

**International Frontier Resources Corporation**

**Consolidated Financial Statements**

December 31, 2005

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## Auditors' Report

To the Shareholders of  
**International Frontier Resources Corporation**

We have audited the consolidated balance sheets of **International Frontier Resources Corporation** as at December 31, 2005 and 2004 and the consolidated statements of loss and deficit and cash flows for the years then ended. 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 December 31, 2005 and 2004 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Calgary, Alberta  
April 11, 2006

Chartered Accountants

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## International Frontier Resources Corporation

### Consolidated Balance Sheets

December 31 2005 2004

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#### Assets

##### Current

Cash and cash equivalents	\$ 12,905,913	\$ 9,961,732
Receivables	1,930,590	177,595
Inventory	82,125	-
Prepays	<u>132,412</u>	<u>12,273</u>
	<b>15,051,040</b>	10,151,600
Refundable deposits (Note 5)	1,441,325	351,500
Property and equipment (Note 6)	6,998,635	4,256,207
Intangible (Note 7)	<u>45,000</u>	<u>14,201</u>
	<b>\$ <u>23,536,000</u></b>	<b>\$ <u>14,773,508</u></b>

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#### Liabilities

##### Current

Payables and accruals	\$ 288,565	\$ 214,944
Asset retirement obligations (Note 8)	201,390	232,752
Future income taxes (Note 9)	393,368	668,488
Convertible debentures (Notes 10)	<u>62,648</u>	<u>216,860</u>
	<b><u>945,971</u></b>	<b><u>1,333,044</u></b>

#### Shareholders' Equity

Share capital (Note 11)	25,111,254	15,458,255
Contributed surplus (Note 11)	3,928,117	2,588,519
Equity component of convertible debentures	2,352	8,140
Warrants (Note 11)	-	10
Deficit	<u>(6,451,694)</u>	<u>(4,614,460)</u>
	<b><u>22,590,029</u></b>	<b><u>13,440,464</u></b>
	<b>\$ <u>23,536,000</u></b>	<b>\$ <u>14,773,508</u></b>

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Contingent liabilities (Note 14)

Subsequent event (Note 18)

On behalf of the Board

**(Signed) "Wm. Patrick Boswell"** Director **(Signed) "W.J. McNaughton"** Director

See accompanying notes to the consolidated financial statements.

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**International Frontier Resources Corporation**  
**Consolidated Statements of Loss and Deficit**

Years ended December 31, 2005 2004

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Revenue		
Oil	\$ 866,189	\$ 693,270
Royalties	<u>(210,111)</u>	<u>(131,939)</u>
	<b>656,078</b>	561,331
Interest and other income	<u>219,135</u>	<u>64,299</u>
	<u><b>875,213</b></u>	<u>625,630</u>
Expenses		
Field operating costs	409,408	411,930
Depletion and depreciation	203,434	1,435,685
Accretion of asset retirement obligations (Note 8)	21,711	21,004
General and administration	631,618	717,109
Stock based compensation	1,562,448	2,067,864
Write off investment	52,875	3,675
Interest and bank charges	<u>6,832</u>	<u>5,905</u>
	<u><b>2,888,326</b></u>	<u>4,663,172</u>
Loss before income taxes	<b>(2,013,113)</b>	(4,037,542)
Future income tax recovery (Note 9)	<u>(175,879)</u>	<u>(662,594)</u>
Net loss	\$ <u><b>(1,837,234)</b></u>	\$ <u>(3,374,948)</u>
Net loss per share		
Basic (Note 12)	\$ <u><b>(0.05)</b></u>	\$ <u>(0.15)</u>
Diluted (Note 12)	\$ <u><b>(0.05)</b></u>	\$ <u>(0.15)</u>
<hr/>		
Deficit, beginning of year	\$ (4,614,460)	\$ (1,239,512)
Net loss	<u>(1,837,234)</u>	<u>(3,374,948)</u>
Deficit, end of year	\$ <u><b>(6,451,694)</b></u>	\$ <u>(4,614,460)</u>

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See accompanying notes to the consolidated financial statements.

# International Frontier Resources Corporation

## Consolidated Statements of Cash Flows

Years ended December 31

2005

2004

### Operating

Net loss	\$ (1,837,234)	\$ (3,374,948)
Depletion and depreciation	203,434	1,435,685
Accretion of asset retirement obligations	21,711	21,004
Abandonment costs incurred (Note 8)	(69,610)	-
Stock based compensation	1,562,448	2,067,864
Gain on sale of investments	(4,746)	-
Write off investment	52,875	3,675
Future income tax recovery	<u>(175,879)</u>	<u>(662,594)</u>
	<b>(247,001)</b>	<b>(509,314)</b>
Change in non-cash operating working capital (Note 16)	<u><b>(1,090,090)</b></u>	<u>124,529</u>
	<u><b>(1,337,091)</b></u>	<u>(384,785)</u>

