

DIADEM

RESOURCES LTD.
(A Development Stage Company)

CONSOLIDATED FINANCIAL STATEMENTS (Unaudited - Prepared by Management)

AUGUST 31, 2006

Notice: The unaudited interim consolidated financial statements of Diadem Resources Ltd. ("Company") as at and for the three months ended August 31, 2006 ("Financial Statements") have been prepared by management and have not been reviewed by the Company's auditors. The Financial Statements should be read in conjunction with the consolidated financial statements for the year ended May 31, 2006 which are available at the SEDAR website at www.sedar.com. The Financial Statements are presented in Canadian dollars, unless otherwise indicated, and are prepared in accordance with Canadian generally accepted accounting principles.

DIADEM RESOURCES LTD.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Expressed in Canadian Dollars)	August 31 2006	May 31 2006
	\$	\$
ASSETS		
Current		
Cash and term deposits	579,498	262,756
Prepaid expenses and sundry receivables	21,128	23,604
	600,626	286,360
Mineral interests (Note 3)	3,015,360	2,788,881
Equipment (Note 4)	6,187	6,689
Other assets	-	21
	3,622,173	3,081,951
LIABILITIES		
Current		
Accounts payable and accrued liabilities	498,437	557,499
	498,437	557,499
SHAREHOLDERS' EQUITY		
Capital stock (Note 5)	31,841,871	31,080,221
Warrants	783,430	783,430
Contributed surplus	877,154	872,805
Shares to be issued	54,475	54,475
Deficit	(30,433,194)	(30,266,479)
	3,123,736	2,524,452
	3,622,173	3,081,951

Commitments and contingencies (Notes 1, 3 and 9)

DIADEM RESOURCES LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
(Unaudited)

(Expressed in Canadian Dollars)	Three months ended August 31	
	2006	2005
	\$	\$
REVENUE		
Interest income	1,726	3,861
Gain on sale of investment	-	10,625
	1,726	14,486
EXPENSES		
Amortization	502	732
Interest	2,874	2,260
Financial advisory services	75,000	-
General corporate costs	59,816	107,443
Write-off of other investment	21	-
Stock-based compensation	4,349	73,440
	142,562	183,875
NET LOSS for the period	(140,835)	(169,389)
Costs associated with issuance of capital stock	(25,879)	-
DEFICIT , beginning of period	(30,266,479)	(28,959,851)
DEFICIT, end of period	(30,433,194)	(29,129,240)
Net loss per share -basic and diluted	(0.01)	(0.02)
Weighted average number of common shares (Note 5(a))	10,595,260	9,700,566

See accompanying notes to the consolidated financial statements

DIADEM RESOURCES LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Expressed in Canadian Dollars)	Three months ended August 31	
	2006	2005
	\$	\$
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the period	(140,835)	(169,389)
Adjustment for items not affecting cash:		
Amortization	502	732
Stock-based compensation	4,349	73,440
Write-down of investment	21	(10,625)
	(135,964)	(105,842)
Net changes in non-cash working capital balances:		
Prepaid expenses and sundry receivables	2,476	373
Subscription receivable	-	10,000
Accounts payable and accrued liabilities	(59,062)	(101,107)
Cash flows from operating activities	(192,550)	(196,576)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of investment	-	10,625
Mineral interests	(226,479)	(448,320)
Cash flows from investing activities	(226,479)	(437,695)
CASH FLOWS FROM FINANCING ACTIVITIES		
Common shares issued for cash	761,650	-
Costs associated with issuance of capital stock	(25,879)	-
	735,771	-
Change in cash during the period	316,742	(634,271)
CASH, beginning of period	262,756	1,455,535
CASH, end of period	579,498	821,264

SUPPLEMENTAL INFORMATION (Note 7)

DIADEM RESOURCES LTD.
(A Development Stage Company)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2006
(Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS AND GOING CONCERN

Diadem Resources Ltd. (the "Company" or "Diadem") is in the process of acquiring, exploring and developing its mineral interests in North America and is thus considered to be a development stage company. The business of mining and exploring for minerals involves a high degree of risk and there can be no assurance that current exploration programs will result in profitable mining operations.

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements and non-compliance with regulatory requirements.

The recoverability of the amounts shown for mineral interests is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves, upon future profitable production and/or the proceeds from the disposition thereof. To date, the Company has not earned significant revenues.

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and on the assumption that the Company will be able to realize the carrying value of its assets and discharge its liabilities in the normal course of operations as a going concern.

