



Yangarra Resources Ltd.
Consolidated Financial Statements
December 31, 2009 and 2008

Management's Responsibility

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 29, 2010

"James G. Evaskevich" (signed)

James G. Evaskevich
Chief Executive Officer

"Penny Payne" (signed)

Penny Payne
Chief Financial Officer

To the Shareholders of Yangarra Resources Ltd.:

We have audited the consolidated balance sheets of Yangarra Resources Ltd. as at December 31, 2009 and 2008, and the consolidated statements of operations, comprehensive loss 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, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
April 26, 2010

Meyer Norris Penny LLP

Chartered Accountants

Yangarra Resources Ltd.
Consolidated Balance Sheets
As at December 31

	2009	2008
Assets		
Current		
Accounts receivable	\$ 658,080	\$ 1,710,780
Prepaid expenses and deposits	152,853	437,923
	810,933	2,148,703
Investment (note 5)	–	10,468
Property and equipment (note 6)	38,830,516	41,922,138
	\$ 39,641,449	\$ 44,081,309
Liabilities		
Current		
Bank debt (note 7)	\$ 8,195,069	\$ 8,853,990
Credit facility (note 8)	–	4,665,000
Accounts payable and accrued liabilities	465,554	2,228,920
Commodity price risk contracts (note 13)	113,361	–
	8,773,984	15,747,910
Asset retirement obligation (note 9)	2,181,727	2,124,242
Preferred shares (note 10)	1,000,000	–
Future income tax liability (note 15)	837,357	1,757,145
	12,793,068	19,629,297
Shareholders' Equity		
Share capital (note 10)	43,019,290	34,116,201
Warrants (note 11)	340,600	–
Contributed surplus (note 12)	2,972,097	2,551,397
Deficit	(19,483,606)	(12,215,586)
	26,848,381	24,452,012
	\$ 39,641,449	\$ 44,081,309

Nature of operations and basis of presentation (note 1)
Commitments (note 20)

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 consolidated financial statements

Yangarra Resources Ltd.
Consolidated Statements of Operations, Comprehensive Loss and Deficit
For the years ended December 31

	2009	2008
Revenue		
Petroleum and natural gas sales	\$ 3,579,738	\$ 8,642,336
Royalties	(195,223)	(1,329,490)
Royalty recoveries (note 14)	289,728	–
	3,674,243	7,312,846
Other income	10,855	–
Commodity price risk contracts (note 13)	(113,361)	226,800
	3,571,737	7,539,646
Expenses and other items		
Production	1,994,861	1,635,946
Transportation	137,692	193,159
General and administrative	898,084	813,314
Interest and financing fees	1,295,660	1,404,947
Stock-based compensation (note 12)	206,091	579,609
Depletion and depreciation	8,064,412	4,797,322
Accretion	146,621	125,069
(Gain) loss on investment (note 5)	(23,201)	115,152
Gain on debt settlement	(54,965)	–
	12,665,255	9,664,518
Loss before income taxes	(9,093,518)	(2,124,872)
Income taxes		
Future income tax recovery (note 15)	1,825,498	299,792
Net loss and comprehensive loss for the year	(7,268,020)	(1,825,080)
Deficit, beginning of year	(12,215,586)	(10,390,506)
Deficit, end of year	\$ (19,483,606)	\$ (12,215,586)
Net loss per share – basic and diluted	\$ (0.09)	\$ (0.03)
Weighted average number of shares – basic and diluted	78,313,321	67,499,983

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

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

	2009	2008
Operating		
Net loss for the year	\$ (7,268,020)	\$ (1,825,080)
Add back (deduct) non-cash items		
Unrealized loss on commodity risk management contracts	113,361	–
Interest and financing fees	705,000	393,993
Stock-based compensation	206,091	579,609
Salary compensation (<i>note 10(b)(vii)</i>)	84,000	–
Depletion and depreciation	8,064,412	4,797,322
Accretion	146,621	125,069
(Gain) loss on investment	(23,201)	115,152
Future income tax recovery	(1,825,498)	(299,792)
Abandonment expenditures (<i>note 9</i>)	(95,910)	(65,995)
	<u>106,856</u>	<u>3,820,278</u>
Change in non-cash working capital (<i>note 16</i>)	<u>1,023,649</u>	<u>(428,503)</u>
	<u>1,130,505</u>	<u>3,391,775</u>
Financing		
Issue of equity instruments, net of issue costs	416,335	1,301,464
Repurchase of common shares	–	(50,633)
Bank debt (repayment) proceeds, net	(658,921)	1,158,526
Financing fees	(270,000)	(60,000)
Related party advance	70,913	250,000
	<u>(441,673)</u>	<u>2,599,357</u>
Investing		
Expenditures on property and equipment	(1,614,961)	(5,770,571)
Proceeds on disposition of property and equipment	–	78,776
Business combination (<i>note 4</i>)	92,063	–
Proceeds on sale of investment (<i>note 5</i>)	33,669	–
Change in non-cash working capital (<i>note 16</i>)	800,397	(299,337)
	<u>(688,832)</u>	<u>(5,991,132)</u>
Change in cash during the year	–	–
Cash, beginning of year	–	–
Cash, end of year	\$ –	\$ –
Supplemental cash flow information		
Interest paid	\$ 594,496	\$ 1,000,543

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

1. Nature of 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 audited consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Yangarra Resources Corp. (“YRC”) and Athabaska Energy Ltd. (“Athabaska”) (note 4) after the elimination of intercompany transactions and balances.

