Yangarra Resources Ltd.
Consolidated Financial Statements
December 31, 2006

To the Shareholders of Yangarra Resources Ltd.

Management is responsible for the preparation and presentation of the accompanying financial statements, including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting principles and ensuring that all information in the annual report is consistent with the statements. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors exercises its responsibilities for financial controls through an Audit Committee. The Audit Committee is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

Meyers Norris Penny LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

April 18, 2007

"James G. Evaskevich" (signed)
James G. Evaskevich
Chief Executive Officer

“Penny Payne” (signed)
Penny Payne
Chief Financial Officer

Auditors' Report

To the Shareholders of Yangarra Resources Ltd.:

We have audited the consolidated balance sheets of Yangarra Resources Ltd. as at December 31, 2006 and 2005, and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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.

Meyers Norris Penny LLP

Calgary, Alberta
April 18, 2007

Chartered Accountants

		2006		2005
Assets				
Current				
Cash	$	–	$	81,671
Accounts receivable		**1,795,688**		2,667,511
Prepaid expenses and deposits		**249,497**		143,290
Deferred financing fees *(note 8)*		**114,750**		–
		2,159,935		2,892,472
Goodwill *(note 4)*		–		396,208
Investment *(note 5)*		**109,258**		109,258
Property and equipment *(note 6)*		**46,012,569**		42,150,409
	$	**48,281,762**	$	45,548,347
Liabilities				
Current				
Bank indebtedness	$	**479,925**	$	–
Bank debt *(note 7)*		**10,100,000**		9,450,000
Credit facility *(note 8)*		**5,000,000**		–
Accounts payable and accrued liabilities		**4,197,732**		5,625,090
		19,777,657		15,075,090
Asset retirement obligation *(note 9)*		**1,508,698**		1,238,226
Future income tax liability *(note 13)*		**3,055,830**		4,090,121
		24,342,185		20,403,437
Shareholders' Equity				
Share capital *(note 10)*		**31,474,785**		31,188,344
Contributed surplus *(note 11)*		**1,571,300**		1,099,935
Deficit		**(9,106,508)**		(7,143,369)
		23,939,577		25,144,910
	$	**48,281,762**	$	45,548,347

Approved on behalf of the Board of Directors

"James G. Evaskevich" (signed)
James G. Evaskevich

"Gordon A. Bowerman" (signed)
Gordon A. Bowerman

The accompanying notes are an integral part of these financial statements

		2006		2005
Revenue				
Petroleum and natural gas sales	$	**9,439,251**	$	8,354,853
Royalties, net of Alberta Royalty Tax Credit		**(1,335,695)**		(1,391,569)
		8,103,556		6,963,284
Other income		**10,459**		26,791
		8,114,015		6,990,075
Expenses				
Production		**1,689,564**		1,309,872
Transportation		**175,681**		120,043
General and administrative		**1,287,103**		1,152,511
Interest		**806,013**		397,309
Financing fees *(notes 7 and 8)*		**276,191**		–
Stock-based compensation *(notes 10 and 11)*		**251,168**		369,628
Depletion and depreciation		**6,241,307**		4,144,373
Accretion		**91,118**		34,154
Impairment loss on goodwill *(note 4)*		**396,208**		–
		11,214,353		7,527,890
Loss before income taxes		**(3,100,338)**		(537,815)
Income taxes				
Future income tax recovery *(note 13)*		**(1,137,199)**		(271,468)
Net loss for the year		**(1,963,139)**		(266,347)
Related party adjustment *(note 3)*		–		(831,165)
Deficit, beginning of year		**(7,143,369)**		(6,045,857)
Deficit, end of year	$	**(9,106,508)**	$	(7,143,369)
Net loss per share – basic and diluted	$	**(0.04)**	$	(0.01)
Weighted average number of shares – basic and diluted		**53,759,207**		31,228,861

The accompanying notes are an integral part of these financial statements

Yangarra Resources Ltd.
Consolidated Statements of Cash Flows
For the years ended December 31