### Investing

Additions to petroleum and natural gas properties	(2,879,878)	(3,741,311)
Proceeds from disposition of property and equipment	57,000	-
Additions to intangibles	<u>(100,000)</u>	<u>-</u>
	<b>(2,922,878)</b>	<b>(3,741,311)</b>
Change in non-cash investing working capital (Note 16)	<u><b>(656,293)</b></u>	<u>201,730</u>
	<u><b>(3,579,171)</b></u>	<u>(3,539,581)</u>

### Financing

Shares issued for cash	9,298,589	12,808,518
Share issue costs	(295,191)	(889,151)
Convertible debentures	<u>-</u>	<u>975,000</u>
	<b>9,003,398</b>	<b>12,894,367</b>
Change in non-cash financing working capital (Note 16)	<u><b>(53,130)</b></u>	<u>22,941</u>
	<u><b>8,950,268</b></u>	<u>12,917,308</u>

Net increase in cash and cash equivalents 4,034,006 8,992,942

Cash and cash equivalents,

Beginning of year	<u>10,313,232</u>	<u>1,320,290</u>
End of year	<u><b>\$ 14,347,238</b></u>	<u><b>\$ 10,313,232</b></u>

Cash and cash equivalents are represented by:

Cash and temporary investments	\$ 12,905,913	\$ 9,961,732
Refundable deposits	<u>1,441,325</u>	<u>351,500</u>
	<u><b>\$ 14,347,238</b></u>	<u><b>\$ 10,313,232</b></u>

See accompanying notes to the consolidated financial statements.

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# **International Frontier Resources Corporation**

## **Notes to the Consolidated Financial Statements**

December 31, 2005

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### **1. Nature of operations**

The Company, since inception, is engaged primarily in the exploration for and development of petroleum and natural gas reserves. These activities are conducted in two cost centres, being Canada and the United Kingdom.

The costs associated with the acquisition and development thereon to date is recognized in these consolidated financial statements in accordance with the accounting policies outlined in Note 2. Accordingly, their carrying value represents costs incurred to date and do not necessarily reflect present or future values. The recoverability of these amounts is dependent upon the existence of economically recoverable petroleum and natural gas reserves.

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### **2. Summary of significant accounting policies**

#### **Basis of presentation**

The consolidated financial statements include the accounts of the Company, its wholly owned United Kingdom subsidiary, Britcana Energy Ltd. and its 50% interest in Sidox Chemicals Canada Ltd. All inter-company transactions and balances are eliminated upon consolidation.

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles within the framework of the accounting policies summarized below.

#### **Measurement uncertainty**

The preparation of consolidated financial statements requires management to make estimates that affect the reported amounts of assets, liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting period. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

The most significant estimate is related to the recoverability of petroleum and natural gas properties. Amounts recorded for depletion and depreciation, asset retirement obligations and amounts used in impairment test calculations are based upon estimates of petroleum and natural gas reserves and future costs to develop those reserves. By their nature, these estimates of reserves, costs and related future cash flows are subject to uncertainty, and the impact on the consolidated financial statements of future periods could be material.

The amounts recorded relating to the fair value of stock options issued are based on estimates of the future volatility of the Company's share price, expected lives of the options, expected dividends and other relevant assumptions.

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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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### 2. Summary of significant accounting policies (Continued)

#### **Petroleum and natural gas interests**

The Company follows the full cost method of accounting for petroleum and natural gas operations as determined by the Canadian Institute of Chartered Accountants ("CICA"), Accounting Guideline 16 ("AcG-16"), whereby all costs of exploration for and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both successful and unsuccessful wells, asset retirement costs and overhead charges directly related to exploration activities. Proceeds from the sale of oil and gas properties will be applied against the capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation. For depletion and depreciation purposes, relative volumes of natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Depletion of exploration and development costs and depreciation of production equipment is provided using the unit-of-production method based upon estimated proved petroleum and natural gas reserves. The costs of significant undeveloped properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment has occurred. Estimated future costs to be incurred in developing proved reserves are included in costs subject to depletion.

At each reporting period the Company performs an impairment test to determine the recoverability of capitalized costs associated with reserves. An impairment loss is recognized in net earnings when the carrying amount of a cost centre exceeds its fair value. The carrying amount of the cost centre is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves plus the costs of unproved properties. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited to the amount by which the carrying amount exceeds the sum of the fair value of proved and probable reserves and the costs of unproved properties that have been subject to a separate impairment test and contain no probable reserves.

#### **Asset retirement obligations**

The Company recognizes the fair value of estimated asset retirement obligations on the consolidated balance sheet when a reasonable estimate of fair value can be made. Asset retirement obligations include those legal obligations where the Company will be required to retire tangible long lived assets such as well sites, pipelines and facilities. The asset retirement cost, equal to the initially estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long lived asset. Changes in the estimated obligation resulting from revisions to estimated timing or amount of undiscounted cash flows are recognized as a change in the asset retirement obligation and the related asset retirement cost.

