

**Financial Statements of
Canadian Spirit Resources Inc.**

December 31, 2008

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Canadian Spirit Resources Inc.

REPORT OF MANAGEMENT

April 23, 2009

The accompanying Financial Statements of Canadian Spirit Resources Inc., for each of the years ended December 31, 2008 and 2007, are the responsibility of Management.

Management has prepared the Financial Statements in accordance with accounting principles generally accepted in Canada. If alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has ensured that the Financial Statements are presented fairly in all material respects.

Canadian Spirit Resources Inc. maintains internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for reviewing and approving the Financial Statements and Management's Discussion and Analysis and, primarily through its Audit Committee, ensures that management fulfills its responsibilities for financial reporting.

The Audit Committee is appointed by the Board and is entirely composed of Directors who are independent of the Company. The Audit Committee meets regularly with management, and periodically with the external auditors, to discuss internal controls and reporting issues and to satisfy itself that each party is properly discharging its responsibilities. It reviews the Financial Statements and the external auditors' report. The Audit Committee also considers, for review by the Board and approval by the shareholders, the engagement or reappointment of the external auditors.

PricewaterhouseCoopers LLP, the external auditors, have audited the Financial Statements, for each of the years ended December 31, 2008 and 2007, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders. PricewaterhouseCoopers LLP have full and free access to the Audit Committee.

(signed) "Donald R. Gardner"

Donald R. Gardner,
Chief Executive Officer

(signed) "Dean G. Hill"

Dean G. Hill,
Chief Financial Officer

Canadian Spirit Resources Inc.

AUDITORS' REPORT

April 23, 2009

To the Shareholders of Canadian Spirit Resources Inc.

We have audited the balance sheets of Canadian Spirit Resources Inc. (the "Company") as at December 31, 2008 and 2007 and the statements of operations, comprehensive loss and deficit, and cash flows for each of the years ended December 31, 2008 and 2007. 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 financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years ended December 31, 2008 and 2007 in accordance with Canadian generally accepted accounting principles.

"PricewaterhouseCoopers LLP"

Chartered Accountants

Calgary, Alberta

Canadian Spirit Resources Inc.

BALANCE SHEETS

As at December 31 2008 2007

ASSETS

Current assets:

Cash and cash equivalents	\$ 11,217,762	\$ 1,063,490
Accounts receivable	1,585,657	89,447
Prepaid expenses and other	47,054	52,542
	<u>12,850,473</u>	<u>1,205,479</u>

Property, plant and equipment (note 3)	<u>34,685,065</u>	<u>37,543,148</u>
	<u>\$ 47,535,538</u>	<u>\$ 38,748,627</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Accounts payable and accrued trade liabilities	\$ 1,132,785	\$ 854,444
Accrued liability for share appreciation rights (note 5)	<u>-</u>	<u>18,000</u>
	<u>1,132,785</u>	<u>872,444</u>

Asset retirement obligation (note 4)	211,848	198,685
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Shareholders' equity

Equity instruments (note 5)	59,074,572	49,168,204
Contributed surplus (note 5)	5,233,673	4,928,402
Deficit	<u>(18,117,340)</u>	<u>(16,419,108)</u>
	<u>46,190,905</u>	<u>37,677,498</u>
	<u>\$ 47,535,538</u>	<u>\$ 38,748,627</u>

Nature of operations and going concern (note 1)

Commitments (note 8)

ON BEHALF OF THE BOARD:

(signed) "Philip H. Grubbe"

Director

(signed) "J.R. Richard Couillard"

Director

Canadian Spirit Resources Inc.

STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

For the year ended December 31

2008

2007

Revenue

Interest and other income	\$ 133,344	\$ 90,522
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Expenses

Consulting fees	192,098	186,664
Salaries and benefits	823,283	427,344
Other general administration	598,959	491,503
Stock-based compensation (note 5)	357,595	(197,290)
Accretion expense	8,697	11,621
Amortization expense	25,485	46,244

2,006,117

966,086

Loss before income taxes

	(1,872,773)	(875,564)
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Recovery of future income taxes (note 7)

174,541

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Net loss and comprehensive loss

	(1,698,232)	(875,564)
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Deficit, beginning of period

(16,419,108)

(15,543,544)

Deficit, end of period

\$ (18,117,340)

\$ (16,419,108)

Loss and comprehensive loss per share (basic & diluted)

\$ (0.04)

\$ (0.03)

Nature of operations and going concern (note 1)

Canadian Spirit Resources Inc.

