DIATREME RESOURCES LIMITED
and its controlled entities
ABN 33 061 267 061

General Purpose Financial Report
for the year ended 31 December 2005

DIRECTORS' REPORT

Your Directors present their report on the consolidated entity consisting of Diatreme Resources Limited ("the Company") and the entities it controlled at the end of, or during, the year ended 31 December 2005.

Directors

The following persons were Directors of the Company during the whole of the year and continue in office at the date of this report:

A J Fawdon
D H Hall
L J Litzow

C V Alexander was appointed as a Director on 12 August 2005 and continues in office up to the date of this report.

Principal activities

The principal continuing activities of the consolidated entity have been the exploration for gold, heavy mineral sands, base metals and diamonds in Australia. There were no significant changes in the nature of the consolidated entity's principal activities during the year.

Operating results and review of operations

The operating profit/(loss) after income tax of the consolidated entity for the financial year ended 31 December 2005 was a loss of $1,289,927 (2004 : loss of $219,234). The operating profit/(loss) reflects the nature of the consolidated entity's principal activity and the partial disposal of the consolidated entity's investment in debentures.

Dividends paid or recommended

No dividend has been paid since the end of the previous year and the Directors do not recommend the payment of any dividend for the year ended 31 December 2005.

Significant changes in state of affairs

Apart from the raising of an additional $3,897,880 of equity by the issuance of shares and options, there has been no significant change to the nature of the consolidated entity's activities or state of affairs during the year and no changes are anticipated.

Matters subsequent to the end of the financial year

Subsequent to 31 December 2005 the Company has issued 975,000 ordinary fully paid shares relating to the exercising of 975,000 30 May 2007 options. The 30 May 2007 options were exercised at $0.20 raising an additional $195,000 in contributed equity.

No other matter or circumstance has arisen since the end of the financial year that has significantly affected, or may significantly affect the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in financial years subsequent to 31 December 2005.

DIRECTORS' REPORT (continued)

Likely developments

There are no likely developments in the operations of the consolidated entity which are expected to significantly affect the results of the consolidated entity in subsequent years.

Information on Directors

Charles Victor Alexander - FCA FAusIMM
Non-Executive Chairman

Experience

Board member and Chairman since 12 August 2005, Mr Alexander is a Chartered Accountant with over 35 years commercial experience in multinational and domestic companies. He has held senior management positions with the Mobil Oil Corporation, Warner Lambert Corporation and with Exxon in Australia and overseas. In 1988, he partnered Pannel Kerr Forster and Abbott Tout in forming a corporate advisory firm with specialisation in company turnarounds. He has had over 15 years mining industry experience and is currently Managing Director/CEO of Minerals Corporation Limited.

Mr Alexander is a Director of the Queensland Resources Council and chairs their Corporate Governance Committee. He also chairs the Australasian Industrial Minerals Society (AIMS), the Australian industry body for industrial minerals.

Directorships and listed public companies

Director of Minerals Corporation Limited since August 1993.

Special responsibilities

Chairmanship responsibilities.

Anthony John Fawdon - F.A.I.C.D., F.Aus.I.M.M.
Managing Director/CEO

Experience

Board member since 12 January 2001, Mr Fawdon has been active in the Australian mining and exploration industry for 32 years, working until 1982 in various management levels for multinational companies. He then became founder and director of several listed mineral explorers, including the Queensland based gold and base metal explorer Strike Mining NL in 1994 for which he was Managing Director/CEO until mid 2000.

As a current Director of the Queensland Resources Council, he chairs the Council's Exploration Committee. He is also Chairman of Opal Horizon Limited.

Directorships and listed public companies

Director of Minerals Corporation Limited between 28 April 2005 and 5 December 2005.

Special responsibilities

Corporate and exploration management. Company manager responsible to the Board.

DIRECTORS' REPORT (continued)

Information on Directors (continued)

David Hugh Hall - B.App.Sc. (Geol), G.Dip.E.Sc.
Executive Director

Experience

Board member since 12 January 2001, Mr Hall is a geologist with over 25 years experience in both field exploration and office administration. During this time, he has developed skills and experience in exploration and corporate management. He has specialist experience in project maintenance and tenement administration, government / landholder / native title liaison, and public / private company dealings. He is a member of the Queensland Resources Council Exploration Committee and a non-executive director of Opal Horizon Limited.

Directorships and listed public companies

Nil directorships held.

Special responsibilities

Exploration administration and management.

Lawrence James Litzow - F.C.A., A.A.U.Q., A.C.I.S.
Non-Executive Director / Corporate Secretary

Experience

Board member since 12 January 2001, Mr Litzow has had a successful career as a Chartered Accountant and now consults in specialist accounting and corporate matters. He holds positions as corporate secretary with a number of public and private companies. His background includes tenure as Managing Partner of Douglas Heck & Burrell, Chartered Accountants, member of the Small Business Council (advising the Federal Minister for Small Business), Chairman of the Small Business Taxation Group (Canberra), State Chairman of the Taxation Institution of Australia and non-executive director/corporate secretary of Opal Horizon Limited.

Directorships and listed public companies

Director of Tamawood Limited since 9 June 2000 and Impact Capital Limited since 16 December 2004.

Special responsibilities

Corporate secretarial services.

