

May 2, 2011

**DARNLEY BAY RESOURCES LIMITED - Management's Discussion and Analysis**  
For the year ended December 31, 2010

GENERAL

Darnley Bay Resources Limited was formed in 1993 to explore for and develop base metal 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. Darnley Bay is currently exploring and drilling for base metals on its 4,600 km<sup>2</sup> land holding. It has a partnership with Diadem Resources Ltd. on 33 claims where 13 kimberlite pipes have been discovered to date, of which 7 have proven diamondiferous. The Company is committed to pursue equity financing and seek joint venture partnerships to enable the current exploration and development program to continue.

EXPLORATION ACTIVITIES AND OUTLOOK

During the year, the Company commenced field and drill activities to locate deposits of metals and diamonds in the Paulatuk, Northwest Territories area. Analysis and modeling of the geophysical and geological data led the Company to seek additional financing so that it could significantly expand its base metals drill program in the third quarter. The ongoing support from the Inuvialuit Regional Corporation (IRC), the community of Paulatuk and other local participants is encouraging.

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 metals and diamond targets. In addition, the Company and Diadem Resources Ltd. jointly hold 33 claims on the Parry Peninsula northeast of Paulatuk, where the focus is diamond exploration. 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.

Through a new partnership agreement with Diadem Resources Ltd. announced on July 9, 2010, the Company began a kimberlite pipe drill program in the third quarter and continued field work into the fourth quarter.

Some of the highlights from the year ended December 31, 2010 include:

- Ground gravity, magnetic and electromagnetic surveys over base metals targets were carried out in the August to October 2010 period. Geological mapping occurred during the same period.
- Drilling of base metals targets commenced on August 28, 2010 and continued to November 20, 2010. Three targets were drilled at widely separate locations, totaling 878 m. Drilling proved challenging, with glacial overburden and unconsolidated sediments in excess of 150 m encountered at each target. An underlying unit of vuggy dolomite compounded the drilling difficulties. The early onset of unusual winter weather reduced production as the season wore on. Two of the three holes penetrated the overburden and reached sedimentary bedrock. Neither explained the geophysical targets and warrant further drilling.
- Numerous Inuvialuit residents of Paulatuk were hired as employees and trainees for exploration and camp positions. The Paulatuk Hunters and Trappers Committee and the Inuvialuit Land Administration were contracted to provide wildlife and environmental monitors respectively. Services provided by Inuvialuit companies and partnerships include provision of helicopters, air transport, logistics and land surveying.
- Diadem Resources Ltd. notified the Company on November 12, 2010 that it intended to exercise its option for diamond exploration and production on ten prospecting permits (2,040 km<sup>2</sup>) currently held by the Company south and southwest of Paulatuk, where the two companies previously explored for diamonds, upon payment of certain fees and expenditures to the Company. As a result, the two companies plan to form a 50/50 joint venture for the area.
- On September 17, 2010, the Company paid its debt installment of \$327,249 to the Inuvialuit Land Corporation, more than three months prior to its due date. This reduces the interest costs for the final debt installment due December 21, 2011.

Subsequent to the year-end, the Company reports the following activities:

- Commencing late in the fourth quarter of 2010 and continuing through the first quarter of 2011, the Company reviewed the 2010 drill program and undertook measures to improve the drilling approach in 2011. An independent review of the current drill program was carried out by Jacquelin Gauthier, P. Eng., Geo. After visits to Yellowknife and Toronto, Mr. Gauthier made a series of recommendations to optimize the program and implement cost efficiencies. He will continue to act as an advisor to the Company.
- 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 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 continuing 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.
- An assessment report was filed for the airborne geophysical surveys flown over the Company's prospecting permits in spring 2010. It is anticipated that Indian & Northern Affairs Canada will refund deposits to the Company, paid to acquire the prospecting permits.
- 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 through tender and additional equipment (including snow machines and ATVs). It also provided hand's-on training in camp management and operation to Inuvialuit residents of Paulatuk. The Company will be reimbursed \$127,448 for the camp purchase, which is the net amount after 113 days of camp rental in 2010 and a 90-day commitment in 2011.
- Diadem Resources Ltd. reported analysis of kimberlite samples from the 2010 drill core obtained from the three newly discovered kimberlite pipes. Reports received from CF Mineral Research Ltd. indicate the presence of a high incidence of kimberlite indicator minerals (chrome diopside, olivine, purple and orange garnets of particular note is the presence of one microdiamond which measured approximately 0.25mm in diameter). Microprobe analyses of kimberlitic indicator mineral grains are considered encouraging, indicating favorable diamond preservation conditions.
- The 2010 work on the 33 Parry Peninsula claims included a land survey on 24 of these claims. Nine of these claims reached their 10-year anniversary and were taken to lease in early 2011. The land surveys are a necessary part of this process. An assessment report was filed for this work, resulting in a refund of \$80,847.52 in extension deposits due from Indian & Northern Affairs Canada to the Company's partnership with Diadem Resources Ltd.

## SELECTED ANNUAL INFORMATION

	2010	2009	2008
Net income (loss) (in thousands)	10	(492)	(632)
Income (loss) per common share	0.00	(0.01)	(0.01)
Total assets (in thousands)	7,873	4,777	638
Shareholders' equity (in thousands)	6,895	2,900	(1,432)

## BALANCE SHEET AND OPERATIONS

At December 31, 2010, assets totaled \$7,873,360 compared to \$4,777,386 at year end December 31, 2009. This amount includes a cumulative mineral property expense at the year end of \$5,709,011 (\$671,340 in 2009) and a total receivable amount of \$594,344 compared to \$131,823 in 2009. The current liability decreased to \$978,198 from \$1,877,231 at the 2009 year-end. The share capital increased to \$25,739,681 from \$23,192,738 in 2009 through the issue of 14,845,931 common shares (39,987,633 in 2009) for \$5,170,327 (\$5,698,626 in 2009) less \$855,599 (\$1,691,100 in 2009) representing the fair value of warrants, \$1,231,200 (\$471,402 in 2009) for the tax effect of flow-through shares and \$658,691 (\$968,182 in 2009) in share issue cost. There were 100,000 shares issued upon the exercise of options for \$10,000, a debt conversion for 3,041,361 shares valued at \$718,466 and the addition of the fair value of options exercised of \$6,070, fair value of warrants exercised of \$20,940 and fair value of compensation options exercised of \$95,096 (\$nil in 2009). The stock options granted and exercised in the current period resulted in stock-based compensation expense of \$540,400 (2009 - \$227,940) and agent's options issued and exercised had a net value of \$164,581 (\$422,000 in 2009). The Company reported a net income at December 31, 2010 of \$9,590 compared to a net loss of \$492,463 in 2009. The ongoing corporate and general expenses required to run a public company continue to be monitored closely.

## LIQUIDITY AND CAPITAL RESOURCES

The Company is an exploration and development company and has no revenue. At December 31, 2010, the Company had cash resources of \$1,214,083 compared to \$3,965,696 at the 2009 year-end. There were 11,804,570 shares issued for cash totaling \$4,451,861 during the year through brokered private placements, exercise of options, agent's compensation options and warrants (39,987,633 shares issued for \$5,698,626 in 2009). A further 3,041,361 shares were issued through debt conversion for a \$718,466 reduction in payables (\$nil in 2009). The Company has working capital of \$1,186,151 compared to \$2,228,815 at year-end 2009 and an accumulated deficit of \$23,132,085 (\$23,141,675 at the 2009 year-end). The Company is actively working to reduce liabilities through ongoing communication with primary creditors and, if necessary, further debt settlement is planned where allowable.

The Company's current funding objective is to support a metal exploration program and fulfill its obligations to the Inuvialuit Regional Corporation. At the year-end, financial resources were sufficient to allow for an ongoing exploration program including geophysical analysis and drilling. At the same time, the Company is negotiating future

diamond exploration options with Diadem Resources Ltd. The ability to raise the capital resources to undertake these projects is dependent upon the venture capital market and metal prices.

