



**Interim Financial Statements of**  
**Canadian Spirit Resources Inc.**  
*(unaudited)*

**March 31, 2011**

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# Canadian Spirit Resources Inc.

## STATEMENTS OF FINANCIAL POSITION (unaudited)

	As at March 31, 2011	As at December 31, 2010	As at January 1, 2010
<b>ASSETS</b>			
Non-current assets:			
Exploration and evaluation assets (note 6)	\$ 45,598,298	\$ 55,383,734	\$ 35,214,311
Property, plant and equipment (note 7)	12,177,434	19,856	37,636
Mineral property (note 9)	<u>1</u>	<u>1</u>	<u>1</u>
	57,775,733	55,403,591	35,251,948
Current assets:			
Cash and cash equivalents	18,330,812	33,941,607	9,647,890
Term deposits (note 5)	1,250,000	-	-
Accounts receivable (note 10)	99,164	262,515	203,995
Prepaid expenses and other	<u>118,371</u>	<u>81,586</u>	<u>51,290</u>
	19,798,347	34,285,708	9,903,175
	<u>\$ 77,574,080</u>	<u>\$ 89,689,299</u>	<u>\$ 45,155,123</u>
<b>LIABILITIES AND SHAREHOLDERS' CAPITAL</b>			
Non-current liabilities:			
Decommissioning liability (note 11)	\$ 1,052,297	\$ 1,055,573	\$ 563,352
Current liabilities:			
Accounts payable and other accrued liabilities	1,621,705	13,284,179	418,095
Shareholders' capital:			
Common shares (note 12)	90,885,601	90,932,625	56,672,226
Share purchase warrants (note 12)	-	-	1,940,927
Contributed surplus (note 14)	6,533,415	6,233,108	5,909,962
Deficit	<u>(22,518,938)</u>	<u>(21,816,186)</u>	<u>(20,349,439)</u>
	74,900,078	75,349,547	44,173,676
	<u>\$ 77,574,080</u>	<u>\$ 89,689,299</u>	<u>\$ 45,155,123</u>

Corporate information and basis of presentation (note 1)  
Commitments (note 18)

ON BEHALF OF THE BOARD:

(signed) "Philip H. Grubbe"  
Director

(signed) "J.R. Richard Couillard"  
Director

## Canadian Spirit Resources Inc.

### STATEMENTS OF INCOME / (LOSS) AND COMPREHENSIVE INCOME / (LOSS)

For the Three Months ended March 31  
(unaudited)

	2011	2010
<b>Revenue</b>		
Petroleum and natural gas sales, net of royalties	\$ 402,641	\$ -
<b>Interest and other income</b>	53,101	10,925
<b>Expenses</b>		
Operating and production	36,506	-
Transportation	1,504	-
Exploration and evaluation	5,505	1,378
Depletion, depreciation and amortization (note 7)	389,601	6,415
Finance costs, accretion (note 11)	7,420	5,717
General and administrative, net (note 16)	476,562	362,574
Share-based compensation, net (note 13)	241,396	260,330
	<u>1,158,494</u>	<u>636,414</u>
<b>Net income / (loss) and comprehensive income / (loss)</b>	<u>\$ (702,752)</u>	<u>\$ (625,489)</u>
<b>Basic income / (loss) per share (note 15)</b>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
<b>Diluted income / (loss) per share (note 15)</b>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>

Corporate information and basis of presentation (note 1)

Deferred income taxes (note 17)

Minimum lease payments (note 18)

# Canadian Spirit Resources Inc.

## STATEMENTS OF CASH FLOW

For the Three Months ended March 31

(unaudited)

