Yangarra Resources Ltd.

Interim Consolidated Financial Statements

Three and nine months ended September 30, 2009 and 2008

(Unaudited – Prepared by Management)

Notice of No Auditor Review of Interim Consolidated Financial Statements

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed these unaudited interim consolidated financial statements as at and for the three and nine months ended September 30, 2009 and 2008.

Yangarra Resources Ltd.
Interim Consolidated Balance Sheets
(unaudited)

		September 30 2009		December 31 2008
Assets				
Current				
Accounts receivable	$	**1,416,390**	$	1,710,780
Prepaid expenses and deposits		**396,424**		437,923
		1,812,814		2,148,703
Investment *(note 3)*		**–**		10,468
Property and equipment *(note 4)*		**35,644,022**		41,922,138
	$	**37,456,836**	$	44,081,309
Liabilities				
Current				
Bank debt *(note 5)*	$	**8,325,547**	$	8,853,990
Credit facility *(note 6)*		**4,473,439**		4,665,000
Accounts payable and accrued liabilities *(note 16)*		**2,605,031**		2,228,920
Commodity price risk contracts *(note 14(c)(iii))*		**120,344**		–
		15,524,361		15,747,910
Asset retirement obligation *(note 7)*		**2,214,004**		2,124,242
Future income tax liability *(note 8)*		**331,883**		1,757,145
Long-term payable *(notes 9 and 16)*		**176,868**		–
		18,247,116		19,629,297
Shareholders' Equity				
Share capital *(note 10)*		**34,344,788**		34,116,201
Contributed surplus		**2,551,397**		2,551,397
Deficit		**(17,686,465)**		(12,215,586)
		19,209,720		24,452,012
	$	**37,456,836**	$	44,081,309

Future operations and basis of presentation *(note 1)*
Commitments *(note 16)*
Subsequent event *(note 17)*

The accompanying notes are an integral part of these interim consolidated financial statements

	Three months ended September 30		Nine months ended September 30	
	2009	2008	**2009**	2008
Revenue				
Petroleum and natural gas sales *(note 14(c)(iii))*	$ **889,449**	$ 2,071,008	$ **2,825,010**	$ 6,836,072
Royalties	**(28,114)**	(375,526)	**(107,540)**	(1,167,442)
Royalty recoveries *(note 11)*	**–**	–	**175,636**	–
	861,335	1,695,482	**2,893,106**	5,668,630
Interest	**–**	–	**10,855**	–
Unrealized gain (loss) on commodity price risk contracts *(note 14(c)(iii))*	**(255,687)**	1,279,296	**(120,344)**	76,940
	605,648	2,974,778	**2,783,617**	5,745,570
Expenses				
Production	**410,311**	361,413	**1,040,206**	1,068,185
Transportation	**20,062**	46,460	**82,882**	140,562
General and administrative	**178,991**	244,021	**564,828**	744,902
Interest and financing fees	**300,279**	315,693	**802,460**	929,999
Stock-based compensation	**–**	15,685	**–**	587,321
Depletion and depreciation *(note 4)*	**5,217,275**	1,062,110	**7,248,123**	3,330,372
Accretion	**37,134**	32,410	**109,544**	93,324
(Gain) loss on investment *(note 3)*	**–**	25,124	**(23,201)**	101,194
	6,164,052	2,102,916	**9,824,842**	6,995,859
(Loss) income before income taxes	**(5,558,404)**	871,862	**(7,041,225)**	(1,250,289)
Future income tax reduction *(note 8)*	**(1,250,366)**	–	**(1,570,346)**	–
Net (loss) income and comprehensive loss for the period	**(4,308,038)**	871,862	**(5,470,879)**	(1,250,289)
Deficit, beginning of period	**(13,378,427)**	(12,512,657)	**(12,215,586)**	(10,390,506)
Deficit, end of period	$ **(17,686,465)**	$ (11,640,795)	$ **(17,686,465)**	$ (11,640,795)
Net (loss) income per share				
Basic and diluted [(1)]	$ **(0.05)**	$ 0.01	$ **(0.07)**	$ (0.02)
Weighted average number of shares				
Basic	**78,445,038**	69,776,582	**76,533,515**	66,492,766
Diluted	**78,445,038**	70,802,423	**76,533,515**	67,005,105

(1) The effect of options is anti-dilutive in loss periods.

