International Frontier Resources Corporation
Consolidated Financial Statements
December 31, 2006

Contents

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, 2006 and 2005 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, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Grant Thornton LLP

Calgary, Alberta
April 17, 2007

Chartered Accountants

International Frontier Resources Corporation

Consolidated Balance Sheets

December 31	**2006**	2005
Assets		
Current		
Cash and cash equivalents	**$ 11,853,540**	$ 12,905,915
Receivables	**456,190**	1,930,590
Inventory	**82,125**	82,125
Prepaids	**31,590**	132,410
	12,423,445	15,051,040
Restricted cash on deposit (Note 4)	**1,538,125**	1,441,325
Property and equipment (Note 5)	**12,237,085**	6,998,635
Intangibles (Note 6)	**40,000**	45,000
	$ 26,238,655	$ 23,536,000
Liabilities		
Current		
Payables and accruals	**$ 1,075,270**	$ 288,565
Asset retirement obligations (Note 7)	**239,045**	201,390
Future income taxes (Note 8)	**1,655,510**	393,370
Convertible debentures (Notes 9)	**62,650**	62,650
	3,032,475	945,975
Shareholders' Equity		
Share capital (Note 10b)	**26,410,600**	25,111,255
Contributed surplus (Note 10f)	**4,474,570**	3,928,115
Equity component of convertible debentures	**2,350**	2,350
Deficit	**(7,681,340)**	(6,451,695)
	23,206,180	22,590,025
	$ 26,238,655	$ 23,536,000

Commitments and contingencies (Note 13)
Subsequent events (Note 17)

On behalf of the Board

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

See accompanying notes to the consolidated financial statements.

International Frontier Resources Corporation
Consolidated Statements of Loss and Deficit

Years ended December 31,	2006	2005
Revenue		
Oil and natural gas	$ 965,370	$ 866,190
Royalties	(219,005)	(210,110)
	746,365	656,080
Interest and prospect fees	621,595	219,135
	1,367,960	875,215
Expenses		
Field operating costs	398,785	409,410
Depletion, depreciation and amortization	1,222,010	203,435
Accretion of asset retirement obligations (Note 7)	21,560	21,710
General and administration	822,325	631,620
Stock based compensation	729,830	1,562,450
Write off of investment	-	52,875
Interest and bank charges	11,630	6,830
	3,206,140	2,888,330
Loss before income taxes	(1,838,180)	(2,013,115)
Future income tax recovery (Note 8)	608,535	175,880
Net loss	$ (1,229,645)	$ (1,837,235)
Net loss per share		
Basic and diluted (Note 11)	$ (0.03)	$ (0.05)

Deficit, beginning of year	$ (6,451,695)	$ (4,614,460)
Net loss	(1,229,645)	(1,837,235)
Deficit, end of year	$ (7,681,340)	$ (6,451,695)

See accompanying notes to the consolidated financial statements.

International Frontier Resources Corporation
Consolidated Statements of Cash Flows

Years ended December 31	2006	2005
Operating		
Net loss	$ (1,229,645)	$ (1,837,235)
Depletion, depreciation and amortization	1,222,010	203,435
Accretion of asset retirement obligations	21,560	21,710
Abandonment costs settled (Note 7)	(5,960)	(69,610)
Stock based compensation	729,830	1,562,450
Gain on sale of investment	-	(4,745)
Write off of investment	-	52,875
Future income tax recovery	(608,535)	(175,880)
	129,260	(247,000)
Change in non-cash operating working capital (Note 15)	977,365	(1,090,090)
	1,106,625	(1,337,090)
Investing		
Additions to property and equipment	(6,433,410)	(2,879,880)
Proceeds from disposition of property and equipment	-	57,000
Restricted cash on deposit	(96,800)	(1,089,825)
Investment in Sidox Chemicals Canada Inc.	-	(100,000)
	(6,530,210)	(4,012,705)
Change in non-cash investing working capital (Note 15)	1,384,560	(656,295)
	(5,145,650)	4,669,000
Financing		
Shares issued for cash	2,990,565	9,298,590
Share issue costs	(3,915)	(295,190)
	2,986,650	9,003,400
Change in non-cash financing working capital (Note 15)	-	(53,130)
	2,986,650	8,950,270
Net (decrease) increase in cash and cash equivalents	(1,052,375)	2,944,180
Cash and cash equivalents,		
Beginning of year	12,905,915	9,961,735
End of year	$ 11,853,540	$ 12,905,915

See accompanying notes to the consolidated financial statements.

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 centers, being Canada and the United Kingdom.