DIRECTORS' REPORT
(continued)

Meetings of Directors

During the financial year there were 17 meetings of Directors held. Attendances were as follows:

Director	Meetings attended	Meetings held whilst a director
A J Fawdon	17	17
D H Hall	17	17
L J Litzow	17	17
C V Alexander	5	5

Company Secretary

The Company Secretary is Mr L J Litzow. Details of Mr Litzow's qualifications and experience are set out in Information on Directors.

Remuneration

Principles used to determine the nature and amount of remuneration

Executive Directors
The combination of Directors' fees, salary, non-cash benefits and superannuation make up the Executive Directors total remuneration. The salary component of Executive Directors' remuneration packages is reviewed annually to ensure the Executives' pay is competitive with the market. Executive Directors' pay is not directly linked to the financial performance of the consolidated entity.

Non-executive Directors
Fees and payments to Non-executive Directors reflect the demands which are made on, and the responsibilities of, the Director. Non-executive Directors' fees and payments are reviewed annually by the Board.

Aggregate Directors' fees
Directors' fees are determined within an aggregate Directors' fee pool limit, which is periodically recommended for approval by shareholders. The maximum currently stands at $150,000 in aggregate plus statutory superannuation.

Details of remuneration

Details of the nature and amount of each major element of the emoluments of each Director of the Company and the officers of the Company and the consolidated entity are:

2005

Name	Directors' fee $	Salary $	Superannuation $	Other $	Non-cash benefit $	Total $
C V Alexander	11,250	-	1,012	-	-	12,262
A J Fawdon	11,417	94,166	8,985	-	-	114,568
D H Hall	11,083	90,083	9,105	-	-	110,271
L J Litzow	11,667	-	1,050	21,166	-	33,883
Total	45,417	184,249	20,152	21,166	-	270,984

DIRECTORS' REPORT
(continued)

Remuneration (continued)

Details of remuneration (continued)

2004

Name	Directors' fee $	Salary $	Superannuation $	Other $	Non-cash benefit $	Total $
A J Fawdon	-	65,000	5,850	-	-	70,850
D H Hall	-	65,000	5,850	-	-	70,850
L J Litzow	-	-	-	19,996	-	19,996
Total	-	130,000	11,700	19,996	-	161,696

Specified Executives

The Company and consolidated entity did not have any other executives ("specified executive") with authority for the strategic direction and management of the consolidated entity during the year.

Directors' shareholdings

The number of ordinary shares in the parent entity held during the year by each Director and their personally related entities is set out below:

Name	Balance at the start of the year	Received on exercising options	Net purchased / (sold)	Other changes *	Balance at the end of the year
C V Alexander	-	-	-	-	-
A J Fawdon	4,223,074	-	-	-	4,223,074
D H Hall	2,141,063	-	-	-	2,141,063
L J Litzow	2,261,092	-	-	-	2,261,092
Total	8,625,229	-	-	-	8,625,229

* Movement recorded to recognise appointment as a Director

Directors' option holdings

The number of May 2007 unlisted options in the Company held during the financial year by each Director and their personally related entities is set out below:

Name	Balance at the start of the year	Received on the exercising options	Net purchased / (sold)	Other changes *	Balance at the end of the year
C V Alexander	-	-	-	-	-
A J Fawdon	1,000,000	-	-	-	1,000,000
D H Hall	1,000,000	-	-	-	1,000,000
L J Litzow	1,009,617	-	-	-	1,009,617
Total	3,009,617	-	-	-	3,009,617

* Movement recorded to recognise appointment as a Director

DIRECTORS' REPORT
(continued)

Directors' option holdings (continued)

The number of October 2007 listed options in the Company held during the financial year by each Director and their personally related entities is set out below:

Name	Balance at the start of the year	Received on the exercising rights	Net purchased / (sold)	Other changes *	Balance at the end of the year
C V Alexander	-	-	-	-	-
A J Fawdon	-	2,111,327	(1,537,899)	-	573,428
D H Hall	-	433,397	-	-	433,397
L J Litzow	-	1,130,547	-	-	1,130,547
Total	-	3,675,271	(1,537,899)	-	2,137,372

* Movement recorded to recognise appointment as a Director

Share options

Options over unissued ordinary shares of the Company at the beginning of the year are as follows:

Expiry date	Exercise price	Number of options
30 May 2007	$0.20	7,687,791

Options over unissued ordinary shares of the Company issued during the year are as follows:

Date options granted	Expiry date	Exercise price	Number of options
29 November 2005	31 October 2007	$0.25	35,523,941

No options were exercised or expired during the year.

Options over unissued ordinary shares of the Company at the end of the year are as follows:

Expiry date	Exercise price	Number of options
30 May 2007	$0.20	7,687,791
31 October 2007	$0.25	35,523,941
		43,211,732

Options exercised or expired subsequent to the end of the year:

Expiry date	Exercise price	Number of options
30 May 2007	$0.20	975,000

DIRECTORS' REPORT
(continued)

Insurance of officers

During the year, the consolidated entity did not pay a premium to insure certain officers of the consolidated entity. However, at an appropriate time, the consolidated entity will be seeking to insure certain officers of the consolidated entity under an appropriate Directors and officers insurance policy.