	Three months ended September 30		Nine months ended September 30	
	2009	2008	**2009**	2008
Operating				
Net (loss) income for the period	$ **(4,308,038)**	$ 871,862	$ **(5,470,879)**	$ (1,250,289)
Add back non-cash items:				
Unrealized loss (gain) on commodity price risk contracts	**255,687**	(1,279,296)	**120,344**	(76,940)
Interest and financing fees	**150,473**	54,898	**304,795**	156,660
Shares for services *(notes 9 and 10)*	**37,800**	–	**63,000**	–
Stock-based compensation	–	15,685	–	587,321
Depletion and depreciation	**5,217,275**	1,062,110	**7,248,123**	3,330,372
Accretion	**37,134**	32,410	**109,544**	93,324
Loss (gain) on investment	–	25,124	**(23,201)**	101,194
Future income tax reduction	**(1,250,366)**	–	**(1,570,346)**	–
Abandonment expenditures *(note 7)*	**(6,064)**	(57,924)	**(33,943)**	(57,924)
	133,901	724,869	**747,437**	2,883,718
Change in non-cash working capital *(note 12)*	**360,560**	55,648	**460,157**	(146,901)
	494,461	780,517	**1,207,594**	2,736,817
Financing				
Issue of equity instruments, net of costs	**(19,664)**	10,000	**(19,664)**	710,318
Repurchase of equity instruments	–	(48,506)	–	(48,506)
Bank debt (repayment) proceeds, net	**(466,870)**	505,388	**(528,443)**	785,294
Financing fees	–	–	**(270,000)**	(45,000)
Related party advance	–	–	–	250,000
	(486,534)	466,882	**(818,107)**	1,652,106
Investing				
Expenditures on property and equipment	**(524,935)**	(1,443,728)	**(955,846)**	(4,024,093)
Proceeds on disposition of property and equipment	–	–	–	50,000
Proceeds on sale of investment	–	–	**33,669**	–
Change in non-cash working capital *(note 12)*	**517,008**	196,329	**532,690**	(414,830)
	(7,927)	(1,247,399)	**(389,487)**	(4,388,923)
Increase (decrease) in cash	–	–	–	–
Cash, beginning of period	–	–	–	–
Cash, end of period	$ –	$ –	$ –	$ –
Supplemental cash flow information				
Interest paid	$ **146,071**	$ 258,697	$ **498,214**	$ 762,928

The accompanying notes are an integral part of these interim consolidated financial statements

1. Future operations and basis of presentation

Yangarra Resources Ltd. (the "Company") is a publicly traded company involved in the production, exploration and development of resource properties in Western Canada. These unaudited interim consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Yangarra Resources Corp. ("YRC") after the elimination of intercompany transactions and balances.

These unaudited interim 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. 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, negotiate favorable terms with its lenders and obtain capital financing from investors sufficient to meet current and future obligations.

As at September 30, 2009, the Company had a working capital deficiency of $13,711,547 (December 31, 2008 – $13,599,207) and an accumulated deficit of $17,686,465 (December 31, 2008 – $12,215,586). At the same time, the Company continues to generate positive cash flow from operations. The Company's senior secured bank debt is subject to a Forbearance Agreement dated June 16, 2009 and a Loan Extension Agreement dated October 27, 2009 (collectively the "Loan Agreements"). The Loan Agreements include several additional covenants with respect to production levels, capital expenditures, drilling programs and certain other expenses and requirements as outlined in note 5.

