

Canadian Spirit Resources Inc.

MANAGEMENT DISCUSSION AND ANALYSIS

For the year ended December 31, 2006

This management discussion and analysis (“MD&A”) of the financial conditions and results of operations should be read in conjunction with the audited financial statements for the year ended December 31, 2006.

Date

This MD&A includes information up to April 19, 2007.

Reader’s Advisory

The corporate information contained in these pages contains forward-looking information. The reader is cautioned that assumptions used in the preparation of such information, although considered reasonable by Canadian Spirit Resources Inc. at the time of preparation, may prove to be incorrect. The actual results achieved during the future period will vary from the information provided herein and the variations may be material. Consequently, there is no representation by Canadian Spirit Resources Inc. that actual results achieved during the future period will be the same in whole or in part as those estimated.

Corporate Overview

Canadian Spirit Resources Inc. (“CSRI” or the “Company”) is a natural resources exploration company currently focusing on the identification and assembly of unconventional natural gas opportunities in western Canada. Effective June 15, 2004, the Company changed its name to Canadian Spirit Resources Inc. from Spirit Energy Corp.

The Company holds a 100% undivided interest, subject to a 10% net profit interest, in ten mineral claims covering 1,425 hectares of land in the Iskut River area of the Liard Mining Division, British Columbia (the “Isk Wollastonite Mineral Properties”).

Prior to May 2002, the Company’s primary activity was to evaluate its Isk Wollastonite Mineral Properties. The Company determined that this mineral property contains significant reserves, but are uneconomic to produce at current prices due to lack of access and infrastructure. During 2001 and 2002 the Company impaired the carrying value of the mineral property to \$1 from \$4,788,596. During the exploration and evaluation phase of operations from 1992 through April 2002, the Company incurred approximately \$8.0 million of losses, including the impairment of this mineral property.

Since May 2002, the Company’s focus has been to evaluate the resource potential of certain unconventional natural gas exploration properties and is considered to be in its development stage of operations. Although some preliminary evaluation work was performed on coalbed methane prospects prior to May 2002, the decision to change the strategic direction of the Company from evaluation of the Isk Wollastonite Mineral Properties to an evaluation of unconventional natural gas prospects occurred during May 2002. The Company’s strategic advantages are the extensive knowledge and experience of its technical team in coal and unconventional natural gas exploration, the proprietary data base of potential unconventional natural gas resources in western Canada developed during 2002 and early 2003 and the energy development experience of its management, employees and directors.

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Results of Operations

Farrell Creek, British Columbia:

The focus of the Company's activities is currently on the planning and execution of a pilot production project in the Farrell Creek area of northeastern British Columbia. Prior to 2006, the Company had drilled six test wells on its lands to evaluate the unconventional natural gas potential of the Moosebar, Gates, Bluesky and Gething Formations. The first test well was drilled, cored, evaluated and suspended in the eastern portion of its land holdings during 2003. The next two test wells were drilled, cased, cored, and logged to evaluate a contiguous block of thirty sections in the west side of the Farrell Creek area during 2004. In 2005, three additional test wells were drilled, cased, cored and logged, one of which was principally to core and evaluate the Moosebar and Gates Formations. The acquisition of additional land brought the total mineral rights in this area to an average working interest of 94% in 39,506 acres. Fracture stimulation and testing of the Bluesky Formation in two test wells yielded uneconomic results and evaluation of the Gething Formation commenced with the fracture stimulation of the c-083-H test well.

Activity in 2006 began with testing of the productive capability of the Gething Formation at c-083-H and the drilling and casing of the b-092-H and d-093-H test wells. Together, these three wells formed the beginning of the Company's planned five well pilot production project. Production testing of the Gething Formation continued with the fracture stimulation of the b-092-H test well in February.

In September, Sproule Associates issued their final report with an evaluation of 1.8 trillion cubic feet of discovered natural gas resource in the Gething, Moosebar and Gates Formations on the Company's lands at Farrell Creek. See **Business Risks** on Page 9 of this MD&A.