2. Significant accounting policies

Basis of presentation

The consolidated financial statements include the accounts of the Company, it's wholly owned United Kingdom subsidiary, Britcana Energy Ltd. and its 50% jointly controlled interest in Sidox Chemicals Canada Ltd. ("Sidox Canada") accounted for on the proportionate consolidation method. 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.

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 this note. 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.

Measurement uncertainty

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles 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 calculation of asset retirement obligations include estimates of the ultimate settlement amounts, inflation factors, credit adjusted discount rates and timing of settlement. The impact of future revisions to these assumptions on the consolidated financial statements of future periods could be material.

2. Summary of significant accounting policies (Continued)

Measurement uncertainty (Continued)

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.

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, whereby all costs of exploration for and development of petroleum and natural gas reserves are capitalized in a cost centre for each country in which the Company has operations. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both successful and unsuccessful wells 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.

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 before royalties as determined by independent engineers. 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.

2. Summary of significant accounting policies (Continued)

Asset retirement obligations (Continued)

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. Actual expenditures incurred are charged against the accumulated obligation.

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. Bank borrowings are considered to be financing activities.

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.

Intangible assets

The Company's proportionate share of an exclusive licensing agreement for the Sidox product in Canada is held by Sidox Chemicals Canada Ltd. The agreement covering an exclusive license for Canada has a ten-year term and costs related thereto are being amortized on a straight line basis over the period. Intangible assets are subject to an annual impairment test whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

2. Summary of significant accounting policies (Continued)

Depreciation

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

Convertible debentures

The debt component of convertible debentures outstanding 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.

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 income tax rates. Changes in income taxes rates that are substantively enacted are reflected in the period the change occurs.

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. 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 or other instruments are used to repurchase common shares at the average market rate for the period. 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. Diluted per share amounts reflect the potential silution 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.

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 as 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.

2. Summary of significant accounting policies (Continued)

Stock-based compensation

The Company has a stock option plan as described in Note 10c). The Company uses the fair-value method of accounting for stock options granted to employees and directors. Fair values are determined using the Black-Scholes option pricing model. Compensation costs are recognized in the statement of loss and deficit over the vesting period.

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 its customer. 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.

3. Investment in Sidox Chemicals Canada Ltd.

The Company's initial investment in Sidox Canada was recorded at $10.

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 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, 2006.

3. Investment in Sidox Chemicals Canada Ltd. (Continued)

Company's proportionate share of balances included in these consolidated financial statements related to Sidox Canada is:

		2006		2005
Assets				
Cash	$	**49,990**	$	49,985
Inventory		**82,125**		82,125
Intangibles		**40,000**		45,000
		172,115		177,110
Liabilities				
Payables		**-**		-
Net assets	$	**172,115**	$	177,110
Revenues	$	**-**	$	-
Expenditures		**19,990**		97,890
Net Loss	$	**19,990**	$	97,890
Cash from (used) in operating activities	$	**5**	$	(53,180)
Cash from investing activities	$	**-**	$	101,795
Cash used in financing activities	$	**-**	$	-

4. Restricted cash on deposit

As at December 31, 2006, the Company has provided an assignment of cash totalling $1,538,125 (2005 - $1,441,325) as security on the irrevocable standby letter of credit against restricted cash on deposit on Northwest Territories Exploration Licenses (see Note 13) as follows:

		2006		2005
EL - 391	$	**-**	$	58,575
EL - 416		**-**		41,500
EL - 423		**310,000**		310,000
EL - 429		**781,250**		781,250
EL - 432		**250,000**		250,000
EL - 441		**196,875**		-
	$	**1,538,125**	$	1,441,325

During the year, the standby letters of credit on EL – 391 and EL – 416 and the full amount of the deposits were refunded to the Company.

5. Property and equipment

December 31, 2006	**Cost**	**Accumulated Depletion and Depreciation**	**Net Book Value**
Petroleum and natural gas properties	**$ 15,197,280**	**$ 2,985,915**	**$ 12,211,365**
Office furniture and equipment	**82,480**	**56,760**	**25,720**
	$ 15,279,760	**$ 3,042,675**	**$ 12,237,085**

December 31, 2005	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	$ 8,746,085	$ 1,775,240	$ 6,970,845
Office furniture and equipment	78,210	50,420	27,790
	$ 8,824,295	$ 1,825,660	$ 6,998,635

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 $10,462,310 (2005 - $5,124,585) have no cost basis for income tax purposes. During the period, $135,230 (2005 - $184,880) of overhead expenses directly related to exploration and development activities in the Northwest Territories and $425,045 (2005 - $Nil) related to exploration and development and prospect generation in the North Sea were capitalized. Of these amounts, $6,175 (2005 - $10,530) related to interest expense capitalized for activities the Northwest Territories and $Nil (2005 - $Nil) related to the activities in the North Sea. Also during the period, $Nil (2005 - $72,440) 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, 2006, undeveloped properties in the Northwest Territories with a cost of $10,251,460 (2005 - $6,046,195) and undeveloped properties in the North Sea with a cost of $1,105,265 (2005 - $175,855) have been included in petroleum and natural gas properties but have not been included in the respective cost centers for purposes of calculating depletion.