	2011	2010
<b>Operating Activities:</b>		
Net income / (loss) and comprehensive income / (loss)	\$ (702,752)	\$ (625,489)
Add (deduct) items not affecting cash:		
Depletion, depreciation and amortization (note 7)	389,601	6,415
Finance costs, accretion (note 11)	7,420	5,717
Share-based compensation, net (note 13)	241,396	260,330
	<u>(64,335)</u>	<u>(353,027)</u>
Changes in non-cash working capital (note 19)	<u>(11,535,908)</u>	<u>(140,917)</u>
	<u>(11,600,243)</u>	<u>(493,944)</u>
<b>Financing Activities:</b>		
Common shares issued for cash (note 12)	-	4,384,550
Common shares purchased and cancelled (note 12)	(54,740)	-
Share issue costs (note 12)	(978)	(600)
	<u>(55,718)</u>	<u>4,383,950</u>
<b>Investing Activities:</b>		
Exploration and evaluation expenditures (note 6)	(1,838,204)	(979,167)
Expenditures on property, plant and equipment (note 7)		
Development costs of petroleum and natural gas assets	(280,005)	-
Plant and equipment	(639,691)	-
Fixtures and office equipment	(3,843)	(5,943)
	<u>(2,761,743)</u>	<u>(985,110)</u>
Change in asset retirement obligations	(10,696)	8,298
Capitalized share-based compensation	67,605	105,237
	<u>(2,704,834)</u>	<u>(871,575)</u>
Purchase of term deposits (note 5)	<u>(1,250,000)</u>	<u>-</u>
	<u>(3,954,834)</u>	<u>(871,575)</u>
<b>Change in cash</b>	<b>(15,610,795)</b>	<b>3,018,431</b>
<b>Cash position, beginning of period</b>	<b>33,941,607</b>	<b>9,647,890</b>
<b>Cash position, end of period</b>	<b>\$ 18,330,812</b>	<b>\$ 12,666,321</b>
<i>Cash taxes paid</i>	<u>\$ -</u>	<u>\$ -</u>
<i>Interest paid</i>	<u>\$ -</u>	<u>\$ -</u>

# Canadian Spirit Resources Inc.

## STATEMENTS OF CHANGES IN SHAREHOLDERS' CAPITAL

(unaudited)

	Common Shares	Share Purchase Warrants	Contributed Surplus	Deficit	Total
<b>As at January 1, 2010</b>	\$ 56,672,226	\$ 1,940,927	\$ 5,909,962	\$ (20,349,439)	\$ 44,173,676
Issue of common shares:					
Exercise of stock options	107,550	-	-	-	107,550
Exercise of share purchase warrants	4,277,000	-	-	-	4,277,000
Issuer bid share purchases	-	-	-	-	-
Share issue costs	(600)	-	-	-	(600)
Transfers:					
Exercise of stock options	49,460	-	(49,460)	-	-
Exercise of share purchase warrants	1,252,146	(1,252,146)	-	-	-
Net income / (loss)	-	-	-	(625,489)	(625,489)
Share-based compensation, gross	-	-	365,567	-	365,567
<b>As at March 31, 2010</b>	<u>\$ 62,357,782</u>	<u>\$ 688,781</u>	<u>\$ 6,226,069</u>	<u>\$ (20,974,928)</u>	<u>\$ 48,297,704</u>
<b>As at January 1, 2011</b>	\$ 90,932,625	\$ -	\$ 6,233,108	\$ (21,816,186)	\$ 75,349,547
Issue of common shares:					
Exercise of stock options	-	-	-	-	-
Exercise of share purchase warrants	-	-	-	-	-
Issuer bid share purchases	(46,046)	-	(8,694)	-	(54,740)
Share issue costs	(978)	-	-	-	(978)
Transfers:					
Exercise of stock options	-	-	-	-	-
Exercise of share purchase warrants	-	-	-	-	-
Net income / (loss)	-	-	-	(702,752)	(702,752)
Share-based compensation, gross	-	-	309,001	-	309,001
<b>As at March 31, 2011</b>	<u>\$ 90,885,601</u>	<u>\$ -</u>	<u>\$ 6,533,415</u>	<u>\$ (22,518,938)</u>	<u>\$ 74,900,078</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (*unaudited*)

Three months ended March 31, 2011 and 2010

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### 1. **CORPORATE INFORMATION AND BASIS OF PRESENTATION**

#### **Corporate Information**

Canadian Spirit Resources Inc. (“CSRI” or the “Corporation”) is incorporated in the province of British Columbia and is a public company listed on the TSX Venture Exchange (the “Exchange”). The head office is located at Suite 1950, Ford Tower, 633 6<sup>th</sup> Avenue S.W., Calgary, Alberta, Canada T2P 2Y5.

CSRI’s principal business activity is the acquisition, exploration, development and production of petroleum and natural gas resources. Since May 2002, the Corporation has been evaluating and is now developing the resource potential of unconventional natural gas properties at the Farrell Creek location in northeastern British Columbia.