STATEMENTS OF CASH FLOWS

For the year ended December 31

2008

2007

Operating Activities:

Net loss	\$ (1,698,232)	\$ (875,564)
Add (deduct) items not affecting cash:		
Amortization expense	25,485	46,244
Accretion expense	8,697	11,621
Recovery of future income taxes	(174,541)	-
Stock-based compensation	357,595	(197,290)
	<u>(1,480,996)</u>	<u>(1,014,989)</u>
Changes in non-cash working capital items	<u>(75,628)</u>	<u>(25,998)</u>
	<u>(1,556,624)</u>	<u>(1,040,987)</u>

Financing Activities:

Equity instruments issued for cash	10,549,785	3,744,700
Equity instruments re-purchased and cancelled	(65,675)	-
Equity instruments issue costs	(473,525)	(209,525)
	<u>10,010,585</u>	<u>3,535,175</u>

Investing Activities:

Computer and office equipment, furniture	(60,634)	(3,251)
Recovery of (expenditure on) exploration and development costs	2,965,831	(4,679,288)
Acquisition and retention of natural gas rights	(68,133)	(84,453)
	<u>2,837,064</u>	<u>(4,766,992)</u>
Changes in non-cash working capital items	<u>(1,136,753)</u>	<u>123,416</u>
	<u>1,700,311</u>	<u>(4,643,576)</u>

Change in cash

10,154,272 (2,149,388)

Cash position, beginning of period

1,063,490 3,212,878

Cash position, end of period

\$ 11,217,762 \$ 1,063,490

Cash taxes paid

\$ - \$ -

Interest paid

\$ - \$ -

See the accompanying notes to the financial statements

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

1. NATURE OF OPERATIONS, GOING CONCERN AND BASIS OF PRESENTATION

Canadian Spirit Resources Inc. (the “Company”) is incorporated in British Columbia and is a public company listed on the TSX Venture Exchange (the “Exchange”).

Since May 2002, the Company has been evaluating the resource potential of certain unconventional natural gas properties and is considered to be in its development stage of operations. The recoverability of amounts shown for natural gas properties is dependent ultimately upon the determination of economically recoverable reserves. The Company’s ability to continue its operations and to realize assets at their carrying values is dependent upon the continued support of its shareholders and joint venture partners, obtaining additional financing and generating revenues sufficient to cover its operating costs. The Company has incurred losses since inception totaling \$18,117,340 which includes a net loss after income taxes of \$1,698,232 for the twelve months ended December 31, 2008 (2007: loss of \$875,564).

These financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due. The financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities at amounts different from those reflected; such adjustments could be material and thus the use of accounting principles applicable to a going concern may or may not be appropriate.

2. SIGNIFICANT ACCOUNTING POLICIES

Measurement Uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles (“GAAP”) 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. The amounts recorded for amortization, asset retirement obligation, impairment of unproved properties, stock based compensation and future income taxes are based upon estimates. Actual results could differ from those estimates.

Joint Interests

Exploration, development and production activities are conducted jointly with external parties and, accordingly, the Company only reflects its proportionate interest in such activities.

Cash and Cash Equivalents

Cash and short term deposits include investments with an original maturity of three months or less.

Financial Instruments and Derivatives

(a) Classification:

GAAP requires that all financial instruments be classified either as held-for-trading financial assets or liabilities, available-for-sale financial assets, held-to-maturity financial assets, loans and receivables or other financial liabilities.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

The Company has classified each of its financial instruments as a) cash and cash equivalents as held-for-trading financial assets; b) accounts receivable as loans and receivables; and c) accounts payable and accrued trade liabilities as other financial liabilities.

The Company does not have any other financial assets or financial liabilities, nor does it have any embedded derivative financial instruments or contracts.

(b) **Recognition and Measurement:**

GAAP requires that all financial instruments including derivatives and most embedded derivatives be measured initially at fair value and then subsequently at amortized cost, with the exception of loans and receivables, debt securities classified as held-to-maturity financial assets, and other financial liabilities which may be measured at amortized cost from inception.

The Company does not have any financial instruments designated as hedges and therefore does not present a separate statement of other comprehensive income.

Property, Plant and Equipment

(a) **Natural Gas Interests:**

The Company follows the full cost method of accounting for exploration and development expenditures whereby all costs relating to the acquisition of, exploration for and development of natural gas reserves are capitalized. Such costs include lease acquisitions, geological and geophysical, lease rentals on undeveloped properties, drilling both productive and non-productive wells, production equipment, and overhead charges directly related to acquisition, exploration and development activities. Proceeds received from disposals of properties and equipment are credited against capitalized costs unless the disposal would alter the rate of depletion and amortization by more than 20 percent, in which case a gain or loss on disposal is recorded.

Upon commencement of commercial production all costs of acquisition, exploration and development of natural gas reserves, associated tangible plant and equipment costs, asset retirement obligations and estimated costs of future development of proved undeveloped reserves are depleted and/or amortized by the unit of production method based on estimated gross proved reserves before royalties as determined by independent evaluators. Natural gas reserves are converted to equivalent units using their relative energy content of six thousand cubic feet of natural gas to one barrel of oil.

The costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion calculations. These properties are assessed annually to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

Natural gas assets are evaluated annually or when events or conditions dictate to determine that the costs are recoverable and do not exceed the fair value of the properties. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves plus the lower of cost and market of unproved properties exceed the carrying value of the petroleum and natural gas assets. If the carrying value of the petroleum and natural gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market of unproved properties. The cash flows are estimated using future product prices and costs and are discounted using the risk-free interest rate.

(b) **Mineral Property:**

Expenditures incurred on properties identified as having development potential are recorded at cost and are deferred on a project basis until the viability of the project is determined. If a project is successful, the project costs are amortized using the unit of production method based on recoverable mineral reserves. If a project is abandoned or it is determined that the mineral property is uneconomic to produce, the accumulated project costs are charged to earnings in the period in which the determination is made.

(c) **Office Equipment:**

Computer and office equipment are recorded at cost and amortized on a straight line basis over their estimated useful life of three years. Furniture and fixtures are recorded at cost and amortized on a straight line basis over their estimated useful life of five years.

Asset Retirement Obligation

The Company follows the accounting methodology outlined in Section 3110 of the Canadian Institute of Chartered Accountants (“CICA”) Handbook with respect to asset retirement obligations. The Company records the present value of legal obligations associated with the retirement of long-lived tangible assets, such as producing well sites and natural gas processing plants, in the period in which they are incurred with a corresponding increase in the carrying amount of the related long-lived asset. The liability accretes until the Company settles the retirement obligation. The carrying amounts of the long-lived assets are depleted using the unit of production method. Actual costs to retire tangible assets are deducted from the liability as incurred.

Revenue Recognition

Revenues from the sale of natural gas and other hydrocarbons are recorded when title passes to an external party and when collectibility is reasonably assured.

Stock-based Compensation

(a) **Stock Options:**

Stock options are accounted for based on the fair value method. The fair value is measured at the grant date and charged to earnings over the vesting period with a corresponding increase to contributed surplus. Consideration paid to the Company on exercise of all options is credited to share capital.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

- (b) Performance Units:
Compensation costs attributable to performance units are recognized as a charge to stock-based compensation expense when the likelihood of payout based on inherent performance factors is determined to be probable.
- (c) Share Appreciation Rights:
Compensation cost attributable to awards to employees that call for settlement in cash is measured at intrinsic value and charged to stock-based compensation expense on a straight-line basis over the vesting period with a corresponding increase in accrued liabilities.

Comprehensive Income

Comprehensive Income is defined as the change in equity from transactions and other events from non-owner sources and other comprehensive income comprises revenues, expenses, gains and losses that, in accordance with GAAP, are recognized in comprehensive income but excluded from net earnings or loss.

Earnings per Share

Basic earnings per common share are calculated on net earnings using the weighted average number of shares outstanding during the fiscal period. Diluted earnings per share information is calculated using the treasury stock method which assumes that proceeds obtained upon exercise of options and warrants would be used to purchase common shares at the average market price for the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

Flow-Through Shares

The Company has financed a portion of its exploration and development activities through the issue of Flow-Through Shares. Under the terms of these share issues, the related resource expenditure deductions for income tax purposes are renounced to investors. Accordingly, when the expenditures are renounced and upon filing of documents with the taxation authorities, share capital is reduced and a recovery of future income taxes is recorded by the estimated value of the renounced tax deductions.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using enacted or substantively enacted income tax rates. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period the change occurs. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

Changes in Accounting Policies and Practices

The following new accounting pronouncements have been adopted with effect from January 1, 2008:

CICA Handbook: Section 1535, *Capital Disclosures*; Section 3862, *Financial Instruments – Disclosures*; and Section 3863 *Financial Instruments – Presentation*.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital – see note 10.

Sections 3862 and 3863 have replaced Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections placed increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks – see note 9.

Future Changes in Accounting Policies

The following is an overview of accounting standard changes that the Company will be required to adopt in the near future:

CICA Handbook: Section 3064, *Goodwill and Intangible Assets*

Section 3064 will revise the definition of an intangible asset in order to align with International Financial Reporting Standards by clarifying the criteria for the recognition of intangible assets and providing guidance to help distinguish intangible assets from expenses. The new section will also provide guidance on the recognition and measurement of internally developed intangible assets.

This new standard is effective for fiscal years beginning on or after October 1, 2008 and therefore the Company plans to adopt it effective January 1, 2009. The Company does not expect this change to have a material effect on its financial statements.