There is uncertainty about the Company's ability to realize the carrying value of its assets and discharge its liabilities as they come due. The ability of the Company to continue as a going concern is dependent upon, among other things, being able to obtain additional financing and achieve positive cash flows from operations.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These interim unaudited consolidated financial statements include all adjustments that are, in the opinion of management, necessary for fair presentation. The results of operations for the three month period ended August 31, 2006 are not necessarily indicative of the results expected for the full year.

These interim unaudited consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and follow the same accounting policies and methods set forth in the Company's audited consolidated financial statements as at and for the year ending May 31, 2006 and should be read in conjunction with those audited financial statements and notes thereto.

Certain comparative figures have been reclassified to conform with the current presentation.

3. MINERAL INTERESTS

	Balance May 31, 2006 \$	Additions \$	Writedowns \$	Balance August 31, 2006 \$
Acquisition costs				
Franklin Project,				
Northwest Territories	1,190,764	-	-	1,190,764
Duquesne West, Quebec	25,000	-	-	25,000
	1,215,764	-	-	1,215,764
Deferred exploration costs				
Franklin Project,				
Northwest Territories	1,528,751	52,061	-	1,580,812
Duquesne West, Quebec	44,366	174,418	-	218,784
	1,573,117	226,479	-	1,799,596
	2,788,881	226,479	-	3,015,360

DIADEM RESOURCES LTD.
(A Development Stage Company)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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 (Expressed in Canadian Dollars)

	Balance May 31, 2005 \$	Additions \$	Writedowns \$	Balance August 31, 2005 \$
Acquisition costs				
Franklin Project, Northwest Territories	1,190,764	-	-	1,190,764
Attawapiskat Project, Ontario	15,000	10,000	-	25,000
	<u>1,205,764</u>	<u>10,000</u>	<u>-</u>	<u>1,215,764</u>
Deferred exploration costs				
Franklin Project, Northwest Territories	513,068	438,240	-	951,308
Attawapiskat Project, Ontario	327,098	80	-	327,178
Otish Mountains, Quebec	300,000	-	-	300,000
	<u>1,140,166</u>	<u>438,320</u>	<u>-</u>	<u>1,578,486</u>
	<u>2,345,930</u>	<u>448,320</u>	<u>-</u>	<u>2,794,250</u>

(a) Franklin Project, Northwest Territories

Effective November 26, 2003, the Company entered into an agreement to form a joint venture ("Franklin Project") with Darnley Bay Resources Limited ("DBR") for diamond exploration in an area near Paulatuk in the Northwest Territories.

The transaction results from an acquisition from Carnarvon Capital Corporation ("CCC") of that company's right to enter into the joint venture. To acquire the rights to form the joint venture, Diadem issued to CCC 375,000 Diadem common shares, valued at \$600,000. Paul Carroll, Chairman and CEO of Diadem, also is President of CCC and all of its share capital is owned by members of his immediate family. As part of the transfer to Diadem of the transaction with DBR, CCC and Mr. Carroll have agreed that during the period ending December 31, 2008 neither CCC nor Mr. Carroll would acquire a controlling interest in any diamond exploration or development project in Canada (or in California) other than through Diadem or with the consent of Diadem.

Under the agreement, Diadem was to expend \$5,000,000 on diamond exploration within the Inuvialuit settlement region north of the 68th parallel by December 31, 2006. When this earn-in level of expenditure is completed, Diadem will have earned an undivided 50% participating interest in the selected lands, with DBR holding the other 50%. If a decision is made to carry out a feasibility study on the lands, it will have the right to fund the feasibility study, and if the property is placed into commercial production Diadem's interest will increase to 75% and DBR's interest will decrease to 25%.

Effective March 15, 2005, Diadem's earn-in requirement on the lands north of the 68th parallel was reduced to approximately \$3,100,000 and the earn-in period was extended to December 31, 2007. DBR relinquished its participating interest in the joint venture lands south of the 68th parallel and transferred to Diadem 100% ownership in the permits and claims south of the 68th parallel.

The Company and DBR entered into a Cooperation Agreement with the Inuvialuit Regional Corporation ("IRC") whereby the IRC agreed to cooperate to develop the diamond potential of certain Inuvialuit and Crown lands. The agreement is for a term of 5 years commencing January 1, 2004 with provisions for renewal and termination. Diadem and DBR are required to obtain all necessary Inuvialuit permits and approvals and will pay the fees and charges under the Inuvialuit Rules with a minimum amount payable each year of \$50,000. Diadem and DBR were to incur at least \$2,000,000 of work by June 30, 2005.