#### SUMMARY OF QUARTERLY RESULTS

<i>For the three month period ended</i>	<i>Dec. 31</i>	<i>Sept. 30</i>	<i>June 30,</i>	<i>Mar. 31</i>
	<i>2010</i>	<i>2010</i>	<i>2010</i>	<i>2010</i>
Net (income) loss (in thousands)	(1,054)	709	209	126
Loss (income) per common share	(0.00)	0.01	0.01	0.01
Total assets (in thousands)	7,873	8,907	4,316	4,371
Shareholders' equity (in thousands)	6,895	7,058	3,388	3,511

  

<i>For the three month period ended</i>	<i>Dec. 31</i>	<i>Sept. 30</i>	<i>June 30</i>	<i>Mar. 31</i>
	<i>2009</i>	<i>2009</i>	<i>2009</i>	<i>2009</i>
Net loss (in thousands)	(36)	147	274	107
Loss per common share	0.01	0.01	0.01	0.01
Total assets (in thousands)	4,777	959	883	592
Shareholders' equity (deficiency) (in thousands)	2,900	(1,364)	(1,447)	(1,539)

#### ANALYSIS OF MINERAL PROPERTY EXPENDITURES

	<i>2010</i>	<i>2009</i>
Project management	91,640	60,620
Project consulting fees	137,943	16,349
Licenses and permits	39,888	64,744
Property access and agreement costs	<u>4,768,200</u>	<u>90,151</u>
	5,037,671	231,864

#### ANALYSIS OF CORPORATE AND GENERAL EXPENSES

	<i>2010</i>	<i>2009</i>
Project evaluation and management services	139,850	113,475
Stock based compensation	540,400	227,940
Administration services	71,193	101,853
Office support services & supplies	107,830	65,255
Accounting services	78,450	45,000
Premises rent	60,196	58,165
Legal fees	41,375	14,202
Audit fees	39,925	25,700
Stock transfer/exchange fees	53,342	39,042
Shareholder communication	73,459	54,549
Interest	19,254	221,899
Miscellaneous	<u>-</u>	<u>250</u>
	1,225,274	967,330

## COMMON SHARES ISSUED

Common shares issued at December 31, 2010 were 103,584,645 and at December 31, 2009 were 88,738,714. During the year, there were 291,667 shares issued through the exercise of \$0.24 warrants and 36,750 through the exercise of \$0.25 warrants, and there were 751,153 shares issued through compensation options exercised at \$0.15. In addition, there were 100,000 shares issued through the exercise of \$0.10 options and 3,041,361 shares issued through debt conversion. On August 25, 2010, there were 10,625,000 share purchase units sold through private placement at \$0.40 per unit. Each unit holder is entitled to one flow share and one half of one share purchase warrant. The 5,312,500 warrants are exercisable for a two year period at \$0.45. The agent received a compensation option to purchase 1,062,500 broker units with the same terms.

On December 31, 2009, there were 33,333,334 shares issued, which included 24,443,368 common shares and 8,889,966 flows-through shares, at \$0.15. Common shares issued had share purchase warrants attached which allowed holder to purchase an additional 12,221,684 shares at \$0.25 for three years. There were 3,333,333 agent's options granted. The option is open for three years and consists of a unit for one common share and one half of one common share purchase warrant for \$0.15. The additional 6,654,299 issued in 2009 include 2,475,000 shares issued at \$0.10, the 791,633 flow-through shares issued at \$0.12 and the 2,720,000 common shares issued at \$0.10 plus 534,000 common shares and 133,666 flow-through shares at \$0.12 and \$0.15 that were subscribed for in December 2008 and issued in January, 2009.