		2006		2005
Operating				
Net loss for the year	$	**(1,963,139)**	$	(266,347)
Add back (deduct) non-cash items				
Other income		–		(1,995)
Financing fees		**223,250**		–
Stock-based compensation		**251,168**		369,628
Depletion and depreciation		**6,241,307**		4,144,373
Accretion		**91,118**		34,154
Impairment loss on goodwill		**396,208**		–
Future income tax recovery		**(1,137,199)**		(271,468)
		4,102,713		4,008,345
Change in non-cash working capital *(note 14)*		**(439,980)**		(280,299)
		3,662,733		3,728,046
Financing				
Issue of equity instruments		**132,200**		905,250
Equity instrument issue costs		**(16,758)**		(20,639)
Proceeds from bank debt, net		**650,000**		4,581,250
Proceeds from credit facility		**5,000,000**		–
Financing fees		**(218,000)**		–
Proceeds on repayment of related party advance *(note 3)*		–		508,029
		5,547,442		5,973,890
Investing				
Expenditures on property and equipment		**(9,757,009)**		(10,573,951)
Proceeds on disposition of property and equipment		**207,000**		300,000
Bank indebtedness acquired *(note 3)*		–		(305,169)
Amalgamation costs *(note 3)*		–		(307,532)
Change in non-cash working capital *(note 14)*		**(221,762)**		1,444,952
		(9,771,771)		(9,441,700)
Decrease (increase) in cash during the year		**(561,596)**		260,236
(Bank indebtedness) cash, beginning of year		**81,671**		(178,565)
Cash (bank indebtedness), end of year	$	**(479,925)**	$	81,671

Supplemental cash flow information

Interest paid	$	**802,300**	$	319,091

The accompanying notes are an integral part of these financial statements

1. Nature of operations and basis of presentation

Yangarra Resources Ltd. (the "Company") was formed by the amalgamation on November 9, 2005 (note 3), under the Business Corporations Act (Alberta), of Yangarra Resources Inc. ("Predecessor Yangarra") and TriOil Ltd. ("TriOil"). The Company is involved in the production, exploration and development of resource properties.

In conjunction with the amalgamation, Predecessor Yangarra effected a 0.95 to 1 consolidation of its equity instruments. All equity instrument figures included herein are reflected on a post-consolidation basis.

These consolidated financial statements have been prepared on a going concern basis which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. As at December 31, 2006, the Company had a working capital deficit of $17,617,722 (2005 – $12,182,618) and an accumulated deficit of $9,106,508 (2005 – $7,143,369). Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due. The Company's ability to continue as a going concern is dependent upon its ability to attain profitable operations and generate funds therefrom and to continue to obtain capital financing from investors sufficient to meet current and future obligations.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Yangarra Resources Corp. ("YRC").

2. Significant accounting policies

The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles in Canada. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements and accompanying notes. Actual results could differ from these estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

a) ***Cash and cash equivalents***

Cash and cash equivalents consist of bank balances (overdrafts) and term deposits with maturities of three months or less.

b) ***Investments***

Investments are stated at cost less provisions for other than temporary impairment, if any. Investments are classified as a long-term asset in concurrence with the nature of the investment.

c) ***Goodwill***

Goodwill represents the excess of the cost of an acquisition over the net of the amounts assigned to assets acquired and liabilities assumed. Goodwill is not amortized but is tested for impairment at least annually. The Company monitors its goodwill balance to determine whether any impairment has occurred. In order to make that determination, the Company bases the recoverability using the current and estimated cash flows of the underlying business on an undiscounted basis. If this review indicates that goodwill will not be recovered, the Company recognizes a write-down of the unamortized portion of goodwill in excess of its recoverable amount.

2. Significant accounting policies (continued)

d) *Property and equipment*

The Company follows the full cost method of accounting for its petroleum and natural gas operations. Under this method all costs related to the acquisition of, exploration for, and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, stock-based compensation directly related to field personnel, costs of drilling both productive and non-productive wells and overhead costs directly related to exploration and development activities which have been charged in accordance with standard industry operating agreements. Proceeds from the sale of resource properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion by greater than 20%.