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, 2009, the Company had a working capital deficiency of \$7,963,051 (2008 – \$13,599,207) and an accumulated deficit of \$19,483,606 (2008 – \$12,215,586). 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.

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 received final approval from the TSX Venture Exchange on December 31, 2009 upon completion of all aspects of the formal Proposal.

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

- a) The Company continued 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 7. The senior lender has a first secured charge on the property, assets and undertakings of the Company;
- b) A second secured creditor that was owed \$4,950,000 including accrued interest and fees, but whose interest is subordinate to that of the senior lender, had its debts satisfied as disclosed in note 8;
- c) Ordinary unsecured creditors who were owed \$2,018,065 had their debts settled as follows:
 - i) The first \$558 of each such ordinary unsecured creditor's claim was paid in cash resulting in a total cash payment of \$55,000; and
 - ii) The balance was satisfied via the issuance of common shares of the Company at a deemed price of \$0.17 per share resulting in the issuance of 11,600,000 common shares (note 10(b)(xi)).
- d) The Company acquired Athabaska on December 31, 2009 as disclosed in note 4.
- e) The Company completed a private placement on December 31, 2009 for total proceeds of \$500,000 as disclosed in note 10(b)(xii).

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 within the reasonable limits of materiality and the framework of the significant accounting policies summarized below:

a) Cash

Cash consists of bank balances and overdrafts.

b) Investments

Investments are classified as held-for-trading financial assets and are measured at fair value with changes in fair value recognized in earnings.

c) 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, asset retirement costs, 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. The costs of significant unevaluated properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment occurs.

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 %

2. Significant accounting policies (continued)

d) Long-lived assets

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

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. Under the full cost method of accounting, a “ceiling test” is performed to recognize and measure impairment, if any, of the carrying amount of petroleum and natural gas properties. Impairment is recognized if the carrying amount of the petroleum and natural gas properties, less the cost of undeveloped properties, net of impairment, exceeds the estimated undiscounted future cash flows from the Company’s proved reserves. The future cash flows are based on a forecast of prices and costs, as provided by an independent third party. The magnitude of the impairment, if any, is then measured by comparing the carrying amount of petroleum and natural gas properties less the cost of undeveloped properties, net of impairment, to the estimated discounted future cash flows from the Company’s proved and probable reserves. The future cash flows are discounted at the Company’s risk-free interest rate, using forecasted prices and costs.

Any impairment recognized is recorded as additional depletion and depreciation expense.

e) Asset retirement obligation

Asset retirement costs and liabilities associated with site restoration and abandonment of property and equipment 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.

f) Joint venture operations

A portion 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.

g) Bank debt and credit facility

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) 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.

2. Significant accounting policies (continued)

i) *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.

j) *Stock-based compensation*

Stock-based compensation 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 forfeited, previously recognized compensation expense associated with such stock options is reversed.

k) *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.

l) *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.

m) *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. Amounts related to the fair value of stock options and warrants are based on estimates of share price volatility, risk-free interest rate and expected lives of options and warrants. Future income tax assets and liabilities are reported based on estimates of future income tax rates. Amounts reported for the fair value of commodity price risk contracts are based on the counterparties' estimates of future commodity prices.

By their nature, these estimates and related future cash flows are subject to measurement uncertainty, and the impact on 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.

2. Significant accounting policies (continued)

n) *Financial instruments*

All financial instruments, including derivatives, are to be recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities except those held-for-trading and available for sale are measured at amortized cost determined using the effective interest rate method. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to earnings when derecognized or impaired.

The Company has classified its financial assets and liabilities as follows:

<u>Held-for-trading</u>	<u>Loans and receivables</u>	<u>Other liabilities</u>
Investment	Accounts receivable	Bank debt
Commodity price risk contracts		Credit facility
		Accounts payable and accrued liabilities
		Preferred shares

At each balance sheet date, the Company will assess financial assets for impairment with any impairment recorded in the consolidated statement of operations.

o) *Commodity price risk contracts*

The Company may use various types of derivative financial instruments to manage risks associated with crude oil and natural gas price fluctuations. These instruments are not used for trading or speculative purposes. Proceeds and costs realized from holding the related contracts are recognized in petroleum and natural gas revenues at the time that each transaction under a contract is settled. For the unrealized portion of such contracts, the Company utilizes the fair value method of accounting. The fair value is based on an estimate of the amounts that would have been paid to or received from counterparties to settle these instruments given future market prices and other relevant factors. The method requires the fair value of the derivative financial instruments to be recorded at each balance sheet date with the unrealized gains or losses on these contracts recorded through the consolidated statement of operations.

The Company has elected to account for its physical delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts on an accrual basis rather than as non-financial derivatives.

p) *Transaction costs*

Transaction costs attributable to financial instruments classified as other than held-for-trading are included in the recognized amount of the related financial instrument and recognized over the life of the resulting financial instrument using the effective interest rate method.

q) *Comprehensive income*

Comprehensive income (loss) is the change in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources and includes unrealized gains and losses on financial assets classified as available-for-sale. The Company has reported a consolidated statement of comprehensive loss combined with the consolidated statement of operations. When related amounts are recorded in accordance with this new standard, a new category for accumulated other comprehensive income will be presented in the shareholders' equity section of the consolidated balance sheet.

