



(An Exploration Stage Company)

CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2008 AND 2007

(Expressed in Canadian Dollars)

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R E S O U R C E S L T D.

(An Exploration Stage Company)

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AUDITORS' REPORT

To the Shareholders of
DIADEM RESOURCES LTD.

We have audited the consolidated balance sheets of Diadem Resources Ltd. (a Development Stage Company) as at May 31, 2008 and 2007 and the consolidated statements of operations and deficit and cash flows for each of the years in the two-year period ended May 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2008 and 2007 and the results of its operations and its cash flows for each of the years in the two-year period ended May 31, 2008 in accordance with Canadian generally accepted accounting principles.

MCGOVERN, HURLEY, CUNNINGHAM, LLP

A handwritten signature in cursive script that reads 'McGovern, Hurley, Cunningham, LLP'.

**Chartered Accountants
Licensed Public Accountants**

Toronto, Canada
September 15, 2008

DIADEM RESOURCES LTD.
 (An Exploration Stage Company)
CONSOLIDATED BALANCE SHEETS
 AS AT MAY 31

(Expressed in Canadian Dollars)	2008 \$	2007 \$
ASSETS		
CURRENT		
Cash	6,438	592,007
Accounts receivable-		
Due from related parties (Note 7)	4,504	4,453
Taxes recoverable (Note 4)	28,872	92,112
Prepaid expenses	<u>5,197</u>	<u>3,338</u>
	45,011	691,910
MINERAL INTERESTS (Note 3)	3,851,614	2,760,573
EQUIPMENT (Note 5)	<u>4,731</u>	<u>6,759</u>
	<u>3,901,356</u>	<u>3,459,242</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Notes 3 and 7)	1,074,434	318,432
Other taxes payable (Note 10)	<u>500,261</u>	<u>163,948</u>
	<u>1,574,695</u>	<u>482,380</u>
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Notes 6(a) and (b))	33,824,873	33,824,873
WARRANTS (Note 6(d))	543,799	543,799
CONTRIBUTED SURPLUS (Note 6(f))	1,667,538	1,664,828
DEFICIT	<u>(33,709,549)</u>	<u>(33,056,638)</u>
	<u>2,326,661</u>	<u>2,976,862</u>
	<u>3,901,356</u>	<u>3,459,242</u>

Commitments and contingencies (Notes 1, 3 and 10)

APPROVED ON BEHALF OF THE BOARD:

Signed "P. A. Carroll"_____, Director

Signed "Aime Bertrand"_____, Director

(An Exploration Stage Company)

**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
FOR THE YEARS ENDED MAY 31**

(Expressed in Canadian Dollars)	2008 \$	2007 \$
REVENUE		
Gain on sale of investment and other	-	43,979
Interest income	6,400	22,005
Foreign exchange	<u>228</u>	<u>22,005</u>
	<u>6,628</u>	<u>65,984</u>
EXPENSES		
Amortization	2,028	2,210
Business development	52	2,357
Capital tax (recovered)	(79)	4,234
Advisory fees	-	106,200
Interest and penalties (Note 10)	340,820	94,265
Management fees, salaries and benefits	192,000	227,499
Office expenses and other	12,174	54,822
Professional fees	45,333	53,728
Shareholder relations	48,820	58,885
Travel	-	3,912
Stock-based compensation	2,710	8,593
Write-down of mineral interests (Note 3(b))	<u>15,681</u>	<u>2,001,693</u>
	<u>659,539</u>	<u>2,618,398</u>
Loss before income taxes	(652,911)	(2,552,414)
Future income taxes (Note 9)	<u>(756,854)</u>	<u>1,019,686</u>
NET LOSS FOR THE YEAR	(1,409,765)	(1,532,728)
DEFICIT , beginning of year	(33,056,638)	(30,266,479)
Costs associated with issuance of capital stock (Note 9)	<u>756,854</u>	<u>(1,257,431)</u>
DEFICIT , end of year	<u>(33,709,549)</u>	<u>(33,056,638)</u>
NET LOSS PER SHARE - basic and diluted	(0.07)	(0.10)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES	18,944,647	15,413,488

See accompanying notes to the consolidated financial statements.