Environmental regulation

The consolidated entity is not subject to any significant environmental regulation (apart from normal requirements under its mineral tenements) in respect of its operations.

Proceedings on behalf of consolidated entity

No person has applied to the Court under Section 237 of the Corporations Act 2001 for leave to bring proceedings on behalf of the Company, or to intervene in any proceedings to which the Company is a party, for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

No proceedings have been brought or intervened in on behalf of the consolidated entity with leave of the Court under Section 237 of the Corporations Act 2001.

Corporate Governance

The Board of Directors is responsible for the Corporate Governance of the consolidated entity. The Board is committed to achieving the highest standards of corporate behaviour and accountability.

Auditor's Independence Declaration

Section 307C of the Corporations Act 2001 requires the company's auditors, Pitcher Partners, to provide the Directors with a written Independence Declaration in relation to their audit of the financial report for the year ended 31 December 2005. The Auditor's Independence Declaration is attached and forms part of this Directors' Report.

Signed in accordance with a resolution of the Board of Directors.

D H Hall
Executive Director

Brisbane, 16 March 2006

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AUDITOR'S INDEPENDENCE DECLARATION TO THE DIRECTORS OF DIATREME RESOURCES LIMITED

In relation to our audit of the financial report of Diatreme Resources Limited and its controlled entities for the year ended 31 December 2005, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Pitcher Partners

PITCHER PARTNERS

S A Green
Partner

Brisbane, 16 March 2006

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DIRECTORS' DECLARATION

The Directors declare that the financial statements and notes set out on pages 10 to 28:

(a) comply with Accounting Standards, the Corporations Regulations 2001 and other mandatory financial reporting requirements; and

(b) give a true and fair view of the Company's and consolidated entity's financial position as at 31 December 2005 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date.

In the Directors' opinion:

(a) the financial statements and notes are in accordance with the Corporations Act 2001; and

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Directors.

D H Hall
Executive Director

Brisbane, 16 March 2006

INCOME STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

	Note	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
Revenue					
Revenue relating to exploration operations		11,089	59,667	11,089	59,667
Interest		123,750	-	123,750	-
	2	134,839	59,667	134,839	59,667
Expenditure					
Employee benefits and on costs		201,450	132,529	201,450	132,529
Exploration expenditure written off		100,000	824	-	824
Professional fees		53,986	47,296	52,726	47,296
Depreciation		3,765	1,932	3,765	1,932
Loss in value of debentures		862,594	-	862,594	-
Listing costs		47,382	16,189	47,382	16,189
Administration costs		155,589	80,131	140,036	70,304
Profit (loss) from ordinary activities before	3	(1,289,927)	(219,234)	(1,173,114)	(209,407)
Income tax expense	4	-	-	-	-
Net profit(loss)	18	(1,289,927)	(219,234)	(1,173,114)	(209,407)

	Cents	Cents
Basic earnings per share	(2.04)	(0.64)
Diluted earnings per share	(2.04)	(0.64)

The above Income Statements should be read in conjunction with the accompanying notes.

BALANCE SHEETS
AS AT 31 DECEMBER 2005

	Note	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
Current Assets					
Cash and cash equivalents	5	2,300,771	456,608	1,881,572	433,032
Receivables	6	130,854	17,890	121,342	13,511
Investments	7	258,163	-	258,163	-
Other current assets	8	13,865	44,405	13,865	44,405
Total Current Assets		2,703,653	518,903	2,274,942	490,948
Non Current Assets					
Receivables	9	12,213	3,214	577,985	279,606
Investments	10	51,603	51,603	1,691,643	1,691,643
Property, plant and equipment	11	8,841	6,735	8,841	6,735
Exploration interests	12	5,227,630	4,281,350	1,309,895	661,047
Other	13	114,960	109,960	24,960	24,960
Total Non Current Assets		5,415,247	4,452,862	3,613,324	2,663,991
Total Assets		8,118,900	4,971,765	5,888,266	3,154,939
Current Liabilities					
Payables	14	522,995	227	122,995	-
Provisions	15	37,249	11,335	37,249	11,335
Total Current Liabilities		560,244	11,562	160,244	11,335
Non Current Liabilities					
Borrowings	16	-	-	-	130,848
Total Non Current Liabilities		-	-	-	130,848
Total Liabilities		560,244	11,562	160,224	142,183
Net Assets		7,558,656	4,960,203	5,728,022	3,012,756
Equity					
Contributed equity	17	9,707,258	5,818,878	9,707,258	5,818,878
Accumulated profits/(losses)	18	(2,148,602)	(858,675)	(3,979,236)	(2,806,122)
Total Equity		7,558,656	4,960,203	5,728,022	3,012,756

The above Balance Sheets should be read in conjunction with the accompanying notes.

STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2005

		Consolidated		Parent	
	Note	2005	2004	2005	2004
		$	$	$	$
Total equity at the beginning of the year		4,960,203	3,119,072	3,012,756	1,161,798
Adjustments on adoption of AASB 132 and AASB 139, net of tax:					
- retained earnings		-	-	-	-
Net profit / (loss)		(1,289,927)	(219,234)	(1,173,114)	(209,407)
Transactions with equity holders in their capacity as equity holders:					
Contributions of equity, net of transaction costs		3,888,380	2,060,365	3,888,380	2,060,365
Total equity at the end of the year		7,558,656	4,960,203	5,728,022	3,012,756

The above Statements of Changes in Equity should be read in conjunction with the accompanying notes.

STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2005

	Note	Consolidated		Parent	
		2005 $ Inflows (Outflows)	2004 $ Inflows (Outflows)	2005 $ Inflows (Outflows)	2004 $ Inflows (Outflows)
Cash flows from operating activities					
Sundry receipts (GST inclusive)		62,848	90,967	48,776	86,867
Payments to suppliers/employees (GST inclusive)		(539,319)	(465,001)	(398,074)	(381,420)
Payments for exploration expenditure		(946,280)	(202,359)	(648,848)	(71,887)
Interest received		114,161	6,116	114,161	6,116
Net cash inflow(outflow) from operating activities	24	(1,308,590)	(570,277)	(883,985)	(360,324)
Cash flows from investing activities					
Payments for property, plant and equipment		(5,871)	(5,667)	(5,871)	(5,667)
Acquisition of investment in unlisted entity		-	(4,328)	-	(4,328)
Proceeds from sale of debentures		1,879,243	-	1,879,243	-
Net cash inflow(outflow) from investing activities		1,873,372	(9,995)	1,873,372	(9,995)
Cash flows from financing activities					
Loan from / (repayment) - related entity		400,000	-	(420,228)	(232,841)
Proceeds on issue of equity instruments		1,397,914	766,371	1,397,914	766,371
Capital raising costs		(509,534)	(48,006)	(509,534)	(48,006)
Loan to related entity		(8,999)	(59)	(8,999)	(59)
Net cash inflow(outflow) from financing activities		1,279,381	718,306	459,153	485,465
Net increase (decrease) in cash held		1,844,163	138,034	1,448,540	115,146
Cash at beginning of financial year		456,608	318,574	433,032	317,886
Cash at the end of financial year	5	2,300,771	456,608	1,881,572	433,032

The above Statements of Cash Flows should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

1. Summary of Significant Accounting Policies

This general purpose financial report has been prepared in accordance with Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Consensus Views and the Corporations Act 2001.

Except for certain assets which, as noted, are at valuation, the financial statements are prepared in accordance with the historical cost convention. Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year.

(a) Basis of preparation of the financial report

This is the first financial report prepared in accordance with the Australian Equivalents of International Financial Reporting Standards ("AIFRS"). The financial reports were prepared under Australian Generally Accepted Accounting Principles ("AGAAP") until 31 December 2004. There are certain differences between accounting policies under AIFRS and AGAAP and where applicable the comparative figures have been restated to reflect these adjustments. Reconciliations of equity and operating profit/loss between AGAAP and AIFRS are provided in Note 28.

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all periods presented, unless otherwise stated.

(b) Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all entities controlled by Diatreme Resources Limited ("parent entity") as at 31 December 2005 and the results of all controlled entities for the year then ended. Diatreme Resources Limited and its controlled entities together are referred to in this financial report as the consolidated entity. The effects of all transactions between entities in the consolidated entity are eliminated in full.

Where control of an entity is obtained during a financial year, its results are included in the consolidated statement of financial performance from the date on which control commences.

(c) Revenue

Revenue is measured at the fair value of the consideration received or receivable, and recognised when the service is provided, or ownership of the product has passed to the customer.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

1. Summary of Significant Accounting Policies (continued)

(d) Income Tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based upon the applicable income tax rate adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or a liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction other than a business combination that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

(e) Non-Current Assets

The carrying amounts of all non-current assets are reviewed at least annually to determine whether they are in excess of their recoverable amount. If the carrying amount of a non-current asset exceeds the recoverable amount, the asset is written-down to the lower value. In assessing recoverable amounts the relevant cash flows have not been discounted to their present value.

(f) Investments

Debentures
Investments in term deposits are recorded at cost less a provision for diminution in value. Interest is recognised as earned and accrued as required in the financial statements.

Interests in securities
Investments in securities are recorded at cost less a provision for diminution in value. Dividends are recognised as earned and accrued as required in the financial statements.

(g) Depreciation

Depreciation on fixed assets has been calculated on diminishing value basis. Estimates of remaining useful lives are made on a regular basis for all assets.

The depreciation rates used for each class of assets are as follows:

Furniture and fittings	20%	Diminishing value
Field vehicles	22.5%	Diminishing value
Plant and equipment	40%	Diminishing value

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

1. Summary of Significant Accounting Policies (continued)

(h) Exploration Expenditure

Exploration expenditure is accumulated separately for each area of interest. Such expenditure comprises net direct costs and an appropriate portion of related overhead expenditure.

Expenditure is carried forward when incurred in areas where economic mineralisation is indicated, but activities have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves, and active and significant operations in relation to the area are continuing. Each such area is regularly reviewed. If the area of interest is abandoned or it is considered unlikely that a project will proceed to development, costs accumulated to that area of interest are written off against income in the period of abandonment. Exploration expenditure may also be written off where areas of interest are partly relinquished.