In conjunction with the requirements of the Loan Agreements, management has addressed the Company's ability to continue as a going concern as follows:

a) Operating cash flows are projected to be positive in the current oil and gas price environment but are not sufficient to support significant investment in the development of the Company's properties during the balance of the fiscal 2009 year. The Company has restricted capital projects for the 2009 year to closely match the cash flows generated from operations;

b) On August 28, 2009, the Company issued 4,680,873 common shares for the settlement of $280,847 of accounts payable (note 10(a));

c) On November 10, 2009, the Company received court approval for its formal proposal to restructure under the Bankruptcy and Insolvency Act (the "Proposal") (note 17);

d) The Company entered into a participation and farmout agreement with Athabaska Energy Ltd. ("Athabaska") (note 13(c)), for a three well drilling program to increase production levels and generate additional cash flow from operations;

e) The Company has proposed a merger with Athabaska, subject to TSX Venture Exchange approval;

f) The Company has engaged a consultant to monitor the Company's operations;

g) The Company has committed to raising additional equity and/or subordinated debt in the minimum amount of $500,000 for working capital purposes by December 31, 2009; and

h) The Company continues its efforts to reduce general and administrative expenses.

There can be no assurance that the steps management is taking will be successful and any adjustments necessary to the financial statements if the Company ceases to be a going concern could be material.

1. Future operations and basis of presentation (continued)

These unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and on a basis consistent with the audited December 31, 2008 consolidated financial statements except certain disclosures have been condensed or omitted. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the notes contained in the Company's audited December 31, 2008 consolidated financial statements.

Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Accordingly, actual results could differ from those estimates.

The operating results for the three and nine months ended September 30, 2009 may not be indicative of the results for the year ended December 31, 2009.

2. Change in accounting policies

On January 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants Handbook *Section 3064 Goodwill and Intangible Assets* which replaces the previous goodwill and intangible asset standard and revises the requirement for recognition, measurement, presentation and disclosure of intangible assets. The adoption of this standard had no impact on the Company's unaudited interim consolidated financial statements.

3. Investment

The Company held a minority equity position in a public company which was sold in May 2009 for cash proceeds of $33,669. The reported amount of (gain) loss on investment for the three and nine months ended September 30, 2009 and 2008 is comprised of the following:

	Three months ended September 30		*Nine months ended September 30*	
	2009	*2008*	*2009*	*2008*
Realized loss	$ –	$ –	$ 231,638	$ –
Reversal of previously recognized unrealized net losses	–	–	(254,839)	–
Unrealized (gain) loss on mark-to-market	–	25,124	–	101,194
	$ –	$ 25,124	$ (23,201)	$ 101,194

4. Property and equipment

September 30, 2009	*Cost*	*Accumulated depletion and depreciation*	*Net book value*
Petroleum and natural gas properties	$ 66,131,980	$ 30,568,491	$ 35,563,489
Office equipment	279,281	198,748	80,533
	$ 66,411,261	$ 30,767,239	$ 35,644,022

4. Property and equipment (continued)

December 31, 2008	*Cost*	*Accumulated depletion and depreciation*	*Net book value*
Petroleum and natural gas properties	$ 65,161,973	$ 23,337,991	$ 41,823,982
Office equipment	279,281	181,125	98,156
	$ 65,441,254	$ 23,519,116	$ 41,922,138

At September 30, 2009, the Company excluded $1,348,111 (December 31, 2008 – $1,773,042) of resource properties relating to unproved properties from the depletion calculation. Unproved properties have been separately evaluated by management for impairment. In addition, $7,169,500 (December 31, 2008 – $7,886,400) of future development costs were included in the depletion calculation.

During the three and nine months ended September 30, 2009, the Company capitalized nil (three and nine months ended September 30, 2008 – $11,883 and $328,489, respectively, comprised of stock-based compensation of $8,912 and $246,366, respectively, and $2,971 and $82,123, respectively, of related future income taxes) for options granted to field consultants. The Company also capitalized $1,069 and $15,170, respectively, (three and nine months ended September 30, 2008 – nil) of general and administrative costs as well as related costs 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.