DIADEM RESOURCES LTD.
 (An Exploration Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
 FOR THE YEARS ENDED MAY 31

(Expressed in Canadian Dollars)	2008 \$	2007 \$
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss for the year	(1,409,765)	(1,532,728)
Adjustment for items not affecting cash:		
Amortization	2,028	2,210
Write-down of mineral interests	-	2,001,693
Gain on disposal of investment and other	-	(43,979)
Stock-based compensation	2,710	8,593
Future income taxes	<u>756,854</u>	<u>(1,019,686)</u>
	<u>(648,173)</u>	<u>(583,897)</u>
Net changes in non-cash working capital balances:		
Prepaid expenses	(1,859)	1,175
Taxes recoverable	63,240	(55,587)
Sundry receivable	-	1,555
Due from related parties	(51)	(4,453)
Accounts payable and accrued liabilities	122,799	(137,538)
Other taxes payable	<u>336,313</u>	<u>56,419</u>
	<u>520,442</u>	<u>(138,429)</u>
Cash flows from operating activities	<u>(127,731)</u>	<u>(722,326)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Common shares issued for cash	-	2,856,053
Costs associated with issuance of capital stock	<u>-</u>	<u>(198,572)</u>
Cash flows from financing activities	<u>-</u>	<u>2,657,481</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Equipment	-	(2,280)
Mineral interests	<u>(457,838)</u>	<u>(1,603,624)</u>
Cash flows from investing activities	<u>(457,838)</u>	<u>(1,605,904)</u>
Change in cash during the year	(585,569)	329,251
CASH , beginning of year	<u>592,007</u>	<u>262,756</u>
CASH , end of year	<u>6,438</u>	<u>592,007</u>

SUPPLEMENTAL INFORMATION (Note 8)

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 an exploration 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, aboriginal claims and non-compliance with regulatory and environmental 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Company and its subsidiary are in accordance with Canadian generally accepted accounting principles and their basis of application is consistent with that of the previous year, except as described below. Outlined below are those policies considered particularly significant.

Basis of Consolidation:

The consolidated financial statements include the accounts of Diadem Resources Ltd. and its wholly-owned subsidiary Diadem Explorations Inc.

Equipment and Amortization:

Equipment is recorded at cost and is amortized over its estimated useful life using the declining balance basis at the following annual rates:

Computer and office equipment	30%
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Accounting Changes:

On June 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530, *Comprehensive Income*; Section 3251, *Equity*; section 3855, *Financial Instruments-Recognition and Measurement*; Section 3861, *Financial Instruments-Disclosure and Presentation*; and section 3865, *Hedges*.

Financial Instruments:

Under the new standards, financial assets and liabilities, including derivative instruments, are initially recognized and subsequently measured based on their classification as "held-for-trading", "available-for-sale financial assets", "held-to-maturity", "loans and receivables", or "other" financial liabilities. Held-for-trading financial instruments are measured at their value with changes in fair value recognized in net income for the period. Available-for-sale financial assets are measured at their fair value and changes in fair value are included in other comprehensive income until the asset is removed from the balance sheet.

(An Exploration Stage Company)**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**FOR THE YEARS ENDED MAY 31, 2008 and 2007

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Held-to-maturity investments, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method. Derivative instruments, including embedded derivatives, are measured at their fair value with changes in fair value recognized in net income for the period, unless the instrument is a cash flow hedge and hedge accounting applies, in which case changes in fair value are recognized in other comprehensive income.

Comprehensive Income

Section 1530 of the CICA Handbook establishes standards for reporting and presenting comprehensive income. Comprehensive income, composed of net income and other comprehensive income, is defined as the change in shareholders' equity from transactions and other non-owner sources. The Company has no accumulated other comprehensive income and, therefore, no statement of other comprehensive income has been prepared.

Hedging

Section 3865 of the CICA Handbook specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed. As at and for the year ended May 31, 2008, the Company had no hedges in place.

The application of these new standards has no impact on the Company's consolidated financial statements as at and for the year ended May 31, 2008.