2. Significant accounting policies (continued)

r) Capital disclosures

Capital disclosures provide information about (i) an entity's objectives, policies, and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance.

3. Changes in accounting policies

During 2009, the Company adopted the following new or revised Canadian accounting standards and abstracts. Prior periods have not been restated. The adoption of these policies had no impact on the Company's financial position or results of operations however the policies did result in new disclosures.

- (a) *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.
- (b) *EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities* which clarifies that an entity must consider its own risk and the credit risk of the counterparty when measuring the fair value of derivative instruments.
- (c) Amendments to *Section 3855 Financial Instruments — Recognition and Measurement*. The changes bring greater consistency between Canadian GAAP, IFRS and US GAAP regarding the timing of impairment recognition for debt instruments. The amendments allow more debt instruments to be classified as loans and receivables. In addition, the amendments require reversal of previously recognized impairment losses on available-for-sale financial assets in specified circumstances and require that loans and receivables that an entity intends to sell immediately or in the near term be classified as held for trading. The transitional provisions are complex and are accompanied by disclosure requirements to explain any reclassifications made on adopting the amendments.
- (d) Amendments to *Section 3862 Financial Instruments — Disclosures*. The amendments require improved and consistent disclosures about fair value measurements of financial instruments and liquidity risk. The amendments apply to annual financial statements relating to fiscal years ending after September 30, 2009. In the first fiscal year of application, an entity need not provide comparative information for the disclosures required by the amendments. See note 18.

(e) Pending accounting pronouncements

The Company is currently assessing the impact of these following new standards on its consolidated financial statements:

i) *Business combinations and non-controlling interests*

In January 2009, the Accounting Standards Board ("AcSB") issued *Section 1582 Business Combinations*, *Section 1601 Consolidations* and *Section 1602 Non-controlling Interests*. *Section 1582* replaces *Section 1581 Business Combinations* and provides the Canadian equivalent to *International Financial Reporting Standards ("IFRS") 3 Business Combinations*. *Section 1601* and *Section 1602* replace *Section 1600 Consolidated Financial Statements*. *Section 1602* provides the Canadian equivalent to *International Accounting Standard ("IAS") 27 Consolidated and Separate Financial Statements*, for non-controlling interests. These standards are effective January 1, 2011.

3. Changes in accounting policies (continued)

ii) *Equity*

In August 2009, the AcSB issued amendments to *Section 3251 Equity* as a result of issuing *Section 1602 Non-controlling Interests*. The amendments require non-controlling interests to be recognized as a separate component of equity. The amendments apply only to entities that have adopted Section 1602 and are not expected to have an impact on the Company's financial statements.

iii) *Comprehensive Revaluation of Assets and Liabilities*

In August 2009, the AcSB issued amendments to *Section 1625 Comprehensive Revaluation of Assets and Liabilities* for consistency with new *Section 1582 Business Combinations*. The amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011 and are not expected to have an impact on the Company's financial statements.

iv) *Accounting changes*

In June 2009, the AcSB issued an amendment to *Section 1506 Accounting Changes* which is effective for fiscal years beginning on or after July 1, 2009. The amendment excludes from the scope of Section 1506 changes in accounting policies upon the complete replacement of an entity's primary basis of accounting, as will occur when an entity adopts IFRS.

v) *International Financial Reporting Standards*

The AcSB has confirmed that accounting standards in Canada will converge with IFRS. Entities will be required to adopt IFRS effective January 1, 2011 with a restatement of the comparative periods for 2010 including an opening balance sheet as at January 1, 2010. Under IFRS, the primary audience is capital markets and as a result, there is significantly more disclosure required. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policies and increased note disclosures which must be addressed.

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

4. Business combination

On December 31, 2009, the Company acquired all of the issued and outstanding shares of Athabaska Energy Ltd. (“Athabaska”), a non-arm’s length private corporation, in exchange for 50,000,004 common shares of the Company.

Although the Company and Athabaska are related by virtue of common shareholders, officers and directors, the acquisition resulted in a substantive change of ownership of Athabaska. Consequently, the acquisition has been recognized at the \$2,524,326 exchange amount of consideration paid, with a third-party reserve evaluation of Athabaska’s petroleum and natural gas assets representing independent evidence of fair value.