Depletion of resource properties and related equipment, net of estimated salvage or residual value, is provided using the unit of production method based upon estimated proven resource reserves before royalties, as determined by independent engineers. For depletion purposes, relative volumes of petroleum and 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.

Other property and equipment, such as computer and office equipment and leasehold improvements (“office equipment”), are initially recorded at cost.

Depreciation is provided using methods and rates intended to depreciate the cost of office equipment over estimated useful lives.

	Method	Rate
Computer equipment	declining balance	30 %
Leasehold improvements	straight-line	5 years
Office equipment	declining balance	20 %

e) *Long-lived assets*

Long-lived assets consist of property and equipment and resource properties. Long-lived assets held for use are measured, depleted or depreciated as described in the applicable accounting policies.

The Company performs impairment testing on long-lived assets held for use whenever events or changes in circumstances indicate that the carrying value of property and equipment or resource properties may not be recoverable. Impairment losses are recognized when undiscounted future cash flows from the Company's proved reserves, undeveloped land and future development projects are less than the carrying value of property and equipment and resource properties. Any impairment is included in earnings for the year.

If the carrying value is assessed not to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the property and equipment and resource properties exceeds the sum of the discounted cash flows from proved plus probable reserves, undeveloped land and future development projects. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

f) *Joint venture operations*

Substantially all of the Company's petroleum and natural gas exploration and production activities are conducted jointly with others, and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

2. Significant accounting policies (continued)

g) *Bank debt*

The Company classifies borrowings as a current liability where the lender has a right to demand payment within twelve months, or where the lender may not re-finance the borrowing for a further lending period longer than twelve months.

h) *Asset retirement obligation*

Asset retirement costs and liabilities associated with site restoration and abandonment of long-lived assets are initially measured at a fair value which approximates the cost a third party would incur in performing the tasks necessary to retire such assets. Such costs are capitalized as part of the cost of property and equipment and amortized to expense through depletion over the life of the asset. The change in the liability due to the passage of time is measured by applying an interest method of allocation to the opening liability and is recognized as an increase in the carrying value of the liability and an expense. The expense is recorded as accretion expense in the statement of operations. A change in the liability resulting from revisions to either the timing or the amount of the original estimate of undiscounted cash flows is recognized as an increase or decrease in the carrying amount of the liability, with an offsetting increase or decrease in the carrying amount of the associated asset.

i) *Future income taxes*

The Company follows the asset and liability method of accounting for future income taxes. Under this method, future income tax assets and liabilities are recorded based on temporary differences between the carrying amount of balance sheet items and their corresponding tax bases. In addition, the future benefits of income tax assets, including unused tax losses, are recognized, subject to a valuation allowance, to the extent that it is more likely than not that such future benefits will ultimately be realized. Future income tax assets and liabilities are measured using enacted tax rates and laws expected to apply when the tax liabilities or assets are to be either settled or realized.

j) *Flow through shares*

Expenditure deductions for income tax purposes related to exploratory activities funded by flow-through equity instruments are renounced to investors in accordance with income tax legislation. The Company provides for the future effect on income taxes related to flow-through equity instruments as a reduction of share capital and an increase in future income tax liabilities when the renouncement documents are filed with taxation authorities.

k) *Stock-based compensation*

Stock-based compensation expense is based on the estimated fair value of options granted at the time of the grant. The fair value is recognized as stock-based compensation with a corresponding increase to contributed surplus over the vesting period of the options. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that vested options expire, previously recognized compensation expense associated with such stock options is not reversed. In the event that unvested options are cancelled, previously recognized compensation expense associated with such stock options is reversed.

l) *Per share amounts*

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated based on the treasury stock method which assumes that any proceeds obtained on the exercise of options and warrants would be used to purchase common shares at the average price during the period. The effect of anti-dilutive options and warrants is not included in the calculation of diluted earnings per share.