Foreign Currency Translation:

The Company's functional and reporting currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the statement date. Non-monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at historical exchange rates. Revenue and expense items, other than amortization, are translated at the average rate of exchange for the year. An exchange gain or loss that arises on translation or settlement of a foreign currency denominated monetary item is included in operations for the period.

Mineral Interests:

The exploration activities of the Company are directed towards the search, evaluation and development of mineral properties. Major expenditures are required to locate and establish ore reserves to develop metallurgical processes and to construct mining and processing facilities at a particular site.

The recoverability of values assigned to mineral interests is dependent upon discovery of economically recoverable reserves, confirmation of the Company's interest in the mineral claims, the ability to obtain necessary financing to complete development and future profitable production or proceeds from disposition. Management reviews the carrying value of the Company's interest in each property whenever events or changes in circumstances indicate that their carrying amount may not be recoverable and, where necessary, these properties are written down to their estimated recoverable amount. It is reasonably possible that certain events could adversely affect management's estimates of recoverable amounts and the need for, as well as the amount of, provision for impairment in the carrying value of mineral interests and related assets.

The cost of acquisition of mineral interests and related exploration costs are deferred until the properties to which they relate are placed into production, sold or allowed to lapse. These costs will be amortized over the estimated useful life of the properties following commencement of commercial production or written off if the properties are sold or allowed to lapse. The Company does not accrue future costs to keep the properties in good standing. Administrative expenditures, not directly related to property maintenance, are charged to operations as incurred.

Continued...

(An Exploration Stage Company)**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**FOR THE YEARS ENDED MAY 31, 2008 and 2007

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company recognizes government assistance in the form of mineral exploration and mining tax credits when the amounts to be received can be reasonably estimated and collection can be reasonably assured. The amount of mineral exploration and mining tax credit reduces the Company's capitalized mineral property costs.

Stock-based Compensation:

All stock-based awards made to employees and non-employees are measured and recognized using a fair value based method. For employees, the fair value of the options at the date of grant is accrued and charged to operations or capitalized to a resource property, with the offsetting credit to contributed surplus, on a straight line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is complete or the date the performance commitment is reached or the date upon which the equity instruments are granted if they are fully vested and non-forfeitable.

Use of Estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the year. Actual results could differ from estimates. During the fiscal years presented, management has made a number of significant estimates and valuation assumptions regarding the recoverability of investments in mining interests and deferred exploration costs. These estimates and valuation assumptions are in accordance with Canadian mining industry practice. Other significant estimates include the valuation of stock-based compensation, contingencies, asset retirement obligations and tax accounts.

Share Purchase Warrants:

The Company, from time-to-time, issues units which are normally comprised of a common share and a share purchase warrant. The common shares are issued at the then current market value with the share purchase warrant exercisable at a price equal to or higher than the market value of the common share. The Company allocates the proceeds of the unit offering between the common shares and the share purchase warrants based on the fair value of each component.

Asset Retirement Obligations:

The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred. Also, when the liability is initially recorded, a corresponding increase in the carrying amount of the related asset is recorded.

On an annual basis, the liability is increased by the interest factor that was applied in the initial measurement of fair value and the asset is amortized over the estimated life of the related asset. The amount of the liability will be subject to re-measurement at the end of each reporting period. Any adjustment to this liability will impact the related asset.

As at May 31, 2008 and 2007, the Company had no significant asset retirement obligations.

Loss Per Share:

Basic loss per share is calculated using the weighted number of shares outstanding for the period. Diluted loss per share is calculated using the treasury stock method. In order to determine diluted loss per share, the treasury stock method assumes that any proceeds from the exercise of dilutive stock options and warrants would be used to repurchase common shares at the average market price during the period, with the incremental number of shares being included in the denominator of the diluted loss per share calculation.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The diluted loss per share calculation excludes any potential conversion of options and warrants that would increase earnings per share or decrease loss per share.