As at December 31, 2006, $1,000,620 (2005 - $44,830) impairment of petroleum and natural gas assets has been recorded as part of depletion to reflect the excess carrying amount of assets over fair value of future reserves. These amounts are 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:

	2007	2008	2009	2010	2011	2012	Increase Thereafter
Crude oil BBL	$52.64	$52.95	$53.28	$52.87	$51.53	$52.63	2.0%

6. Intangible assets

December 31, 2006

		Cost		Accumulated Amortization		Net Book Value
Sidox license	**$**	**50,000**	**$**	**10,000**	**$**	**40,000**

December 31, 2005

		Cost		Accumulated Amortization		Net Book Value
Sidox license	$	50,000	$	5,000	$	45,000

7. 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 $472,500 (2005 - $410,000). A credit-adjusted risk-free rate of 9% and inflation rate of 2% was used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

		2006		2005
Balance, beginning of year	**$**	**201,390**	$	232,750
Liabilities incurred		**22,055**		16,540
Liabilities settled		**(5,960)**		(69,610)
Accretion expense		**21,560**		21,710
Balance, end of year	**$**	**239,045**	$	201,390

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8. 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 32.49% (2005 - 33.60%) to loss before income taxes. This difference results from the following items:

	2006	2005
Loss before income taxes	**$ (1,838,180)**	$ (2,013,115)
Expected tax recovery at combined federal and provincial statutory rates	**$ (597,225)**	$ (676,410)
Increase (decrease) resulting from:		
Statutory rate change	**(271,690)**	(85,000)
Resource allowance	**11,200**	8,725
Stock-based compensation	**237,120**	524,985
Valuation allowance	**12,140**	88,330
Other	**(80)**	(36,510)
Future income tax recovery	**$ (608,535)**	$ (175,880)

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

	2006	2005
Excess of carry value of property and equipment over tax values	**$ 2,310,100**	$ 1,168,160
Asset retirement obligations	**(69,320)**	(67,665)
Share issue costs	**(151,360)**	(252,725)
Non-capital losses carry-forwards	**(408,350)**	(427,795)
Other	**(25,560)**	(26,605)
	$ 1,655,510	$ 393,370

c) Tax losses

The Company has incurred losses for income tax purposes of approximately $1,708,000 (2005 - $1,531,000), 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:

	Canada	UK	Total
2008	$ 9,000	$ -	$ 9,000
2009	90,000	-	90,000
2010	66,000	-	66,000
2011	265,000	-	265,000
2012	508,000	-	508,000
2015	593,000	-	593,000
2026	150,000	27,000	177,000
	$ 1,681,000	$ 27,000	$ 1,708,000

9. Convertible debentures

At December 31, 2006, the fair value of the remaining $65,000 of convertible debentures is approximately $62,650. The debentures pay interest at a rate of 9.5% per year and the remainder of the convertible debentures are convertible into common shares at $0.70 per share to June 2007 and $0.75 per share to June 2008 at which time they expire. There is no security on the convertible debentures.

During 2005, $910,000 of debentures had been converted based upon the terms in the debenture agreement, into 1,512,821 common shares of the Company. At December 31, 2005, the fair value of the remaining $65,000 of convertible debentures is approximately $62,648.

10. Share capital

a) Authorized:
Unlimited common shares
Unlimited preferred shares

b) Issued:

	December 31, 2006		December 31, 2005	
	Number of Shares	**Amount**	Number of Shares	Amount
Common shares				
Beginning of year	**40,245,215**	**$ 25,111,255**	31,956,580	$ 15,458,255
Issued for cash	**-**	**-**	2,745	2,250
Issued upon exercise of warrants	**1,521,250**	**2,814,315**	4,183,070	3,543,850
Issued upon exercise of options	**275,000**	**359,625**	490,000	425,350
Issued upon conversion of debentures	**-**	**-**	262,820	160,000
Issued upon acquisition of properties	**-**	**-**	75,000	150,000
Flow-through shares	**-**		3,275,000	5,567,500
Tax effected flow-through shares	-	**(1,870,680)**	-	-
Tax effected share issue costs	**-**	**(3,915)**	-	(195,950)
Balance, end of year	**42,041,465**	**$ 26,410,600**	40,245,215	$ 25,111,255