From August through December 2006, two additional test wells, b-003-I and b-002-I were drilled, completed and fracture stimulated as part of the pilot production program. Preliminary engineering and cost analysis on the tie-in, facilities and pipeline to the Duke Energy sales pipeline was completed and landowner approvals obtained.

All four test wells completed in the Gething Formation flowed natural gas and modest amounts of saline water. The Company believes these results are encouraging given the early stage of evaluating this new unconventional basin. Activity to date in 2007 has concentrated on achieving consistent production of natural gas and water with improved reliability of equipment and the reduction of operating costs.

Bittern Lake, Alberta:

During 2004 and 2005 the Company acted as agent in acquiring three sections of land in Alberta under a joint venture with an independent third party. Under the terms of the joint venture, the partner paid 100% of the initial land acquisition and drilling costs up to \$2.5 million to earn a 50% working interest in the joint venture lands. The area of mutual interest ("AMI") in the joint venture lands covers four townships in central Alberta.

In late September and early October of 2005 the Company drilled and completed one Horseshoe Canyon well on the joint venture lands. Based upon completion results of this first well the Company drilled three additional wells on the same section of land. After initial positive indications from the first completed well, formation water production increased and the well was shut in. A second well was completed in February 2006 to further evaluate this play. Due to the inability to acquire a sizable land base for development on reasonable terms, the Company plans to farm out or dispose of these lands.

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Isk Wollastonite, British Columbia:

No field work was conducted at the Isk Wollastonite mine site during 2006. A development option held by a third party expired on December 31, 2005. Three mineral claims were allowed to lapse in December 2006. Due to expressions of interest to evaluate these claims for other mineral deposits, the Company obtained an annual extension on the remaining mineral claims during 2006. Annual extensions are available to the Company for the next nine years. The Company will continue to pursue farming these claims out to third parties.

Reserves

The Company has no proved or probable natural gas reserves at December 31, 2006. The Company's Statement of Reserves Data and Other Oil and Gas Information is incorporated in the Company's Annual Information Form dated April 19, 2007.

Selected Annual Information

For the years ended or as at December 31	2006	2005	2004
Total revenues	\$ 277,305	\$ 499,089	\$ 74,117
Net loss	\$ (1,075,215)	\$ (3,806,416)	\$ (1,741,820)
Net loss per share (basic & diluted)	\$ (0.04)	\$ (0.16)	\$ (0.10)
Total current assets	\$ 3,455,043	\$ 11,764,255	\$ 6,814,513
Total assets	\$ 36,249,029	\$ 34,011,298	\$ 20,884,673
Total current liabilities	\$ 857,202	\$ 3,722,768	\$ 1,223,229
Total long term liabilities	\$ 692,650	\$ 1,260,395	\$ 871,569

Significant items affecting results over the past three years

During the three year period ended December 31, 2006, the Company had no operating revenue and is considered to be in its development stage of operations. Reported revenue during the three years includes interest on cash deposits, management fees under a joint venture agreement and option fees pursuant to a development agreement covering the Isk Wollastonite Mineral Properties. The increase in reported revenue in 2005 was the result of significantly high average cash balances during the year plus management fees from a joint venture which commenced in 2005. In 2006, average cash balances were lower and the management fees terminated at the end of the first quarter. Option fees earned in 2004 and 2005 were very minor and the option was not renewed in 2006.

The fair value of stock options is measured at the grant date and charged to earnings on a pro-rata basis over the vesting period with a corresponding increase in contributed surplus. The number of stock options issued in a period, the vesting provisions of such options and the historic volatility of the Company's share price influence the amount of stock-based compensated expense in current and future periods. The compensation amount for stock options charged against earnings in 2006 was \$646,782 (2005: \$1,845,184 and 2004: \$770,592).

In 2003, the Company granted share appreciation rights ("SARs") entitling the holders to cash payments equal to the excess of the then current price of the common shares (to a maximum of \$3.65) over the exercise price of the right. The provision for the potential liability associated with SARs was calculated quarterly over the three year vesting period of these rights based on the closing price of the Company shares. The compensation cost is charged to stock-based compensation expense on a straight-line basis

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over the vesting period with a corresponding increase in accrued liabilities. The holder's right to exercise vested SARs is conditional upon the Company achieving certain production or profit thresholds. Total compensation recovery for SARs for 2006 was \$642,000 (2005: expense of \$330,667 and 2004: expense of \$767,333).