The consideration paid for the acquisition of Athabaska has been allocated to the fair value of the net assets of Athabaska as follows:

Net assets acquired:

Cash	\$	92,063
Other working capital		72,443
Petroleum and natural gas properties		3,114,312
Asset retirement obligation		(49,402)
Future income tax liability		(705,090)
		<u>2,524,326</u>
	\$	<u>2,524,326</u>

Consideration paid:

50,000,004 common shares of the Company (<i>note 10(b)</i>)	\$	<u>2,524,326</u>
---	----	------------------

5. 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 is comprised of the following:

	2009	2008
Realized loss	\$ 231,638	\$ –
Reversal of previously recognized unrealized net losses	(254,839)	–
Unrealized loss on mark-to-market	–	115,152
	<u>\$ (23,201)</u>	<u>\$ 115,152</u>

6. Property and equipment

<i>December 31, 2009</i>	<i>Cost</i>	<i>Accumulated depletion and depreciation</i>	<i>Net book value</i>
Petroleum and natural gas properties	\$ 70,134,763	\$ 31,380,391	\$ 38,754,372
Office equipment	279,281	203,137	76,144
	<u>\$ 70,414,044</u>	<u>\$ 31,583,528</u>	<u>\$ 38,830,516</u>

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

6. Property and equipment (continued)

<i>December 31, 2008</i>	<i>Cost</i>		<i>Accumulated depletion and depreciation</i>		<i>Net book value</i>
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 December 31, 2009, the Company excluded \$1,206,467 (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, \$11,055,300 (2008 – \$7,886,400) of future development costs were included in the depletion calculation.

During 2009, the Company capitalized \$13,517 (2008 – \$324,802) related to the asset retirement obligation of property and equipment and \$286,145 (2008 – \$331,096) comprised of stock-based compensation of \$214,609 and \$71,536 of related future income taxes (2008 – \$248,321 and \$82,775, respectively) for options granted to field consultants. The Company also capitalized \$86,765 (2008 – \$107,385) 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 petroleum and natural gas properties at the 2009 interim balance sheet dates and determined that there was an impairment of \$4,300,000 in the September 30, 2009 interim period, which has been included in depletion and depreciation. The December 31, 2009 ceiling test determined that there was no additional impairment. For purposes of this impairment test, the following future commodity prices were used:

	<i>WTI US\$/bbl</i>	<i>WTI Cdn \$/bbl</i>	<i>Alberta AECO Average Cdn \$/mcf</i>
2010	75.00	71.25	5.80
2011	81.60	77.52	6.70
2012	85.85	81.56	7.05
2013	90.20	85.69	7.45
2014	97.40	92.53	7.55
Escalation rate thereafter	2%	2%	2%

7. 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 interest rate on the revolving operating demand loan was increased to bank prime plus 4.0% (previously bank prime plus 0.5%) per annum calculated daily and payable monthly. Commencing October 27, 2009, the interest rate was reduced to bank prime plus 1.0%.

7. Bank debt (continued)

Pursuant to the Loan Agreements, the Company agreed 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 (completed);
- 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 (completed December 31, 2009);
- c) Obtain prior written consent from the senior lender for all capital expenditures (on-going);
- d) Maintain a specified level of production (on-going);
- e) Complete a drilling program for three specified wells (completed);
- 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 November 30, 2009 (note 10(b)(vii));
- g) Remove any liens exercised against the property and assets of the Company (completed 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 (note 10(b)(viii));
- i) Complete the Proposal with its creditors, including its subordinated lender (note 8), by December 31, 2009 (note 1);
- j) Complete the proposed merger with Athabaska Energy Ltd. (note 4);
- k) Raise additional equity and/or subordinated debt in the minimum amount of \$500,000 for working capital purposes by December 31, 2009 (note 10(b)(xii)); and
- l) Abide by all other covenants as specified in the Loan Agreements (on-going).

The maximum amount of the revolving operating demand loan is \$8,300,000 (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 December 31, 2009, the \$8,195,069 (2008 – \$8,853,990) reported amount of bank debt was comprised of \$7,800,000 (2008 – \$8,150,000) drawn on the revolving operating demand loan and \$395,069 (2008 – \$703,990) of bank overdraft.

In addition to the revolving operating demand loan facility, the Company has a treasury risk line available for interest rate, foreign exchange and commodity price risk management which is repayable per contract maturities. See note 13 for disclosure of commodity price risk contracts.

The bank 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.

The Company is subject to a financial covenant with respect to working capital, which the Company was in compliance with at December 31, 2009. The annual renewal date of the bank debt is May 31, 2010.

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

8. Credit facility

Principal amount of credit facility – December 31, 2008	\$ 4,500,000
Commitment fee for 2009 facility	90,000
4% deferred fee due on maturity of 2008 facility	180,000
2008 amortization of transaction costs	(105,000)
<hr/>	
Reported balance – December 31, 2008	4,665,000
2009 amortization of transaction costs	(105,000)
2009 commitment fee installments	(60,000)
Issuance of 23,333,333 common shares (note 10(b)(x))	(3,500,000)
Issuance of 1,000,000 preferred shares (note 10(c))	(1,000,000)
<hr/>	
Reported balance – December 31, 2009	<u>\$ –</u>

As at December 31, 2008, the Company had a \$4,500,000 credit facility (the “2008 facility”) with a subordinated lender bearing interest at 12% (2007 – 9%) per annum calculated and payable monthly and maturing on December 31, 2008. The Company was required to pay a 4% deferred fee in the amount of \$180,000 upon the maturity of the 2008 facility, payable in installments of \$60,000 per month from January to March 2009.

In December 2008, the Company renewed the credit facility for a one year term commencing on January 1, 2009 and maturing on December 31, 2009 (the “2009 facility”). In respect of the 2009 facility, the Company was required to pay \$105,000 of renewal and commitment fees, of which \$15,000 was paid in 2008 with the remainder payable in installments of \$30,000 per month from January to March 2009. These costs were netted against the principal amount of the credit facility and amortized to interest in the consolidated statement of operations using the effective interest rate method.

