International Frontier Resources Corporation

Consolidated Financial Statements

December 31, 2007

Contents

Auditors' Report

To the Shareholders of
International Frontier Resources Corporation

We have audited the consolidated balance sheet of **International Frontier Resources Corporation** as at December 31, 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the year 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 audit.

We conducted our audit 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 International Frontier Resources Corporation as at December 31, 2007 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The comparative financial statements as at and for the year ended December 31, 2006 presented for comparative purposes were audited by another firm of Chartered Accountants which expressed an opinion without reservation on those financial statements in their report dated April 17, 2007.

(Signed) "*Deloitte & Touche LLP*"

Calgary, Alberta
March 21, 2008

Chartered Accountants

International Frontier Resources Corporation
Consolidated Balance Sheets

December 31	2007	2006
Assets		
Current		
Cash and cash equivalents (Note 15)	**$ 25,316,940**	$ 11,853,540
Receivables	**1,227,990**	456,190
Inventory	**-**	82,125
Prepaids	**162,690**	31,590
	26,707,620	12,423,445
Restricted cash on deposit (Note 5)	**2,267,175**	1,538,125
Property and equipment (Note 6)	**17,504,875**	12,237,085
Inventory (Note 4)	**82,125**	-
Intangibles (Note 7)	**35,000**	40,000
	$ 46,596,795	$ 26,238,655
Liabilities		
Current		
Payables and accruals	**$ 4,207,115**	$ 1,075,270
Convertible debentures (Note 10)	**62,650**	-
Current portion of asset retirement obligations (Note 8)	**30,000**	-
	4,299,765	1,075,270
Asset retirement obligations (Note 8)	**306,020**	239,045
Future income taxes (Note 9)	**1,141,630**	1,655,510
Convertible debentures (Note 10)	**-**	62,650
	5,747,415	3,032,475
Shareholders' Equity		
Share capital (Note 11)	**44,121,725**	26,410,600
Warrants (Note 11)	**3,757,090**	-
Contributed surplus (Note 11)	**6,732,940**	4,474,570
Equity component of convertible debentures (Note 10)	**2,350**	2,350
Deficit	**(13,764,725)**	(7,681,340)
	40,849,380	23,206,180
	$ 46,596,795	$ 26,238,655

Commitments and contingencies (Note 14)
Nature of operations (Note 1)

On behalf of the Board

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

See accompanying notes to the interim consolidated financial statements.

International Frontier Resources Corporation

Consolidated Statements of Operations, Comprehensive Loss and Deficit

Years ended December 31,	**2007**	2006
Revenue		
Oil	**$ 787,020**	$ 965,370
Less: Royalties	**(179,530)**	(219,005)
	607,490	746,365
Interest income	**1,154,975**	449,095
Prospect fee income	**194,755**	172,500
	1,957,220	1,367,960
Expenses		
Field operating costs	**508,025**	398,785
Depletion, depreciation and impairments (Note 6)	**4,459,275**	1,222,010
Accretion (Note 8)	**16,775**	21,560
Foreign exchange loss	**265,165**	-
General and administration	**872,790**	833,955
Stock based compensation (Note 11)	**1,851,725**	729,830
	7,973,755	3,206,140
Loss before income taxes	**(6,016,535)**	(1,838,180)
Future income tax expense (recovery) - (Note 9)	**66,850**	(608,535)
Net loss and comprehensive loss	**$ (6,083,385)**	$ (1,229,645)
Deficit, beginning of year	**(7,681,340)**	(6,451,695)
Deficit, end of year	**$ (13,764,725)**	$ (7,681,340)

Net loss per share (Note 12)		
Basic and diluted `	**$ (0.11)**	$ (0.03)

See accompanying notes to the consolidated financial statements.