Asset retirement costs are amortized using the unit-of-production method and are included in depletion and depreciation in the consolidated statements of loss and deficit. Increases in the asset retirement obligations resulting from the passage of time are recorded as accretion of asset retirement obligations in the consolidated statements of loss and deficit.



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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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### 2. Summary of significant accounting policies (Continued)

#### Joint venture operations

Substantially all of the Company's exploration and production activities are conducted jointly with others and accordingly the accounts reflect only the Company's proportionate interest in such activities.

#### Flow-through common shares

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 estimated tax benefits transferred to shareholders upon renouncement are recorded as an increase to future income taxes and a reduction to share capital at the time the resource expenditure deductions are renounced.

#### Cash and cash equivalents

Cash and cash equivalents include cash on hand, balances with banks and short-term deposits with original maturities of three months or less and refundable deposits. Bank borrowings are considered to be financing activities.

#### Depreciation

Depreciation of office furniture and equipment is provided on a diminishing balance basis over the estimated useful lives of the assets at annual rates ranging from 20% to 30%.

#### Intangible assets

The Company's proportionate share of an exclusive licensing agreement for the Sidox product in Canada that is held by its subsidiary Sidox Chemicals Canada Ltd. The agreement covering an exclusive license for Canada has a ten-year term and costs related thereto have been amortized on a straight line basis over that period.

#### Inventory

Inventory includes product that is stated at the lower of cost and net realizable value. Cost is determined on a weighted average cost basis.

#### Income taxes

Income taxes are recorded using the liability method. Future income taxes are calculated based on temporary differences arising from the difference between the tax basis of an asset and liability and its carrying value using substantively enacted tax rates. Changes in income tax rates that are substantively enacted are reflected in the accumulated future income tax balances in the period the change occurs.

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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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### 2. Summary of significant accounting policies (Continued)

#### Per share amounts

The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market rate for the period.

#### Financial instruments

The Company has estimated the fair value of its financial instruments, which include cash and cash equivalents, receivables, payables and accruals, and convertible debentures. The Company has used valuation methodologies and market information available at year end to determine fair value. Unless otherwise disclosed, there are no significant differences between the carrying value of these financial instruments and their estimated fair value.

#### Stock-based compensation

The Company grants stock options to its key consultants, directors, officers and employees upon employment and periodically during the period of employment.

The Company uses the fair-value method of accounting for stock options granted to key consultants, employees and directors after January 1, 2003. Compensation costs are recognized over the vesting period. Fair values are determined using the Black-Scholes option pricing model. The Company used the intrinsic value method of accounting for stock options granted to employees prior to January 1, 2003.

#### Revenue recognition

Revenue associated with the production and sales of crude oil, natural gas and natural gas liquids owned by the Company are recognized when title passes from the Company to the purchaser. Other revenue is recognized in the period that the service is provided to the customer.

#### Foreign currency translation

The accounts of the Company's foreign subsidiary are translated into Canadian dollars under the temporal method of accounting, whereby monetary items are translated at exchange rates in effect at the balance sheet date and non-monetary translated at rates of exchange in effect when the assets were acquired or obligations incurred. Foreign exchange gains and losses are included in the consolidated statement of loss and deficit.

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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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### 3. Change in accounting policies

- a) Effective January 1, 2004, the Company retroactively adopted the new Canadian accounting standard as outlined in CICA Handbook section 3110 "Asset Retirement Obligations". Prior to January 1, 2004, the Company had not incurred any obligation for restorations. As such, the adoption of the new standard did not effect any period prior to 2004.
- b) Effective January 1, 2004, the Company adopted CICA Accounting Guideline 16 "Oil and Gas Accounting – Full Cost". The new guideline modifies the way the impairment test is performed and requires cost centres be tested for recoverability using undiscounted future cash flows from proved reserves plus the cost of undeveloped properties. When the carrying amount of the asset is not recoverable, the asset would be written down to its fair value. Fair value is determined to be discounted cash flow plus the cost of undeveloped properties. Discounted cash flow is calculated using a present value technique that incorporates proved plus probable reserves, prices that are consistent with those used by the Company in developing other corporate information and a risk free interest rate. The adoption of the guideline resulted in an impairment charge relating to property and equipment (see Note 6).
- c) Effective January 1, 2004, the Company adopted the standards outlined in CICA Handbook section 3063, "Impairment of Long-Lived Assets", which establishes standards for the recognition, measurement and disclosure of any impairment of long-lived assets. The accounting policy has been adopted prospectively and had no impact on the consolidated financial statements.

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### 4. Investment in Sidox Chemicals Canada Ltd.

In June 2005, the patent owner of Sidox exercised its right to acquire 50% of the issued and outstanding shares of the Company's wholly owned subsidiary Sidox Chemicals Canada Ltd. ("Sidox Canada"). In conjunction with this reorganization, Sidox Canada cancelled its outstanding shares and issued new shares. The Company purchased 50% of the outstanding shares of Sidox Canada for a cash consideration of \$135,000 and payment in kind of \$90,000 through provision of 2 tonnes of Sidox material at \$45,000 per tonne. In addition, the Company was obligated to pay \$100,000 on behalf of Sidox Canada to acquire an exclusive licensing agreement to the patented technology Sidox in Canada. The investment in Sidox Canada is subject to joint control and accordingly has been proportionately consolidated in these financial statements at December 31, 2005.