DIADEM RESOURCES LTD.
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2006
 (Expressed in Canadian Dollars)

On March 1, 2005 the Inuvialuit extended the date from June 30, 2005 to September 30, 2005. Expenditures through August 31, 2006 were approximately \$1,831,000. The Company and DBR have not met the requirements of the Cooperation Agreement with the IRC. Management believes that the main concern of

3. MINERAL INTERESTS (Continued)

the IRC is the execution of the field program, which, at the time of writing, is on-going, and as such the IRC will look favourably upon the project.

The Inuvialuit will receive a 2% diamond royalty on mining rights exploited by the joint venture. The Inuvialuit can hold certain claims in the area in which there is a 15-year deferral of Crown royalties. In such cases the Inuvialuit will receive an additional 4% royalty while the deferral applies. If a positive feasibility is completed, the Inuvialuit have the right to acquire up to a 10% participating interest by paying the corresponding percentage of the cost of the feasibility study.

(b) Duquesne West Project, Quebec

On April 18, 2006, Diadem entered into an option agreement to acquire a 50% vested interest and the right to increase the vested interest to 57.5% in the Duquesne West project ("Project") north of Rouyn-Noranda, Quebec. The option agreement is with Jack Stoch Geoconsultant Services Inc. ("Vendor") and Globex Mining Enterprises Inc. ("Globex"). At the time the agreement was entered into Diadem made an initial cash payment to the Vendor of \$25,000.

The definitive option agreement is dated July 17, 2006. Under the agreement, Diadem can earn a 50% fully vested interest in the Project by spending \$6,000,000 over three years on exploration and development, of which \$1,000,000 is to be spent by June 30, 2007, an additional \$2,000,000 is to be spent by June 30, 2008 and an additional \$3,000,000 is to be spent by June 30, 2009. On September 5, 2006, Diadem made an additional cash payment to the Vendor of \$225,000, and issued 1,250,000 Diadem common shares to the Vendor having an assigned value of \$338,750. Diadem is also required to make additional cash payments of \$150,000 to the Vendor by June 30, 2007 and \$200,000 by June 30, 2008. Upon Diadem acquiring its 50% interest in the Project, Diadem would grant to the Vendor a 2.25% gross metal royalty based on Diadem's 50% interest in the Project. Once the 50/50 joint venture is formed, further exploration and development costs will be shared proportionately by Diadem and Globex.

Upon Diadem earning its 50% fully vested interest in the Project, it will have a one-time option to complete, at its cost, a positive bankable feasibility study required to put the Project into commercial production. Upon completion of a positive bankable feasibility study, or upon Diadem putting the Project into commercial production, including arranging the financing therefore, it will have the right to acquire from Globex an additional 7.5% fully vested interest in the Project upon payment to Globex of \$250,000 cash and the issue to Globex of 5% of the then issued and outstanding common shares of Diadem.

4. EQUIPMENT

	August 31, 2006		May 31, 2006	
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>	<u>Net</u>
	\$	\$	\$	\$
Computer and office equipment	13,414	7,227	6,187	6,689

5. SHAREHOLDERS' EQUITY

(a) Capital Stock

Authorized capital stock of the Company consists of an unlimited number of special shares, redeemable and retractable at paid-up value and an unlimited number of common shares.

During 2006, the common shares of Company were consolidated on a 1-for-16 basis. These consolidated financial statements fully reflect this share consolidation.

(b) Issued and Outstanding Shares

Details of issued and outstanding common shares are as follows:

	2006		2005	
	#	\$	#	\$
Balance, May 31	9,679,394	31,080,221	9,550,038	30,844,248
Issued pursuant to:				
Conversion of Series B Preference Shares	-	-	121,675	229,724
Flow-through financings (Note 5(c))	1,813,454	761,650	-	-
Adjustment for rounding due to share consolidation	-	-	(131)	-
Balance, August 31	11,492,848	31,841,871	9,671,582	31,073,972

(c) Flow-through Financings

During July 2006, the Company placed 1,813,454 flow-through common shares at a price of \$0.42 per share for gross proceeds of \$761,650.

(d) Warrants

A summary of the Company's warrant activity during the quarters ended August 31, 2006 and 2005 is as follows:

	August 31, 2006		August 31, 2005	
	Warrants	Weighted Average Exercise price	Warrants	Weighted Average Exercise price
	#	\$	#	\$
Outstanding, beginning of period	2,239,583	1.60	2,614,921	1.75
Expired	-	-	-	-
Outstanding, end of period	2,239,583	1.60	2,614,921	1.75

A summary of warrants outstanding at August 31, 2006 is as follows:

<u>Expiry date</u>	<u>Warrants</u>	<u>Exercise Price</u>	<u>Fair Value</u>
	#	\$	\$
October 22, 2006	<u>2,239,583</u>	1.60	<u>783,430</u>

On October 22, 2006, the warrants expired unexercised.