On October 22, 2009, the subordinated lender accepted the Company’s Proposal to its creditors (note 1) pursuant to which the credit facility was settled as follows:

- a) \$450,000 of accrued interest and fees satisfied through the issuance of 9,000,000 common shares of the Company at a deemed price of \$0.05 per share (note 10(b)(ix));
- b) \$3,500,000 satisfied through the issuance of 23,333,333 common shares of the Company at a deemed price of \$0.15 per share (note 10(b)(x)); and
- c) \$1,000,000 satisfied through the issuance of preferred shares of the Company, such preferred shares having a 5% annual dividend payable in common shares of the Company, redeemable at any time by the Company and redeemable by the subordinated lender on June 30, 2011 (note 10(c)).

The credit facility was 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 subordinated lender and the senior lender (note 7).

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

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:

	2009	2008
Asset retirement obligation, beginning of year	\$ 2,124,242	\$ 1,740,366
Liabilities incurred	13,517	115,502
Liabilities acquired (<i>note 4</i>)	49,402	–
Dispositions	–	(12,847)
Liabilities settled	(95,910)	(65,995)
Effect of change in estimates	(56,145)	222,147
Accretion	146,621	125,069
Asset retirement obligation, end of year	<u>\$ 2,181,727</u>	<u>\$ 2,124,242</u>

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

	2009	2008
Undiscounted cash flows	\$ 4,263,142	\$ 4,450,264
Discount rate	7% - 10%	7%
Inflation rate	2%	2%
Weighted average expected timing of cash flows	10.3 years	11.5 years

10. Share capital

a) Authorized

Unlimited number of common shares, without nominal or par value

Unlimited number of preferred shares, without nominal or par value

b) Common shares issued

	<i>Number of shares</i>	<i>Amount</i>
Balance, December 31, 2007	63,396,167	\$ 32,533,251
Financing fees (<i>i</i>)	450,000	45,000
Exercise of stock options (<i>ii</i>)	1,312,500	346,742
Exercise of warrants (<i>iii</i>)	4,703,245	861,522
Repurchased shares (<i>iv</i>)	(300,000)	(144,598)
Private placement (<i>v</i>)	6,000,000	600,000
Share issue costs, net of \$4,072 of future income tax	–	(12,216)
Tax effect of 2007 flow-through shares	–	(113,500)
Balance, December 31, 2008	<u>75,561,912</u>	<u>\$ 34,116,201</u>

(Continued)

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

10. Share capital (continued)

b) Common shares issued (continued)

	<i>Number of shares</i>	<i>Amount</i>
Balance, December 31, 2008	75,561,912	\$ 34,116,201
Settlement of accounts payable (vi)	4,680,781	280,847
Salary compensation (vii)	1,764,000	88,200
Senior lender fees (viii)	1,000,000	150,000
Subordinated lender interest and fees (ix)	9,000,000	450,000
Subordinated lender credit facility (x)	23,333,333	3,500,000
Unsecured creditor settlement (xi)	11,600,000	1,963,065
Flow-through unit private placement (xii)	10,000,000	159,400
Business combination (note 4)	50,000,004	2,524,326
Share issue costs, net of \$20,916 of future income tax	–	(62,749)
Tax effect of 2008 flow-through shares (v)	–	(150,000)
Balance, December 31, 2009	<u>186,940,030</u>	<u>\$ 43,019,290</u>

- i) In January 2008, the Company issued 450,000 common shares as consideration for \$45,000 of financing fees related to the 2007 renewal of the credit facility (note 8) which were reported as a long-term payable at December 31, 2007.
- ii) In April and July 2008, the Company issued a total of 1,312,500 common shares on the exercise of the same number of stock options for cash proceeds of \$168,200. In addition to the cash proceeds, a \$178,542 pro-rata allocation of the options' fair value was reclassified from contributed surplus to the amount for common shares.
- iii) During the second quarter of 2008, the Company issued 4,703,245 common shares on the exercise of the same number of warrants for proceeds of \$799,552, of which \$549,552 was paid in cash upon exercise and \$250,000 was received in March 2008 as advances from two shareholders, who are also officers and directors of the Company, and applied against proceeds due at the time the shareholders exercised warrants. In addition to the proceeds, \$61,970 was reclassified to the amount for common shares from the previously reported value of warrants (note 11).
- iv) In July 2008, the Company obtained regulatory approval to proceed with a normal course issuer bid (the "Bid") pursuant to which the Company may purchase up to 3,381,354 of its common shares (approximately 5% of the Company's outstanding shares) over the period of one year. All acquisitions of the Company's shares pursuant to the Bid will be made through the facilities of the TSX Venture Exchange Inc. at the market price on the date of purchase. Common shares purchased under the Bid are cancelled and returned to treasury on a monthly basis.

During August to December 2008, pursuant to the Bid, the Company purchased 300,000 of its common shares at a weighted average market price of \$0.17 per share for a total cost of \$50,633. At the time of purchase, the average per share reported amount of the Company's shares was \$0.48 per share resulting in reduction of share capital of \$144,598 for the assigned value of the purchased shares. The \$93,965 difference between the assigned value and the cost of the purchased shares was credited to contributed surplus.