Outstanding share purchase options granted to directors, officers and consultants include 2,600,000 at \$0.10 (expiring on August 5, 2011), 300,000 at \$0.15 (expiring on November 12, 2011) and 300,000 at \$0.32 (expiring on November 27, 2011). There were 300,000, exercisable for \$0.27 for a two year period granted on July 27 and 1,750,000 granted on September 1, 2010 exercisable at \$0.37 for five years. All are in accordance with the Company's Stock Option Plan (see note 6(e) of the audited financial statements). There are 41,866 shares held in escrow.

## RELATED PARTY TRANSACTIONS

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

During the year, amounts charged for management fees by La Prairie Ltd. (controlled by Leon La Prairie, Chairman/director) were \$48,000 (\$48,000 in 2009), rent and office services amounts were \$60,196 (\$58,165 in 2009) and \$7,277 (\$9,678 in 2009) respectively. Mr. La Prairie charged \$77,000 for consulting services (2009 - \$57,750) as Chairman. Reimbursable expenses including travel, office and meeting costs for 2010 totalled \$3,078 (\$1,918 in 2009).

In 2010, Stephen Reford, CEO/director charged \$38,850 for professional fees related to executive management (\$31,750 in 2009). Fees relating to deferred project expense of

\$111,390 were charged in 2010 (\$46,684 in 2009). Reimbursable property expenses including travel amounted to \$32,213 compared to \$13,819 in 2009 and corporate administration expenses totaled \$8,774 (\$nil in 2009).

Legal fees were \$42,907 in 2008. Patricia Mannard, Chief Financial Officer provided corporate maintenance and accounting management services in the amount of \$78,450 in 2010 and \$45,000 in 2009. Donald Yamkowy charged the Company \$25,805 (2009 - \$7,735) in project development expenses and \$17,632 (\$8,218 in 2009) in reimbursable expenses. Greg O'Halloran appointed Corporate Secretary of the Company in 2010 charged \$46,154 for consulting services. A legal firm of which director Mark Bennett is a partner provided legal services, related to the issuance of shares, in the amount of \$35,102 (\$nil in 2009).

As at December 31, 2010, accounts payable to the above related parties total \$129,162 (2009 - \$741,856).

At the time of this report, the directors and officers of the Company hold share purchase options. Each of Reford, La Prairie and Mannard have options to purchase 600,000 shares at \$0.10 up to August 5, 2011. An additional 900,000, \$0.10 options are available to three directors with the same terms. There are 300,000 options at \$0.15 expiring on November 12, 2011 and 300,000 at \$0.32 expiring on November 27, 2011 available to the remaining two directors. On July 27, 2010, there were 300,000 two year options granted to the new director Jay Richardson exercisable at \$0.27. On September 1, 2010, Reford and La Prairie were granted an additional 400,000 options exercisable at \$0.37 for five years, Mannard was granted 200,000 and the remaining five directors were granted 100,000 each with the same terms.

## COMMITMENTS

Notes 4 and 11 of the financial statements for the year ended December 31, 2010 cover the intent of current agreement conditions with the Inuvialuit Land Corporation, the status of the relationship with Diadem Resources Ltd. regarding future exploration of diamonds and other commitments to finders and the Company's agent.

On December 22, 2009, the Company renewed terms with the Inuvialuit Land Corporation for access to the property in the area surrounding Paulatuk, Northwest Territories, for the purpose of base metal exploration.

On July 7, 2010, the Company signed a memorandum of understanding to form a joint venture with Diadem Resources Ltd.; formerly this has been expressed as an agreement held with Carnarvon Capital Corporation, to operate a diamond exploration program. The joint venture will renew a letter agreement with the Inuvialuit Land Corporation allowing access to the property that lies within the Inuvialuit Settlement Region.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of its financial statements requires the Company to use estimates and assumptions that affect the reported amounts of assets and liabilities as well as revenues and expenses.

Our discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles. Our significant accounting policies are contained in Note 2 to the audited financial statements for the year ended December 31, 2010 and changes in those policies. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions.