2. Significant accounting policies (continued)

m) ***Revenue recognition***

Revenue is recognized from oil sales when the oil is delivered to the buyer and from gas sales when the gas passes through the pipeline at the delivery point.

n) ***Commodity contracts***

Commodity contracts that do not meet the criteria for the use of hedge accounting are recorded on the balance sheet at fair value and changes in fair value are recognized in income in the period in which the change occurs.

o) ***Deferred financing fees***

Fees paid to secure debt financing are deferred and amortized to financing fees on the consolidated statement of operations and deficit over the term of the related debt.

p) ***Use of estimates***

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Accounts receivable are stated after evaluation as to their collectibility and an appropriate allowance for doubtful accounts is provided where considered necessary. Amounts recorded for depletion of resource properties, amortization of property and equipment, asset retirement obligations and impairment calculations are based on estimates of natural gas and crude oil reserves and future costs required to develop those reserves. By their nature, these estimates of reserves, including the estimates of future prices and costs, and the related future cash flows are subject to measurement uncertainty, and the impact in the consolidated financial statements of future periods could be material. These assumptions are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

3. Business acquisition and amalgamation

On November 9, 2005, Predecessor Yangarra and TriOil, companies related through common directors, completed a non-arm's length amalgamation. Pursuant to the amalgamation, the Company issued 0.95 shares for each outstanding share of Predecessor Yangarra, 0.95 options for each outstanding option of Predecessor Yangarra, one share for each outstanding TriOil share, one warrant for each outstanding TriOil warrant, and one option for each outstanding TriOil option. The transaction was accounted for as a purchase with Predecessor Yangarra deemed the acquirer.

As the amalgamation is a related party transaction, it has been measured at the carrying amount of the net assets acquired, as recorded in the accounts of TriOil. The difference between the carrying amount of the net assets and TriOil's share capital in the amount of $645,323 plus $185,842 of amalgamation costs incurred by Predecessor Yangarra (net of tax of $121,690), has been recorded as a charge to the Company's deficit.

3. Business acquisition and amalgamation (continued)

The carrying amount has been allocated to TriOil's net assets as follows:

Current assets	$	1,449,621
Due to related party		508,029
Property and equipment		13,929,922
Goodwill		396,208
Bank indebtedness		(305,169)
Other current liabilities		(2,229,920)
Asset retirement obligation		(631,101)
Future income tax liability		(2,009,624)
Related party transaction adjustment, net of tax of $121,690		831,165
Net assets acquired	$	11,939,131
Purchase price		
24,219,700 common shares	$	11,631,599
Amalgamation costs		307,532
	$	11,939,131

4. Goodwill

Goodwill was acquired through the amalgamation between Yangarra and TriOil as described in note 3. Goodwill represents the excess of the cost over the net of the amounts assigned to assets acquired and liabilities assumed through the August 13, 2004 amalgamation between TriOil and Entrada Energy Inc. As at December 31, 2006, the Company determined that the $396,208 carrying value of goodwill was not recoverable and consequently wrote-off the carrying value as a loss on the impairment of goodwill in the statement of operations and deficit.

5. Investment

As at December 31, 2006, the fair value of the Company's investment was estimated to be $383,100 (2005 – $75,400).

6. Property and equipment

	December 31, 2006		
	Cost	*Accumulated depletion and depreciation*	*Net book value*
Petroleum and natural gas properties	$ 58,748,195	$ 12,868,391	$ 45,879,804
Office equipment	242,245	109,480	132,765
	$ 58,990,440	$ 12,977,871	$ 46,012,569

6. Property and equipment (continued)

	December 31, 2005		
	Cost	*Accumulated depletion and depreciation*	*Net book value*
Petroleum and natural gas properties	$ 48,649,879	$ 6,678,591	$ 41,971,288
Office equipment	237,094	57,973	179,121
	$ 48,886,973	$ 6,736,564	$ 42,150,409

At December 31, 2006, the Company excluded $1,965,988 (2005 – $1,266,105) of resource properties relating to unproved properties from the depletion calculation. Unproved properties have been separately evaluated by management for impairment. In addition, $10,279,000 (2005 – $9,263,750) of future development costs were included in the depletion calculation.

The Company did not capitalize any general and administrative costs during 2006 or 2005 other than to the extent of the Company's working interest in operated capital expenditure programs on which operator's fees have been charged in accordance with standard industry operating agreements.