10. Share capital (continued)

b) Common shares issued (continued)

- v) 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 of which \$350,000 was subscribed for by officers and directors of the Company.

The \$150,000 of related tax benefits of the flow-through share proceeds were renounced to investors in February 2009 with an effective date of December 31, 2008. As at December 31, 2009, the Company had incurred all of the qualifying flow-through expenditures.

- vi) In August 2009, the Company issued 4,680,781 common shares at a value of \$0.06 per share for the settlement of \$280,847 of accounts payable.
- vii) Between August 18 and December 31, 2009, the Company issued 1,764,000 common shares at a value of \$0.05 per share to the President and CEO for \$84,000 of salary compensation and \$4,200 of related Goods and Services Tax for the period May 1 to November 30, 2009.
- viii) On December 31, 2009, the Company issued 1,000,000 common shares at a value of \$0.15 per share to the Company's senior lender as payment of a \$150,000 fee (note 7(b)).
- ix) Between August 18 and December 31, 2009, the Company issued 9,000,000 common shares at a value of \$0.05 per share to the Company's subordinated lender as payment for \$450,000 of interest expense and fees (note 8).
- x) On December 31, 2009, the Company issued 23,333,333 common shares at a value of \$0.15 per share to the Company's subordinated lender as settlement of \$3,500,000 of credit facility indebtedness (note 8).
- xi) On December 31, 2009, the Company issued 11,600,000 common shares at a value of \$0.17 per share to unsecured creditors as settlement of \$1,963,065 of accounts payable (note 1).
- xii) On December 31, 2009, the Company completed a private placement of 10,000,000 units on a flow-through basis at \$0.05 per unit for total proceeds of \$500,000. Each unit is comprised of one flow-through common share and one flow-through common share purchase warrant exercisable at \$0.10 per flow-through common share until December 31, 2014. Officers and directors subscribed for 100% of the units.

At the time of the private placement, \$340,600 was ascribed to the warrants using the Black-Scholes fair value pricing model based on a risk-free rate of 2.8%, expected volatility of 146% and an expected life of 5 years. \$159,400 was ascribed to common shares.

The related tax benefits of the flow-through share proceeds will be renounced to investors with an effective date of December 31, 2010. The Company has until December 31, 2011 to incur the qualifying flow-through expenditures, none of which had been incurred as at December 31, 2009.

c) Preferred shares issued

On December 31, 2009, the Company issued 1,000,000 preferred shares to its subordinated lender (note 8) at a price of \$1.00 per share with an annual dividend rate of 5% payable semi-annually in common shares of the Company. The preferred shares have an eighteen month term, at which time they are redeemable for \$1,000,000 cash.

As the terms of the preferred shares provide for a mandatory redemption at a fixed amount, they are classified as a financial liability. The December 31, 2009 estimated fair value of preferred shares approximates their carrying value and redemption value.

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

10. Share capital (continued)

d) 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 2009 and 2008, the Company granted the following options which vest immediately and expire five years from the date of grant:

<i>Granted</i>	<i>Number of options</i>	<i>Exercise price</i>	<i>Estimated fair value</i>
December 2009	12,350,000	\$0.10	\$ 420,700
January 2008	1,750,000	\$ 0.10	\$ 186,690
April 2008	1,875,000	0.18	366,350
June 2008	125,000	0.34	42,570
	3,750,000		\$ 595,610

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

	<i>2009</i>	<i>2008</i>
Weighted average fair value per option	\$ 0.03	\$ 0.16
Risk-free interest rate	2.8%	3.0% - 3.8%
Expected volatility	146%	189% - 203%
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.

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

	<i>December 31, 2009</i>		<i>December 31, 2008</i>	
	<i>Options</i>	<i>Weighted – average exercise price</i>	<i>Options</i>	<i>Weighted – average exercise price</i>
Opening	6,267,025	\$ 0.31	4,137,275	\$ 0.42
Granted	12,350,000	0.10	3,750,000	0.15
Exercised	–	–	(1,312,500)	0.13
Expired	(511,750)	(0.60)	(232,750)	(0.70)
Forfeited	(394,000)	(0.31)	(75,000)	(0.70)
Closing	17,711,275	\$ 0.15	6,267,025	\$ 0.31

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

10. Share capital (continued)

d) Stock options (continued)

<i>Range of exercise price</i>	<i>Number outstanding</i>	<i>Weighted-average remaining contractual life (years)</i>	<i>Weighted-average exercise price</i>	<i>Number exercisable</i>
\$ 0.10 – \$ 0.35	16,519,000	4.46	\$ 0.12	16,519,000
\$ 0.45 – \$ 0.50	799,025	0.91	0.50	799,025
\$ 0.71 – \$ 0.74	393,250	0.33	0.73	393,250
	<u>17,711,275</u>	<u>4.21</u>	<u>\$ 0.15</u>	<u>17,711,275</u>

11. Warrants

The following table summarizes information about warrants outstanding as at:

	<i>December 31, 2009</i>			<i>December 31, 2008</i>		
	<i>Number of warrants</i>	<i>Exercise price</i>	<i>Fair value ascribed</i>	<i>Number of warrants</i>	<i>Exercise price</i>	<i>Fair value ascribed</i>
Opening	–	\$ –	\$ –	4,703,245	\$ 0.17	\$ 61,970
Issued (<i>note 10(b)(xii)</i>)	10,000,000	0.10	340,600	–	–	–
Exercised	–	–	–	(4,703,245)	(0.17)	(61,970)
Closing	<u>10,000,000</u>	<u>\$ 0.10</u>	<u>\$ 340,600</u>	<u>–</u>	<u>\$ –</u>	<u>\$ –</u>

The warrants outstanding at December 31, 2009 expire on December 31, 2014.