Flow-through Financing:

The Company has financed a portion of its exploration activities in Canada through the issue of flow-through shares, which transfers the tax deductibility of Canadian exploration expenditures to the investor. Proceeds received on the issue of such shares are credited to capital stock. The related exploration costs, when incurred, are charged to mineral interests.

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. The tax benefit forgone on renunciation of Canadian exploration expenditures to investors is charged to deficit as a cost of equity financing when such amounts are renounced.

Income Taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method of tax allocation, future income taxes are determined based on the differences between the financial reporting and tax bases of assets and liabilities. These income tax assets and liabilities are measured using the substantially enacted tax rates in which the income tax assets and liabilities are expected to be settled or realized. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

New Accounting Pronouncements:

- (i) Financial Instruments-Disclosure (Section 3862) and Financial Instruments-Presentation (Section 3863)

Section 3862 replaces the disclosure portion of Section 3861, Financial Instruments-Disclosure and Presentation, and enhances the disclosure requirements on the nature and extent of risks arising from financial instruments and how these risks are managed. Section 3863 carries forward the presentation requirements from Section 3861. Effective June 1, 2008, the Company adopted these standards. Beyond additional disclosures, the adoption of these new pronouncements would not have an effect on the Company's financial position or results of operations.

- (ii) Capital Disclosures (Section 1535)

Section 1535 establishes standards for disclosure of qualitative and quantitative disclosure about an entity's capital and how it is managed in order to enable users of its financial statements to evaluate the entity's objectives, policies and processes of managing its capital. Effective June 1, 2008, the Company adopted these standards. Beyond additional disclosures, the adoption of these standards would not have an effect on the Company's financial position or results of operations.

- (iii) General Standards of Financial Statement Presentation (Section 1400)

The amendment to this section provides revised guidance related to management's responsibility to assess the ability of the entity to continue as a going concern. Effective June 1, 2008, the Company adopted the amendment to this section. Beyond additional disclosure, the adoption of this amendment would not have an effect on the Company's financial position or results of operations.

(An Exploration Stage Company)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED MAY 31, 2008 and 2007

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(iv) International Financial Reporting Standards

On February 13, 2008, the Accounting Standards Board confirmed that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards (“IFRS”) for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The Company is assessing the impact of the conversion from Canadian generally accepted accounting principles to IFRS on its consolidated financial statements and will develop a conversion implementation plan.

3. MINERAL INTERESTS

	Balance May 31, 2007 \$	Additions \$	Write-downs \$	Balance May 31, 2008 \$
Acquisition costs				
Franklin Project, Northwest Territories	<u>1,142,696</u>	<u>-</u>	<u>-</u>	<u>1,142,696</u>
Deferred exploration costs				
Franklin Project, Northwest Territories	<u>1,617,877</u>	<u>1,091,041</u>	<u>-</u>	<u>2,708,918</u>
	<u>2,760,573</u>	<u>1,091,041</u>	<u>-</u>	<u>3,851,614</u>

	Balance May 31, 2006 \$	Additions \$	Write-downs \$	Balance May 31, 2007 \$
Acquisition costs				
Franklin Project, Northwest Territories	1,190,764	-	(48,068)	1,142,696
Duquesne West, Quebec	<u>25,000</u>	<u>563,750</u>	<u>(588,750)</u>	<u>-</u>
	<u>1,215,764</u>	<u>563,750</u>	<u>(636,818)</u>	<u>1,142,696</u>
Deferred exploration costs				
Franklin Project, Northwest Territories	1,528,751	185,643	(96,517)	1,617,877
Duquesne West, Quebec	<u>44,366</u>	<u>1,223,992</u>	<u>(1,268,358)</u>	<u>-</u>
	<u>1,573,117</u>	<u>1,409,635</u>	<u>(1,364,875)</u>	<u>1,617,877</u>
	<u>2,788,881</u>	<u>1,973,385</u>	<u>(2,001,693)</u>	<u>2,760,573</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 resulted 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

(An Exploration Stage Company)**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**FOR THE YEARS ENDED MAY 31, 2008 and 2007

3. MINERAL INTERESTS (Continued)

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. In fiscal 2007, the Company relinquished and wrote-off the carrying value of the lands south of the 68th parallel.