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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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#### 4. Investment in Sidox Chemicals Canada Ltd. (Continued)

At December 31, 2005 the Company's proportionate share of balances included in these consolidated financial statements related to Sidox Canada is:

Assets		
Cash	\$	49,985
Inventory		82,125
Intangibles		<u>45,000</u>
		177,110
Liabilities		
Payables		<u>50,000</u>
Net assets	\$	<u>127,110</u>
Revenues	\$	-
Expenditures		<u>97,890</u>
Net Loss	\$	<u>97,890</u>
Cash used in operating activities	\$	(53,181)
Cash from investing activities	\$	101,793
Cash used in financing activities	\$	-

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#### 5. Refundable Deposits

As at December 31, 2005, the Company has provided an assignment of cash totalling \$58,575 (2004 - \$nil) as security on the irrevocable standby letter of credit against lease rentals on Northwest Territories Exploration License No. 391. As at December 31, 2005, no expenditures have been made and EL-391 has expired.

As at December 31, 2005, the Company has provided an assignment of cash totalling \$41,500 (2004 - \$41,500) as security on the irrevocable standby letter of credit against refundable deposits on Northwest Territories Exploration License No. 416 (see Note 14). The work program on EL-416 and has been completed and an application has been made to refund the Company's \$41,500 deposit.

As at December 31, 2005, the Company has provided an assignment of cash totalling \$310,000 (2004 - \$310,000) as security on the irrevocable standby letter of credit against refundable deposits on Northwest Territories Exploration License No. 423 (see Note 14).

As at December 31, 2005, the Company has provided an assignment of cash totalling \$781,250 (2004 - \$nil) as security on the irrevocable standby letter of credit against refundable deposits on Northwest Territories Exploration License No. 429 (see Note 14).

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## International Frontier Resources Corporation

### Notes to the Consolidated Financial Statements

December 31, 2005

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#### 5. Refundable Deposits (Continued)

As at December 31, 2005, the Company has provided an assignment of cash totalling \$250,000 (2004 - \$nil) as security on the irrevocable standby letter of credit against refundable deposits on Northwest Territories Exploration License No. 432 (see Note 14).

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6. Property and equipment	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>2005 Net Book Value</u>
Petroleum and natural gas properties	\$ 8,746,086	\$ 1,775,238	\$ 6,970,848
Office furniture and equipment	<u>78,209</u>	<u>50,422</u>	<u>27,787</u>
	<u>\$ 8,824,295</u>	<u>\$ 1,825,660</u>	<u>\$ 6,998,635</u>

  

	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>2004 Net Book Value</u>
Petroleum and natural gas properties	\$ 5,807,225	\$ 1,584,321	\$ 4,222,904
Office furniture and equipment	<u>76,209</u>	<u>42,906</u>	<u>33,303</u>
	<u>\$ 5,883,434</u>	<u>\$ 1,627,227</u>	<u>\$ 4,256,207</u>

The Company has financed a portion of its exploration and development activities from the proceeds of flow-through share issues. As a result, petroleum and natural gas properties with a cost of \$4,901,394 (2004 - \$1,374,983) have no cost basis for income tax purposes. During the year, \$184,879 (2004 - \$59,043) of overhead expenses directly related to exploration and development activities were capitalized and \$10,529 (2004 - \$38,594) of interest expense was capitalized. Also during the year, \$72,438 (2004 - \$549,228) of expenses incurred in conducting a pilot project to test the Sidox product were capitalized to petroleum and natural gas properties.

As at December 31, 2005, undeveloped properties with a cost of \$6,222,050 (2004 - \$3,550,670) included in petroleum and natural gas properties have not been subject to depletion.

As at December 31, 2005, \$44,833 (2004 - \$859,723) impairment of petroleum and natural gas assets has been recorded to reflect the excess carrying amount of assets over fair value of future reserves. This amount is included in depletion and depreciation on the consolidated statements of loss and deficit.