The Company applied the ceiling test to its capitalized assets as at September 30, 2009 and determined that there was a $4,300,000 impairment which has been included in the reported amount of depletion and depreciation expense. For purposes of this impairment test, the following future commodity prices were used:

	WTI US$/bbl	*WTI Cdn $/bbl*	*Alberta AECO Average Cdn $/mcf*
2009 - remainder	65.00	59.80	4.50
2010	71.40	67.83	6.10
2011	78.05	74.15	7.20
2012	84.90	80.66	7.45
2013	92.00	87.40	7.60
Escalation rate thereafter	2%	2%	2%

5. Bank debt

The Company's senior secured bank debt is subject to a Forbearance Agreement dated June 16, 2009 and a Loan Extension Agreement dated October 27, 2009 (collectively the "Loan Agreements") between the senior lender and the Company. During the period May 1 to October 26, 2009, the revolving operating demand loan was an increased interest rate of prime plus 4.0% (previously prime plus 0.5%) per annum calculated daily and payable monthly. Commencing October 27, 2009, the interest rate was reduced to prime plus 1.0%.

Pursuant to the Loan Agreements, the Company covenants and agrees that it shall:

a) Pay principal and interest on the outstanding loan balance by way of a monthly payment of $175,000 from June to September 2009;

b) Accept the senior lender's retainer of a consultant to monitor the Company's operations as mandated by the Bank with the costs of the consultant paid for by the Company;

c) Obtain prior written consent from the senior lender for all capital expenditures;

5. Bank debt (continued)

d) Maintain a specified level of production;

e) Complete a drilling program for three specified wells (note 13(c));

f) Enter into an agreement with the President and Chief Executive Officer ("CEO") of the Company for all salary compensation to be made in the form of common shares of the Company until such time that the senior lender agrees that such agreement is no longer necessary;

g) Remove any liens exercised against the property and assets of the Company (completed in July 2009);

h) Pay a $150,000 fee earned and payable to the senior lender on October 15, 2009 in the form of 1,000,000 common shares of the Company at a value of $0.15 per share;

i) Complete the Proposal with its creditors, including its subordinated lender (note 6), by December 31, 2009 (note 17);

j) Complete the proposed merger with Athabaska Energy Ltd. (note 13(c)), subject to TSX Venture Exchange approval;

k) Raise additional equity and/or subordinated debt in the minimum amount of $500,000 for working capital purposes by December 31, 2009; and

l) Abide by all other covenants as specified in the Loan Agreements.

The maximum amount of the revolving operating demand loan is $8,300,000 (June 30, 2009 – $8,825,000; December 31, 2008 – $9,000,000) with monthly reductions based on the Company's excess cash flow (as defined in the Loan Agreements) commencing January 31, 2010. As at September 30, 2009, the $8,325,547 (December 31, 2008 – $8,853,990) reported amount of bank debt was comprised of $8,200,000 (December 31, 2008 – $8,150,000) drawn on the revolving operating demand loan and $125,547 (December 31, 2008 – $703,990) of bank overdraft.

The Company is subject to a financial covenant with respect to working capital, which the Company was not in compliance with at September 30, 2009 which has been acknowledged in light of the creditor Proposal. The annual renewal date of the bank debt is May 31, 2010.

6. Credit facility

	September 30 2009	*December 31 2008*
Principal amount of credit facility	$ 4,500,000	$ 4,500,000
Unamortized portion of transaction costs	(26,561)	(105,000)
	4,473,439	4,395,000
Commitment fee for 2009 facility	–	90,000
4% deferred fee due on maturity of 2008 facility	–	180,000
	$ 4,473,439	$ 4,665,000

As at September 30, 2009 and December 31, 2008, the Company had a $4,500,000 credit facility with a subordinated lender bearing interest at 12% per annum calculated and payable monthly and maturing on December 31, 2009. As at September 30, 2009, the Company was in compliance with one of the three financial covenants.

6. Credit facility (continued)

On October 22, 2009, the subordinated lender accepted the Company's Proposal to its creditors (note 17) pursuant to which the credit facility will be settled as follows:

a) $1,000,000 will be satisfied via the issuance of preferred shares of the Company, such preferred shares having a 5% annual dividend payable in common shares of the Company, being redeemable at any time by the Company and being due for redemption on April 15, 2011.

b) $450,000, being the amount equal to the claim for accrued interest and fees from May 1 to October 15, 2009, will be satisfied via the issuance of 9,000,000 common shares of the Company at a deemed price of $0.05 per share of which 1,745,753 common shares were issued on August 18, 2009 pursuant to a previous agreement; and

c) The balance of $3,500,000 will be satisfied via the issuance of 23,333,333 common shares of the Company at a deemed price of $0.15 per share.