#### **Basis of Presentation**

The unaudited interim financial statements, and the notes thereto, have been prepared as at and for the three months ended March 31, 2011. All amounts are presented in Canadian dollars.

The financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to interim financial statements, including IFRS 1: *First-time Adoption of IFRS* and IAS 34: *Interim Financial Reporting*, as issued by the International Accounting Standards Board (“IASB”) and the International Financial Reporting Interpretations Committee (“IFRIC”).

These financial statements are condensed and represent the Corporation’s first financial statements that have been prepared in accordance with IFRS applicable to interim financial statements. The transition date to IFRS was January 1, 2010. Previously, the financial statements were prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). Please refer to note 22 for all relevant reconciliations for the transition from GAAP to IFRS.

In management’s opinion, the financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized in note 2.

The Audit Committee reviewed and the Board of Directors of the Corporation approved the release of these unaudited financial statements, and the notes thereto, on June 27, 2011.

#### **Basis of Measurement**

The financial statements have been prepared on a going concern basis using the historical cost convention, except for the following:

- Financial assets and liabilities are initially measured at fair value;
- Decommissioning liabilities are measured at net present value; and
- Share-based compensation is measured at fair value.

#### **Use of Estimates**

The preparation of the financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ materially from those estimates and assumptions.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (*unaudited*)

Three months ended March 31, 2011 and 2010

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The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The areas involving a higher degree of judgment of complexity, or where assumptions and estimates are significant to the financial statements include:

- Exploration and Evaluation Assets and Property, Plant and Equipment;
- Petroleum and Natural Gas Reserves;
- Decommissioning Liability;
- Share-based Compensation; and
- Deferred Taxes.

### ***Exploration and Evaluation Assets and Property, Plant and Equipment***

Upon the determination that a group of petroleum and natural gas assets are moving from the evaluation stage to the development stage, the related exploration and evaluation assets are transferred to developed and producing assets. The Corporation has determined that this transfer is effective upon a well or field becoming both technically feasible and commercially viable.

Capitalized development and production assets less accumulated depletion, depreciation, and impairments are limited to an amount equal to the recoverable amount, which is calculated as estimated future net revenue from proven plus probable reserves after royalties plus future development costs less estimated future abandonment costs, or fair value less costs to sell. If the carrying value exceeds the recoverable amount, the excess is recorded as an impairment of petroleum and natural gas assets. The Corporation tests the petroleum and natural gas assets for impairment at each reporting period or whenever indicators of impairment become apparent.

The recoverable amounts of cash generating units (“CGU’s), as determined by the Corporation, and individual assets are based on the higher of value in use calculations (cash flow estimation from reserve reports) and fair value less costs to sell (based on recent nearby land sale activity). These calculations require the use of estimates and assumptions. For example, a change in the price of natural gas may impact the estimated life of a CGU and may then require an impairment adjustment to the carrying value of the assets within that CGU.

### ***Petroleum and Natural Gas Reserves***

Reserve estimates impact a number of estimates made by the Corporation, including the valuation of petroleum and natural gas assets and the calculations of depletion and depreciation. The effects of changes in estimates on the unit of production calculations are accounted for prospectively over the estimated remaining recoverable reserves.

Independent petroleum engineering consultants are retained to evaluate the Corporation’s recoverable reserves and to prepare an evaluation report at least annually. Reserves evaluation requires significant judgments to be made on future petroleum and natural gas prices, expected rates of production, future capital expenditures and engineering data. Future development costs are estimated taking into account the level of development required to produce the reserves by reference to operators, where applicable, and internal engineers. The Corporation expects that over time its reserve estimates will be revised upward or downward based on updated information such as the results of drilling, testing and production levels. Reserves are determined pursuant to National Instrument 51-101: *Standards of Disclosure for Oil and Gas Activities*, and the Canadian Oil and Gas Evaluations Handbook.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

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### ***Decommissioning Liability***

Decommissioning costs will be incurred by the Corporation at the end of the operating life of the Corporation's wells and facilities. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors including changes to relevant legal and regulatory requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations. The Corporation selected a risk-free nominal discount rate to calculate the net present value of the future decommissioning costs. Changes in the discount rate or the inflation rate for determining future decommissioning costs could have a significant effect on the carrying amount of the decommissioning liability.

### ***Share-based Compensation***

Key judgments used to calculate the fair value of share-based payments involve the use of the Black-Scholes option pricing model, including share price volatility, option life estimates, and the risk-free nominal discount rate used.