During the fourth quarter of 2005, the Company expended \$1,121,164 completing and production testing two test wells at Farrell Creek for conventional gas in the Bluesky Formation and expended a further \$51,744 in early 2006 to conclude these activities. Although these wells continue to be prospective for shale gas in the Gates and Moosebar Formations and natural gas from coal and shale in the Gething Formation, it was determined that the Bluesky Formation does not contain commercially recoverable quantities of hydrocarbons. As a result, the Company has made impairment provisions of \$51,744 for 2006 and \$1,121,164 for 2005 (2004: \$Nil) relating to the Bluesky completion costs.

Revenue

Revenues represent interest on cash deposits, management fees under a joint venture agreement, and fees received as compensation for extending the mineral option agreement. Revenues earned from management fees during 2006 were \$45,000 (2005: \$180,000). The Company does not have any natural gas revenue at this time.

General and Administration Expenses

For the years ended December 31	2006	2005	2004
Consulting fees	\$ 284,089	\$ 245,452	\$ 274,103
Salaries and benefits	931,467	861,460	338,261
Other general and administrative	638,058	508,151	249,817
	<u>1,853,614</u>	<u>1,615,063</u>	<u>862,181</u>
Less: capitalized costs	(621,222)	(648,911)	(260,070)
	<u>1,232,392</u>	<u>966,152</u>	<u>602,111</u>
Stock-based compensation	4,782	2,175,851	1,537,925
	<u>\$ 1,237,174</u>	<u>\$ 3,142,003</u>	<u>\$ 2,140,036</u>

Consultants' fees, which had declined 10% from 2004 to 2005 due to reduced geological and engineering work, increased by \$38,637 or 16% in 2006 over 2005. Additional engineering associated with the facilities and pipeline to tie in the Company's pilot production project together with technical assistance on the Farrell Creek Experimental Scheme Application were offset by reductions in geological and land consulting. These changes mirror the transition of the Company's activity from exploration and land acquisition to testing, optimization and development. Staff recruiting fees of \$40,275 were a significant factor in 2006 representing the entire increase over consultants' fees in 2005. Capitalized consulting fees related to exploration activity in 2006 were \$61,526 (2005: \$66,918; 2004: \$58,435).

Salaries and benefits rose by \$70,007 or 8% in 2006 versus 2005 reflecting primarily changes in base salaries and benefits plus the full year impact of staff additions in 2005. The substantial jump in salaries and benefits in 2005 over 2004 was the result of geological, engineering, land and financial staff additions in the first half of 2005. Staff reductions and turnover in 2006 reflected the Company's decision to focus

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on the testing and development of its Farrell Creek prospect. Severance payments in 2006 offset immediate reductions in salaries and benefits however, this is expected to be a positive factor in 2007.

The Company capitalizes salaries and benefits associated with staff directly related to exploration activities. In 2006, \$514,736 of salaries and benefits was capitalized compared to \$521,919 in 2005 (2004: \$162,513).

Other General and Administration Costs

For the years ended December 31	2006	2005	2004
Professional fees	\$ 129,186	\$ 127,966	\$ 96,749
Investor relations & filing fees	184,276	74,866	54,523
Office premises & insurance	162,110	166,297	39,364
Office supplies	88,960	87,472	22,053
Staffing costs	43,564	30,754	18,393
Other	29,962	20,796	18,735
	<u>638,058</u>	<u>508,151</u>	<u>249,817</u>
Less: capitalized costs	<u>(44,960)</u>	<u>(39,381)</u>	<u>-</u>
	<u>\$ 593,098</u>	<u>\$ 468,770</u>	<u>\$ 249,817</u>

In total, gross other general and administration costs increased by \$129,907 or 26% in 2006 over 2005 due principally to additional investor relations expenditures and higher filing fees which together rose by \$109,410. The retention of an investor relations firm plus fees and expenses associated with investor conferences were the main components of investor relations expense in 2006. Investor relations expenses are expected to increase modestly in 2007 with continued emphasis in this area.