The prices used in the impairment test evaluation of the Company's petroleum properties were as follows:

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Increase Thereafter</u>
Crude oil BBL	\$48.74	\$48.52	\$47.28	\$45.92	\$43.71	\$44.72	2.7%

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**International Frontier Resources Corporation**  
**Notes to the Consolidated Financial Statements**

December 31, 2005

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**7. Intangible assets**

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>2005 Net Book Value</u>
Sidox license	\$ <u>50,000</u>	\$ <u>5,000</u>	\$ <u>45,000</u>

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>2004 Net Book Value</u>
Options	\$ <u>14,201</u>	\$ <u>-</u>	\$ <u>14,201</u>

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**8. Asset retirement obligations**

The Company's asset retirement obligations result from net ownership interest in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately \$410,000. A credit-adjusted risk-free rate of 9% was used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

	<u>2005</u>	<u>2004</u>
Balance, beginning of year	\$ <b>232,752</b>	\$ -
Liabilities incurred	<b>16,537</b>	211,748
Liabilities settled	<b>(69,610)</b>	-
Accretion expense	<u><b>21,711</b></u>	<u>21,004</u>
Balance, end of year	\$ <u><b>201,390</b></u>	\$ <u>232,752</u>

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## International Frontier Resources Corporation

### Notes to the Consolidated Financial Statements

December 31, 2005

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#### 9. Income taxes

- a) The total provision for income taxes differs from the expected amount calculated by applying the combined federal and provincial tax rates of approximately 33.60% (2004 - 38.50%) to loss before income taxes. This difference results from the following items:

	<u>2005</u>	<u>2004</u>
Loss before income taxes	\$ <u>(2,013,113)</u>	\$ <u>(4,037,542)</u>
Expected tax recovery at combined federal and provincial statutory rates	\$ (676,406)	\$ (1,554,454)
Increase (decrease) resulting from:		
Statutory rate change	(85,000)	(1,549)
Resource allowance	8,723	50,882
Stock-based compensation	524,983	796,128
Valuation allowance	88,331	-
Other	<u>(36,510)</u>	<u>46,399</u>
Future income tax recovery	\$ <u>(175,879)</u>	\$ <u>(662,594)</u>

- b) Future income taxes consist of the following temporary differences:

	<u>2005</u>	<u>2004</u>
Excess of carry value of property and equipment over tax values	\$ 1,168,160	\$ 1,401,078
Asset retirement obligations	(67,667)	(89,610)
Share issue costs	(252,726)	(266,071)
Non-capital losses carry-forwards	(427,793)	(361,378)
Other	<u>(26,606)</u>	<u>(15,531)</u>
	\$ <u>393,368</u>	\$ <u>668,488</u>

- c) Tax losses

The Company has incurred losses for income tax purposes of approximately \$1,531,000 (2004 - \$938,000), the related benefit of these losses has been recognized in the consolidated financial statements by reducing future income taxes. Unless sufficient taxable income is earned these losses will expire as follows:

2008	\$ 9,000
2009	90,000
2010	66,000
2011	265,000
2012	508,000
2015	<u>593,000</u>
	\$ <u>1,531,000</u>

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## International Frontier Resources Corporation

### Notes to the Consolidated Financial Statements

December 31, 2005

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#### 10. Convertible debentures

During the year ended December 31, 2004, the balance of the remaining \$100,000 in convertible debentures issued in 2001 were converted to 222,222 common shares of the Company.

On June 4, 2004, the Company issued convertible redeemable debentures for total proceeds of \$975,000. The debentures have a term of four years, pay interest at a rate of 9.5% per year and are convertible into common shares at \$0.60 per share in year one, \$0.65 per share in year two, \$0.70 per share in year three and \$0.75 per share in year four.

The Company's convertible debentures are presented in their component parts. The debt component represents the present value of the payment obligations, interest and principal, to be satisfied in cash, discounted at the rate of interest that would be applicable to a debt-only instrument of comparable term and risk. The residual amount of the debenture represents the equity component and is presented in shareholders' equity. These component parts have been measured at their respective estimated fair values at the time the convertible debentures were originally issued.

As at December 31, 2005, \$910,000 (2004 - \$750,000) of debentures had been converted into 1,512,821 (2004 - 1,249,990) common shares of the Company. At December 31, 2005, the fair value of the remaining \$65,000 of convertible debentures is approximately \$62,648.

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#### 11. Share capital

- a) **Authorized:**  
 Unlimited common shares  
 Unlimited preferred shares

b) <b>Issued:</b>	2005		2004	
	Number of Shares	Amount	Number of Shares	Amount
<b>Common shares</b>				
Beginning of year	31,956,580	\$ 15,458,255	15,034,918	\$ 3,743,098
Issued for cash	5,000	2,250	6,861,250	5,581,363
Issued upon exercise of warrants	4,183,070	3,543,848	5,217,500	2,993,425
Issued upon exercise of options	490,000	425,350	430,000	305,230
Issued upon conversion of debentures	262,818	160,000	1,472,212	850,000
Issued upon acquisition of properties	75,000	150,000	-	-
Flow-through shares, net	3,275,000	5,567,500	2,940,700	2,454,145
Tax effected share issue costs	-	(195,949)	-	(469,006)
Balance, end of year	40,247,468	\$ 25,111,254	31,956,580	\$ 15,458,255



# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

### 11. Share capital (Continued)

c) Flow-through share information:	<u>2005</u>	<u>2004</u>
Carried forward from prior year	\$ 2,384,991	\$ 323,350
Amount of flow-through shares issued	5,567,500	3,990,480
Expenditures incurred	<u>(2,387,392)</u>	<u>(1,928,839)</u>
Remaining obligation	\$ <u>5,565,099</u>	\$ <u>2,384,991</u>

Under the terms of the current year flow-through agreement, the Company is required to expend \$5,565,099 (2004 - \$2,384,991) on qualifying oil and natural gas expenditures prior to December 31, 2006. As at December 31, 2005, the Company had incurred all of the 2004 requirements.