(i) Trade and Other Creditors

These amounts represent liabilities for goods and services provided to the consolidated entity prior to the end of the reporting period and which remain unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

(j) Employee Entitlements

Liabilities for wages and salaries, including non-monetary benefits, annual leave are recognised in other payables in respect of employee's services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

(k) Cash

Cash and cash equivalents include cash on hand, deposits held at call, other short term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$
2. Revenue				
Interest	123,750	6,116	123,750	6,116
Management fees	8,267	50,958	8,267	50,958
Other	2,822	2,593	2,822	2,593
	134,839	59,667	134,839	59,667

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$

3. Profit/(Loss)

Profit/(loss) from ordinary activities before income tax expense has been arrived at after recording the following specific credits and charges:

Credits:				
Interest received	123,750	6,116	123,750	6,116
Charges:				
Exploration expenditure written off	100,000	824	-	824
Depreciation	3,765	1,932	3,765	1,932
Provision for employee entitlements	25,914	(1,088)	25,914	(1,088)
Loss on disposal of debentures	758,423	-	758,423	-
Provision for diminution in value	104,171	-	104,171	-

4. Income Tax Expense and Future Income Tax Benefits

Profit (loss) before income tax expense	(1,289,927)	(219,234)	(1,173,114)	(209,407)
Prima facie income tax expense (benefit) calculated at 30%	(386,978)	(65,770)	(351,934)	(62,822)
Tax effect of permanent differences	-	-	-	-
Future income tax benefit not recognised	386,978	65,770	351,934	62,822
Income tax expense	-	-	-	-

The future income tax benefit has not been brought to account. The future income tax benefit of the income tax losses carried forward will only be obtained if:

(i) the consolidated entity derives assessable income of a nature and an amount sufficient to enable the benefit from the deduction of the losses to be realised;

(ii) the consolidated entity continues to comply with the conditions for deductibility imposed by legislation; and

(iii) no changes in tax legislation adversely affect the consolidated entity in realising the benefit of the deduction of the losses.

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$

5. Current Assets – Cash and cash equivalents

Cash at bank and on hand	2,300,771	456,608	1,881,572	433,032

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
6. Current Assets – Receivables				
Trade debtors	51,950	4,417	51,950	4,417
Sundry debtors	69,315	13,473	59,802	9,094
Accrued revenue	9,589	-	9,589	-
	130,854	17,890	121,341	13,511
7. Current Assets – Investments				
Debentures	362,334	-	362,334	-
Provision for diminution in value	(104,171)	-	(104,171)	-
	258,163	-	258,163	-
8. Current Assets – Other				
Prepayments	13,865	44,405	13,865	44,405
9. Non Current Assets – Receivables				
Loans to controlled entities	-	-	565,772	276,392
Loan to a director related entity	12,213	3,214	12,213	3,214
	12,213	3,214	577,985	279,606

The loan to a director related entity is interest free, unsecured with no fixed term of repayment.

	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
10. Non Current Assets - Investments				
Investment in unquoted entities	51,603	51,603	51,603	51,603
Investment in controlled entities (Note 23)	-	-	3,620,000	3,620,000
Provision for diminution in value	-	-	(1,979,960)	(1,979,960)
	51,603	51,603	1,691,643	1,691,643

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$
11. Non Current Assets – Property, plant and equipment				
Office equipment – at cost	5,578	5,578	-	-
Accumulated depreciation	(5,578)	(5,578)	-	-
	-	-	-	-
Furniture and fittings – at cost	20,297	20,297	15,106	15,106
Accumulated depreciation	(19,923)	(19,830)	(14,732)	(14,639)
	374	467	374	467
Motor vehicles – at cost	22,647	22,647	22,647	22,647
Accumulated depreciation	(21,058)	(20,597)	(21,058)	(20,597)
	1,589	2,050	1,589	2,050
Plant and equipment – at cost	89,856	83,986	89,197	83,327
Accumulated depreciation	(82,978)	(79,768)	(82,319)	(79,109)
	6,878	4,218	6,878	4,218
	8,841	6,735	8,841	6,735

Reconciliations of the carrying amounts of each class of property, plant and equipment at the beginning and end of the current financial year are set out below:

	Office furniture	Motor vehicles	Plant and equipment	Total
Consolidated				
Carrying amount at 1 January 2005	467	2,050	4,218	6,735
Additions	-	-	5,870	5,870
Disposals	-	-	-	-
Depreciation	(93)	(461)	(3,210)	(3,764)
Carrying amount at 31 December 2005	374	1,589	6,878	8,841
Parent				
Carrying amount at 1 January 2005	467	2,050	4,218	6,735
Additions	-	-	5,870	5,870
Disposals	-	-	-	-
Depreciation	(93)	(461)	(3,210)	(3,764)
Carrying amount at 31 December 2005	374	1,589	6,878	8,841

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$
12. Non Current Assets – Exploration interests				
Geological, geophysical, drilling and other expenditure at cost	5,227,630	4,281,350	1,309,895	661,047

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$
13. Non Current Assets – Other				
Security deposits	114,960	109,960	24,960	24,960
14. Current Liabilities – Payables				
Deposit funds from a director related entity	400,000	-	-	-
Sundry creditors	122,995	227	122,995	-
	522,995	227	122,995	-
15. Current Liabilities – Provisions				
Employee entitlements	37,249	11,335	37,249	11,335
	Number	Number	Number	Number
Number of employees at year end	3	3	3	3