During 2006, the Company capitalized $179,354 (2005 – $180,318) related to the asset retirement obligation of property and equipment and $374,104 (2005 – nil) comprised of stock-based compensation of $265,614 and $108,490 of related future income taxes for options granted to a field consultants.

The Company applied the ceiling test to its capitalized assets as at December 31, 2006 and determined that there was no impairment. For purposes of this impairment test, the following future commodity prices were used:

	Edmonton Par Price Cdn $/bbl	*Alberta AECO-C Spot Cdn $/mcf*
2007	74.10	7.72
2008	77.62	8.59
2009	70.25	7.74
2010	65.56	7.55
2011	61.90	7.72
Escalation rate thereafter	2%	2%

7. Bank debt

The Company has a revolving operating demand loan available to a maximum of $11,500,000 (2005 – $11,500,000), requiring payments of interest only, and subject to availability, lender's review and right of demand. Interest is calculated daily and payable monthly at prime plus 0.5% (2005 – prime plus 0.5%). In addition to the revolving operating demand loan facility, the Company has a treasury risk line available for interest rate, foreign exchange and commodity risk management (see note 12). The treasury risk line is repayable per contract maturities.

The credit facilities are secured by a general assignment of book debts, a $10,000,000 debenture, a $35,000,000 supplemental debenture, evidence of insurance coverage with the lender as first loss payee, title representation of petroleum and natural gas reserves, and assignment of revenues and monies under material contracts. The debentures contain a floating charge over all assets of the Company with a negative pledge and undertaking to provide fixed charges on the Company's major producing petroleum and natural gas reserves.

7. Bank debt (continued)

As at December 31, 2006, the Company had drawn $10,100,000 (2005 – $9,450,000) on the revolving operating demand loan facility and no amount on the treasury risk line (2005 – nil).

In conjunction with the renewal of the Company's bank facilities in 2006, the Company paid a $11,500 renewal fee which has been included in the amount for financing fees reported in the consolidated statement of operations and deficit.

Pursuant to the terms of the bank debt, the Company is subject to a financial covenant with respect to working capital. As at December 31, 2006, the Company was in breach of the covenant. The revolving operating demand loan is a current liability by its nature therefore no reclassification between long-term and current liabilities is required.

8. Credit facility

a) In June 2006, the Company obtained a $3,000,000 credit facility with a maturity date of September 15, 2006, bearing interest at 9% per annum calculated and payable monthly. The facility was repaid on September 12, 2006 (see (b)). In conjunction with the $3,000,000 credit facility, the Company paid $113,000 of financing fees which were recorded in the consolidated statement of operations and deficit over the term of the facility.

b) In August 2006, the Company obtained a new credit facility available to a maximum of $6,000,000 bearing interest at 9% per annum calculated and payable monthly. On September 12, 2006, the lender advanced the Company $5,000,000 on this facility, of which $3,000,000 was used to repay the facility described in (a).

As at December 31, 2006, the Company had drawn $5,000,000 on the credit facility. The facility matured in March 2007 and the Company has obtained a month-to-month extension to June 30, 2007 for an additional 0.75% per month on the amount of the facility outstanding at the beginning of each month.

The $6,000,000 credit facility is secured by a $7,500,000 demand debenture providing a second priority security interest over all personal property assets of the Company, a second priority floating charge security interest over all real property assets of the Company and a negative pledge and undertaking to provide fixed charges on the Company's petroleum and natural gas reserves as selected by the lender, evidence of insurance coverage with the lender as second loss payee, title representation of petroleum and natural gas reserves, a corporate guarantee from YRC secured by a $7,500,000 demand debenture and a negative pledge and undertaking and an Interlender, Subordination, Postponement and Priority Agreement between the lender and the senior lender (note 7).

In conjunction with the $6,000,000 credit facility, the Company paid fees of $266,441 which have been recorded to deferred financing fees. Of this amount, $120,000 was paid by the issuance of 292,683 common shares of the Company. Deferred financing fees are amortized over the term of the facility to financing fees on the consolidated statement of operations and deficit. At December 31, 2006, amortization of $151,691 had been recorded to financing fees, resulting in the $114,750 reported carrying value of deferred financing fees.