### d) Stock options:

The Company has a stock option plan available to key consultants, officers, directors, and employees of the Company. The exercise price of each option approximates the market price for the common shares on the date the option was granted. As at December 31, 2005, 3,320,000 common shares were reserved for issuance under the plan. Options granted under the plan vest upon granting and have a term of five years to expiry.

#### Outstanding and exercisable

	<u>2005</u>		<u>2004</u>	
	<u>Number of</u> <u>Options</u>	<u>Weighted</u> <u>Average</u> <u>Exercise</u> <u>Price</u>	<u>Number of</u> <u>Options</u>	<u>Weighted</u> <u>Average</u> <u>Exercise</u> <u>Price</u>
Beginning of year	2,810,000	\$ 1.02	1,435,000	\$ 0.42
Granted	1,000,000	\$ 1.80	1,805,000	\$ 1.34
Exercised	<u>(490,000)</u>	<u>\$ 0.41</u>	<u>(430,000)</u>	<u>\$ 0.39</u>
Balance, end of year	<u>3,320,000</u>	<u>\$ 1.34</u>	<u>2,810,000</u>	<u>\$ 1.02</u>

#### Expiry dates

	<u>2005</u>		<u>2004</u>	
	<u>Number of</u> <u>Options</u>	<u>Price</u>	<u>Number of</u> <u>Options</u>	<u>Price</u>
April 10, 2008	-	\$ -	90,000	\$ 0.25
December 23, 2008	690,000	\$ 0.45	1,090,000	\$ 0.45
January 26, 2008	90,000	\$ 0.50	90,000	\$ 0.50
April 1, 2009	90,000	\$ 0.45	90,000	\$ 0.45
November 16, 2009	650,000	\$ 1.50	650,000	\$ 1.50
December 23, 2009	800,000	\$ 1.60	800,000	\$ 1.60
February 11, 2010	900,000	\$ 1.85	-	\$ -
September 15, 2010	<u>100,000</u>	<u>\$ 1.35</u>	-	\$ -
	<u>3,320,000</u>	<u>\$ 1.34</u>	<u>2,810,000</u>	<u>\$ 1.02</u>

# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

**11. Share capital** (Continued)

**d) Stock options** (Continued):

**Outstanding and exercisable** (Continued)

<u>Exercise Price</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Options Outstanding</u>	<u>Weighted Average Contractual Life (years)</u>	<u>Weighted Average Exercise Price</u>	<u>Options Exercisable</u>	<u>Weighted Average Exercisable Price</u>
\$0.25 - \$0.50	870,000	3.04	\$ 0.46	870,000	\$ 0.46
\$1.35 - \$1.85	<u>2,450,000</u>	<u>4.03</u>	<u>\$ 1.66</u>	<u>2,450,000</u>	<u>\$ 1.66</u>
	<u>3,320,000</u>	<u>3.77</u>	<u>\$ 1.34</u>	<u>3,320,000</u>	<u>\$ 1.34</u>

The weighted average fair market value of options granted for the year ended December 31, 2005 is \$1.56 per option (2004 - \$1.15 per option). The fair value of each option granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	<u>2005</u>	<u>2004</u>
Risk-free interest rate	<b>3.55%</b>	3.75%
Expected life of options	<b>5</b>	5
Volatility in price of the Company's shares	<b>130.00%</b>	121.57%
Dividend yield rate	<b>0%</b>	0%

**e) Warrants:**

Warrants outstanding are as follows:

	<u>2005</u>		<u>2004</u>	
	<u>Number of Warrants</u>	<u>Amount</u>	<u>Number of Warrants</u>	<u>Amount</u>
Balance, beginning of year	<b>12,430,225</b>	<b>\$ 10</b>	5,420,000	\$ 10
Issued in conjunction with				
Private Placement	-	-	250,000	-
Private Placement	-	-	12,160,000	-
Flow-through shares (iii),(iv),(v)	<b>1,637,500</b>	-	1,565,225	-
Exercised	<b>(6,139,670)</b>	<b>(10)</b>	(6,915,000)	-
Expired	<b>(6,290,555)</b>	-	(50,000)	-
Balance, end of year	<u><b>1,637,500</b></u>	<u><b>\$ -</b></u>	<u>12,430,225</u>	<u>\$ 10</u>

# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

### 11. Share capital (Continued)

#### e) Warrants (Continued):

	2005			2004		
	Number of Warrants Outstanding	Exercise Price	Number of Common Shares for Exercise of Warrants	Number of Warrants Outstanding	Exercise Price	Number of Common Shares for Exercise of Warrants
Private Placement (i)	-	\$ -	-	2,000,000	\$ 0.25	2,000,000
Private Placement (ii)*	-	\$ -	-	2,785,000	\$ 1.15	1,392,500
Private Placement (ii)*	-	\$ -	-	6,080,000	\$ 1.50	3,040,000
Flow-through Shares (iii),(iv), v)	<u>1,637,500</u>	<u>\$ 1.85</u>	<u>1,637,500</u>	<u>1,565,225</u>	<u>\$ 1.75</u>	<u>1,565,225</u>
	<u>1,637,500</u>	<u>\$ 1.85</u>	<u>1,637,500</u>	<u>12,430,225</u>	<u>\$ 1.18</u>	<u>7,997,225</u>

\* Represents one full warrant. Two full warrants entitles the holder to acquire one common share at the price indicated.

- i) As of June 11, 2003, the Company acquired 100% of Sidox Canada. The consideration paid for the purchase of all of the issued and outstanding shares of Sidox Canada was the issuance of 2,000,000 non-transferable performance warrants with a carrying value of \$10, entitling holders to acquire one common share at \$0.25 for two years and \$0.35 in the third year. The warrants can only be exercised if Sidox Canada acquires a ten year exclusive license for Sidox and if wells in which the Company holds an interest that have been treated with Sidox achieve a minimum 25% barrel of oil per day increase for a period of 100 days. The purchase of Sidox Canada was from a company controlled by a director of the Company.

At December 31, 2005, all of the conditions of exercise had been met and the 2,000,000 warrants were exercised at \$0.35 for total proceeds of \$700,000.

- ii) In conjunction with a private placement occurring May 17, 2004 and closing July 19, 2004, the Company issued 6,080,000 units at \$0.80 per unit for total proceeds of \$4,851,200. Each unit consists of one common share, one Series "A" warrant and one Series "B" warrant. Two Series "A" warrants entitle the holder to acquire one common share at \$1.15 per share for a period of 180 days. Two Series "B" warrants entitle the holder to acquire one common share at \$1.50 for a period of 365 days. Series "B" warrants can only be exercised if the holder has exercised the Series "A" warrant. At December 31, 2005, all of the Series "A" warrants and 1,128,200 of the Series "B" warrants have been exercised and the remaining Series "B" warrants expired on July 1, 2005.

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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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### 11. Share capital (Continued)

#### e) Warrants (Continued):

- iii) In conjunction with a private placement occurring September 29, 2004 and closing October 26, 2004, the Company issued 2,530,000 flow-through share units at \$1.35 per unit for total proceeds of \$3,415,500. Each unit consists of one common flow-through share and one-half Series "C" warrant. One full warrant entitles the holder to purchase one additional non-flow through common share at a price of \$1.75 on or before September 30, 2005. A commission of 7.5% was paid to the Underwriters by issuance of 189,750 non-flow through units consisting of one common share and one half warrant having the same terms and conditions as the units comprised in the offering. At December 31, 2005, 264,470 of the Series "C" warrants have been exercised and the remaining Series "C" warrants expired on October 1, 2005.
- iv) In conjunction with a non-brokered private placement occurring November 10, 2004 and closing on December 23, 2004, the Company issued 410,700 flow-through share units at \$1.40 per unit for total proceeds of \$574,980. Each unit consists of one common flow-through share and one-half Series "C" warrant. One full warrant entitles the holder to purchase one additional non-flow through common share at a price of \$1.75 on or before June 30, 2005. The remaining Series "C" warrants expired on July 1, 2005.
- v) In conjunction with a non-brokered private placement occurring November 3, 2005 and closing on November 24, 2005, the Company issued 3,275,000 flow-through share units at \$1.70 per unit for total proceeds of \$5,567,500. Each unit consists of one common flow-through share and one-half warrant. One full warrant entitles the holder to purchase one additional non-flow through common share at a price of \$1.85 on or before May 24, 2006.

#### f) Contributed surplus:

	<u>2005</u>	<u>2004</u>
Balance, beginning of year	\$ 2,588,519	\$ 660,135
Value attributed to stock options granted	1,562,448	2,067,864
Value of stock options exercised	<u>(222,850)</u>	<u>(139,480)</u>
Balance, end of year	\$ <u>3,928,117</u>	\$ <u>2,588,519</u>

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### 12. Per share amounts

Basic net loss per common share is computed by dividing the net loss by the weighted average number of common shares outstanding for the year. Diluted net loss per common share is computed by dividing net loss by the diluted weighted average number of common shares outstanding for the year. In the calculation of diluted per share amounts, options under the stock option plan are assumed to have been converted or exercised on the later of the beginning of year and the date granted. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. Loss per share on a diluted weighted average basis is the same as that presented for basic, as all factors are anti-dilutive.