Professional fees were up \$1,220 or 1% in 2006 compared to 2005. Increases in audit and audit related fees plus resource evaluation expenses were virtually offset by a reduction in legal fees. The 32% increase in professional fees from 2004 to 2005 was due to the initial resource evaluation work provided by the Company's independent evaluator. Professional fees are anticipated to increase in 2007.

Office space and insurance costs were 3% or \$4,187 lower in 2006 relative to 2005 due to a one-time rent incentive associated with a move to new premises in July 2006 which offset increases in insurance and office operating costs. In late 2004, the Company moved to larger more expensive premises due to the expiry of its prior sublease arrangements resulting in a very material increase in office expense in 2005. An office cost sharing arrangement which was in place during all of 2004 was terminated during 2005 and also contributed to the higher 2005 figure. Office related expenses are anticipated to increase disproportionately in the next two years due to the tight market conditions in Calgary and the terms of the Company's existing sublease agreement.

Staffing and other costs have risen on average approximately 50% per year for the last two years due to penalty interest on the issue of flow-through shares, additional travel expenses and staffing survey fees. Staffing related costs are expected to increase modestly in 2007 while other costs are expected to decline.

Other capitalized costs represent land and mapping software used in exploration activity for which the Company initially subscribed to in 2005.

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Summary of Quarterly Results

Net income and losses prior to income taxes including the income tax benefit recorded during fiscal 2004 for the last twelve quarters were:

Net income (loss) by quarter	2006		2005		2004	
	Amount	Per Share	Amount	Per Share	Amount	Per Share
First Quarter	\$ (975,817)	\$ (0.04)	\$ (1,094,574)	\$ (0.05)	\$ (264,063)	\$ (0.02)
Second Quarter	31,536	-	(745,055)	(0.03)	(383,750)	(0.02)
Third Quarter	174,092	0.01	(469,598)	(0.02)	(561,337)	(0.03)
Fourth Quarter	(305,026)	(0.01)	(1,497,189)	(0.06)	(868,870)	(0.05)
Loss before income taxes	(1,075,215)	(0.04)	(3,806,416)	(0.16)	(2,078,020)	(0.12)
Future income tax recovery	-	-	-	-	336,200	0.02
Net loss after tax	<u>\$ (1,075,215)</u>	<u>\$ (0.04)</u>	<u>\$ (3,806,416)</u>	<u>\$ (0.16)</u>	<u>\$ (1,741,820)</u>	<u>\$ (0.10)</u>

For each period up to and including December 31, 2006, the existence of stock options and warrants affected the calculation of diluted shares outstanding. As the effect of this dilution is to reduce the reported loss per share, diluted loss per share information has not been shown.

In 2004 and 2005, the Company 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 were renounced to investors in the year of issue. At December 31, 2006, the Company had estimated tax assets of \$2,865,567 (2005: \$2,800,864; 2004: \$2,590,825) against which a valuation allowance has been applied and therefore no tax recovery has been recognized. The tax assets are based upon estimated income tax pools at December 31, 2006 of \$41,022,783 (2005: \$29,314,160; 2004: \$20,901,100). The effect of renouncing income tax pools to investors is to reduce tax deductions that are available to offset future taxable income of the Company. Accordingly, when the expenditures are renounced, share capital is reduced and future income tax liabilities are increased by the estimated value of the renounced tax deductions. Flow-through share issues in December 2004 and 2003 resulted in a recovery of future income taxes which reduced the reported net loss in these periods by \$336,200 during 2004 (2003: \$346,200).