International Frontier Resources Corporation

Consolidated Statements of Cash Flows

Years ended December 31	2007	2006
Operating		
Net loss	$ (6,083,385)	$ (1,229,645)
Non Cash Items:		
Depletion, depreciation and impairments	4,459,275	1,222,010
Accretion	16,775	21,560
Stock based compensation	1,851,725	729,830
Future income tax expense	66,850	(608,535)
Asset retirement liabilities settled	(223,145)	(5,960)
	88,095	129,260
Change in non-cash operating working capital (Note 15)	340,855	977,365
	428,950	1,106,625
Investing		
Additions to property and equipment	(9,016,845)	(6,433,410)
Proceeds from disposition of property and equipment	4,770	-
Restricted cash on deposit	(729,050)	(96,800)
Change in non-cash investing working capital (Note 15)	1,888,090	1,384,560
	(7,853,035)	(5,145,650)
Financing		
Shares and warrants issued for cash	22,890,000	2,990,565
Share issue costs	(2,002,515)	(3,915)
	20,887,485	2,986,650
Net increase (decrease) in cash and cash equivalents	13,463,400	(1,052,375)
Cash and cash equivalents,		
Beginning of year	11,853,540	12,905,915
End of year	$ 25,316,940	$ 11,853,540

See accompanying notes to the consolidated financial statements.

1. Nature of operations and basis of presentation

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 geographical areas, being Canada and the United Kingdom.

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.

2. Significant accounting policies

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.

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.

2. Summary of significant accounting policies (Continued)

Measurement uncertainty (continued)

The Company may from time to time issue flow-through shares to finance a portion of its capital expenditure program. The income tax deductions associated with the expenditures funded by flow-through arrangements are renounced to investors in accordance with the appropriate tax legislation. To recognize the foregone tax benefits to the Company, share capital is reduced and a future tax liability is recorded equal to the estimated amount of future income taxes when the expenditure renouncements are filed.

The capital expenditures classification made with respect to the renouncement of flow-through shares is based on estimates from geological and geophysical information obtained and the classification of the expenditures may be challenged by the taxation authorities and in this regard the assessments may be different from that of management. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes of estimates in future periods could be significant.

Property and equipment

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.

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.

2. Summary of significant accounting policies (Continued)

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. 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 earning an average interest rate of 4.00% in 2007 (2006 – 3.20%)

Inventory

Inventory is comprised of chemical inventory 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)

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. A valuation allowance is recorded against any future income tax asset if the Company is not "more likely than not" to be able to utilize the associated tax deductions.

Per share amounts

Basic earnings per share is computed by dividing the earnings for the period by the weighted average number of common shares outstanding during the year. Diluted earnings per share reflects the potential dilution that could occur if potentially dilutive securities were exercised or converted to common stock. The dilutive effect of options and warrants and their equivalent is computed by application of the treasury stock method and the effect of convertible securities by the "if converted" method. Diluted amounts are not presented when the effect of the computations are anti-dilutive due to the losses incurred. Accordingly, there is no difference in the amounts presented for basic and diluted loss per share.

Stock-based compensation

The Company has a stock option plan as described in Note 11(d). 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 operations at the date of grant as the options vest immediately. Compensation expense is adjusted for the estimated amount of forfeitures at the time compensation expense is recognized.

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 or when income is earned.

2. Summary of significant accounting policies (Continued)

Foreign currency translation

Monetary assets and liabilities denominated in a foreign currency are translated at the exchange rate prevailing at the balance-sheet date. Non-monetary assets and liabilities and transactions denominated in a foreign currency are translated at the exchange rates in effect at the transaction date.

Integrated foreign subsidiaries are accounted for using the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the balance-sheet date. Non-monetary assets are translated at historical rates. Revenue and expenses are translated at average rates for the period. Foreign exchange gains and losses are included in net loss in the period in which they arise.

3. New accounting policies

Effective January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Section 1530, "Comprehensive Income", Section 3855, "Financial Instruments – Recognition and Measurement", Section 3861, "Financial Instruments – disclosure and Presentation" and Section 3865, "Hedges". The Company has adopted these standards retrospectively without restatement.

Upon adoption of Section 3855, all financial instruments are classified into one of the following five categories: held-for-trading, loans and receivables, held-to-maturity investments, available for-sale financial assets or other financial liabilities. Subsequent measurement of the financial instruments is based on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired.