International Financial Reporting Standards (“IFRS”)

In February 2008, the CICA's Accounting Standards Board confirmed that IFRS will replace Canadian generally accepted accounting principles in 2011 for profit-oriented Canadian publicly accountable enterprises. As such, the Company will be required to report its results in accordance with IFRS beginning in 2011. In the time leading up to the conversion date, some existing Canadian standards will change to converge with IFRS. The Company's financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with Canadian generally accepted accounting principles as it exists on each reporting date. Financial statements commencing with the quarter ended March 31, 2011, including comparative information, will be prepared on an IFRS basis.

The Company has developed a changeover plan to complete the transition to IFRS by January 1, 2011, including the preparation of required comparative information. The key elements of the Company's changeover plan include:

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

- (a) determining appropriate changes to accounting policies and required amendments to financial disclosures;
- (b) identifying and implement changes in associated processes and information systems;
- (c) complying with internal control requirements;
- (d) communicating collateral impacts to internal departments; and
- (e) educating and training internal and external stakeholders.

The Company is currently analyzing accounting policy alternatives and identifying implementation options for the corresponding process changes. CSRI will update its IFRS changeover plan as necessary to reflect new and amended accounting standards issued by the International Accounting Standards Board. As IFRS is expected to change prior to 2011, the full impact of IFRS on the Company's financial statements is not reasonably determinable at this time.

3. PROPERTY, PLANT AND EQUIPMENT

	<u>2008</u>	<u>2007</u>
Unproved natural gas properties	\$ 35,804,319	\$ 38,697,551
Mineral property	1	1
Computer and office equipment, furniture	225,272	164,638
	<u>36,029,592</u>	<u>38,862,190</u>
Less: Accumulated depletion, amortization & impairment	<u>(1,344,527)</u>	<u>(1,319,042)</u>
Total property, plant and equipment	<u>\$ 34,685,065</u>	<u>\$ 37,543,148</u>

As the Company had no production or proved reserves as at December 31, 2008, there was no depletion charge for the period. There has been no impairment of unproved natural gas properties in 2008 or 2007.

During the second half of 2008, the Company received a reimbursement of \$5.0 million of previously expended drilling and completion costs from a joint venture partner. The recovery of these expenditures has been recorded as a net reduction in unproved natural gas properties capitalized costs as at December 31, 2008. No gain or loss has been recorded.

During the year ended December 31, 2008, the Company capitalized \$676,753 (2007: \$644,675) of overhead directly related to exploration and development activities.

The Company's mineral property is the Isk Wollastonite project where the Company holds a 100 percent undivided interest, subject to a 10 percent net profits interest, in a mineral claim covering 450 hectares in the Iskut River area of the Liard Mining Division, British Columbia.

In prior years, the book value of the mineral property was written down to \$1 to reflect its present economic value.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

4. ASSET RETIREMENT OBLIGATION

	2008	2007
Balance, beginning of year	\$ 198,685	\$ 158,650
Liabilities incurred	22,279	14,029
Revisions in estimated future obligation	-	14,385
Accretion expense	8,697	11,621
Less: liabilities disposed of	<u>(17,813)</u>	<u>-</u>
Balance, end of year	<u>\$ 211,848</u>	<u>\$ 198,685</u>

The total future asset retirement obligation including costs to reclaim and abandon wells and facilities plus the years in which such costs are expected to be incurred, is estimated by management. At December 31, 2008 the estimated total future liability of \$1,053,587 has a present value of \$211,848 assuming the liability is settled in approximately 23 years, using an estimated credit-adjusted risk-free interest rate of 9.0 percent, and an inflation rate of 2.25 percent.

5. EQUITY INSTRUMENTS

The Company has authorized share capital of an unlimited number of common shares of no par value. The Company has closed the following private placements since the beginning of 2007:

On July 16, 2008, the Company issued 2,493,319 Units at \$1.05 per Unit and 400,000 Flow-Through Shares at \$1.20 per share. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for eighteen months at an exercise price of \$1.40 per share. The fair value of the warrants was estimated at the date of closing, using the Black-Scholes pricing model, under which the Company assigned a value of \$0.49 per whole warrant or \$697,169 of the Unit proceeds to warrants, with the remaining \$1,920,816 of the Unit proceeds assigned to common shares. The Flow-Through Shares entitle the holder to certain income tax benefits in the form of Canadian Development Expense. The full proceeds of the Flow-Through Shares placement, or \$480,000, has been assigned to common shares and had been fully expended on eligible development costs by the end of fiscal 2008.

On February 19, 2008, the Company issued 11,220,000 Units at \$0.50 per Unit. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for two years at an exercise price of \$0.80 per share. Prior to expiry, if the common shares of the Company close at a price of \$1.20 per share or greater for twenty consecutive trading days, then the Company shall have the option upon thirty days written notice to require the exercise of the warrants by the end of such period at which time any unexercised warrants shall expire. The fair value of the warrants was estimated at the date of closing using the Black-Scholes pricing model, under which the Company assigned a value of \$0.18 per whole warrant or \$1,311,618 of the Unit proceeds to warrants, with the remaining \$4,298,382 of the Unit proceeds assigned to common shares.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

On December 28, 2007, the Company issued 250,000 Flow-Through Shares at \$0.80 per share. The Flow-Through Shares entitled the holder to certain income tax benefits in the form of Canadian Development Expense. The full proceeds of the Flow-Through Shares placement, or \$200,000, was assigned to common shares and had been fully expended on eligible development costs as at December 31, 2007.