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$
16. Non Current Liabilities – Borrowings				
Loan from controlled entity	-	-	-	130,848
17. Contributed equity				
Issued capital	9,707,258	5,818,878	9,707,258	5,818,878
a) Ordinary shares			Number	Number
Number of ordinary fully paid shares			71,047,149	52,610,234
Weighted average number of shares			63,116,750	34,096,027

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

17. Contributed equity (continued)

Movements in ordinary share capital:

Date	Details	Number of shares	Issue Price	$
31 December 2003	Balance	30,409,127		3,758,513
2004				
29 June	Share purchase plan issue	1,005,877	$0.07	66,600
15 October	Lost Sands Pty Ltd acquisition	13,420,000	$0.10	1,342,000
12 November	Private placement	945,000	$0.09	85,050
17 December	Private placement	6,830,230	$0.09	614,721
	Prospectus costs	-		(49,006)
31 December 2004	Balance	52,610,234		5,817,878
2005				
6 June	Prospectus	18,436,915	$0.20	3,687,383
	Prospectus costs	-		(464,458)
31 December 2004	Balance	71,047,149		9,040,803

b) Options

Movements in option capital:

Date	Details	Number of shares	Issue Price $	$
31 December 2003	Balance	6,687,791		-
2004				
22 December	Private placement	1,000,000	0.001	1,000
31 December 2004	Balance	7,687,791		1,000
2005				
29 November	October 2007 allotment	35,523,941	0.020	710,531
	Issue costs	-		(45,076)
31 December 2005	Balance	43,211,732		666,455

Grant date	Expiry date	Exercise price	Options granted	Options exercised	Unissued shares
31 December 2003 balance			6,687,791	-	6,687,791
2004					
22 December	30 May 2007	$0.20	1,000,000	-	1,000,000
31 December 2004 balance			7,687,791		7,687,791
2005					
29 November	31 October 2007	$0.25	35,523,941	-	35,523,941
31 December 2005 balance			43,211,732		43,211,732

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$

18. Accumulated profits/(losses)

Accumulated losses at the beginning of the year	(858,675)	(639,441)	(2,806,122)	(2,596,715)
Net profit/(loss)	(1,289,927)	(219,234)	(1,173,114)	(209,407)
Accumulated losses at the end of the year	(2,148,602)	(858,675)	(3,979,236)	(2,806,122)

19. Segment Information

The consolidated entity operates in one business segment as an explorer for gold, heavy mineral sands, base metals and diamonds in Australia.

20. Directors and Executives Disclosures

Directors

The names of persons who were directors of the Company at any time during the year are as follows:

Executive Directors
A J Fawdon and D H Hall

Non-executive Directors
C V Alexander and L J Litzow

Principles used to determine the nature and amount of remuneration

Executive Directors

The combination of Directors' fees, salary, non-cash benefits and superannuation make up the Executive Directors total remuneration. The salary component of Executive Directors' remuneration packages is reviewed annually to ensure the Executives pay is competitive with the market. Executive Directors' pay is not directly linked to the financial performance of the consolidated entity.

Non-executive Directors

Fees and payments to Non-executive Directors reflect the demands which are made on, and the responsibilities of, the Director. Non-executive Directors' fees and payments are reviewed annually by the Board.

Aggregate Directors' fees

Directors' fees are determined within an aggregate Directors' fees pool limit, which is periodically recommended for approval by shareholders. The maximum currently stands at $150,000 in aggregate plus statutory superannuation.

20. Directors and Executives Disclosures (continued)

Details of remuneration

Details of the nature and amount of each major element of the emoluments of each Director of the Company and the officers of the Company and the consolidated entity are:

2005

Name	Directors' fee $	Salary $	Superannuation $	Other $	Non-cash benefit $	Total $
C V Alexander	11,250	-	1,012	-	-	12,262
A J Fawdon	11,417	94,166	8,985	-	-	114,568
D H Hall	11,083	90,083	9,105	-	-	110,271
L J Litzow	11,667	-	1,050	21,166	-	33,883
Total	45,417	184,249	20,152	21,166	-	270,984

2004

Name	Directors' fee $	Salary $	Superannuation $	Other $	Non-cash benefit $	Total $
A J Fawdon	-	65,000	5,850	-	-	70,850
D H Hall	-	65,000	5,850	-	-	70,850
L J Litzow	-	-	-	19,996	-	19,996
Total	-	130,000	11,700	19,996	-	161,696

Specified Executives

The Company and consolidated entity did not have any other executives ("specified executive") with authority for the strategic direction and management of the consolidated entity during the financial year.