All derivative instruments are recorded in the balance sheet at fair value unless they qualify for the normal sale and normal purchase exemption. All changes in their fair value are recorded in net income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income until the underlying hedged transaction is recognized in net income. Any hedge ineffectiveness is immediately recognized in net income. The other categories of financial instruments are recognized at amortized cost using the effective interest rate method.

Upon adoption of these standards, the Company classified its cash and cash equivalents as held-for-trading, which are measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at cost. Accounts payable and notes payable are classified as other financial liabilities, which are measured at amortized cost.

For financial assets and financial liabilities that are not classified as held-for-trading, the transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are adjusted to the fair value initially recognized for that financial instrument. These costs are expensed using the effective interest rate method.

The adoption of Section 1530 has no material impact on the consolidated financial statements of the Company.

3. New accounting policies (continued)

The Company currently does not utilize hedges or other derivative financial instruments in its operations, and as a result of the adoption of Section 3865 had no material impact on the consolidated financial statements of the Company.

The adoption of these new standards had no impact on the Company's opening deficit as at January 1, 2007.

The new standards establish a new statement of comprehensive income, which is comprised of net earnings and other comprehensive income. The Company currently has no other comprehensive income items.

The Company has also adopted Section 3251, "Equity" and Section 1506, "Accounting Changes". Section 3251 replaces Section 3250, "Surplus" and describes standards for the presentation of equity and changes in equity for reporting periods as a result of the application of Section 1530, "Comprehensive Income". The only impact of Section 1506, "Accounting Changes", is to provide disclosure of when an entity has not applied a new source of GAAP that has been issued but is not yet effective. This is the case with Section 3862, Financial Instruments Disclosures" and Section 3863, "Financial Instruments Presentations" which are required to be adopted for fiscal years beginning on or after October 1, 2007. The Company will adopt these standards on January 1, 2008 and it is expected the only effect on the Company will be additional disclosures regarding the significance of financial instruments for the entity's financial position and performance; and the nature, extent and management of risks arriving from financial instruments to which the entity is exposed.

The Company is assessing the new and revised accounting pronouncements that have been issued that are not yet effective:

- As of January 1, 2008, the Company will be required to adopt two new CICA standards, Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation," which will replace Section 3861 "Financial Instruments – Disclosure and Presentation." The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006 and the Company is assessing the impact on its consolidated financial statements.

- As of January 1, 2008, the Company will be required to adopt Section 1535 "Capital Disclosures," which will require companies to disclose their objectives, policies and processes for managing capital. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006 and the Company is assessing the impact on its consolidated financial statements.

- The Company will be required to adopt CICA Handbook Section 3031, Inventories. This new accounting standard is effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2008. This new standard is not expected to have a material impact on the Company's consolidated financial statements.

3. New accounting policies (continued)

- The CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

- In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064, Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

4. Investment in Sidox Chemicals Canada Ltd.

The investment in Sidox Canada is subject to joint control and accordingly has been proportionately consolidated in these financial statements at December 31, 2007.

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

	2007	2006
Assets		
Cash	**$ 49,990**	$ 49,990
Receivables	**12,265**	12,265
Inventory	**82,125**	82,125
Intangibles	**35,000**	40,000
	179,380	184,380
Liabilities		
Payables	**87,730**	77,455
Net assets	**$ 91,650**	$ 106,925
Revenues	**$ -**	$ -
Expenditures	**15,275**	19,990
Net Loss	**$ 15,275**	$ 19,990

5. Restricted cash on deposit

As at December 31, 2007, the Company has provided an assignment of cash totaling $2,267,175 (2006 - $1,538,125) as security on the irrevocable standby letters of credit for the Northwest Territories Exploration Licenses (see Note 14) as follows:

	2007	2006
EL – 423	$ **509,180**	$ 310,000
EL – 429	**781,250**	781,250
EL – 432	**250,000**	250,000
EL – 441	**352,440**	196,875
EL – 445	**68,750**	-
EL – 443	**305,555**	-
	$ **2,267,175**	$ 1,538,125