On November 29, 2007, the Company and DBR entered into an amending agreement providing for an extension to June 30, 2008 of the period during which Diadem may earn a 50% interest in the Franklin Project. To satisfy Diadem's 50% earn-in requirement, Diadem was required to incur expenditures aggregating \$1.0 million during the period September 1, 2007 through June 30, 2008. A list of expenditures in excess of \$1.0 million has been provided to DBR for the amended period for earn-in. DBR has not yet ratified the list of expenditures. Under the terms of the agreement, DBR will be required to carry its 50% pro rata share of on-going exploration and development costs or suffer dilution of its interest. Under the amended agreement, Diadem will advance \$1.0 million to subsequent Franklin Project programs on behalf of DBR and DBR will not have to contribute the first \$1.0 million of its 50% share of costs. If Diadem advances the \$1.0 million, DBR will repay such advance, without interest, out of its share of any future production from a diamond mine on the Franklin Project.

If a decision is made to carry out a feasibility study for a diamond mine, Diadem has the right to fund the study and, if the property is advanced to commercial production, Diadem's 50% interest will increase to 75% and DBR's interest will decrease to 25%.

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.

At May 31, 2008, accounts payable includes an amount of \$100,000 payable to DBR in respect of payments made to the IRC, plus interest of \$7,109. This amount is considered a loan from DBR and bears interest at DBR's bank prime plus 1%. Diadem was to repay the loan by March 31, 2008; however, at May 31, 2008, the loan remains outstanding. Also included in payables is \$100,000 payable directly to the IRC.

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(An Exploration Stage Company)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED MAY 31, 2008 and 2007

3. MINERAL INTERESTS (Continued)

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 north of Rouyn-Noranda, Quebec. The option agreement was with Jack Stoch Geoconsultant Services Inc. ("Vendor") and Globex Mining Enterprises Inc. ("Globex").

The option agreement became effective July 17, 2006. Under the agreement, Diadem could have earned 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 was to be spent by June 30, 2007, an additional \$2,000,000 was to be spent by June 30, 2008 and an additional \$3,000,000 was to be spent by June 30, 2009. Diadem made initial cash payments to the Vendor of \$225,000, and issued to the Vendor 1,250,000 Diadem common shares valued at \$338,750 based on the quoted, closing market price of the Company's shares on the day of closing the agreement.

During May 2007, the Company elected not to proceed further with the project, allowed the option to lapse and wrote-off the carrying value of the project. During 2008, the Company incurred \$15,681 in exploration expenditure which was expensed.

4. TAXES RECOVERABLE

Taxes recoverable consist of:

	<u>2008</u>	<u>2007</u>
	\$	\$
Province of Quebec income and mining tax credits	-	18,910
Province of Quebec sales tax credits	-	64,744
Government of Canada goods and services tax credits	<u>28,872</u>	<u>8,458</u>
	<u>28,872</u>	<u>92,112</u>

5. EQUIPMENT

	<u>2008</u>		<u>2007</u>	
	<u>Cost</u>	Accumulated <u>Amortization</u>	<u>Net</u>	<u>Net</u>
	\$	\$	\$	\$
Computer and office equipment	15,694	10,963	4,731	6,759

6. 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.

(An Exploration Stage Company)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED MAY 31, 2008 and 2007

6. SHAREHOLDERS' EQUITY (Continued)

(b) Issued and Outstanding Shares

Details of issued and outstanding common shares are as follows:

	2008		2007	
	#	\$	#	\$
Balance, beginning of year	18,944,647	33,824,873	9,679,394	31,080,221
Issued pursuant to:				
Shares issued for cash	-	-	110,000	33,000
Conversion of Series B Preference Shares	-	-	28,850	54,475
Flow-through financings (Note 6(c))	-	-	7,876,403	2,823,053
Shares issued for property	-	-	1,250,000	338,750
Issue of warrants (Notes 6 (c) and (d))	-	-	-	(504,626)
Balance, end of year	<u>18,944,647</u>	<u>33,824,873</u>	<u>18,944,647</u>	<u>33,824,873</u>

(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.