### ***Deferred Taxes***

The Corporation uses judgment in determining the tax classification and deductibility of costs incurred, as well as in determining the probability and timing of realizing deferred tax assets based on applying income tax laws and regulations and the likelihood of reversal of temporary differences between the accounting and tax bases of the Corporation's assets and liabilities.

## **2. SIGNIFICANT ACCOUNTING POLICIES**

### **Exploration and Evaluation Assets**

Costs incurred relating to establishing the commercial viability and technical feasibility of petroleum and natural gas properties are initially capitalized as intangible exploration and evaluation ("E&E") assets. These include costs such as land and lease acquisition, geological and geophysical expenditures, and the drilling and completion of test wells. However, costs incurred relating to general prospecting prior to obtaining any legal rights to explore are expensed as incurred. E&E costs are not depleted and are carried forward at cost until proved reserves are determined to exist. A review of all exploration or drilling licenses is carried out at least annually to determine if reserves exist. Upon the determination of proved reserves, costs are first tested for impairment and then reclassified as petroleum and natural gas assets within property, plant and equipment. If commercial viability and technical feasibility are not established through the determination of proved reserves and there are no future plans for activity or leases have expired, then the E&E assets are determined to be impaired.

### **Property, Plant and Equipment**

Unless initially classified as E&E assets, all costs related to the acquisition, exploration and development of petroleum and natural gas properties are capitalized and are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. These costs include land and lease acquisition costs, annual charges on producing and non-producing properties, geological and geophysical costs, costs of drilling and completing productive and non-productive wells, costs for production facilities, decommissioning costs, and carrying costs. Repair and maintenance costs are expensed as incurred. Petroleum and natural gas assets are accumulated in cost centres based on CGU's. The Farrell Creek Montney Formation project and the Farrell Creek Gething Formation project have been determined to be the Corporation's two CGU's. Costs are depleted or depreciated using the unit-of-production method based upon estimated proved plus probable reserves after royalties.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

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Costs subject to depletion include estimated future costs to develop proved plus probable reserves and exclude estimated salvage value. Reserve and production volumes of natural gas are converted to common units on the equivalency basis of six thousand cubic feet to one barrel of oil, reflecting the approximate relative energy content. Proceeds from the disposition of petroleum and natural gas properties are offset against the accumulated costs of the properties sold and any gains or losses will be recorded in the statement of operations and comprehensive income / (loss) in the period when the disposition occurred.

### **Petroleum and Natural Gas Activities**

The Corporation capitalizes, within both E&E assets and property, plant and equipment, the portion of general and administrative overhead costs that are directly attributable to the respective exploration and development activity.

### **Impairment**

An impairment test is performed whenever events and circumstances indicate that the carrying value of an asset or a CGU may exceed the recoverable amount. The recoverable amount is calculated as the higher of the fair value less costs to sell (determined by recent land sale activity in the Farrell Creek vicinity) and the value in use (determined using estimated future cash flows discounted to present value). Exploration and evaluation assets are allocated to either of the two CGU's prior to impairment testing; the Corporation groups both the E&E and developed and producing components of the two CGU's for the purposes of impairment. If there is indication of an impairment loss, the costs carried on the statement of financial position in excess of the recoverable amount are charged to the statement of operations and comprehensive income / (loss). Impairment losses from prior periods are assessed at each reporting date for objective evidence that the impairment loss no longer exists or has decreased. Impairment losses can be reversed if there is objective evidence of a change in the estimates used to determine the recoverable amount. Reversal of impairment losses cannot exceed the carrying value of the asset prior to impairment less any depletion or depreciation that would have been taken if no impairment had been recognized.

### **Fixtures and Office Equipment**

Computer equipment and software, as well as 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.

### **Financial Instruments**

All financial assets and liabilities are recognized on the statement of financial position when the Corporation becomes a party to the contractual provisions of the instrument and are initially recognized at fair value. Subsequent measurement of the financial instruments is based on their classification. Each financial instrument is classified into one of the following categories:

- Financial assets and financial liabilities at fair value through profit and loss;
- Loans or receivables;
- Financial assets held to maturity;
- Financial assets available for sale; and
- Other financial liabilities.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

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The classification depends on the characteristics and the purpose for which the financial instruments were acquired. Except in very limited circumstances, the classification of financial instruments is not subsequently changed. Financial instruments carried at fair value through profit and loss on the statement of financial position include cash and cash equivalents and loans and receivables. Realized and unrealized gains and losses on financial assets and liabilities carried at fair value through profit and loss are recognized against income / (loss) in the periods such gains and losses arise. All initial and transaction costs related to these financial assets and liabilities are included in net income / (loss) when incurred.