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## International Frontier Resources Corporation

### Notes to the Consolidated Financial Statements

December 31, 2005

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#### 12. Per share amounts (Continued)

Weighted average shares outstanding:

	<u>2005</u>	<u>2004</u>
Basic, beginning of year	35,141,388	22,551,889
Shares issued pursuant to options	611,216	761,500
Shares issued pursuant to conversion of debenture	56,081	150,000
Shares issued pursuant to warrants	<u>-</u>	<u>1,500,000</u>
Diluted, end of year	<u>35,808,685</u>	<u>24,963,389</u>

In calculating diluted common share amounts for the year ended December 31, 2005, the Company excluded 3,987,500 options and warrants (2004 - 11,847,225) because the exercise price was greater than the average market price of its common shares in those years.

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#### 13. Related party transactions

During the year, the Company paid consulting fees to certain officers and directors and in 2004 debenture interest to a company controlled by a director. Royalties incurred during the year in conjunction with the Company's Royalty Incentive Plan are payable to certain officers of the Company and are included in payables and accruals at December 31, 2005. These transactions were measured at the exchange amount which approximated fair market value as set out below:

	<u>2005</u>	<u>2004</u>
Consulting fees	\$ 186,000	\$ 155,120
Royalty expense	20,835	-
Debenture interest	<u>-</u>	<u>2,000</u>
	<u>\$ 206,835</u>	<u>\$ 157,120</u>

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#### 14. Contingent liabilities

- a) The Company has lodged a letter of credit in the amount of \$41,500 for its share of a \$381,608 refundable deposit on NWT Exploration License No. 416. The letter of credit is secured by an assignment of cash of \$41,500. The Company is contingently liable under the letter of credit for its proportional share of any portion of a \$1,526,430 gross work commitment not fulfilled. The deposit will be refunded by \$1 for every \$4 spent on qualified expenditures on EL-416.

The work commitment on EL-416 has been fulfilled and an application has been submitted for a refund of \$381,608. At December 31, 2005, EL-416 has expired.

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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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### 14. Contingent liabilities (Continued)

- b) The Company has lodged a letter of credit in the amount of \$310,000 for its share of a \$6,200,000 refundable deposit on NWT Exploration License No. 423. The letter of credit is secured by an assignment of cash of \$310,000. The Company is contingently liable under the letter of credit for its proportional share of any portion of a \$24,800,000 gross work commitment not fulfilled. The deposit will be refunded by \$1 for every \$4 spent on qualified expenditures on EL-423.

At December 31, 2005, the Company has incurred approximately \$40,000 of qualified expenditures on EL-423.

- c) The Company has lodged a letter of credit in the amount of \$781,250 for its share of a \$3,125,000 refundable deposit on NWT Exploration License No. 429. The letter of credit is secured by an assignment of cash of \$781,250. The Company is contingently liable under the letter of credit for its proportional share of any portion of a \$12,500,000 gross work commitment not fulfilled. The deposit will be refunded by \$1 for every \$4 spent on qualified expenditures on EL-429.

At December 31, 2005, no qualified expenditures have been incurred on EL-429.

- d) The Company has lodged a letter of credit in the amount of \$250,000 for its share of a \$1,000,000 refundable deposit on NWT Exploration License No. 432. The letter of credit is secured by an assignment of cash of \$250,000. The Company is contingently liable under the letter of credit for its proportional share of any portion of a \$4,000,000 gross work commitment not fulfilled. The deposit will be refunded by \$1 for every \$4 spent on qualified expenditures on EL-416.

At December 31, 2005 no qualified expenditures have been incurred on EL-432.

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### 15. Financial Instruments

As disclosed in Note 2, the Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to fair value, foreign currency and industry credit risks. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

#### a) Commodity price risk

The Company will be subject to commodity price risk for the delivery of natural gas and crude oil.

#### b) Credit risk

Substantially all of the Company's accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks.

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# International Frontier Resources Corporation

## Notes to the Consolidated Financial Statements

December 31, 2005

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### 16. Supplemental cash flow information

Changes in non-cash working capital items increase (decrease) cash as follows:

	<u>2005</u>	<u>2004</u>
Receivables	\$ (1,752,995)	\$ 293,218
Prepays	(120,139)	(414)
Payables and accruals	<u>73,621</u>	<u>56,396</u>
	<u>\$ (1,799,513)</u>	<u>\$ 349,200</u>
Operating activities	\$ (1,090,090)	\$ 124,529
Investing activities	(656,293)	201,730
Financing activities	<u>(53,130)</u>	<u>22,941</u>
	<u>\$ (1,799,513)</u>	<u>\$ 349,200</u>
Interest paid	<u>\$ 10,529</u>	<u>\$ 38,594</u>

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### 17. Commitments

The Company is party to an agreement to lease its premises until December 31, 2006. The annual rent of premises consists of a minimum rent plus occupancy costs. Minimum rent payable for premises until the end of the lease are as follows:

2006	\$ 56,108
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### 18. Subsequent event

On January 5, 2006 the Company announced the issuance of 150,000 stock options to Directors and senior management under the Company's stock option plan. The options have an exercise price of \$1.95 per share and are subject to TSX Venture approval.

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### 19. Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted in the current year.