During November 2006, the Company placed 4,767,654 Units at a price of \$0.34 per Unit for aggregate gross proceeds of \$1,621,002. Each Unit consisted of one flow-through common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one additional common share for a period of one year with an exercise price of \$0.45 per share and thereafter at an exercise price of \$0.60 per share for the period ending 24 months from the date of issuance. The gross proceeds were prorated to capital stock and warrants based on the relative fair value of each component, as follows: capital stock - \$1,251,599; warrants - \$369,403. A total of \$81,050 in cash commissions was paid and 381,412 non-flow-through broker warrants were issued, exercisable for a period of one year with an exercise price of \$0.45 per share and thereafter at an exercise price of \$0.60 per share for the period ending 24 months from the date of issuance. The broker warrants were valued at \$39,173. The fair values of the warrants and broker warrants were estimated using the Black-Scholes option-pricing model with the following weighted average assumptions: expected dividend yield of 0%, expected stock volatility of 100%, risk-free interest rate of 4.18% and an expected warrant life of 2 years.

During December 2006, the Company placed 1,295,295 Units at a price of \$0.34 per Unit for gross proceeds of \$440,400. Each Unit consisted of one flow-through common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one additional common share for a period of one year with an exercise price of \$0.45 per share and thereafter at an exercise price of \$0.60 per share for the period ending 24 months from the date of issuance. The gross proceeds were prorated to capital stock and warrants based on the relative fair value of each component, as follows: capital stock - \$305,177; warrants - \$135,223.

Continued...

(An Exploration Stage Company)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED MAY 31, 2008 and 2007

6. SHAREHOLDERS' EQUITY (Continued)

(d) Warrants

A summary of the Company's warrant activity during the years ended May 31, 2008 and 2007 is as follows:

	2008		2007	
	Warrants	Weighted Average Exercise price	Warrants	Weighted Average Exercise price
	#	\$	#	\$
Outstanding, beginning of year	5,209,061	0.45	2,239,583	1.60
Granted	-	-	6,444,361	0.45
Cancelled	-	-	(1,235,300)	(0.45)
Expired	-	-	(2,239,583)	1.60
Outstanding, end of year ⁽¹⁾	<u>5,209,061</u>	0.60	<u>5,209,061</u>	0.45

A summary of warrants outstanding at May 31, 2008 is as follows:

Expiry date	Warrants #	Exercise Price \$	Fair Value \$
November 15, 2008	3,913,766	0.60	408,576
December 20, 2008	<u>1,295,295</u>	0.60	<u>135,223</u>
	<u>5,209,061</u>	0.60	<u>543,799</u>

(1) During 2008 and pursuant to the terms of the warrants described in Note 6(c), the exercise price of the outstanding warrants increased from \$0.45 per share to \$0.60 per share.

(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. Diadem's stock option plan 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:

	Options #	Weighted average exercise price \$
	Outstanding, May 31, 2006	812,500
Expired	<u>(421,875)</u>	1.63
Outstanding, May 31, 2007	390,625	1.63
Expired	<u>(259,375)</u>	1.60
Outstanding, May 31, 2008	<u>131,250</u>	1.62

Continued...

6. SHAREHOLDERS' EQUITY (Continued)

The following is a summary of stock options outstanding at May 31, 2008:

<u>Expiry Date</u>	<u>Exercise Price</u>	Options Outstanding	Options Exercisable
	\$	#	#
October 8, 2008	1.84	6,250	6,250
October 8, 2008	1.60	31,250	31,250
November 20, 2008	1.60	6,250	6,250
October 18, 2009	1.68	15,625	15,625
November 1, 2009	1.60	46,875	46,875
July 19, 2010	1.60	<u>25,000</u>	<u>20,000</u>
		<u>131,250</u>	<u>126,250</u>

(f) Contributed Surplus

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

	<u>2008</u>	<u>2007</u>
	\$	\$
Balance, beginning of year	1,664,828	872,805
Stock-based compensation	2,710	8,593
Expiry of warrants	-	<u>783,430</u>
Balance, end of year	<u>1,667,538</u>	<u>1,664,828</u>