The Corporation uses the trade-date method of accounting to record all purchases and sales of financial assets carried at fair value. Financial instruments carried at cost or amortized cost include accounts receivable and accounts payable and other accrued liabilities. Gains and losses on financial assets and liabilities carried at cost or amortized cost are recognized in net income / (loss) in the period the assets or liabilities are settled.

### **Income / (Loss) per Share**

The Corporation computes basic income / (loss) per share using net income / (loss) divided by the weighted average number of common shares outstanding during the period. The Corporation uses the treasury stock method in computing the weighted average number of diluted common shares outstanding. This method assumes that the proceeds upon exercise of in-the-money stock options and share purchase warrants are used to repurchase the Corporation's common shares at the average market price during the relevant period. No adjustment to diluted income / (loss) per share is made if the result of this calculation is anti-dilutive.

### **Flow-through Shares**

The Corporation has from time to time financed a portion of its exploration and development activities through the issue of Flow-through Shares. Under the terms of these share issuances, the related resource expenditure deductions for income tax purposes are renounced to investors. In the period the shares are issued, a premium liability is recorded if there is a difference between the offering price and the market price on the date of announcement of the offering. Accordingly, in the period the expenditures are incurred and deductions are renounced upon the filing of the relevant documents with the taxation authorities, the premium liability is extinguished and is offset by the recording of a Flow-through Shares premium income item.

### **Income Taxes**

Income tax expense represents the sum of current tax and deferred tax expense. Income tax is recognized in net income / (loss) except to the extent it relates to items recognized directly in shareholders' capital, in which case the income tax expense is recognized in shareholders' capital. Current income taxes are measured at the amount, if any, expected to be recoverable from or payable to taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period. The Corporation follows the liability method of accounting for income taxes. Under this method, deferred income tax assets or liabilities are recorded to reflect differences between the accounting and tax base of assets and liabilities, and income tax loss carry-forwards. Deferred income taxes are measured using tax rates that are expected to apply to the period when the deferred tax asset is realized or deferred tax liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period. The effect of any changes in tax rates is recognized in net income / (loss) in the period in which the change occurs or in shareholders' capital, depending on the nature of the item(s) affected by the adjustment. Deferred income tax assets are recognized for deductible temporary differences to the extent it is probable that future taxable profit will be available against which the deferred tax assets can be utilized.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

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The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent it is no longer probable that sufficient taxable profits will be available to allow the asset to be recovered.

### **Decommissioning Liabilities**

The Corporation recognizes the estimated fair value of future decommissioning liabilities associated with E&E assets and property, plant and equipment as a liability in the period in which they are incurred, normally when the asset is purchased or developed. The liability is based on the estimated costs to abandon and reclaim the net ownership interest in all wells and facilities and the estimated timing of the costs to be incurred in future periods.

This estimate is evaluated on a periodic basis and any adjustments are made to the carrying amount. The change in net present value of the future decommissioning liabilities due to the passage of time and calculated using an estimated risk-free nominal discount rate for the period is expensed as finance costs, accretion. The decommissioning cost, which is the net present value of the decommissioning liabilities at the inception of the assets, is capitalized as part of the cost of the related long-lived asset and amortized using the unit-of production method. Actual decommissioning liabilities settled during the period reduce the decommissioning liability.

### **Joint Operations**

Petroleum and natural gas operations are conducted jointly with external parties and, accordingly, these financial statements reflect only the Corporation's proportionate interest in such activities.

### **Revenue Recognition**

Revenues from the sale of petroleum and natural gas products are recognized when title passes from the Corporation to an external party and collectability is reasonably assured. Title passes from the Corporation to an external party once the product is credited at the station point within the pipeline system.