10. Share capital (Continued)

c) Flow-through share information:

	2006	2005
Carried forward from prior year	$ 5,337,725	$ 2,155,110
Amount of flow-through shares issued	-	5,564,225
Expenditures incurred	(5,337,725)	(2,381,160)
Remaining obligation	$ -	$ 5,337,725

d) Stock options:

The Company has a stock option plan available to 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, 2006, 3,355,000 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	December 31, 2006 Number of Options	December 31, 2006 Weighted Average Exercise Price	December 31, 2005 Number of Options	December 31, 2005 Weighted Average Exercise Price
Balance, beginning of year	3,320,000	$ 1.34	2,810,000	$ 1.02
Granted	500,000	$ 1.57	1,000,000	$ 1.80
Expired	(190,000)	$ 1.37	-	$ -
Exercised	(275,000)	$ 0.64	(490,000)	$ 0.41
Balance, end of year	3,355,000	$ 1.42	3,320,000	$ 1.34

Expiry dates	December 31, 2006 Number of Options	December 31, 2006 Price	December 31, 2005 Number of Options	December 31, 2005 Price
December 23, 2008	465,000	$ 0.45	690,000	$ 0.45
January 26, 2009	90,000	$ 0.50	90,000	$ 0.50
April 1, 2009	75,000	$ 0.45	90,000	$ 0.45
November 16, 2009	525,000	$ 1.50	650,000	$ 1.50
December 23, 2009	800,000	$ 1.60	800,000	$ 1.60
February 11, 2010	800,000	$ 1.85	900,000	$ 1.85
September 15, 2010	100,000	$ 1.35	100,000	$ 1.35
January 5, 2011	150,000	$ 1.95	-	$ -
June 30, 2011	350,000	$ 1.40	-	$ -
	3,355,000	$ 1.42	3,320,000	$ 1.34

10. Share capital (Continued)

d) Stock options:

	Options Outstanding			Options Exercisable	
Exercise Price	Options Outstanding	Weighted Average Contractual Life (years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercisable Price
$0.45 - $0.50	630,000	2.03	$ 0.46	630,000	$ 0.46
$1.35 - $1.95	2,725,000	3.28	$ 1.64	2,725,000	$ 1.64
	3,355,000	3.04	$ 1.42	3,355,000	$ 1.42

The weighted average fair market value of options granted in the period ended December 31, 2006 is $1.46 per option (2005 - $1.56 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:

	December 31, 2006	December 31, 2005
Risk-free interest rate	**4.20%**	3.55%
Expected life of options	**5**	5
Volatility in price of the Company's shares	**151.00%**	130.00%
Dividend yield rate	**0%**	0%

e) Warrants:

Warrants outstanding are as follows:

	December 31, 2006		December 31, 2005	
	Number of Warrants	**Amount**	Number of Warrants	Amount
Balance, beginning of year	**1,637,500**	**$ -**	12,430,225	$ 10
Issued in conjunction with Flow-through shares	**-**	**-**	1,637,500	-
Exercised (i)	**(1,521,250)**	**-**	(6,139,670)	(10)
Expired (i)	**(116,250)**	**-**	(6,290,555)	-
Balance, end of year	**-**	**$ -**	1,637,500	$ -

10. Share capital (Continued)

e) Warrants:

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. At December 31, 2006, 1,521,250 warrants have been exercised and the remaining 116,250 warrants expired on May 24, 2006.

f) Contributed surplus:

	2006	2005
Balance, beginning of year	**$ 3,928,115**	$ 2,588,520
Value attributed to stock options granted	**729,830**	1,562,450
Value of stock options exercised	**(183,375)**	(222,855)
Balance, end of year	**$ 4,474,570**	$ 3,928,115

11. Per share amounts

	2006	2005
Weighted average shares outstanding	**41,409,880**	35,141,390
Shares issued pursuant to options	**651,626**	611,215
Shares issued pursuant to conversion of debenture	**55,310**	56,080
Fully diluted, weighted average number of shares	**42,116,816**	35,808,685

In calculating diluted common share amounts for the year ended December 31, 2006, the Company excluded 3,432,000 options and warrants (2005 – 3,987,500) because the exercise price was greater than the average market price of its common shares during the year.