As discussed previously, stock-based compensation expense for stock option grants and SARs contributed significantly to the variability of the Company's income and losses during the last twelve quarters. The 600,000 SARs issued to two officers and a senior employee in August 2003 are now fully vested and changes in the value of the Company's shares have an immediate impact on the quarterly provision for this conditional liability. In the second and third quarters of 2006, the recapture of previously recorded stock-based compensation expense due to a falling share price resulted in reported net income for these periods. Excluding the effects of stock-based compensation, the Company's pre-tax losses by quarter would have been:

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<u>Net loss by quarter prior to stock-based compensation expense</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
First Quarter	\$ (216,771)	\$ (174,540)	\$ (124,615)
Second Quarter	(277,597)	(178,745)	(204,315)
Third Quarter	(257,468)	(21,039)	(178,968)
Fourth Quarter	(318,597)	(1,256,241)	(32,197)
Loss before income taxes	<u>\$ (1,070,433)</u>	<u>\$ (1,630,565)</u>	<u>\$ (540,095)</u>

Also, as discussed previously, the fourth quarter of 2006 includes an impairment charge of \$51,744 (2005: \$1,121,164) relating to completion work on the Bluesky Formation at Farrell Creek that proved to be uneconomic.

Fourth Quarter Results

During the fourth quarter of 2006 the Company earned \$56,179 (2005: \$80,935; 2004: \$28,844) in interest revenue from cash deposits. Revenues earned from management fees during the fourth quarter of 2006 were \$Nil (2005: \$45,000).

General and administrative expenses for the three month period ended December 31 are as follows:

<u>Three months ended December 31</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Consulting fees	\$ 111,630	\$ 58,224	\$ 106,218
Salaries and benefits	230,040	295,991	102,596
Other general administration	167,636	142,238	(845)
	<u>509,306</u>	<u>496,453</u>	<u>207,969</u>
Less: Capitalized costs	<u>(166,742)</u>	<u>(221,370)</u>	<u>(152,970)</u>
	342,564	275,083	54,999
Stock-based compensation	<u>(13,571)</u>	<u>240,947</u>	<u>836,671</u>
	<u>\$ 328,993</u>	<u>\$ 516,030</u>	<u>\$ 891,670</u>

Significant changes in general and administration expenses in the fourth quarter of 2006 relative to the fourth quarter of 2005 and 2004 include the impact of staff reductions in 2006; the increased use of engineering and technical consultants in 2006; and a higher level of investor relations activity.

Salaries and benefits in the fourth quarter of 2006 declined \$65,951 or 22% relative to the fourth quarter of 2005 due to staff reductions in the second and third quarter of 2006. The impact of these changes is expected to continue into 2007.

Consulting fees increased by \$53,406 or 92% over the fourth quarter of 2005. The principal contributors to the increase were \$30,763 for technical consultants used in preparation of the Experimental Scheme Application; \$15,313 of additional engineering work on the preliminary facilities and pipeline design; and \$12,700 in financial consulting expenses, part of which was related to the preparation of financial statements and the maintenance of accounting records.

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Other general and administration expenses in the fourth quarter of 2006 were \$25,398 or 18% higher than the comparative 2005 period. The principal activities resulting in this increase were investor relations conferences and consultants' fees and expenses which rose \$47,512 over 2005 levels.

Capitalized administration expenses declined \$54,628 or 25% in the fourth quarter of 2006 versus 2005 reflecting reductions in technical staff. The material increase between the fourth quarters of 2004 and 2005 resulted from increases in technical staff between these periods.

Stock-based compensation is composed of expenses related to the contingent SARs liability and amortization of the calculated fair value of stock options granted in current and prior periods. In the fourth quarter of 2006, the SARs and stock option components were recovery of \$156,000 and expense of \$146,115 respectively (2005: expense of \$82,333 and expense of \$323,280). Volatility in stock-based compensation expense from period to period is, in the case of SARs related to share price movements and, in the case of stock options related to the issuance of new options or the cancellation or modification of previously issued options.

The net loss of \$305,026 for the fourth quarter of 2006 was down from \$1,497,189 in the fourth quarter of 2005 when the Company took an impairment charge of \$1,121,164 related to Bluesky completion costs.

Capital expenditures in the fourth quarter of 2006 were \$1.8 million compared to \$4.0 million in 2005 and \$1.3 million in 2004. Field activities in the last quarter of 2006 included the drilling and completion of the b-002-I test well, the completion of b-003-I and the testing of all four wells comprising the Company's pilot production program.

