze its system of internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance with respect to the reliability of financial reporting and financial statement preparation.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements as at September 30, 2011 or as of the date of this report.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's Financial Statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reported period. Such estimates and assumptions affect the carrying value of assets, impact decisions as to when exploration and development costs should be capitalized or expensed, and affect estimates for provisions for reclamation costs. Other significant estimates made by the Company include factors affecting valuations of stock based compensation and the valuation of income tax accounts. The Company regularly reviews its estimates and assumptions, however, actual results could differ from these estimates and these differences could be material.

## MANAGEMENT'S EVALUATION OF DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Management is responsible for the design and effectiveness of disclosure controls and procedures to provide reasonable assurance that

- material information relating to the issuer is made known to us by others, particularly during the period in which the interim filings are being prepared, and
- information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation.

Management is responsible for the design of internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements in accordance with accounting principles generally accepted in Canada.

Changes to accounting policies or business processes as a result of the IFRS conversion did not materially affect the Company's internal controls over financial reporting. There have been no significant changes to the Company's disclosure controls and procedures and internal controls over financial reporting that occurred during the period ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's disclosure controls and procedures and internal control over financial reporting.

Because of inherent limitations, internal control over financial reporting and disclosure controls can provide only reasonable assurances and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has evaluated the effectiveness of the Company's disclosure controls and procedures as well as internal controls over financial reporting at the end of the period covered by this MD&A and have concluded that the above named control processes and procedures are appropriately designed and effective as at September 30, 2011.

#### FORWARD LOOKING STATEMENTS

*This report may contain forward-looking statements that involve a number of risks and uncertainties, including statements regarding the outlook for the Company's business and operational results. By nature, these risks and uncertainties could cause actual results to differ materially from what has been indicated. Factors that could cause actual results to differ materially from any forward-looking statement include, but are not limited to failure to establish estimated resources and reserves, the grade and recovery of ore which is mined from estimates, capital and operating costs varying significantly differs from estimates, delays or failure in obtaining governmental, environmental or other project approvals and other factors including those risks and uncertainties identified above. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking information as a result of new information, future results or other such factors which affect this information, except as required by law.*