7. 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:

Asset retirement obligation, December 31, 2008	$ 2,124,242
Accretion	109,544
Liabilities settled	(33,943)
Effect of change in estimates	14,161
Asset retirement obligation, September 30, 2009	$ 2,214,004

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

Undiscounted cash flows	$ 4,418,748
Discount rate	7%
Inflation rate	2%
Weighted average expected timing of cash flows	11 years

8. Future 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:

	Three months ended September 30		*Nine months ended September 30*	
	2009	*2008*	2009	*2008*
Expected income tax reduction at 29.00% (2008 – 29.50%)	$ (1,611,937)	$ 257,200	$ (2,041,955)	$ (368,835)
Non-deductible items (non-taxable income or gains)	(7,099)	(371,781)	858	153,601
Rate adjustment and other	368,670	17,400	419,639	6,028
Change in valuation allowance	–	97,181	51,112	209,206
	$ (1,250,366)	$ –	$ (1,570,346)	$ –

8. Future income taxes (continued)

The components of the net future income asset (liability) are:

	September 30 2009	*December 31 2008*
Asset retirement obligation	$ 553,501	$ 531,061
Non-capital and capital loss carryforwards	51,112	256,116
Share issue costs	12,947	9,416
Property and equipment	(898,331)	(2,553,738)
Valuation allowance	(51,112)	–
	$ (331,883)	$ (1,757,145)

As at September 30, 2009, the Company has approximately $32.9 million of tax pools available for deduction against future taxable income.

9. Long-term payable

As at September 30, 2009, a long-term payable exists related to shares to be issued as payment for salary compensation of the Company's President and CEO and credit facility interest expense detailed as follows:

	Number of shares to be issued	*Amount*
Credit facility interest, May 1 – September 30, 2009 *(note 6)*	4,527,140	$ 226,356
Less: 1,745,753 common shares issued in August 2009 *(note 10)*	(1,745,753)	(87,288)
	2,781,387	139,068
President and CEO compensation, July 1 – September 30, 2009 *(note 5)*	756,000	37,800
	3,537,387	$ 176,868

The number of shares to be issued was determined based on the amount of salary compensation and interest expense payable for the required period divided by $0.05 per share. Pursuant to TSX Venture Exchange rules, the Company may not issue shares to insiders at less than $0.05 per share.

10. Share capital

a) Common shares issued

	Number of shares	*Amount*
Balance, December 31, 2008	75,561,912	$ 34,116,201
Salary compensation (i)	504,000	25,200
Interest expense (ii)	1,745,753	87,288
Creditor settlement (iii)	4,680,783	280,847
Tax effect of flow-through shares (iv)	–	(150,000)
Share issue costs, net of $4,916 of tax	–	(14,748)
Balance, September 30, 2009	82,492,448	$ 34,344,788

i) On August 18, 2009, the Company issued 504,000 common shares at a value of $0.05 per share to the President and CEO for May and June 2009 salary compensation. The common shares are subject to a four month hold period.

10. Share capital (continued)

a) Common shares issued (continued)

ii) On August 18, 2009, the Company issued 1,745,753 common shares at a value of $0.05 per share to the Company's subordinated lender for a portion of May and June 2009 interest expense, the balance of which is included in the long-term payable described in note 9. The common shares are subject to a four month hold period.

iii) On August 28, 2009, the Company issued 4,680,783 common shares at a value of $0.06 per share for the settlement of $280,847 of accounts payable. The common shares are subject to a four month hold period.

iv) In December 2008, the Company issued 6,000,000 common shares on a flow-through basis at $0.10 per share for total proceeds of $600,000. The $150,000 related tax benefits of the flow-through share proceeds were renounced to investors in February 2009 with an effective date of December 31, 2008. The Company has until December 31, 2009 to incur the qualifying flow-through expenditures, of which approximately $215,315 remained unspent at September 30, 2009.