12. Contributed surplus

	<i>2009</i>	<i>2008</i>
Balance, beginning of year	\$ 2,551,397	\$ 1,808,044
Stock-based compensation related to:		
Options granted in current year	420,700	595,610
Options granted in prior years	–	249,094
Unvested forfeited options	–	(16,774)
	<u>420,700</u>	<u>827,930</u>
Exercised options (<i>note 10(b)(ii)</i>)	–	(178,542)
Repurchased shares (<i>note 10(b)(iv)</i>)	–	93,965
Balance, end of year	<u>\$ 2,972,097</u>	<u>\$ 2,551,397</u>

Of the total \$420,700 stock-based compensation recognized in 2009 (2008 – \$827,930), \$214,609 (2008 – \$248,321) attributed to stock options granted to field personnel has been capitalized to property and equipment and the balance of \$206,091 (2008 – \$579,609) recorded as expense in the consolidated statement of operations.

13. Commodity price risk contracts

During 2009, the Company fulfilled a commodity price risk contract for the sale of 1,500 GJ per day of natural gas from April 1 to December 31, 2009 at a fixed price of \$5.69 per GJ. Included in petroleum and natural gas revenue for the year ended December 31, 2009 is \$920,429 of realized gains (2008 – \$211,008 of realized losses) on the fulfilled portion of the commodity contracts.

During 2008, the Company fulfilled the following commodity price risk contracts for the sale of natural gas:

- 500 GJ per day from April 1 to December 31, 2008 at a ceiling price of \$8.46 per GJ and a floor price of \$7.25 per GJ;
- 500 GJ per day from April 1 to December 31, 2008 at a ceiling price of \$8.31 per GJ and a floor price of \$7.75 per GJ;
- 500 GJ per day from April 1 to August 31, 2008 at a ceiling price of \$8.25 per GJ and a floor price of \$7.00 per GJ; and
- 500 GJ per day from April 1 to August 31, 2008 at a ceiling price of \$8.15 per GJ and a floor price of \$7.50 per GJ.

In December 2008, the Company terminated a commodity price risk contract for the total notional quantity of 182,500 GJ of natural gas over the period January 1 to December 31, 2009 at a fixed price of \$7.79 per GJ for proceeds of \$226,800 based on the fair value of the contract on the settlement date. The proceeds are reported as other income for the year ended December 31, 2008.

As at December 31, 2009, the Company is committed to the following commodity price risk contracts for the sale of natural gas:

- 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.

The mark-to-market value of the unfulfilled portion of the above contracts at December 31, 2009 is a liability of \$113,361 based on the remaining contractual terms from January 1, 2010 to December 31, 2010. In March 2010, the Company settled all outstanding commodity price risk contracts for proceeds of \$73,500.

14. Royalty recoveries

During year ended December 31, 2009, the Company recognized a recovery in the amount of \$289,728 of freehold and gross overriding royalties calculated and paid in previous years.

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

15. 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:

	2009	2008
Loss before income taxes	\$ (9,093,518)	\$ (2,124,872)
Combined federal and provincial statutory income tax rate	29.0%	29.5%
Expected income tax reduction	\$ (2,637,120)	\$ (626,837)
Stock-based compensation and other non-deductible charges	61,641	175,558
Effect of tax provision and filing position differences	23,098	58,119
Rate adjustments	376,850	53,267
Other	(12,090)	40,101
Change in valuation allowance	362,123	–
	<u>\$ (1,825,498)</u>	<u>\$ (299,792)</u>

The components of the net future income asset (liability) at December 31 are:

	2009	2008
Asset retirement obligation	\$ 545,432	\$ 531,061
Non-capital and capital loss carryforwards	308,750	256,116
Share issue costs	21,632	9,416
Commodity price risk contracts	31,741	–
Property and equipment	(1,382,789)	(2,553,738)
Valuation allowance	(362,123)	–
	<u>\$ (837,357)</u>	<u>\$ (1,757,145)</u>

As at December 31, 2009, the Company has approximately \$33.5 million of tax pools available for deduction against future taxable income. The Company also has non-capital tax losses of approximately \$1,030,100 available for deduction against future taxable income that expire in 2029.

16. Change in non-cash working capital

	2009	2008
Accounts receivable	\$ 1,058,430	\$ (425,639)
Prepaid expenses and deposits	285,070	(210,728)
Accounts payable and accrued liabilities	480,546	(91,473)
	<u>\$ 1,824,046</u>	<u>\$ (727,840)</u>

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

	2009	2008
Operating	\$ 1,023,649	\$ (428,503)
Investing	800,397	(299,337)
	<u>\$ 1,824,046</u>	<u>\$ (727,840)</u>

17. Related party transactions

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

- i) During the years ended December 31, 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:

	<i>2009</i>	<i>2008</i>
Administration and consulting fees	\$ 159,174	\$ 137,858
Production and capital expenditures	\$ 119,865	\$ 249,493

- ii) During the year ended December 31, 2009, the Company was charged \$7,902 (2008 – \$24,104) by a law firm in which a former director of the Company is a partner.