Pursuant to the terms of the credit facility, the Company is subject to financial covenants for working capital, debt to equity and debt to trailing cash flow. As at December 31, 2006, the Company was in breach of the working capital and debt to trailing cash flow covenants. The credit facility is a current liability by its nature therefore no reclassification between long-term and current liabilities is required.

9. Asset retirement obligation

The following table presents the reconciliation of the carrying amount of the obligation associated with the retirement of the Company's property and equipment:

	2006	*2005*
Asset retirement obligation, beginning of year	$ 1,238,226	$ 394,648
Liabilities acquired *(note 3)*	–	631,101
Liabilities incurred	163,242	159,167
Dispositions	–	(10,861)
Effect of change in estimates	16,112	30,017
Accretion	91,118	34,154
Asset retirement obligation, end of year	$ 1,508,698	$ 1,238,226

The following significant assumptions were used to estimate the asset retirement obligation:

	2006	*2005*
Undiscounted cash flows	$ 2,842,306	$ 2,343,048
Discount rate	7%	7%
Inflation rate	2%	2%
Weighted average expected timing of cash flows	9.8 years	9.5 years

10. Share capital

All share capital figures included herein are on a post-consolidation basis (see notes 1 and 3).

a) Authorized

Unlimited number of common shares, without nominal or par value
Unlimited number of first preferred shares, without nominal or par value
Unlimited number of second preferred shares, without nominal or par value

b) Common shares issued

	Number of shares	*Amount*
Balance, December 31, 2004	26,345,166	$ 18,665,195
Exercise of warrants *(i)*	2,866,625	905,250
Issued in relation to amalgamation *(note 3)*	24,219,700	11,631,599
Share issue costs, net of tax of $6,939	–	(13,700)
Balance, December 31, 2005	53,431,491	$ 31,188,344
Exercise of options *(ii)*	265,500	177,617
Financing fees *(iii)*	292,683	120,000
Share issue costs, net of tax of $5,582 (*iv)*	–	(11,176)
Balance, December 31, 2006	53,989,674	$ 31,474,785

i) During 2005, 2,866,625 shares were issued on the exercise of the same number of warrants at an exercise price of $0.32 per share for gross cash proceeds of $905,250.

10. Share capital (continued)

b) Common shares issued (continued)

ii) During January and February 2006, 265,500 shares were issued on the exercise of the same number of options for total cash proceeds of $132,200 plus a pro-rata share of the related fair value previously recorded to contributed surplus in the amount of $45,417.

iii) In September 2006, the Company issued 292,683 shares as consideration for $120,000 of financing fees related to the credit facility described in note 8(b).

iv) During 2006, the Company paid $15,622 of additional share issue costs related to the amalgamation with TriOil (see note 1) and $1,136 of share issue costs related to the shares issued in (iii).

c) Stock options

The Company has a stock option plan under which the Board of Directors may grant options to directors, officers, other employees and key consultants. The purpose of the plan is to advance the interests of the Company by encouraging these individuals to acquire shares in the Company and thereby remain associated with, and seek to maximize the value of, the Company.

Under the plan, the number of shares reserved for issuance pursuant to the exercise of all options under the plan may not exceed 10% of the issued and outstanding common shares on a non-diluted basis at any time. The options expire not more than five years from the date of grant, or earlier if the individual ceases to be associated with the Company, and vest over terms determined at the time of grant.

During 2006, the Company granted the following options with an expiry of five years from the date of grant:

Date of grant	*Number of options*	*Weighted average exercise price*	*Vesting term*	*Total estimated fair value*	*Related portion of 2006 stock-based compensation expense (note 11)*
February 2006	85,000	$ 0.70	Two years	$ 47,980	$ 8,749
February 2006	75,000	0.70	Five years	53,790	24,417
September 2006	125,000	0.35	Two years	40,150	5,987
October 2006	250,000	0.32	Two years	71,570	7,735
November 2006	125,000	0.32	Two years	37,110	1,726
December 2006	320,000	0.30	Two years	89,410	–
	980,000	$ 0.38		$ 340,010	$ 48,614

The Black-Scholes option pricing model was used to estimate the fair value of options granted based on the following significant assumptions:

	2006	*2005*
Risk-free interest rate	3.9% to 4.1%	3.5% to 5%
Expected volatility	143% to 159%	75% to 86%
Expected life	5 years	5 years

Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options. For the purposes of recording stock-based compensation, the estimated fair value of the options is recognized over the vesting period of the option.