The following section discusses the critical accounting estimates and assumptions that management has made and how they affect the amounts reported in the financial statements. We consider these estimates to be an important part of understanding our financial statements.

### *Asset Impairment*

The Company reviews the carrying values of its deferred exploration expenditures whenever events or changes in circumstances indicate that their carrying values may exceed their estimated recoverable amounts determined by reference to estimated undiscounted future cash flows.

The recoverability of amounts shown is dependent upon the discovery of economically recoverable mineral reserves, the ability of the Company to finance the development of the properties, and on the future profitable production or proceeds from the disposition thereof. An impairment loss is recognized when the carrying value of those assets exceeds its estimated net recoverable amount.

### *Stock-based Compensation*

The Company uses the fair value method to account for stock options granted to directors, officers, employees and non-employees. Accordingly, the fair value of the options at the date of grant is either charged to operations or capitalized to exploration of development expenditures, as appropriate, with an offsetting credit to contributed surplus, over the vesting period of the option. If and when the stock options are exercised, the applicable amounts of contributed surplus are transferred to share capital.

### *Warrants*

Warrants issued as part of a private placement unit are valued using the Black-Scholes model. The proceeds from the issue of units are allocated between share capital and

warrants on a pro-rata basis based on the relative fair values. The related charge is allocated to the appropriate expense or asset category when issued for services or to equity when issued for cash.

#### *Asset Retirement Obligations*

Asset retirement obligations are recognized in the period in which they are incurred if a reasonable estimate of fair value can be determined. An asset retirement obligation is an existing legal obligation associated with the permanent removal from service of a long-lived asset, which results from the acquisition, construction, development or normal operation of the asset. The obligation is measured at fair value and is adjusted in subsequent periods through accretion expense.

The associated asset retirement costs are capitalized as part of the carrying amount of the related asset. Estimating the costs of asset retirement obligations requires extensive judgment about the nature and timing of work to be carried out in view of present environmental laws and regulations, and these estimates are subject to considerable uncertainty. Changes in these estimates could have a material impact on our results of operation and financial position.

#### 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.

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 there under, 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.

The future costs of retiring mining assets include dismantling, remediation, ongoing treatment and monitoring of the site. These are reconciled and recorded as a liability at fair value. The liability is accreted, over time, through periodic charges to earnings. In addition, asset retirement costs are capitalized as part of the asset's carrying value and amortized over the asset's useful life. As the Company has not yet begun mining or milling operations, the Company currently has no identifiable obligations relation to the retirement of its assets.

Amendments to current laws, regulations and permits governing operations and activities of mining companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in exploration expenses, capital expenditures or production costs or reduction in levels of production at producing properties or require abandonment or delays in development of new mining properties. Production of mineral properties may involve the use of dangerous and hazardous substances. While all steps will be taken to prevent discharges of pollutants into the ground water and the environment, the Company may become subject to liability for hazards that cannot be insured against. The Company is subject to all environmental acts and regulations at the federal and provincial levels.

#### MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

In connection with Exemption Orders issued in November 2007 by each of the securities commissions across Canada, the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of the Company will file a Venture Issuer Basic Certificate with respect to the financial information contained in the unaudited interim financial statements and the audited annual financial statements and respective accompanying Management's Discussion and Analysis.

In contrast to the certificate under Multilateral Instrument ("MI") 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings), the Venture Issuer Basic Certification includes a 'Note to Reader' stating that the CEO and CFO do not make any representations relating to the establishment and maintenance of disclosure controls and procedures and internal control over financial reporting, as defined in MI 52-109.

#### STATUS OF TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

On February 13, 2009, the CICA Accounting Standards Board (AcSB) confirmed that the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal quarters beginning on or after January 1, 2011, including comparatives for 2010. The objective is to improve financial reporting by having one single set of accounting standards that are comparable with other entities on an international basis.

The Company commenced its IFRS conversion project during 2009 and established a project governance structure, to monitor the progress and critical decisions in the transition to IFRS. The external auditors have also been consulted throughout the process.