7. RELATED PARTY TRANSACTIONS AND BALANCES

At May 31, 2008, due from related parties includes \$4,504 (2007-\$3,746) due from a corporation over which the Chairman of the Company has direction and control. The expenses were incurred on behalf of the related party and in respect of its regulatory filings. The amount was collected subsequent to May 31, 2008. At May 31, 2007, due from related parties includes \$707 from a corporation over which a former director of the Company exercised control and direction. The receivable resulted from mailing expenses incurred on behalf of the related party and was collected during the year ended May 31, 2008.

Included in accounts payable and accrued liabilities is \$71,888 due to two directors in their capacity of overseeing the Franklin Project exploration program (2007-\$12,040 due to one director). In addition, at May 31, 2008, \$75,000 was payable to the Chairman of the Company in respect of administrative services (2007-\$Nil) and \$10,000 as a loan to cover the cost of certain expenditures incurred by the Company in the ordinary course of business. The cost of services rendered to the Company, directly and indirectly, by these three directors was \$171,763 (2007-\$312,847) during 2008.

During fiscal 2007, directors and officers of the Company subscribed for 808,726 common shares of Diadem for gross proceeds of \$309,900 pursuant to the private placements described in notes 6(b) and 6(c) to the financial statements.

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.

8. SUPPLEMENTARY CASH FLOW INFORMATION

	<u>2008</u>	<u>2007</u>
	\$	\$
Income taxes paid	-	-
Interest paid	121	34,624
Value of Series B first preference shares exchanged for common shares of the Company	-	54,475
Disposal of investment to settle accounts payable	-	44,000
Common shares issued to acquire Duquesne West Project	-	338,750
Broker warrants issued	-	39,173

9. INCOME TAXES

Provision for Income Taxes

Major items causing the Company's income tax rate to differ from the combined Canadian federal and provincial statutory rate of approximately 35% (2007 – 36%) were as follows:

	<u>2008</u>	<u>2007</u>
	\$	\$
(Loss) before income taxes:	<u>(652,911)</u>	<u>(2,552,414)</u>
Expected income tax benefit based on statutory rate	(229,000)	(922,000)
Adjustments to benefit resulting from:		
Non-taxable portion of capital gains	-	(8,000)
Equity finance costs	-	(72,000)
Non-deductible expenses	-	4,000
Expiry of losses	294,000	238,000
Mineral interests	(169,000)	-
Change in tax rates	1,327,854	
Other	(150,000)	201,314
Change in valuation allowance	<u>(317,000)</u>	<u>(461,000)</u>
	<u>756,854</u>	<u>(1,019,686)</u>

Future Income Tax Balances

The tax effects of temporary differences that give rise to future income tax assets at May 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
	\$	\$
Non-capital losses	1,380,000	1,711,000
Financing costs	48,000	99,000
Capital losses	161,000	201,000
Resource properties	3,319,000	3,187,000
Equipment	113,000	140,000
Valuation allowance	<u>(5,021,000)</u>	<u>(5,338,000)</u>
Net future income tax asset	<u>-</u>	<u>-</u>

Continued...

9. INCOME TAXES (Continued)

As at May 31, 2008, the Company had available for deduction against future taxable income, non-capital losses of approximately \$4,735,000 which expire as follows:

<u>Year</u>	<u>Amount</u>
	\$
2009	921,000
2010	238,000
2014	732,000
2015	1,075,000
2026	369,000
2027	671,000
2028	<u>729,000</u>
	<u>4,735,000</u>

In addition, the Company has capital losses aggregating \$1,111,000, Canadian exploration and development expenditures of \$4,899,000, and foreign exploration and development expenses aggregating \$12,238,000, each of which is available for deduction against future taxable income under certain circumstances.

During the year ended May 31, 2007, the Company issued 7,876,403 flow-through shares for proceeds of \$2,823,053. During February 2007, the Company renounced the equivalent expenditure to its investors and recognized a non-cash future income tax recovery of \$1,019,686.