Liquidity and Capital Resources

The Company's capital program for each of the last three years is detailed in the following table:

For the years ended December 31	2006	2005	2004
Lease acquisitions and retentions	\$ 44,629	\$ 2,209,791	\$ 10,109,017
Geological and geophysical	21,773	106,809	56,338
Drilling and completion	9,902,400	6,269,030	2,058,850
Capitalized overhead	604,174	628,218	220,948
Total petroleum and natural gas	<u>10,572,976</u>	<u>9,213,848</u>	<u>12,445,153</u>
Office equipment and furnishings	15,058	68,378	58,245
Total capital expenditures	<u>\$ 10,588,034</u>	<u>\$ 9,282,226</u>	<u>\$ 12,503,398</u>

For the first half of 2007, the Company has a contingent base case capital budget of \$1.3 million which includes an estimated \$290,000 for capitalized overhead and \$10,000 for administrative capital equipment. The Company's budget is reviewed and approved by the Board of Directors on a quarterly basis. The budget for field testing activities for the first half of 2007 is \$1.0 million. Additions to the approved budget for the second half of 2007 is contingent upon results of the Gething production testing program currently in progress.

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Cash administration expenses (G&A excluding stock based compensation) for 2007 are expected to be approximately \$1.8 million before capitalization of exploration related overhead; approximately the same as 2006. Revenue from interest on cash balances is budgeted at \$200,000. The Company has not budgeted for any cash flow from operations during 2007.

At December 31, 2006, the Company had working capital of \$2.6 million, consisting of cash in the amount of \$3.2 million, accounts receivable and prepaid expenses of \$0.3 million, net of accounts payable and accrued trade liabilities of \$0.9 million. The accounts payable and accrued trade liabilities relate to work at Farrell Creek that occurred during December 2006. The Company has no bank indebtedness and has no credit agreements to borrow money in place at this time.

The Company has raised a total of \$38.8 million, after share issue costs, through several private placements and the exercise of warrants and options during the past four years. At December 31, 2006 there were 3,200,000 warrants outstanding with an exercise price of \$2.50 per share that will expire August 11, 2007.

The Company's working capital of \$2.6 million at December 31, 2006 is considered to be sufficient to cover administrative costs of \$0.9 million and the \$1.0 million base case capital budget for the first half of 2007. Additional equity capital will be required to complete the base case capital program for the remainder of 2007.

Business Risks

The principal risks facing the Company are the productive capabilities of the coal and shale resources acquired to date; the uncertainty of further land acquisitions due to the intense competition for both conventional and unconventional opportunities; the availability of drilling and service equipment in a timely manner; and the extraction of hydrocarbons from reservoirs economically.

Government incentives, regulations and taxation of the oil and gas industry in Canada have been significant factors affecting industry profitability. The regulatory environment has been relatively stable for several years. However CSRI is unable to predict or control the direction of future public policy. Regulations regarding safety and the environment are strictly adhered to and CSRI sets a high standard of operating practice in order to minimize risks to employees and the environment.

The Company's ability to continue its operations, develop its assets and realize their carrying values is dependent upon continued support of its shareholders, favorable capital market conditions and commodity prices; obtaining additional equity financing, converting discovered resources into economically recoverable reserves, and ultimately, generating revenues sufficient to cover operating costs and capital requirements.

Disclosure Controls and Procedures and Internal Controls

Disclosure Control Risk

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Operating Officer (acting in the capacity of Chief Executive Officer) and Chief Financial Officer have concluded, based on their evaluation of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2006, that disclosure controls and procedures provide reasonable assurance that material information is made known

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to them by others within the Company subject to the reportable weakness identified below regarding segregation of duties. However, a control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal Control Risks

Management is responsible for certifying the design of the Company's internal control over financial reporting ("ICFR") as required by Multilateral Instrument 52-109 – "Certification of Disclosure in Issuers Annual and Interim Filings". Our ICFR is intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principals (GAAP). ICFR includes those policies and procedures that establish the following:

- maintenance of records in reasonable detail, that accurately and fairly reflect the transactions and dispositions of our assets;
- reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP;
- receipts and expenditures only being made in accordance with authorizations of management and the Board of Directors; and
- reasonable assurance regarding prevention or timely detection of unauthorized collection, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, ICFR may not prevent or detect misstatements. Also, the effectiveness of ICFR is subject to the risk that controls may become inadequate because of changes in condition, or that the degree of compliance with the policies or procedures may deteriorate. Management, including the Chief Operating Officer (acting in the capacity of Chief Executive Officer) and the Chief Financial Officer, carried out the design of the Company's internal controls over financial reporting and concluded, subject to the inherent limitations noted above, the Company has sufficient controls to meet the requirements as stated above and that one reportable weakness existed, at December 31, 2006, as detailed below.