Included in accounts payable and accrued liabilities at December 31, 2009 is \$12,000 (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.

18. Financial instruments and financial risk management

The Company's financial instruments include accounts receivable, investment, accounts payable and accrued liabilities, bank debt, credit facility, preferred shares (note 10) and commodity price risk contracts (note 13). 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 Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

The fair value of the commodity price risk contracts is considered to be Level 2 as it is estimated by discounting the difference in the contract price and forward prices using the remaining volumes in the contract.

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:

18. Financial instruments and financial risk management (continued)

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 December 31, 2009, the maximum credit exposure is the carrying amount of the accounts receivable and accruals of \$658,080 (2008 – \$1,710,780). As at December 31, 2009, the Company's receivables consisted of \$304,930 from joint venture partners and other trade receivables and \$353,150 of revenue receivable from petroleum and natural gas marketers.

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 \$304,930 of revenue accruals and receivables from petroleum and natural gas marketers was received in January and February 2010.

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 December 31, 2009, the largest amount owing from one partner is \$73,259 (see note 21).

The Company did not provide for any doubtful accounts nor was it required to write-off any receivables during the year ended December 31, 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 December 31, 2009, the Company considers its receivables to be aged as follows:

Not past due	\$	415,968
Past due by less than 90 days		28,725
Past due by more than 90 days		213,387
		213,387
	\$	658,080

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.

18. Financial instruments and financial risk management (continued)

b) Liquidity risk (continued)

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, as disclosed in note 7, which is regularly reviewed 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 anticipates it will have adequate liquidity to fund its financial liabilities through its future cash flows. The Company's financial liabilities are comprised of accounts payable and accrued liabilities, bank debt and the credit facility, 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 year ended December 31, 2009, if interest rates had been 1% lower with all other variables held constant, earnings for the period would have been \$79,750 (2008 – \$77,530) higher, respectively, due to lower interest expense. 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 December 31, 2009 and 2008.

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 December 31, 2009 and 2008.

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's commodity price risk contracts are disclosed in note 13.

Yangarra Resources Ltd.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

19. 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:

	2009	2008
Working capital deficiency	\$ (7,963,051)	\$ (13,599,207)
Shareholders' equity	26,848,381	24,452,012
	\$ 18,885,330	\$ 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.

At December 31, 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 7. As a result, the Company's approach to capital management has changed to ensure compliance with the Loan Agreements. The Company's bank facility is determined by the senior lender and based on the lender's borrowing base model and the Company's petroleum and natural gas reserves.

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

20. Commitments

- a) The Company has until December 31, 2011 to incur \$500,000 of qualifying flow-through expenditures as disclosed in note 10(b)(xii).
- b) The Company has entered into lease agreements for office premises, field equipment and a Company vehicle with estimated minimum annual payments as follows:

2010	\$ 178,655
2011	141,236
2012	141,236
2013	83,833

- c) The Company's commodity price risk contract commitments are disclosed in note 13.

21. Contingency

In December 2009, the Company terminated the Standstill Agreement that it had with an industry partner regarding a joint producing property and served that industry partner with a Statement of Claim to the Court of Queen's Bench of Alberta, to which the Company claims breach of the agreements between the parties, gross negligence and default of operator. The Company seeks judgment for specified and such further damages to be determined by the court, as well as appointment as operator. The industry partner has indicated it plans to file a Statement of Defense and Counterclaim. The potential outcome of the lawsuit and claims are undetermined however they may be material. As the likely outcome of this litigation cannot be determined at this time, no provision has been made in these consolidated financial statements.

22. Subsequent events

- a) In March 2010, the Company completed a private placement of 80,000,000 Units at \$0.075 per Unit for gross proceeds of \$6,000,000. Each Unit is comprised of one common share of the Company and one half of one common share purchase warrant, with each full warrant exercisable anytime up to March 15, 2012, at a price of \$0.10 per share, subject to certain earlier termination provisions. Management and directors subscribed for 13,356,669 Units for gross proceeds of \$1,001,750 or 16% of the financing. Finder's fees of \$364,480 were paid in conjunction with the financing. The common shares and warrants issued and the common shares issuable on the exercise of the warrants are all subject to hold periods expiring on July 17, 2010.
- b) In March 2010, the Company acquired a 15% overriding royalty on natural gas and a 5-15% sliding scale overriding royalty on oil that covers approximately eleven sections of Cardium and Glauconite lands in the Willesden Green area.
- c) In March 2010, the Company settled all outstanding commodity price risk contracts for proceeds of \$73,500.
- d) In March 2010, the Company held a special meeting of the shareholders which voted in the affirmative on a resolution to consolidate the common shares of the Company on a five old for one new (5:1) basis. The Company received TSX-V Exchange approval for the consolidation on April 28, 2010 and a new symbol has been given to the Company. Effective April 30, 2010 the Company's stock will trade under the new symbol "YGR" and will trade on a consolidated basis. As a result of the consolidation the Company will have 53,668,006 shares outstanding.