6. Property and equipment

December 31, 2007	Cost	Accumulated Depletion, Depreciation and Impairments	Net Book Value
Petroleum and natural gas properties	$ **24,919,340**	$ **7,434,515**	$ **17,484,825**
Office furniture and equipment	**82,480**	**62,430**	**20,050**
Petroleum and natural gas properties	$ **25,001,820**	$ **7,496,945**	$ **17,504,875**

December 31, 2006	Cost	Accumulated Depletion, Depreciation and Impairments	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
Petroleum and natural gas properties	$ 15,279,760	$ 3,042,675	$ 12,237,085

During the year, $411,450 (2006 - $135,230) of overhead expenses directly related to exploration activities in the Northwest Territories and $614,150 (2006 - $425,045) related to exploration and prospect generation in the North Sea were capitalized. Of these amounts, $6,175 (2006 - $6,175) related to interest expense capitalized for activities the Northwest Territories and $Nil (2006 - $Nil) related to the activities in the North Sea.

Included in the above amounts are, $294,800 (2006 - $Nil) of stock option costs recognized in the period that were capitalized to undeveloped properties in the Northwest Territories and $111,835 (2006 - $Nil) of stock option costs recognized in the period were capitalized to petroleum and natural gas properties in the North Sea.

6. Property and equipment (continued)

As at December 31, 2007 the Company has accumulated capital expenditures for land, seismic, and drilling in the Central Mackenzie Valley, Northwest Territories of $13,805,330 (2006 - $10,251,460). In the North Sea (UKCS) the Company has incurred capital expenditures, at December 31, 2007, of $2,413,000 (2006 - $1,105,265). These costs have been included in petroleum and natural gas properties as undeveloped properties but have not been included in the respective cost centers for purposes of calculating depletion.

In 2007, $Nil (2006 - $1,000,620) 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 in Canada. In addition, in 2007, $4,280,860 (2006 - $Nil) impairment of petroleum and natural gas assets in the North Sea has been recorded as part of depletion.

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

	2008	2009	2010	2011	2012	2013	Increase Thereafter
Crude oil ($C/Bbl)	$55.30	$53.20	$50.50	$48.70	$48.00	$47.20	2.0%

7. Intangible assets

December 31, 2007	**Cost**	**Accumulated Depreciation**	**Net Book Value**
Sidox license	**$ 50,000**	**$ 15,000**	**$ 35,000**

December 31, 2006	Cost	Accumulated Amortization	Net Book Value
Sidox license	$ 50,000	$ 10,000	$ 40,000

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 $832,500 (2006 - $472,500). 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:

	2007	2006
Balance, beginning of year	**$ 239,045**	$ 201,390
Change in estimate	**303,345**	-
Liabilities incurred	**-**	22,055
Liabilities settled	**(223,145)**	(5,960)
Accretion expense	**16,775**	21,560
	336,020	239,045
Less: current portion	**(30,000)**	-
Balance, end of year	**$ 306,020**	$ 239,045

It is expected that this obligation will be funded from the Company's general resources at the time the costs are incurred with the majority of costs expected to occur between 2008 and 2018.

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 30.12% (2006 - 32.49%) to loss before income taxes in Canada and tax rate of approximately 30% (2006 – 30%) in the U.K.. This difference results from the following items:

December 31, 2007

	Canada	U.K.	Total
Loss before income taxes	**$ (1,631,510)**	**$ (4,385,025)**	**$ (6,016,535)**
Expected tax recovery of combined Federal and provincial statutory rates	**(491,410)**	**(1,320,770)**	**(1,812,180)**
Increase (decrease) resulting from:			
Statutory rate change	**520**	**243,950**	**244,470**
Stock based compensation	**557,740**	**-**	**557,740**
Foreign exchange loss	**-**	**33,000**	**33,000**
Change in valuation allowance	**-**	**1,043,820**	**1,043,820**
Future income tax expense	**$ 66,850**	**$ -**	**$ 66,850**