Segregation of Duties

Segregation of duties is a basic, key internal control and one of the most difficult to achieve in a small company. It is used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. Due to limited resources, a complete segregation of duties within the Company's operating and accounting groups can not be fully achieved. The result is that the Company is highly reliant on the qualifications, experience and integrity of its staff and on the performance of mitigating procedures during its financial close processes in order to ensure the financial statements are presented fairly in all material respects. No significant change in the current control process is planned until the Company achieves production and cash flow from operations. Management will continue to review existing mitigating controls and, if appropriate, implement changes to its internal control processes whereby more effective mitigating controls will be adopted.

Critical Accounting Policies

Reference should be made to the Company's significant accounting policies contained in Note 2 of the Company's audited financial statements for the year ended December 31, 2006. These accounting policies can have a significant impact on the financial performance and financial position of the Company.

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Off Balance Sheet Arrangements

The Company has not entered into any off balance sheet arrangements.

Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable and accrued expenses. It is management's opinion that the Company is not exposed to significant interest, currency or credit risk arising from its financial instruments and that their fair values approximate their carrying values due to their short term nature, unless otherwise noted.

Related Party Transactions

During 2006 and 2005, the Company had transactions with directors and a former officer of the Company, persons related to them or companies controlled by them in the normal course of business as follows:

	2006	2005	2004
Consulting fees	\$ 97,650	\$ 79,450	\$ 79,800
Salaries and benefits	\$ 111,640	\$ 104,572	\$ 97,901

Consulting fees in 2006 included \$90,450 (2005: \$79,450; 2004: \$79,800) paid or payable to a director and senior officer of the Company and \$7,200 (2005 and 2004: \$Nil) to a former officer of the Company. Accounts payable includes \$14,157 (2005: \$11,848) due to a director and senior officer for consulting fees earned during 2006 and \$5,350 (2005: \$Nil) due to a former officer of the Company for consulting fees earned during 2006.

Salary and benefits of \$111,640 (2005: \$104,572; 2004: \$97,901) was the compensation paid or payable to a director and senior officer of the Company during 2006.

Transactions with related parties are recorded at cost, which represent exchange amounts for services provided. In addition during 2005, certain directors, relatives of directors, or companies controlled by directors subscribed for 14,354 (2006: Nil) shares or units in private placement offerings of the Company under the same terms as other investors.

Since December 31, 2006 to the date of this report, the Company has continued to employ a director as a salaried employee and has continued to contract with another director to provide management services as a consultant.

Performance Units

On January 18, 2007, the Company granted a total of 119,000 performance units pursuant to its Performance Unit Incentive Plan. Senior officers were granted 93,400 performance units with vesting in equal amounts at the end of performance periods ending on January 1, 2008, 2009 and 2010. Independent directors were granted 25,600 performance units which vest on January 1, 2010. The performance criterion for the performance units granted on January 18, 2007 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 a minimum average price of \$1.75 per share. Payout of vested units is made in cash following the end of each performance period.

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For the year ended December 31, 2006

Share Capital

The Company has authorized share capital of an unlimited number of common shares of no par value. Since December 31, 2006 to the date of this report, the Company has issued no common shares for the exercise of stock options. During this same period, the Company has granted 25,000 options to purchase common shares to a land consultant; 45,000 options to non-executive employees of the Company and 25,000 options to a contract employee performing the function of field production manager. The issued share capital as at April 19, 2007 consists of 28,833,082 common shares. In addition, the Company has 3,200,000 warrants and 2,521,000 stock options outstanding as at April 19, 2007.

Corporate Information

Additional information regarding the Company is available on SEDAR at www.sedar.com or the Company's website at www.csri.ca.