On July 18, 2007, the Company issued 3,053,000 Units at \$1.00 per Unit and 447,000 Flow-Through Shares at \$1.10 per share. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for one year at an exercise price of \$1.10 per share. The fair value of the warrants was estimated at the date of closing using the Black-Scholes pricing model, under which the Company assigned a value of \$0.21 per whole warrant or \$534,275 of the Unit proceeds to warrants, with the remaining \$2,518,725 of the Unit proceeds assigned to common shares. The Flow-Through Shares entitled the holder to certain income tax benefits in the form of Canadian Development Expense. The full proceeds of the Flow-Through Shares placement, or \$491,700, was assigned to common shares and had been fully expended on eligible development costs as of the end of 2007.

The equity instruments issued and outstanding are as follows:

	2008		2007	
	Number of shares	Amount of shares and warrants	Number of shares	Amount of shares and warrants
Balance - beginning of year	32,583,082	\$ 49,168,204	28,833,082	\$ 46,991,811
Equity instruments issued for cash:				
Stock options	465,000	188,400	-	-
Private placements	14,113,319	8,707,985	3,750,000	3,744,700
Warrants exercised	1,514,000	1,653,400	-	-
Equity instruments cancelled:				
Issuer bid share repurchase	(120,000)	(144,875)	-	-
Warrants expired	-	(18,375)	-	(1,358,782)
Equity instruments issue costs	-	(355,141)	-	(209,525)
Credit from contributed surplus	-	167,899	-	-
Tax effect of Flow-Through Shares	-	(292,925)	-	-
Balance - end of year	48,555,401	\$ 59,074,572	32,583,082	\$ 49,168,204

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

Normal Course Issuer Bid

The Company received approval from the Exchange on December 2, 2008 to make a Normal Course Issuer Bid (the "Bid") consisting of the acquisition and cancellation of up to 1 million common shares of the Company's stock, representing 2.1% of the total number of common shares outstanding at the commencement of the Bid. The Bid commenced on December 8, 2008 and will run for a maximum term to November 30, 2009.

As of December 31, 2008, the Company had purchased for cancellation 120,000 common shares of the Company for total cash consideration of \$65,675 (an average price of \$0.55 per common share), representing 0.25% of the total number of common shares outstanding at the commencement of the Bid. As the average cost of equity instruments outstanding at the date of commencement of the Bid was \$1.21 per common share, the difference of \$0.66 per common share or \$79,200 was also charged against equity instruments with the offset recorded as an increase to contributed surplus as at December 31, 2008.

Share Purchase Warrants

In conjunction with previous financings, the Company issued warrants with terms of one to two years to acquire common shares at specific exercise prices.

Issue Date	Exercise Price of Warrants	Out-standing at Dec. 31, 2007	Issued	Exercised or Expired	Out-standing at Dec. 31, 2008	Expiry Date
July 18, 2007	\$1.10	1,526,500	-	(1,474,000) (52,500)	-	⁽¹⁾ July 18, 2008
Feb. 19, 2008	\$0.80	-	5,610,000	(40,000)	5,570,000	⁽²⁾ Feb. 19, 2010
July 16, 2008	\$1.40	-	1,246,660	-	1,246,660	Jan. 16, 2010
	Total	1,526,500	6,856,660	(1,566,500)	6,816,660	

Notes:

- (1) In July 2008, 1,474,000 of these warrants were duly exercised prior to expiry resulting in total proceeds to the Company of \$1,621,400. The remaining 52,500 warrants expired unexercised.
- (2) On July 25, 2008, 40,000 of these warrants were duly exercised resulting in total proceeds to the Company of \$32,000.

Stock Options

The Company has stock option plans for directors, officers, employees and consultants which provides for the granting of options to acquire common shares. Under the terms of each plan, options vest over periods as determined by the Company and expire after a maximum of five years.