Directors' shareholdings

The number of ordinary shares in the parent entity held during the financial year by each Director and their personally related entities is set out below:

Name	Balance at the start of the year	Received on exercising options	Net purchased / (sold)	Other changes *	Balance at the end of the year
C V Alexander	-	-	-	-	-
A J Fawdon	4,223,074	-	-	-	4,223,074
D H Hall	2,141,063	-	-	-	2,141,063
L J Litzow	2,261,092	-	-	-	2,261,092
Total	8,625,229	-	-	-	8,625,229

* Movement recorded to recognise appointment as a Director

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

20. Directors and Executives Disclosures (continued)

Directors' option holdings

The number of May 2007 unlisted options in the Company held during the financial year by each Director and their personally related entities is set out below:

Name	Balance at the start of the year	Received on the exercising options	Net purchased / (sold)	Other changes *	Balance at the end of the year
C V Alexander	-	-	-	-	-
A J Fawdon	1,000,000	-	-	-	1,000,000
D H Hall	1,000,000	-	-	-	1,000,000
L J Litzow	1,009,617	-	-	-	1,009,617
Total	3,009,617	-	-	-	3,009,617

* Movement recorded to recognise appointment as a Director

The number of October 2007 listed options in the Company held during the financial year by each Director and their personally related entities is set out below:

Name	Balance at the start of the year	Received on the exercising rights	Net purchased / (sold)	Other changes *	Balance at the end of the year
C V Alexander	-	-	-	-	-
A J Fawdon	-	2,111,327	(1,537,899)	-	573,428
D H Hall	-	433,397	-	-	433,397
L J Litzow	-	1,130,547	-	-	1,130,547
Total	-	3,675,271	(1,537,899)	-	2,137,372

* Movement recorded to recognise appointment as a Director

Related Party Transactions

Aggregate amounts included in the determination of the profit/(loss) from ordinary activities before income tax expense that resulted from transactions with each class of other related parties were as follows:

	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
Interest	120,000	-	120,000	-
Management fees charged to a Director related entity	-	28,982	-	28,982

Loans to a Director related entity are disclosed in Note 9.

	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
Loans advanced	8,999	59	8,999	59
Loan repayments	-	-	-	-

Investments in debentures issued by a Director related entity are disclosed in Note 7. Movement in debentures is as follows:

	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
Debentures subscribed and issued	3,000,000	-	3,000,000	-
Debentures sold	2,637,666	-	2,637,666	-
Debentures held at year end	362,334	-	362,334	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

21. Related Parties

Wholly owned group

The wholly owned group consists of Diatreme Resources Limited and its wholly owned controlled entities, Regional Exploration Management Pty Ltd, Chalcophile Resources Pty Ltd and Lost Sands Pty Ltd. Ownership interests are set out in Note 23.

Parent Entity

The ultimate parent entity in the wholly owned group is Diatreme Resources Limited.

22. Commitments for Expenditure and Contingent Liabilities

No provision has been made for the following in the financial report of the consolidated entity:

(i) The possibility of native title claim applications at some future time, under the provisions of the Native Title Act (1993), may affect access to and tenure of exploration tenements. Any substantiated claim may have an effect on the value of the tenement affected by the claim;

(ii) So as to maintain current rights to tenure of exploration tenements, the consolidated entity will be required to outlay amounts in respect of tenement rent to the relevant governing authorities and to meet certain annual exploration expenditure commitments. These outlays (exploration expenditure and rent), which arise in relation to granted tenements, inclusive of tenement applications granted subsequent to 31 December 2005 are as follows:

	Consolidated		Parent	
	2005	2004	2005	2004
	$	$	$	$
Tenement Expenditure:				
Payable within 1 year	891,500	894,694	315,000	283,026
Payable between one and two years	770,000	602,253	330,000	109,837
	1,661,500	1,496,947	645,000	392,863
Rental on tenements payable within 1 year	88,121	89,755	14,600	28,609

The outlays may be varied from time to time, subject to approval of the relevant government departments, and may be relieved if a tenement is relinquished. Cash security bonds totalling $105,000 (2004: $100,000) are currently held by the relevant governing authorities to ensure compliance with granted tenement conditions.

(iii) Operating lease commitments for office rental are as follows:				
Payable within 1year	9,712	37,462	9,712	37,462
Payable between one and two years	-	9,712	-	9,712
	9,712	47,174	9,712	47,174

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

23. Investments in Controlled Entities

Name of entity	Country of incorporation	Class of shares	Equity holding 2005 %	Equity holding 2004 %	Cost of parent entity's investment 2005 $	Cost of parent entity's investment 2004 $
Regional Exploration Management Pty Ltd	Australia	Ordinary	100	100	2,278,000	2,278,000
Chalcophile Resources Pty Ltd *	Australia	Ordinary	100	100	-	-
Lost Sands Pty Ltd	Australia	Ordinary	100	-	1,342,000	-

* This entity is 100% owned by Regional Exploration Management Pty Ltd.

Acquisition of a Controlled Entity

On 15 October 2004 the parent entity acquired 100% of the issued share capital of Lost Sands Pty Ltd for $1,342,000. The operating results of this newly controlled entity have been included in the consolidated statement of financial performance since the date of acquisition.

Details of the acquisition are as follows:

	$
Cash	3,781
Receivables	63,000
Exploration interests	1,275,219
	1,342,000
Outflow of cash to acquire controlled entity, net of cash acquired:	
Cash	-
Consideration by issue of shares	1,342,000
	1,342,000

	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
24. Reconciliation of Profit/(Loss) from ordinary activities after income tax to Net Cash Flows from Operating Activities				
Profit/(loss) from ordinary activities after income tax	(1,289,927)	(219,234)	(1,173,114)	(209,407)
Depreciation	3,765	1,932	3,765	1,932
(Profit)/loss on disposal of debentures	758,423	-	758,423	-
Provision for diminution in value	104,171	-	104,171	-
Decrease / (increase) in receivables	(112,964)	(821)	(107,831)	3,093
Decrease / (increase) in other assets	25,540	(117,621)	30,540	(51,654)
Decrease / (increase) in exploration expenditure	(946,280)	(201,536)	(648,848)	(71,064)
Increase / (decrease) in payables	122,768	(31,909)	122,995	(32,136)
Increase / (decrease) in provisions	25,914	(1,088)	25,914	(1,088)
Net cash flows from operating activities	(1,308,590)	(570,277)	(883,985)	(360,324)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