12. Related party transactions

During the year, the Company paid consulting fees and bonuses to certain officers and directors, as well as royalties pursuant to the Company's Royalty Incentive Plan as follows:

		2006		2005
Consulting fees and bonuses	$	282,500	$	186,000
Royalty expense		12,690		20,835
	$	295,190	$	206,835

At December 31, 2006, $85,190 (2005 – $20,385) of the above amounts were included in payables and accruals.

In addition, during the year $43,600 (2005 - $8,400) was paid to a law firm in which a Director of the Company is a partner. Of this amount $460 is included in payables and accruals at December 31, 2006. These costs are included in general and administrative expenses on the consolidated statements of loss and deficit.

The above transactions have been recorded at the exchange amounts that were established and agreed upon by the related parties.

13. Commitments and contingencies

a) 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 (5%) 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.

b) 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 (25%) 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.

c) 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 (25%) 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-432.

13. Commitments and contingencies (Continued)

d) The Company has lodged a letter of credit in the amount of $196,875 for its share of a $10,500,000 refundable deposit on NWT Exploration License No. 441. The letter of credit is secured by an assignment of cash of $196,875. The Company is contingently liable under the letter of credit for its proportional share (7.5%) of any portion of a $787,500 gross work commitment not fulfilled. The deposit will be refunded by $1 for every $4 spent on qualified expenditures on EL-441.

e) The Company is party to an agreement to lease its premises until December 31, 2011. 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:

2007	$	86,568
2008	$	86,568
2009	$	86,568
2010	$	86,568
2011	$	86,568

14. 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.

c) Foreign currency risk
Foreign currency risk is the risk that a variation in exchange rates between the Canadian dollar and foreign currencies will affect the Company's operating and financial results. The Company is exposed to foreign currency risk as the Company holds cash and cash equivalents on hand that are denominated in United States currency and is exposed to foreign currency fluctuations on its operations in the United Kingdom as these are denominated in British pounds. At December 31, 2006, there were no contracts in place to fix the exchange rates on these transactions.

15. Supplemental cash flow information (Continued)

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

	2006	2005
Receivables	$ 1,474,400	$ (1,752,995)
Prepaids	100,820	(120,140)
Payables and accruals	786,705	73,620
	$ 2,361,925	$ (1,799,515)
Operating activities	$ 977,365	$ (1,090,090)
Investing activities	1,384,560	(656,295)
Financing activities	-	(53,130)
.	$ 2,631,925	$ (1,799,515)
Interest paid	$ 17,805	$ 17,360

16. Segmented information

The Company's activities are conducted in two geographic segments: Canada and the United Kingdom. All activities relate to exploration for and development of petroleum and natural gas.

December 31, 2006

.	Canada	U.K.	Total
Oil and gas revenues, net	$ 746,365	$ -	$ 746,365
Interest and other income	621,595	-	621,595
Total revenues, net	1,367,960	-	1,367,960
Capital expenditures	$ 5,504,000	$ 929,410	$ 6,433,410
Property and equipment	$ 11,131,820	$ 1,105,265	$ 12,237,085

For the year ended December 31, 2005, $175,855 was included in property and equipment related to oil and gas exploration costs incurred in the United Kingdom. The remainder of the prior year's operations were conducted in Canada.

17. Subsequent events

a) Subsequent to December 31, 2006, the Company issued 12,400,000 units at a price of $1.25 per unit, for gross proceeds of $15,500,000. Each unit is comprised of one common share and one-half warrant. One full warrant entitles the holder, on exercise to purchase one additional non-flow through share at a price of $1.60 per share on or before February 22, 2008. On the same date the Company issued 4,800,000 flow-through shares at a price of $1.50 per flow-through share, for gross proceeds of $7,200,000.

Concurrently with the issuance of the units and flow-through shares, the Company issued 1,204,000 underwriter warrants which entitle the holder, on exercise, to purchase one common share at a price of $1.60 on or before February 22, 2008. In addition, the Company issued 100,000 Corporate Finance Units to the underwriter. Each unit consists of one common share and one warrant. One warrant entitles the holder to acquire one common share at a price of $1.60 on or before February 22, 2008.

b) On January 9, 2007, the Company announced the issuance of 800,000 stock options to directors and consultants under the Company's stock option plan. The options have an exercise price of $1.30 per share.

18. Comparative figures reclassification

Certain comparative figures have been reclassified to conform to the presentation adopted in the current year. Cash and cash equivalents are defined as cash balances with banks and short-term investments with an original maturity of 90 days or less. The cash and cash equivalents amount on the 2006 consolidated statements of cash flows has been restated to remove $1,089,825 of investments and show this amount as a cash outflow investing activity.