At December 31, 2008, there were 4,426,000 common shares reserved for issuance under the plans. Options to acquire 3,057,000 common shares were outstanding at December 31, 2008, of which 2,444,333 had vested and 612,667 remained unvested, as follows:

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2008 and 2007

Exercise Price of Option	Out-standing at Dec. 31, 2007	Granted	Exercised, Expired or Cancelled	Out-standing at Dec. 31, 2008	Vested at Dec. 31, 2008	Year of Expiry
\$0.40 to \$0.41	465,000	-	⁽²⁾ (465,000)	-	-	2008
\$0.56 to \$0.76	-	⁽⁵⁾⁽⁶⁾ 1,537,000	-	1,537,000	1,053,500	2009-2013
\$0.83 to \$0.85	150,000	-	-	150,000	112,500	2012
\$1.00 to \$1.24	80,000	-	-	80,000	60,000	2009/2012
\$1.50 to \$1.72	680,000	-	-	680,000	680,000	2009
\$2.05	95,000	-	-	⁽¹⁾ 95,000	63,333	2010
\$2.05	20,000	-	-	20,000	13,333	2011
\$2.15	100,000	-	-	100,000	66,667	2011
\$2.50	50,000	-	⁽³⁾ (50,000)	-	-	2008
\$3.30	75,000	-	-	75,000	75,000	2009
\$3.65	450,000	-	⁽⁴⁾ (450,000)	-	-	2008
\$4.15 to \$7.15	320,000	-	-	320,000	320,000	2010
Total	2,485,000	1,537,000	(965,000)	3,057,000	2,444,333	

Notes:

- (1) These stock options were re-priced on September 19, 2006 with no change to the original expiry date.
- (2) These stock options were exercised on January 23, 2008 (225,000) and May 2, 2008 (240,000).
- (3) These stock options were cancelled on February 27, 2008.
- (4) These stock options expired effective August 28, 2008.
- (5) 600,000 of these stock options were granted as a replacement for the share appreciation rights (see Page 17) that were to expire on January 28, 2009, and were exercised subsequent to December 31, 2008.
- (6) 40,000 of these stock options were exercised subsequent to December 31, 2008.

Options granted are accounted for using the fair value method. The compensation cost charged against earnings for stock options granted during the year ended December 31, 2008 was \$375,595 (2007: \$318,710). The stock options outstanding at December 31, 2008 have a weighted average exercise price of \$1.53 (2007: \$2.34).

The fair value of all option grants in 2008 and 2007 was estimated on the date of grant using the Black-Scholes pricing model with the following annualized weighted average assumptions:

	2008	2007
Risk free interest rate	3.20%	4.00%
Expected dividend yield	0%	0%
Expected stock price volatility	86.57%	64.33%
Expected life of options	3.2 years	4.0 years
Weighted average fair value of options granted during the year	\$0.26	\$0.48

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

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Performance Units

In 2006, the Company implemented a full value Performance Unit Incentive Plan for executive officers and directors of the Company. A performance factor ranging from zero to three will be determined for each performance period based on the average closing price of the Company's shares over the last ten trading days of each performance period relative to a share price scale established at the date of grant. Upon each vesting date the units either pay out or expire. Awards under this plan are paid in cash within 60 days of the end of each performance period. Payments for vested units are determined by multiplying the number of units vested by the performance factor achieved during that performance period and multiplying the product by the 10 day average closing price of the Company's shares at the end of the performance period.

On September 19, 2006, executive officers of the Company were granted a total of 39,000 performance units vesting in equal amounts at performance periods ending on the 1st of January 2007, 2008, and 2009. Independent directors of the Company were granted a total of 16,000 performance units vesting on January 1, 2009. For the purpose of calculating the performance factor associated with the 2006 grant, minimum and maximum 10 day average closing share prices were set at \$2.50 and \$5.00 per share respectively for all performance periods. Based on the 10 day average closing share price on the Exchange as at December 31, 2008 of \$0.59 per share and the 10 day average closing share price on the Exchange as at December 31, 2007 of \$0.55 per share, the resultant performance factors for both periods equal zero and therefore the total compensation expense for the 2006 grant for the year ended December 31, 2008 and the year ended December 31, 2007 respectively are \$Nil.

On January 18, 2007, the Company granted a further 119,000 performance units pursuant to its Performance Unit Incentive Plan. Executive officers were granted 93,400 performance units vesting in equal amounts at performance periods ending on the 1st of January 2008, 2009 and 2010. Independent directors were granted 25,600 performance units which vest on January 1, 2010. The criterion for the 2007 grant is the average closing price of the Company's shares for the last 10 trading days of each performance period and vesting is subject to minimum and maximum average share prices of \$1.75 and \$4.25 per share respectively. Payout of vested units is made in cash following the end of each performance period. The total compensation expense for the 2007 grant for the year ended December 31, 2008 and the year ended December 31, 2007 respectively were \$Nil as the 10 day average closing share prices on the Exchange as at December 31, 2008 and December 31, 2007 were \$0.59 and \$0.55 per share respectively.