	Consolidated 2005 $	Consolidated 2004 $	Parent 2005 $	Parent 2004 $
25. Remuneration of Auditors				
Amounts received, or due and receivable by the auditors for audit of the parent entity or any entity in the consolidated entity:				
- Audit / review of the financial reports	16,500	13,000	16,500	13,000
- Taxation compliance services	14,210	5,780	14,210	5,780
- Capital raising reports	-	8,000	-	8,000
- Share registry services	-	307	-	307
- Other assurance services	850	-	850	-
	31,560	27,087	31,560	27,087

26. Financial Instruments

(a) Interest Rate Risk Exposures
The consolidated entity's exposures to interest rate risk and the effective weighted average interest rate for classes of financial assets and financial liabilities are set out below:

2005	Note	Floating Interest	Fixed Interest Maturing	Non-interest bearing	Total
Financial Asset					
Cash	5	2,300,771	-	-	2,300,771
Receivables	6	-	-	130,854	130,854
Investments	7	-	362,334	-	362,334
Other	8/9/13	-	-	141,038	141,038
Total		2,300,771	362,334	271,892	2,934,997
Weighted average interest rate		3.39%	10.50%	-	
Financial Liability					
Payables	14	-	-	522,995	522,995
Total		-	-	522,995	522,995
Weighted average interest rate		-	-	-	
Net financial asset/(liability)		2,300,771	362,334	(251,103)	2,412,002

2004	Note	Floating Interest	Fixed Interest Maturing	Non-interest bearing	Total
Financial Asset					
Cash	5	456,608	-	-	456,608
Receivables	6	-	-	17,890	17,890
Investments	7	-	-	-	-
Other	8/9/13	-	-	157,579	157,579
Total		456,608	-	175,469	632,077
Weighted average interest rate		1.42%	-	-	
Financial Liability					
Payables	14	-	-	227	227
Total		-	-	227	227
Weighted average interest rate		-	-	-	-
Net financial asset/(liability)		456,608	-	175,242	631,850

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

26. Financial Instruments (continued)

(b) Fair Net Values
The consolidated entity's financial assets and liabilities included in current assets and liabilities in the statements of financial position are carried out at amounts approximate net fair value.

(c) Credit Risk Exposures
The consolidated entity's maximum exposure to credit risk at balance date in relation to each class of recognised financial asset is the carrying amount of those assets as indicated in the statements of financial position.

27. Matters subsequent to the end of the financial year

Subsequent to 31 December 2005 the Company has issued 975,000 ordinary fully paid shares relating to the exercising of 975,000 30 May 2007 options. The 30 May 2007 options were exercised at $0.20 raising an additional $195,000 in contributed equity.

No other matter or circumstance has arisen since the end of the financial year that has significantly affected, or may significantly affect the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in financial years subsequent to 31 December 2005.

28. Impact of adopting Australian equivalents to International Financial Reporting Standards

The Company has investigated the transition from current Australian Accounting Standards to Australian equivalents of International Financial Reporting Standards "(IFRS)". The Company's assessment of the impact of adopting Australian equivalents of International Financial Reporting Standards is set out below:

	2005 $	2004 $
Balance sheet		
Total equity as at beginning of year as reported under AGAAP	4,960,203	3,119,072
Adjustments relating to the adoption of IFRS	-	-
As restated under Australian equivalents of IFRS	4,960,203	3,119,072
Income statement		
Net profit/(loss) for the year as reported under AGAAP		(219,234)
Adjustments relating to the adoption of IFRS		-
As restated under Australian equivalents of IFRS		(219,234)

There are no material impacts occur on the recognition and disclosure of cash flows.

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INDEPENDENT AUDIT REPORT
TO THE MEMBERS OF DIATREME RESOURCES LIMITED

Scope

The financial report and directors' responsibility
The financial report comprises the income statements, balance sheets, statement of changes in equity, statements of cash flows, accompanying notes to the financial statements, and the Directors' declaration for both Diatreme Resources Limited ("the company") and Diatreme Resources Limited and its controlled entities ("the consolidated entity") for the year ended 31 December 2005. The consolidated entity comprises both the company and the entities it controlled during that year.

The Directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach
We conducted an independent audit in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the Directors.

INDEPENDENT AUDIT REPORT
TO THE MEMBERS OF DIATREME RESOURCES LIMITED
(continued)

Audit approach (continued)

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

Audit opinion

In our opinion, the financial report of Diatreme Resources Limited is in accordance with:

(a) the Corporations Act 2001, including:
- (i) giving a true and fair view of the company's and consolidated entity's financial position as at 31 December 2005 and of their performance for the year ended on that date; and
- (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and

(b) other mandatory financial reporting requirements in Australia.

Pitcher Partners

PITCHER PARTNERS

S A Green
Partner

Brisbane, 16 March 2006