### **Share-based Compensation**

The Corporation accounts for share-based compensation using the fair-value method of accounting for stock options granted using the Black-Scholes option-pricing model. Share-based compensation expense is recorded over the vesting period with a corresponding amount reflected as contributed surplus. Share-based compensation expense is calculated as the estimated fair value for the related stock options at the time of grant, amortized over their vesting period using graded vesting. When stock options are exercised, the associated amounts previously recorded as contributed surplus are reclassified to common shares. The amount recognized as expense is adjusted for an estimated forfeiture rate for options that will not vest, which is adjusted as actual forfeitures occur, until the shares are fully vested. The Corporation capitalizes, within both E&E assets and property, plant and equipment, the portion of share-based compensation that is directly attributable to the respective exploration and development activity.

### **Cash and Cash Equivalents**

Cash and cash equivalents include investments and term deposits, if any, with a maturity of three months or less at the time of purchase.

### **Leases**

Payments made under operating leases are recognized as an expense in the statement of operations and comprehensive income / (loss) on a straight-line basis over the lease term.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

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### **Foreign Currency**

The functional and presentation currency of the Corporation is the Canadian dollar which is the principal currency of the primary economic environment in which it operates. Foreign currency transactions are translated to the functional currency using the exchange rate at the date of the transaction.

### **3. CHANGES IN ACCOUNTING POLICIES AND PRACTICES**

The quarter ended March 31, 2011 is the first period CSRI is reporting under IFRS applicable to interim financial statements. Accounting standards in effect as at March 31, 2011 have been adopted as part of the transition to IFRS. Recently, the IASB and IFRIC have issued the following new accounting standards or amendments to standards:

#### *IFRS 7: Financial Instruments, Disclosures*

This standard was amended in October 2010 to provide additional disclosure on the transfer of financial assets including the possible effects of any residual risks that the transferring entity retains. These amendments are effective as of July 1, 2011. The Corporation is currently evaluating the impact of these amendments to IFRS 7 on its financial statements.

#### *IFRS 9: Financial Instruments*

This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39: *Financial Instruments, Recognition and Measurement* for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent not clearly representing a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. Under the current expected IASB timeline, the Corporation expects to adopt IFRS 9 on or about January 1, 2013. The application of this standard is not expected to have a material impact on the financial statements of the Corporation.

#### *IFRS 10: Consolidated Financial Statements*

This standard establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supercedes IAS 27: *Consolidated and Separate Financial Statements* and is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard has no current impact on the financial statements of the Corporation.

#### *IFRS 11: Joint Arrangements*

This standard establishes principles for financial reporting by parties to a joint arrangement. IFRS 11 supercedes IAS 31: *Interests in Joint Ventures* and is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The Corporation is currently evaluating the impact of this standard on its financial statements.

#### *IFRS 12: Disclosure of Interests in Other Entities*

This standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard has no current impact on the financial statements of the Corporation.

# Canadian Spirit Resources Inc.

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### IFRS 13: *Fair Value Measurements*

This standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies to other IFRS's that require or permit fair value measurements or disclosures about fair value measurements. This standard is to be applied for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard is not expected to have a material impact on the financial statements of the Corporation.

### IAS 12: *Income Taxes*

This standard was amended in December 2010 to remove subjectivity in determining upon which basis an entity measures the deferred tax relating to an asset. The amendment presumes that an entity will assess whether the carrying value of an asset will be recovered through the sale of such asset. The amendment to IAS 12 is effective for reporting periods beginning on or after January 1, 2012. The Corporation is currently evaluating the impact of this amendment to IAS 12 on its financial statements.

### IAS 27: *Separate Financial Statements*

This standard will replace the existing IAS 27: *Consolidated and Separate Financial Statements*. IAS 27 contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The amended standard will require an entity preparing separate financial statements to account for those investments at cost or in accordance with IFRS 9: *Financial Instruments*. The amended standard is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard has no current impact on the financial statements of the Corporation.

### IAS 28: *Investments in Associates and Joint Ventures*

This standard was amended in 2011 and prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013 with early application permitted. The application of this standard has no current impact on the financial statements of the Corporation.

## 4. **SEGMENTED INFORMATION**

For the period ended March 31, 2011, the Corporation operated primarily in one operating segment, namely the exploration, development, and production of petroleum and natural gas. Revenue is derived from the sale of petroleum and natural gas within Canada and as such there are no other material reportable segments.