Grant Date	Out-standing at Dec. 31, 2007	Granted	Expired	Exercised and Paid	Outstanding and Unvested at Dec. 31, 2008	Expiry Date
Sept. 19, 2006	42,000	-	(13,000)	-	29,000	March 2, 2009
Jan. 18, 2007	119,000	-	(31,100)	-	87,900	March 2, 2010
Total	161,000	-	(44,100)	-	116,900	

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

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Share Appreciation Rights

On August 28, 2003, three senior employees were granted share appreciation rights ("SARs") entitling them to cash payments equal to the excess of the grant date price of the common shares (to a maximum of \$3.65, as amended) over the exercise price of the right. Terms of the SARs are similar to the provisions of the stock option plans however, the exercise of vested SARs was subject to achieving certain minimum performance thresholds.

Exercise Price	Out-standing at Dec. 31, 2007	Granted or (Cancelled)	Exercised or Expired	Out-standing at Dec. 31, 2008	Vested at Dec. 31, 2008	Expiry Date
\$0.48	600,000	(600,000)	-	-	-	⁽¹⁾ Jan. 28, 2009

Note:

(1) In the third quarter 2008, the Board of Directors determined that the exercise conditions associated with these SARs had been achieved and extended the expiry date of the SARs from August 28, 2008 to January 28, 2009. On October 30, 2008 the Board of Directors approved a grant of 600,000 stock options, at an exercise price of \$0.50 per share with a term of five months (having an expiry date of March 31, 2009) to replace all the existing outstanding SARs. The difference of \$0.02 between the exercise price of the SARs and the replacement stock options was paid out to the SARs holders in cash in the fourth quarter 2008. All 600,000 stock options granted as a replacement of the SARs were exercised subsequent to December 31, 2008.

Total compensation recovery for share appreciation rights for the year ended December 31, 2008 was \$18,000 (2007: recovery of \$516,000) due to the cancellation of the SARs as of October 31, 2008. As a result of the cancellation of the SARs, the Company no longer has an accrued liability as at December 31, 2008 relating to the SARs (2007: \$18,000).

Contributed Surplus

	2008	2007
Balance, beginning of year	\$ 4,928,402	\$ 3,250,910
Value of options granted	375,595	792,500
Recovery of expense related to cancelled options	-	(473,790)
Options exercised and transferred to equity instruments	(167,899)	-
Issuer bid share repurchase	79,200	-
Warrants expired	18,375	1,358,782
Balance, end of year	<u>\$ 5,233,673</u>	<u>\$ 4,928,402</u>

Per Share Amounts

The weighted average number of shares outstanding during the year ended December 31, 2008 was basic 44,649,248 (2007: 30,426,918) and diluted 45,004,404 (2007: 30,964,153).

For the year ended December 31, 2008, the existence of stock options and warrants affects the calculation of loss per share on a diluted basis. As the effect of this dilution is to reduce the reported loss per share, diluted loss per share equals basic loss per share.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

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6. RELATED PARTY TRANSACTIONS

Transactions with related parties are recorded at exchange amounts for services provided. During the years ended 2008 and 2007, the only transactions the Company had with its directors, persons related to them or companies controlled by them in the normal course of business were as follows:

	2008	2007
Consulting fees	\$ 188,450	\$ 111,700

During the year ended December 31, 2008, a total of \$188,450 (2007: \$111,700) of consulting fees were paid and accounts payable at December 31, 2008 included \$3,716 (2007: \$17,928) of consulting fees payable to a director and executive officer of the Company. Subsequent to the year-end, this consulting contract with a director and executive officer of the Company was terminated. There were no other transactions with directors, persons related to them or companies controlled by them in the normal course of business during 2008 and 2007.

During 2008, certain directors, relatives of directors, or companies controlled by directors subscribed for Nil (2007: 20,250) shares or units in private placement offerings of the Company under the same terms and conditions as other investors.

7. FUTURE INCOME TAXES

The provision for future income taxes differs from the amount computed by applying the combined statutory Canadian Federal and Provincial tax rates to earnings before taxes. The reasons for these differences are as follows:

	2008	2007
Loss before income taxes	\$ (1,872,773)	\$ (875,564)
Rate	29.50%	32.12%
Computed / expected income taxes	\$ (552,468)	\$ (281,231)
Increase (decrease) in income taxes resulting from:		
Non-deductible stock-based compensation	110,801	102,370
Non-deductible expenses	8,148	6,985
Effect of change in future tax rate	66,130	637,370
Unrecognized future tax benefits	192,848	(465,494)
Recovery of future income taxes	\$ (174,541)	\$ -

The Company calculated a recovery of future income taxes in the amount of \$172,925 in the first quarter of 2008 related to Flow-Through Shares issued in 2007 (see note 5) since the actual renouncement applications were filed with the appropriate authorities in January 2008. Further to the issue of Flow-Through Shares on July 16, 2008 (see note 5), the Company has calculated a further recovery of future income taxes in the amount of \$120,000. Offsetting these recoveries is the future tax effect of \$118,384 relating to the equity instruments issue costs incurred during 2008.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