b) Stock options

	Number of options	*Weighted – average exercise price*
Balance – December 31, 2008	6,267,025	$ 0.31
Expired	(360,000)	(0.30)
Forfeited	(100,000)	(0.55)
Balance – September 30, 2009	5,807,025	$ 0.29

The following table summarizes information about stock options outstanding as at September 30, 2009:

Range of exercise price	*Number outstanding*	*Weighted-average remaining contractual life (years)*	*Weighted-average exercise price*	*Number exercisable*
$ 0.10 – $ 0.35	4,344,000	3.10	$ 0.19	4,344,000
$ 0.45 – $ 0.50	899,025	1.16	0.50	899,025
$ 0.65 – $ 0.74	502,250	0.49	0.72	502,250
$ 0.82	61,750	0.11	0.82	61,750
	5,807,025	2.54	$ 0.29	5,807,025

11. Royalty recoveries

During the three and nine months ended September 30, 2009, the Company recognized a recovery in the amount of nil and $175,636, respectively, of freehold and gross overriding royalties calculated and paid in previous years.

12. Change in non-cash working capital

	Three months ended September30		Nine months ended September 30	
	2009	*2008*	*2009*	*2008*
Accounts receivable	$ (108,358)	$ 265,370	$ 294,390	$ (171,384)
Prepaid expenses and deposits	66,810	(723)	41,499	17,758
Accounts payable and accrued liabilities	919,116	(12,670)	656,958	(408,105)
	$ 877,568	$ 251,977	$ 992,847	$ (561,731)

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

	Three months ended September30		Nine months ended September 30	
	2009	*2008*	*2009*	*2008*
Operating	$ 360,560	$ 55,648	$ 460,157	$ (146,901)
Investing	517,008	196,329	532,690	(414,830)
	$ 877,568	$ 251,977	$ 992,847	$ (561,731)

13. Related party transactions

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

a) During the three and nine months ended September 30, 2009 and 2008, 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:

	Three months ended September30		Nine months ended September 30	
	2009	*2008*	*2009*	*2008*
Administration and consulting fees	$ 26,350	$ 28,649	$ 37,826	$ 101,769
Production and capital expenditures	$ 31,652	$ 117,303	$ 91,294	$ 162,100

b) During the three and nine months ended September 30, 2009, the Company was charged $2,322 and $7,902 (three and nine months ended September 30, 2008 – $10,824 and $18,258) by a law firm in which a former director of the Company is a partner.

c) In June 2009, the Company entered into a participation and farmout agreement (the "Farmout Agreement") with Athabaska Energy Ltd. ("Athabaska"). The Farmout Agreement is a related party transaction as a director and principal shareholder of the Company is also an officer, director and principal shareholder of Athabaska. The Farmout Agreement covers seven sections of Company land and will include the drilling of wells specified in the Agreement with the Company's senior lender (note 5(e)). Pursuant to the terms of the Farmout Agreement, Athabaska will earn one section of the farmout lands for each well drilled. Athabaska will contribute 100% of the cost to drill, complete and tie-in each well to the Company's facilities in order to earn a 60% working interest in each well at payout. The Company will have the option, up to the spud date of each well, to elect to participate for up to a 25% working interest in the well upon notification by Athabaska of the drilling location.

13. Related party transactions (continued)

Included in accounts receivable at September 30, 2009 is $52,307 (December 31, 2008 – nil) and included in accounts payable and accrued liabilities at September 30, 2009 is $7,902 (December 31, 2008 – $24,076) 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.

14. Financial instruments and financial risk management

The Company's financial instruments include accounts receivable, accounts payable and accrued liabilities, bank debt, credit facility, and commodity price risk contracts (note 14(c)(iii)). The carrying values of accounts receivable, accounts payable and accrued liabilities, bank debt, and credit facility approximate their fair values due to their relatively short periods to maturity. The commodity price risk contracts have been marked-to-mark at the balance sheet date.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with the risk management policies as set out herein:

a) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable are with natural gas and liquids marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas and liquids are subject to credit review to minimize the risk of non-payment. As at September 30, 2009, the maximum credit exposure is the carrying amount of the accounts receivable and accruals of $1,416,390 (December 31, 2008 – $1,710,780).