The Company's conversion project has been structured in four phases: preliminary study, evaluation, development, and implementation. To date, the project is progressing according to plan. During 2009 the Company completed the preliminary study phase of the project which involved a high level review of the major differences between current Canadian GAAP and IFRS as related to the Company's accounting policies. During 2009 the Company completed a preliminary in-depth review of its accounting policies and the impact from adopting IFRS, as well as the associated impact of the IFRS transition on business activities.

As of December 31, 2010, the Company had substantially completed the evaluation and development phases of its IFRS conversion project. The following areas have been identified where the accounting differences, including presentation and disclosures, between Canadian GAAP and existing IFRS may have an impact on the Company's financial statements. The accounting differences described below should not be regarded as a complete list of areas that may be impacted by the transition to IFRS. Analysis of accounting policies has substantially been completed, but may be subject to changes as the Company completes the implementation phase of the project, and where IFRS standards are likely to change.

The Company is currently working through the implementation phase. Draft IFRS financial statements are being developed and are about to undergo a thorough review process with the involvement of the Company's auditors and outside consultants. Significant differences between Canadian GAAP and IFRS impacting the Company's opening balance sheet for January 1, 2010 are in the process of being finalized. The Company will prepare IFRS financial statements for its first quarter of fiscal 2011.

The audit committee of the Company is kept informed of management's decision on accounting policy choices under IFRS.

The International Accounting Standards Board has a number of ongoing projects, the outcome of which may have an effect on the changes required to the Company's accounting policies on adoption of IFRS. At the present time however, the Company is not aware of any significant expected changes that would affect the summary provided below. As an update to our previously filed annual and quarterly MD&As, the following provides a summary of the Company's evaluation of potential changes to accounting policies in key areas based on the current standards and guidance within IFRS.

### **Mineral properties**

- Upon transition to IFRS, the Company intends on retaining its accounting policies and practices (as an allowable option) it has applied previously under Canadian GAAP, relating to the recognition of mineral properties, in which case it would continue to capitalize exploration and evaluation ("E&E") expenditures under IFRS, and classify them as either tangible or intangible assets, according to their nature, as required by IFRS. The Company is currently evaluating whether there may be any general expenses that are not directly attributable to any specific

mineral property, and determine their appropriate accounting treatment under IFRS.

- IFRS 6, *Exploration for and Evaluation of Mineral Resources* applies only to the exploration and evaluation (“E&E”) stage, and does not apply to the development and production stages of the mineral reserves development process. Additionally when the technical feasibility and commercial viability of extracting mineral resources is demonstrable, IFRS 6 requires exploration and evaluation assets to cease being classified as such. However as this would be outside the scope, IFRS 6 does not specify where they can be reclassified. It is an accounting policy choice that is available to the Company, which needs to be clearly stated and applied consistently. The choice is again between capitalizing the assets as either tangible or intangible assets. The Company’s project is in exploration and evaluation stage, thus IFRS 6 will apply, and the Company’s mineral property costs will be classified as intangibles.
- The Company currently intends on continuing to use the cost model for its mineral properties, and not apply the revaluation model available under IFRS.

### **Impairment of Assets**

- The Company is currently in the process of evaluating whether there would be any asset impairment at the transition date under IFRS. In assessing whether there is any indication that an asset may be impaired, an impairment test should be performed; consideration would be given to the external and internal sources of information, as prescribed by IAS 36, *Impairment of Assets*. Impairment under IFRS is recognized if the carrying amount exceeds the higher of fair value less cost to sell, or value in use.

### **Share Based Payments**

- Under IFRS, each vesting group of stock options is treated as a distinct award / tranche and the value would be measured and recorded over the respective vesting period. Additionally, an estimate of expected forfeitures would be required when determining the amount of expense to be recorded for the unvested portion as at transition date, as well as going forward.
- The Company is currently in the process of reviewing any stock options that remain unvested at January 1, 2010, and adjust the recording of the expense based on the IFRS requirement.