December 31, 2006

	Canada	U.K.	Total
Loss before income taxes	$ (1,811,310)	$ (26,870)	$ (1,838,180)
Expected tax recovery of combined Federal and provincial statutory rates	(589,165)	(8,060)	(597,225)
Increase (decrease) resulting from:			
Statutory rate change	(271,690)	-	(271,690)
Resource Allowance	11,200	-	11,200
Stock based compensation	237,120	-	237,120
Other	12,060	-	12,060
Future income tax recovery	$ (600,475)	$ (8,060)	$ (608,535)

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

December 31, 2007

	Canada	U.K.	Total
Excess of carry value of property and equipment over tax values	**$ (2,171,510)**	**$ 1,070,215**	**$ (1,101,295)**
Asset retirement obligations	**84,005**	**-**	**84,005**
Share issue costs	**472,070**	**-**	**472,070**
Non-capital loss carry-forwards	**473,805**	**32,510**	**506,315**
	(1,141,630)	**1,102,725**	**(38,905)**
Valuation allowance	**-**	**(1,102,725)**	**(1,102,725)**
Future income tax liability	**$ (1,141,630)**	**$ -**	**$ (1,141,630)**

9. Income taxes (continued)

December 31, 2006

	Canada	U.K.	Total
Excess of carry value of property and equipment over tax values	$ (2,310,000)	$ -	$ (2,310,100)
Asset retirement obligations	69,320	-	69,320
Share issue costs	151,360	-	151,360
Non-capital loss carry-forwards	400,290	8,060	408,350
Other	25,460	-	25,560
Future income tax liability	$ (1,663,570)	$ 8,060	$ (1,655,510)

c) Tax losses

The Company has incurred losses for income tax purposes of approximately $2,433,880 (2006 - $1,681,00) in Canada and $130,000 (2006 - $27,000) in the United Kingdom. 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	U.K..	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	268,000	27,000	295,000
2027	634,880	103,000	737,880
	$ 2,433,880	$ 130,000	$ 2,563,880

10. Convertible debentures

At December 31, 2007, the Company has $65,000 of convertible debentures remaining. The debentures pay interest at a rate of 9.5% per year and 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.

The Company's convertible debentures were presented in their component parts. The debt component of $62,650 (2006 - $62,650) 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 is $2,350 (2006 - $2,350) which 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.

There were no debentures converted during the years ended December 31, 2007 and 2006. A total of 86,667 shares will be issued if the remainder of the debentures are converted at June 30, 2008. The debentures are secured by a floating charge on the Company's assets.

11. Share capital

a) Authorized:
Unlimited common shares
Unlimited preferred shares

b) Issued:

	December 31, 2007			December 31, 2006		
	Number of Shares		**Amount**	Number of Shares		Amount
Common shares						
Beginning of year	**42,041,465**	**$**	**26,410,600**	40,245,215	$	25,111,255
Issued for cash	**12,400,000**		**15,500,000**	-		-
Issued for services	**100,000**		**125,000**			
Value attributed to warrants (Note 11(e)	-		**(3,757,090)**	-		-
Issued upon exercise of warrants	**-**		**-**	1,521,250		2,814,315
Issued upon exercise of options	**-**		**-**	275,000		359,625
Flow-through shares	**5,037,500**		**7,390,000**	**-**		(1,870,680)
Share issue costs, net of tax effect	**-**		**(1,546,785)**	-		(3,915)
Balance, end of year	**59,578,965**	**$**	**44,121,725**	42,041,465	$	26,410,600

(i) In conjunction with a bought deal financing on February 22, 2007 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 thereof with the right to purchase one common share at $1.60.

(ii) In conjunction with the above financing, the Company issued 100,000 Corporate Finance Units to the underwriter. Each unit consists of one common share and one warrant. At December 31, 2007, $125,000 has been included in share capital to reflect the value of these shares at the date of issue.