10. Share capital (continued)

c) Stock options (continued)

The following tables summarize information about stock options outstanding as at:

	December 31, 2006		*December 31, 2005*	
	Options	*Weighted – average exercise price*	*Options*	*Weighted – average exercise price*
Opening	5,250,100	$ 0.62	1,946,550	$ 0.76
Granted	980,000	0.38	1,930,175	0.58
Acquired *(note 3)*	–	–	2,045,000	0.55
Exercised	(265,500)	(0.50)	–	–
Cancelled	(1,391,650)	(0.81)	(671,625)	(0.68)
Closing	4,572,950	$ 0.52	5,250,100	$ 0.62

December 31, 2006				
Range of exercise price	*Number outstanding*	*Weighted-average remaining contractual life (years)*	*Weighted-average exercise price*	*Number exercisable*
$ 0.21 – $ 0.45	1,267,450	4.15	$ 0.35	376,200
$ 0.46 – $ 0.55	2,084,175	3.45	0.51	1,434,588
$ 0.63 – $ 0.74	906,875	2.86	0.70	746,875
$ 0.79 – $ 1.05	314,450	2.09	0.80	314,450
	4,572,950	3.42	$ 0.52	2,872,113

d) Warrants

The following table summarizes information about warrants outstanding as at:

	December 31, 2006		*December 31, 2005*	
	Warrants	*Weighted – average exercise price*	*Warrants*	*Weighted – average exercise price*
Opening	1,191,662	$ 0.90	2,866,625	$ 0.29
Acquired *(note 3)*	–	–	1,328,711	0.87
Exercised	–	–	(2,866,625)	0.29
Expired	(1,191,662)	0.90	(137,049)	0.65
Closing	–	–	1,191,662	$ 0.90

11. Contributed surplus

	2006	2005
Balance – beginning of year	$ 1,099,935	$ 730,307
Stock-based compensation related to:		
Options granted in current year	48,614	361,889
Options granted in prior years	272,416	–
Options acquired on amalgamation	196,335	14,911
Unvested cancelled options *(note 10(c))*	(583)	(7,172)
	516,782	369,628
Exercised options *(note 10(b)(iv))*	(45,417)	–
Balance – end of year	$ 1,571,300	$ 1,099,935

Of the total $516,782 stock-based compensation recognized in 2006 (2005 – $369,628), $265,614 (2005 – nil) attributed to stock options granted to field personnel has been capitalized to property and equipment and the balance of $251,168 (2005 – $369,628) recorded as expense in the consolidated statement of operations and deficit.

12. Commodity contracts

a) During 2005, the Company entered into a European Commodity Collar to sell 1000 GJ of gas per day to a third party from May 1, 2005 to December 31, 2005 at a ceiling price of $9 per GJ and a floor price of $7 per GJ. As at December 31, 2005, the Company had fulfilled the terms of the collar.

b) During 2006, the Company engaged in the following put contracts for the sale of natural gas:

i) 1,000 GJ per day from October 1 to November 30, 2006 at a strike price of $6.50 per GJ and a premium cost of $0.61 per GJ; and

ii) 1,000 GJ per day from October 1 to November 30, 2006 at a strike price of $6.50 per GJ and a premium cost of $0.55 per GJ.

As at December 31, 2006, the Company had fulfilled the terms of the put contracts.