### **Income taxes**

- Currently, the Company is following guidance under EIC 146, *Flow-Through Share*, which indicates that on the date of share issuance, the future income tax liability should be recognized and the shareholders’ equity should be reduced.

- Under IFRS, there is no specific guidance to this regard, and the Company would have one of the following options discussed below. Upon issuance of flow-through shares, due to the fact that investor received both equity interest and a right to a stream of tax deductions, it would have to be assessed whether transaction should be treated as a compound financial instrument or a multiple element arrangement under IAS 32, *Financial Instruments: Presentation*, IAS 39, *Financial Instruments: Recognition and Measurement*, and IAS 18, *Revenue*. Once liability portion has been separately recognized upon initial issuance of flow-through shares, the Company has one of two choice:
  1. Reverse the liability to profit or loss, since IAS 12, *Income Taxes*, requires that a deferred tax liability be recognized for all temporary differences except to the extent that the deferred tax liability arises from the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting profit not taxable profit (loss). As such, there will be no deferred taxes relating to the liability portion of the flow-through shares, and entire liability is reversed to profit or loss.
  2. Reverse liability, and recognized deferred tax liability for the entire taxable portion of the flow-through shares. The amount by which deferred tax liability exceeds the flow-through liability would be recorded as a tax expenses in profit or loss.
- The Company does not expect any substantial impact relating to the adoption of the IFRS standard on income taxes.

### **Presentation of Financial Statements**

- The conversion to IFRS will impact the way the Company presents its financial results. The first financial statements prepared using IFRS (i.e. interim financial statements for the three months ended March 31, 2011) will include numerous notes disclosing extensive transitional information with continuity reconciliations and full disclosure of all new IFRS accounting policies.
- The Company does not expect substantial changes on the presentation of expenses whether by nature or by function on the face of the statement of loss.

### **IFRS 1, First Time Adoption of IFRS**

#### Deemed cost

Upon transition, the Company intends on measuring mineral properties at their deemed cost equivalent to fair value as at January 1, 2010 or revalue amounts previously determined under Canadian GAAP. Accordingly, it would use the carrying values as the IFRS balances as at January 1, 2010.

## Share-based payments

IFRS 1 provides an exemption that allows entities not to apply IFRS 2, *Share-based Payment* to options granted before November 2002, as well as to options granted after November 2002, but vested prior to transition. The Company intends on taking this exemption

## RISKS AND UNCERTAINTIES

The business of the Company involves many risks and uncertainties. Metal exploration involves a high level of risk. Some of the risks include the lack of revenues as the Company is a development stage enterprise. Other risks include the difficulty of finding, assessing and developing an economically viable ore deposit, intense competition in the sector from both large and small competitors, fluctuations in metal prices and currency exchanges, risks associated with renunciation and expenditure of costs relating to flow-through shares and the possibility of legal challenges from environmental and aboriginal groups. These are not an exhaustive list of the risks associated with the business.

## CORPORATE GOVERNANCE

The Company's Corporate Governance Policy can be viewed on [www.sedar.com](http://www.sedar.com). The policy is amended annually and appears as an appendix to the Company's Management Information Circular. The Company maintains its commitment to achieve full compliance with the policy.

## OUTLOOK

The Company has focused its marketing and financing initiatives on Canada, China and Russia to seek new sources of financing and potential joint venture partners. The ongoing support from the Inuvialuit Regional Corporation (IRC), the community of Paulatuk and other local participants is encouraging. The purpose of the exploration and drilling is to locate metal and diamond deposits for eventual development.

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

THE MANAGEMENT'S DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH THE COMPANY'S AUDITED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2010, WHICH ACCOMPANY THIS ANALYSIS AND, ALTERNATELY, ARE AVAILABLE ALONG WITH ALL THE COMPANY'S PUBLIC DOCUMENTS ON [WWW.SEDAR.COM](http://WWW.SEDAR.COM)

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