(iii) On February 22, 2007, the Company also issued 4,800,000 flow-through shares at a price of $1.50 per share, for gross proceeds of $7,200,000.

(iv) On December 13, 2007 in conjunction with a non-brokered private placement, the Company issued 237,500 flow-through shares at a price of $0.80 per share, for gross proceeds of $190,000. The shares issued are subject to a hold period which expires on April 20, 2008.

11. Share capital (continued)

c) Flow-through share obligation information:

		2007		2006
Balance, beginning of year	$	-	$	5,337,725
Flow-through share proceeds		7,390,000		-
Expenditures incurred		(3,891,975)		(5,337,725)
Balance, end of year	$	3,498,025	$	-

d) Stock options:

The Company has a stock option plan available to consultants, officers, directors, and employees of the Company. The Option Plan allows directors, employees and consultants to be granted incentive based compensation under the Option Plan while allowing a rolling maximum of 10% of the number of issued and outstanding shares from time-to-time to be granted under the Option Plan. 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, 2007, 5,855,000 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	2007 Number of Options		2007 Weighted Average Exercise Price	2006 Number of Options		2006 Weighted Average Exercise Price
Balance, beginning of year	3,355,000	$	1.42	3,320,000	$	1.34
Granted	2,500,000	$	0.97	500,000	$	1.57
Expired	-	$	-	(190,000)	$	1.37
Exercised	-	$	-	(275,000)	$	0.64
Balance, end of year	5,855,000	$	1.23	3,355,000	$	1.42

Expiry dates	2007 Number of Options		2007 Price	2006 Number of Options		2006 Price
December 23, 2008	465,000	$	0.45	465,000	$	0.45
January 26, 2009	90,000	$	0.50	90,000	$	0.50
April 1, 2009	75,000	$	0.45	75,000	$	0.45
November 16, 2009	525,000	$	1.50	525,000	$	1.50
December 23, 2009	800,000	$	1.60	800,000	$	1.60
February 11, 2010	800,000	$	1.85	800,000	$	1.85
September 15, 2010	100,000	$	1.35	100,000	$	1.35
January 5, 2011	150,000	$	1.95	150,000	$	1.95
June 30, 2011	350,000	$	1.40	350,000	$	1.40
January 9, 2012	800,000	$	1.30	-	$	-
June 26, 2012	1,700,000	$	0.82	-	$	-
	5,855,000	$	1.23	3,355,000	$	1.42

11. Share capital (continued)

d) Stock options (continued)

December 31, 2007

	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	1.03`	$ 0.46	630,000	$ 0.46
$0.82 - $1.30	2,500,000	4.34`	$ 0.97	2,500,000	$ 0.97
$1.35 - $1.95	2,725,000	2.28	$ 1.64	2,725,000	$ 1.64
	5,855,000	3.03	$ 1.23	5,855,000	$ 1.23

December 31, 2006

	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
$1.30 - $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 year ended December 31, 2007 is $0.92 per option (2006 - $1.46 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:

	2007	2006
Risk-free interest rate	**4.37%**	4.20%
Expected life of options	**5 years**	5 years
Volatility	**163%-170%**	143%-155.00%
Dividend yield rate	**0%**	0%

e) Warrants:

Warrants outstanding are as follows:

	2007		2006	
	Number of Warrants	**Amount**	Number of Warrants	Amount
Balance, beginning of year	**-**	**$ -**	1,637,500	$ -
Issued	**7,504,000**	**3,757,090**	**-**	**-**
Exercised	**-**	**-**	(1,521,250)	-
Expired	**-**	**-**	(116,250)	-
Balance, end of year	**7,504,000**	**$ 3,757,090**	-	$ -

11. Share capital (continued)

e) Warrants (continued)

(i) In conjunction with a bought deal unit financing on February 22, 2007 the Company raised 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. The Company received approval from the TSX-V to extend the expiry date of the warrants from February 22, 2008 to May 22, 2008. Subsequent to year end none of the warrants had been exercised.