5. SHAREHOLDERS' EQUITY (Continued)

(e) Stock Option Plan

The Company has a stock option plan to aid in retaining and encouraging directors, senior officers, employees and service providers of the Company. At the annual general meeting of shareholders held November 28, 2005, the shareholders adopted and approved an amendment to Diadem's stock option plan which permits reserving for issuance under the stock option plan, at any time, of a maximum of 10% of the issued and outstanding shares of the Company at the date of grant. The options are non-assignable and may be granted for a term not exceeding five years. The exercise price is fixed by the board of directors of the Company at the time of grant, subject to all applicable regulatory requirements.

A summary of the Company's stock option activity is as follows:

	<u>Options</u>	<u>Weighted average</u> <u>exercise price</u>
	#	\$
Outstanding, May 31, 2006	812,500	1.63
Expired	(421,875)	1.63
Outstanding, August 31, 2006	390,625	1.63

The following is a summary of stock options outstanding at August 31, 2006:

<u>Expiry Date</u>	<u>Exercise Price</u>	<u>Options</u>
	\$	#
February 20, 2008	1.60	46,875
February 21, 2008	1.60	15,625
May 28, 2008	1.60	196,875
October 8, 2008	1.84	6,250
October 8, 2008	1.60	31,250
November 20, 2008	1.60	6,250
October 18, 2009	1.68	15,625
November 1, 2009	1.60	46,875
July 19, 2010	1.60	25,000
		390,625

(f) Contributed Surplus

A summary of the Company's contributed surplus activity is as follows:

	<u>2006</u>
	\$
Balance, May 31, 2006	872,805
Stock-based compensation	4,349
Balance, August 31, 2006	877,154

6. RELATED PARTY TRANSACTIONS AND BALANCES

Included in accounts payable and accrued liabilities is \$61,222 (May 31, 2006-\$120,167) due to directors for administrative, financial and geological services rendered to and expenses paid on behalf of the Company. Cost of services rendered to the Company by the directors was \$54,000 (2005-\$44,000) during the three month periods ended August 31. In addition and during the three months ended August 31, 2006, \$75,000 was paid to two directors in respect of financial advisory services. These related party 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 related parties.

7. SUPPLEMENTARY CASH FLOW INFORMATION

	<u>2006</u>	<u>2005</u>
	\$	\$
Value of Series B first preference shares exchanged for common shares of the Company	-	229,724

8. INCOME TAXES

As at August 31, 2006 and May 31, 2006, the Company had available for deduction against future taxable income, non-capital losses of approximately \$4,724,000.

In addition, the Company has capital losses aggregating \$115,000, Canadian exploration and development expenditures of \$4,481,000, and foreign exploration and development expenses aggregating \$12,238,000, each of which are available for deduction against future taxable income under certain circumstances. During 2005, the Company issued 2,352,167 flow-through shares for proceeds of \$1,637,200. During February 2006 and 2005, respectively, the Company renounced the equivalent expenditure to its investors and recognized a non-cash future income tax recovery of \$543,245 (2005 - \$286,664). At May 31, 2006, the Company had provided a valuation allowance of \$6,899,000 (2005 - \$7,550,000) against future tax assets. As a consequence of issuing flow-through shares the Company created taxable temporary differences which can be reduced by previously unrecognized future tax assets.

9. COMMITMENTS

As at August 31, 2006, the Company is committed to incur prior to December 31, 2006, on a best efforts basis, approximately \$975,000 in qualifying Canadian exploration expenditures pursuant to a private placement for which flow-through proceeds had been received and renounced to the subscribers with an effective date of December 31, 2005. During July 2006, the Company raised a further \$761,650 by way of a flow-through financing. The Company is committed to incur prior to December 31, 2007, on a best efforts basis, an additional \$761,650 in qualifying Canadian exploration expenditures which will be renounced to the subscribers with an effective date of December 31, 2006.

10. FINANCIAL INSTRUMENTS

Fair Value

Canadian generally accepted accounting principles require that the Company disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates. The carrying amounts for sundry receivables and accounts payable and accrued liabilities on the balance sheet approximate fair value because of the limited term of these instruments.

Foreign Exchange Risk

Certain of the Company's expenses were incurred in United States and Mali currencies and are therefore subject to gains or losses due to fluctuations in these currencies relative to the Canadian dollar.

Commodity Price Risk

The ability of the Company to develop its properties and the future profitability of the Company are directly related to the market price of diamonds and gold.