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Including the recoveries of future income taxes due to the renouncement of Canadian Development Expense associated with the above issuances of Flow-Through Shares, the Company had estimated future tax assets at December 31, 2008 of \$2,561,037 (2007: \$2,400,073) against which a valuation allowance has been applied as follows:

	2008	2007
Property, plant and equipment	\$ 639,899	\$ 944,603
Asset retirement obligation	52,962	49,671
Stock-based compensation	-	4,500
Equity instruments issue costs	186,431	166,770
Tax loss carryforwards	1,681,745	1,234,529
	<u>2,561,037</u>	<u>2,400,073</u>
Less: Valuation allowance	(2,561,037)	(2,400,073)
Future income tax asset	<u>\$ -</u>	<u>\$ -</u>

The following estimated tax deductions are available to reduce future taxable income:

Non-capital losses	\$ 6,698,284
Capital losses	25,932
Canadian exploration expense	3,691,301
Canadian development expense	20,611,023
Canadian oil and gas property expense	13,189,542
Foreign exploration and development expense	120,908
Undepreciated capital cost	803,585
Cumulative eligible capital	2,762
Equity instruments issue expense	745,724
	<u>\$ 45,889,061</u>

Non-capital losses as at December 31, 2008 are available to reduce future taxable income as follows, until the end of:

2009	\$ 599,379
2010	455,973
2014	592,574
2015	543,450
2026	1,166,271
2027	1,424,041
2028	1,916,596
	<u>\$ 6,698,284</u>

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

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8. **COMMITMENTS**

The Company has entered into an office sub-lease agreement which expires on May 30, 2011. Under the terms of the sub-lease agreement, the Company is obligated to pay base annual rent of \$28.00 per square foot on 6,793 square feet as well as its share of the operating costs.

9. **FINANCIAL INSTRUMENTS**

The Company has exposure to the following risks from its use of financial instruments: credit risk, market risk and liquidity risk.

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. The maximum exposure to credit risk at December 31, 2008 is the carrying amount of the Company's accounts receivable balances. As at December 31, 2008 no accounts receivable amounts were past due and the Company did not incur any write-offs relating to accounts receivable balances during 2008. The accounts receivable balance as at December 31, 2008 is comprised of amounts due from the Company's reputable, financially-stable joint venture partners and are proactively collected by the Company on a timely basis.

Market risk is the risk that changes in market indices, such as foreign exchange rates and interest rates, will affect the Company's income or the value of its held financial instruments. Since the Company holds no debt, holds its cash and cash equivalents in the form of bank deposits and has limited dealings with foreign currency exchange, the Company's exposure to market risk is minimal.

Liquidity risk is the risk that the Company will not be able to meet its obligations as they become due. The Company manages its liquidity risk by synchronizing its forecasted cash requirements for operations with its anticipated capital financing activities. The impacts on the Company's liquidity risk due to current equity and commodity price market conditions include a) increased difficulty in raising additional funds for future capital projects and b) a decreased likelihood that the Company will be able to generate sufficient revenues from the sale of natural gas to cover administrative and operating costs. As such, the Company is currently monitoring its cash balances and has not budgeted for any significant capital spending for the next fiscal year.

Fair Value of Financial Instruments

Financial instruments held-for-trading include cash and cash equivalents, loans and receivables include accounts receivable and other financial liabilities include accounts payable and accrued trade liabilities. The fair value of cash and cash equivalents and accounts receivable approximate their carrying values due to the short term nature of these instruments. The fair value of accounts payable and accrued trade liabilities is significantly less than the carrying value due to the credit risk of the Company

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

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10. CAPITAL MANAGEMENT

The Company defines capital as Shareholders' equity and working capital based on the Company's financial statements.

The current objectives of the capital management process are to maximize long term shareholder value by (i) ensuring sufficient funding to enable the Company's unconventional natural gas resource project to reach the stage of reserves, production and funds from operations and by (ii) minimizing the Company's cost of capital consistent with a low level of financial risk.

The policies followed by the Company in managing its capital include:

- (a) ensuring a minimum working capital position of \$3.0 million that covers all budgeted capital commitments, anticipated administration and field operating costs for a minimum period of three months, current reclamation obligations, and other non-contingent financial liabilities;
- (b) funding 100 percent of capital requirements through the issue of equity instruments; and
- (c) holding the proceeds of equity funding in deposit accounts of major financial institutions providing for immediate access.

The Company manages its capital by continuously monitoring the quality and level of working capital and the amount of its financial commitments and current obligations. An annual funding plan is approved by the Board of Directors in conjunction with the capital budget process and capital commitments are made based on a quarterly budget review and approval process. The capital management process takes into account exploration and development results, economic conditions, cost inflation, commodity prices and capital market conditions.