(ii) Concurrently with the issuance of the units, 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 the right to acquire one common share at a price of $1.60 on or before February 22, 2008. The underwriter warrants and corporate finance warrants expired unexercised on February 22, 2008

The weighted average fair market value of warrants granted in the year ended December 31, 2007 is $0.50 per warrant (2006 – $Nil). The fair value of each warrant granted was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2007	2006
Risk-free interest rate	**4.11%**	-
Expected life of options	**1 year**	-
Volatility	**82%**	-
Dividend yield rate	**0%**	0%

f) Contributed surplus:

	2007	2006
Balance, beginning of year	**$ 4,474,570**	$ 3,928,115
Value attributed to stock options granted	**2,258,370**	729,830
Value of stock options exercised	**-**	(183,375)
Balance, end of year	**$ 6,732,940**	$ 4,474,570

At December 31, 2007, $406,640 (2006 – $Nil) of the value attributed to stock options granted in the year were capitalized to petroleum and natural gas properties.

12. Per share

	2007	2006
Net loss	**$ (6,083,385)**	$ (1,229,645)
Weighted average number of shares	**56,889,170**	41,409,880
Basic loss per share	**$ (0.11)**	$ (0.03)
Weighted average number of shares	**56,889,170**	41,409,880
Dilutive effect of stock options	**634,260**	706,936
Dilutive weighted average number of shares	**57,523,430**	42,116,816

In calculating diluted common share amounts for the year ended December 31, 2007, the Company excluded 3,525,000 (2006 – 3,432,000) options and 7,504,000 (2006 – Nil) warrants because the exercise price was greater than the average market price of its common shares during the year. In addition, at December 31, 2007, Nil (2006 – Nil) convertible debentures were included in the amount used in calculating diluted common share amounts.

13. Related party transactions

a) During the year, the Company paid consulting fees to certain officers and directors as follows:

	2007	2006
Director's fees and other compensation	**$ 47,000**	$ 282,500
Royalty incentive program	**10,510**	12,690
	$ 57,510	$ 295,190

At December 31, 2007, $10,510 (2006 – $85,190) of the above amounts were included in payables and accruals.

b) During the year, $30,725 (2006 - $43,600) was paid to a law firm in which a Director of the Company is a partner. Of this amount, $Nil is included in payables and accruals at December 31, 2007. These costs are included in general and administrative expenses on the consolidated statements of operations and deficit.

c) During the year, certain officers and directors of the Company participated in share offerings purchasing 20,400 flow through shares at a price of $1.50 per share in February 2007 and 62,500 flow through shares at a price of $0.80 per share in December 2007.

The above transactions were incurred in the normal course of operations of the Company and have been recorded at the exchange amounts that were established and agreed upon by the related parties.

14. Commitments and contingencies

a) The Company has letters of credit for its share of refundable deposits on Northwest Territories Exploration Licenses. The letters of credit are secured by a total assignment of cash of $2,267,175 (2006 – $1,538,125) – (Note 5). The Company is contingently liable under the letters of credit for its proportionate share of the refundable deposit of $2,267,175 (2006 - $1,538,125). The deposits are refundable to the Company upon the Company meeting its work commitments, in whole or in part in the amount of $9,068,700. The deposits will be refunded by $1 for every $4 spent on qualified expenditures on each Exploration License. A refund of $182,138 was approved on February 29, 2008.

b) 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:

2008	$	86,570
2009	$	86,570
2010	$	86,570
2011	$	86,570

c) The Company has established a Royalty Incentive Agreement for employees, consultants and directors. Under the plan, the compensation committee issues units on an annual basis to employees, consultants and directors. The units entitle the holder to receive an annual payment based on 2% of the Company's annual production revenue, net of transportation and processing fees. Under the terms of the agreement once the Company has recovered payout of 100% of its cumulative annual capital expenditures the payment to employees, consultants and directors is based on 4% of the Company's annual production revenue.