13. Income taxes

The provision for future income taxes differs from the amount computed by applying the combined federal and provincial tax rates to the loss before taxes. The difference results from the following:

	2006	2005
Expected income tax recovery at 34.50% (2005 – 37.62%)	$ (1,069,617)	$ (202,326)
Non-deductible crown and other charges	147,527	290,065
Stock-based compensation	86,653	139,054
Loss on impairment of goodwill	136,692	–
Amalgamation costs	–	(76,793)
Resource allowance	(91,373)	(181,585)
Alberta Royalty Tax Credit	(61,866)	(93,224)
Attributed Canadian Royalty Income	(26,974)	(13,814)
Rate adjustments and other	(258,241)	(132,845)
	$ (1,137,199)	$ (271,468)

13. Income taxes (continued)

The components of future income taxes at December 31 are:

	2006	2005
Future income tax assets		
Asset retirement obligation	$ 437,522	$ 416,292
Non-capital loss carryforwards	296,604	389,026
Share issue costs	179,436	343,996
Amalgamation costs	90,272	121,690
Attributed Canadian Royalty Income	85,753	90,858
Future income tax liabilities		
Carrying amount of property and equipment in excess of tax basis	(4,145,417)	(5,451,983)
	$ (3,055,830)	$ (4,090,121)

As at December 31, 2006, the Company has approximately $32.6 million of tax pools available for deduction against future taxable income. The Company also has non-capital tax losses of $1.0 million available for deduction against future taxable income that expire between 2007 and 2010.

14. Change in non-cash working capital

	2006	2005
Accounts receivable	$ 871,823	$ 1,024,736
Prepaid expenses and deposits	(106,207)	70,063
Accounts payable and accrued liabilities	(1,427,358)	69,854
	$ (661,742)	$ 1,164,653

The change in non-cash working capital has been allocated to the following activities:

	2006	2005
Operating	$ (439,980)	$ (280,299)
Investing	(221,762)	1,444,952
	$ (661,742)	$ 1,164,653

15. Commitments

a) The Company has entered into lease agreements for office premises and equipment with estimated minimum annual payments as follows:

2007	$ 224,097
2008	73,708

b) In February 2007, the Company committed to the following European Commodity Collars for the sale of natural gas:

i) 1,000 GJ per day from March 1 to December 31, 2007 at a ceiling price of $10.00 per GJ and a floor price of $7.00 per GJ with a floor premium cost of $0.12 per GJ; and

ii) 1,000 GJ per day from March 1 to December 31, 2007 at a ceiling price of $8.45 per GJ and a floor price of $7.25 per GJ with a floor premium cost of $0.10 per GJ.

16. Related party transactions

Except as disclosed elsewhere in these financial statements, the Company had the following related party transactions:

a) During the years ended December 31, 2006 and 2005, the Company was charged or invoiced the following amounts by certain of its officers and directors and by companies controlled by certain of the Company's officers and directors:

		2006		*2005*
Administration and consulting fees	$	164,330	$	284,454
Production and capital expenditures	$	324,649	$	293,070

b) During the year ended December 31, 2006, the Company was charged $32,299 (2005 – $103,341) by a law firm in which a director of the Company is a partner.

Included in accounts payable and accrued liabilities is $88,037 (2005 – $147,007) relating to the above transactions. These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

17. Financial instruments

The Company, as part of its operations, carries a number of financial instruments. It is management's opinion that the Company is not exposed to significant credit, interest or currency risks arising from these financial instruments except as otherwise disclosed.

a) ***Fair value***

The carrying amount of cash, accounts receivable, bank indebtedness, bank debt, credit facility and accounts payable and accrued liabilities approximates their fair value due to the short-term maturities of these items.

b) ***Credit risk***

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. The majority of the Company's accounts receivable are in respect of oil and natural gas operations with joint venture partners and are therefore subject to normal industry risks. Company sales are concentrated in the oil and gas industry.

c) ***Interest rate risk***

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in the interest rates. In seeking to minimize the risks from interest rate fluctuations, the Company manages exposure through its normal operating and financing activities. The Company is exposed to interest rate risk primarily through its variable interest rate bank loans.

d) ***Commodity price risk***

The Company's operations are exposed to commodity price fluctuations. The Company was not a party to any hedging arrangements as at December 31, 2006 (see notes 12 and 15).

18. Subsequent event

In March 2007, the Company obtained an extension on its credit facility for an additional 0.75% per month on the amount of the facility outstanding at the beginning of each month (see note 8).