As at September 30, 2009, the Company's receivables consisted of $1,277,072 from joint venture partners and other trade receivables and $139,318 of revenue receivable from a petroleum and natural gas marketer. Receivables from petroleum and natural gas marketers are typically collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any significant collection issues with its petroleum and natural gas marketers. All of the $139,318 of revenue receivable from petroleum and natural gas marketers was received in October and November 2009. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risk exists with joint venture partners as disagreements occasionally arise which increases the potential for non-collection. For properties that are operated by the Company, production can be withheld from joint venture partners who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to joint venture partners from which it can net receivable balances. As at September 30, 2009, the largest amount owing from one partner is $694,659.

14. Financial instruments and financial risk management (continued)

a) Credit risk (continued)

The Company did not provide for any doubtful accounts nor was it required to write-off any receivables during the period ended September 30, 2009. The Company would only choose to write-off a receivable balance (as opposed to providing an allowance) after all reasonable avenues of collection had been exhausted.

As at September 30, 2009, the Company considers its receivables to be aged as follows:

Not past due	$	253,255
Past due by less than 90 days		41,817
Past due by more than 90 days		1,121,318
	$	1,416,390

b) Liquidity risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

On October 22, 2009, the Company held a meeting to present the Proposal (note 17) to restructure to its creditors at which time 85% of affected creditors voted in support of the Proposal. The Company received court approval of the Proposal on November 10, 2009 and is awaiting approval from the TSX Venture Exchange.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company has a revolving reserve-based bank facility, which is reviewed quarterly by the lender. The Company monitors its total debt position monthly. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month.

The Company's financial liabilities are comprised of accounts payable and accrued liabilities, bank debt and the credit facility, all of which have expected maturities of less than one year resulting in their current classification on the balance sheet.

c) Market risk

Market risk consists of interest rate risk, currency risk and commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with a risk management policy as set out herein:

i) Interest rate risk
Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears interest at a floating rate. For the three and nine months ended September 30, 2009, if interest rates had been 1% lower with all other variables held constant, loss for the period would have been $21,267 and $61,145 (three and nine months ended September 30, 2008 – $18,929 and $55,950) lower, respectively, due to lower interest expense.

14. Financial instruments and financial risk management (continued)

c) Market risk (continued)

i) Interest rate risk (continued)

An equal and opposite impact would have occurred had interest rates been higher by the same amounts. The Company had no interest rate swap or financial contracts in place at September 30, 2009.

ii) Currency risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum and natural gas sales are denominated in Canadian dollars; however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at September 30, 2009.

iii) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above.

The Company is committed to the following commodity price risk contracts for the sale of natural gas:

- 1,500 GJ per day from April 1 to December 31, 2009 at a fixed price of $5.69 per GJ;
- 1,000 GJ per day from January 1 to January 31, 2010 at a fixed price of $5.51 per GJ;
- 1,000 GJ per day from February 1 to February 28, 2010 at a fixed price of $5.53 per GJ; and
- 500 GJ per day from January 1 to December 31, 2010 at a fixed price of $5.68 per GJ.

In addition the Company sold calls which provide a ceiling for the price it receives for natural gas as follows:

- 500 GJ per day from January 1 to December 31, 2010 at the ceiling price of $6.25 per GJ;
- 500 GJ per day from March 1 to December 31, 2010 at the ceiling price of $6.50 per GJ; and
- 500 GJ per day from March 1 to December 31, 2010 at the ceiling price of $6.70 per GJ.

Included in petroleum and natural gas revenue for the three and nine months ended September 30, 2009 is $383,988 and $688,168, respectively, of realized gains on the fulfilled portion of the commodity contracts. The mark-to-market value of the unfulfilled portion of the above contracts at September 30, 2009 is a liability of $120,344 based on a remaining term of October 1, 2009 to December 31, 2010.