At May 31, 2008, the Company had provided a valuation allowance of \$5,021,000 (2007 - \$5,338,000) 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. The recognition of the previously unrecognized future income tax asset resulted in a credit to the statement of operations in the amount of \$1,019,686 during the year ended May 31, 2007 with an offsetting charge to deficit as a cost of financing the flow-through share issue. During 2008, Diadem did not incur sufficient Canadian exploration expenditures ("CEE") during calendar 2007 to fully satisfy its flow-through commitments. The reversal of a previously recognized future income tax asset resulted in a charge to the statement of operations in the amount of \$756,854 during the year ended May 31, 2008 with an offsetting credit to deficit as a reduction of financing finance cost previously associated with the flow-through share issue.

10. COMMITMENTS AND CONTINGENCIES

As at May 31, 2007, the Company was committed to incur prior to December 31, 2007, on a best efforts basis, approximately \$2,600,000 in qualifying CEE pursuant to private placements for which flow-through proceeds had been received during 2006 and renounced to the subscribers with an effective date of December 31, 2006. As at December 31, 2007, this shortfall in expenditure was reduced to approximately \$2,095,000.

Diadem did not incur sufficient CEE in 2007 to fully satisfy its flow-through commitments. As a consequence, Diadem recorded approximately \$333,591 during 2008 (2007-\$88,920) in Part XII.6 tax and penalties which is included in the consolidated statement of operations under interest and penalties expense. Other taxes payable includes Part XII.6 tax payable in the aggregate amount of \$487,782.

Since the Company did not meet flow-through share expenditure requirements agreed to through various subscription agreements entered into during 2006, the Company has amended the renunciations provided to subscribers of these shares. The Company has accrued all penalties and interest charges related to this matter that could be reasonably estimated; however, the subscription agreements provided certain indemnities for certain amounts that will become payable by the subscribers upon reassessment of their

10. COMMITMENTS AND CONTINGENCIES (Continued)

personal tax returns with the amended and reduced renunciations. The contingent liability that may be created by this indemnity will depend on various items, including each individual subscriber's personal tax situation, and cannot therefore be reasonably estimated.

The ability of the Company to develop its properties and the future profitability of the Company is directly related to the market price of exploited minerals and metals.

11. FINANCIAL INSTRUMENTS

The Company's financial assets and liabilities consist of cash, receivables, due from related parties, accounts payable and accrued liabilities and other taxes payable. Cash is classified as held-for-trading and is carried at fair value on the balance sheet due to the short-term nature of this financial instrument. Amounts receivable, accounts payable and accruals approximate their fair values due to the relatively short periods to maturity.

The Company's financial instruments are exposed to certain financial risks including currency risk, credit risk, liquidity risk and market risk.

a) Currency risk

The Company operates solely in Canada and a small portion of the Company's capital expenditures are denominated in the United States dollar and a significant portion of the Company's operating costs are denominated in the Canadian dollar. As a consequence, the Company is exposed to currency fluctuations relative to the United States dollar. A significant change in the currency exchange rate between the United States dollar and the Canadian dollar would not have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

b) Interest rate risk

The Company is not exposed to significant interest rate price risk due to the short-term maturity of its monetary assets and liabilities.

c) Credit risk

Credit risk is the risk of unexpected financial loss to the Company if a customer or third party to a financial instrument fails to meet its contractual obligations.

The Company is exposed to credit risk with respect to its accounts receivable comprised principally of goods and services tax recoverable; however, the risk is minimized because the amount due is from a subdivision of the Canadian federal government.

d) Derivatives – mineral properties

The Company retains and/or has obligations related to certain carried interest rights and net smelter royalties ("NSR"), the value of which is derived from future events and commodity prices. These rights are derivative instruments. However, the mineral property interests to which they relate are not sufficiently developed to reasonably determine value.

e) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure and continuously monitors its capital expenditures and cash used in operations. To the extent that the Company expects that it does not have sufficient liquidity to meet these obligations, management will consider securing additional funds through debt or equity transactions. At May 31, 2008, the Company is indebted to suppliers who may not provide future services if not paid.