15. Supplemental cash flow information

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

		2007		2006
Receivables	**$**	**(771,800)**	$	1,474,400
Prepaids		**(131,100)**		100,820
Payables and accruals		**3,131,845**		786,705
	$	**2,228,945**	$	2,361,925
Operating activities	**$**	**340,855**	$	977,365
Investing activities		**1,888,090**		1,384,560
Financing activities		**-**		-
	$	**2,228,945**	$	2,631,925
Interest paid	**$**	**6,175**	$	17,805
Cash and cash equivalents are comprised of:				
Cash	$	**3,242,150**	$	496,340
Short term banker's acceptances (bearing interest rates ranging from 3.81% - 4.61% (2006: 2.55% - 3.85%)		**22,074,790**		11,357,200
	$	**25,316,940**	$	11,853,540

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.

a) Earnings (Loss)

December 31, 2007	Canada	U.K.	Total
Oil revenues, net	$ 787,020	$ -	$ 787,020
Less: royalties	(179,530)	-	(179,530)
	607,490	-	607,490
Interest income	1,120,040	34,935	1,154,975
Prospect fee income	194,755	-	194,755
	1,922,285	34,935	1,957,220
Expenses			
Field operating costs	508,025	-	508,025
Depletion, depreciation and impairments	178,415	4,280,860	4,459,275
Accretion	16,775	-	16,775
Foreign exchange gain (loss)	132,555	132,610	265,165
General and administration	866,300	6,490	872,790
Stock based compensation	1,851,725	-	1,851,725
	3,553,795	4,419,960	7,973,755
Loss before income taxes	(1,631,510)	(4,385,025)	(6,016,535)
Future income tax expense	66,850	-	66,850
Net loss	$ (1,698,360)	$ (4,385,025)	$ (6,083,385)

December 31, 2006	Canada	U.K.	Total
Oil revenues, net	$ 965,370	$ -	$ 965,370
Less: royalties	(219,005)	-	(219,005)
	746,365	-	746,365
Interest income	449,095	-	449,095
Prospect fee income	172,500	-	172,500
	1,367,960	-	1,367,960
Expenses			
Field operating costs	398,785	-	398,785
Depletion, depreciation and impairments	1,222,010	-	1,222,010
Accretion	21,560	-	21,560
General and administration	807,085	26,870	833,955
Stock based compensation	729,830	-	729,830
	3,179,270	26,870	3,206,140
Loss before income taxes	(1,811,310)	(26,870)	(1,838,180)
Future income tax expense	608,535	-	608,535
Net loss	$ (1,202,775)	$ (26,870)	$ (1,229,645)

16. Segmented information (continued)

b) Property and equipment

December 31, 2007	**Canada**	**U.K.**	**Total**
Capital expenditures			
Cash expenditures	**$ 3,834, 760**	**$ 5,177,305**	**$ 9,012,065**
Asset retirement provision	**303,345**	**-**	**303,345**
Stock options costs	**294,800**	**111,835**	**406,635**
	$ 4,432,905	**$ 5,289,140**	**$ 9,722,045**
Property and equipment	**$ 15,391,060**	**$ 2,113,815**	**$ 17,504,875**

December 31, 2006	**Canada**	**U.K.**	**Total**
Capital expenditures			
Cash expenditures	$ 5,504,000	$ 929,410	$ 6,433,410
Asset retirement provision	-	-	-
Stock options costs	-	-	-
	$ 5,504,000	$ 929,410	$ 6,433,410
Property and equipment	$ 11,131,820	$ 1,105,265	$ 12,237,085

17. 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, 2007, there were no contracts in place to fix the exchange rates on these transactions.

17. Financial Instruments (continued)

c) Fair Values

The Company's financial instruments included on the balance sheets as at December 31, 2007 and 2006 are comprised of cash and cash equivalents, accounts receivable, payables and accruals and convertible debentures. The fair values of these financial instruments approximate their carrying value due to the short-term nature of those instruments.

d) Interest Rate Risk

The Company is exposed to interest rate cash flow risk to the extent the changes in market interest rates will impact the Company's interest rate price risk to the extent that the convertible debentures have a fixed interest rate.