The Company also had commodity price risk contracts in place from April 1, 2008 to December 31, 2008. Included in petroleum and natural gas revenue for the three and nine months ended September 30, 2008 is $158,919 and $282,528, respectively, of realized losses on the fulfilled portion of the commodity contracts. The mark-to-market value of the unfulfilled portion of the contracts in place at September 30, 2008 was asset of $76,940 based on a remaining term of October 1, 2008 to December 31, 2008.

15. Capital management

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include:

	September 30 2009	*December 31 2008*
Working capital deficiency	$ (13,711,547)	$ (13,599,207)
Shareholders' equity	19,209,720	24,452,012
	$ 5,498,173	$ 10,852,805

The Company monitors capital based on annual funds from operations and capital expenditure budgets, which are updated as necessary and are reviewed and periodically approved by the Company's Board of Directors.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other facts that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

In order to maintain or adjust the capital structure, the Company considers its forecasted funds from operations while attempting to finance an acceptable capital expenditure program including acquisition opportunities, the current level of bank credit available from the Company's lender, the level of bank credit that may be attainable from its lender as a result of petroleum and natural gas reserve growth, the availability of other sources of debt with different characteristics than existing debt, the sale of assets, limiting the size of the capital expenditure program and the issue of new equity if available on favorable terms.

As at September 30, 2009, the Company's capital structure is subject to external restrictions as a result of the Loan Agreements with the Company's senior lender described in note 5 and as a result, the Company's approach to capital management has changed to ensure compliance with the Loan Agreements.

The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

16. Commitments

a) The Company has until December 31, 2009 to incur $600,000 of qualifying flow-through expenditures related to the issue of 6,000,000 common shares on a flow-through basis issued in December 2008, of which approximately $215,315 remained unspent at September 30, 2009.

b) The Company is committed to commodity price risk contracts for the sale of natural gas as disclosed in note 14(c)(iii).

c) A fee of $150,000 is payable to the senior lender on October 15, 2009 in the form of 1,000,000 common shares of the Company at a value of $0.15 per share (note 5).

17. Subsequent event

On October 22, 2009, the Company held a meeting to present a formal proposal to restructure under the Bankruptcy and Insolvency Act (the "Proposal") to its creditors at which time all affected creditors had the opportunity to vote on the Proposal as presented by the Company. Of the votes cast 85% supported the Proposal which represented approximately 96% of the corresponding monetary value. The Company received court approval of the Proposal on November 10, 2009 and is awaiting the 30 day appeal period and final approval from the TSX Venture Exchange upon completion of all aspects of the formal Proposal.

The purpose of the Proposal is to restructure the financial affairs of the Company in order continue business. Pursuant to the terms of the Proposal:

a) The Company will continue to make payments to its senior lender in accordance with the terms of its present arrangements with that senior lender or any other arrangements that may be agreed upon by that senior lender and the Company as disclosed in note 5. The senior lender has a first secured charge on the property, assets and undertaking of the Company;

b) A second secured creditor that is owed $4,950,000 including accrued interest and fees, but whose interest is subordinate to that of the senior lender, will have its debts satisfied as disclosed in note 6;

c) Ordinary unsecured creditors who are owed up to approximately $1,795,000 will have their debts settled as follows:

    i) The first $500 of each such ordinary unsecured creditor's claim will be paid in cash; and

    ii) The balance will be satisfied via the issuance of common shares of the Company at a deemed price of $0.15 per share; resulting in the anticipated payment of up to $55,000 in cash and the anticipated issuance of up to 11,600,000 common shares, based on the number of known ordinary unsecured creditors.

d) The Company will undertake to merge with Athabaska (subject to Athabaska shareholder approval). The assets of Athabaska will be combined with the assets of the Company no later than 30 days after the Court issues a final order approving of the Proposal. The number of common shares of the Company to be issued in exchange for the shares of Athabaska will be based on the current net asset value of each company as determined by a qualified independent third party expert.

e) Subsequent to the completion of (d), above, the Company will raise $500,000 by selling common shares at a price per share to be determined with reference to then current market conditions, but at a price per share of not less than $0.05, no later than 60 days after the Court issues a final order approving of the Proposal.

The Proposal is expected to be completed on December 10, 2009.