## 5. **TERM DEPOSITS**

On January 25, 2011, the Corporation was issued a non-redeemable Guaranteed Investment Certificate in the amount of \$1,250,000 with a maturity date of June 24, 2011 and earns interest at an annual rate of 1.23%. The renewal terms are on a semi-annual basis thereafter, to correspond with the Corporation's Letter of Credit in favour of the British Columbia Oil and Gas Commission ("BCOGC") (see note 18).

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

### 6. EXPLORATION AND EVALUATION ASSETS

	<b>Intangible Petroleum and Natural Gas Properties</b>	<b>Tangible Plant and Equipment</b>	<b>Total</b>
<b>As at January 1, 2011</b>	\$ 51,559,914	\$ 3,823,820	\$ 55,383,734
Additions	1,802,080	-	1,802,080
Change in asset retirement obligations	(13,140)	-	(13,140)
Capitalized share-based compensation	43,759	-	43,759
Exploration and evaluation expense	5,505	-	5,505
Transfers to property, plant and equipment	(9,947,579)	(1,676,061)	(11,623,640)
<b>As at March 31, 2011</b>	<u>\$ 43,450,539</u>	<u>\$ 2,147,759</u>	<u>\$ 45,598,298</u>
<b>As at January 1, 2010</b>	\$ 31,390,491	\$ 3,823,820	\$ 35,214,311
Additions	19,611,724	-	19,611,724
Change in asset retirement obligations	447,369	-	447,369
Capitalized share-based compensation	105,237	-	105,237
Exploration and evaluation expense	5,093	-	5,093
Transfers to property, plant and equipment	-	-	-
<b>As at December 31, 2010</b>	<u>\$ 51,559,914</u>	<u>\$ 3,823,820</u>	<u>\$ 55,383,734</u>

E&E assets comprise the Corporation's exploration and evaluation projects which are pending the determination of proved reserves.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited) Three months ended March 31, 2011 and 2010

### 7. PROPERTY, PLANT AND EQUIPMENT

	Intangible Petroleum and Natural Gas Assets	Tangible Plant and Equipment	Fixtures and Office Equipment	Total
<i>Cost</i>				
<b>As at January 1, 2011</b>	\$ -	\$ -	\$ 242,002	\$ 242,002
Additions	253,715	639,691	3,843	897,249
Change in asset retirement obligations	2,444	-	-	2,444
Capitalized share-based compensation	23,846	-	-	23,846
Transfers from exploration and evaluation assets	9,947,579	1,676,061	-	11,623,640
<b>As at March 31, 2011</b>	<u>10,227,584</u>	<u>2,315,752</u>	<u>245,845</u>	<u>12,789,181</u>
<i>Accumulated depletion, depreciation and impairment</i>				
<b>As at January 1, 2011</b>	-	-	222,146	222,146
Charge for the period	-	-	-	-
Depletion and depreciation	331,669	55,883	2,049	389,601
Impairment losses	-	-	-	-
<b>As at March 31, 2011</b>	<u>331,669</u>	<u>55,883</u>	<u>224,195</u>	<u>611,747</u>
<b>Carrying amount as at March 31, 2011</b>	<u>\$ 9,895,915</u>	<u>\$ 2,259,869</u>	<u>\$ 21,650</u>	<u>\$ 12,177,434</u>
<i>Cost</i>				
<b>As at January 1, 2010</b>	\$ -	\$ -	\$ 234,516	\$ 234,516
Additions	-	-	7,486	7,486
Transfers from exploration and evaluation assets	-	-	-	-
<b>As at December 31, 2010</b>	<u>-</u>	<u>-</u>	<u>242,002</u>	<u>242,002</u>
<i>Accumulated depletion, depreciation and impairment</i>				
<b>As at January 1, 2010</b>	-	-	196,880	196,880
Charge for the period	-	-	-	-
Depletion and depreciation	-	-	25,266	25,266
Impairment losses	-	-	-	-
<b>As at December 31, 2010</b>	<u>-</u>	<u>-</u>	<u>222,146</u>	<u>222,146</u>
<b>Carrying amount as at December 31, 2010</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 19,856</u>	<u>\$ 19,856</u>
<b>Carrying amount as at January 1, 2010</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 37,636</u>	<u>\$ 37,636</u>

During the three months ended March 31, 2011, the Corporation capitalized \$127,872 (2010: \$117,592) of general and administrative costs within both E&E assets and property, plant and equipment directly related to the respective exploration and development activities. During the three months ended March 31, 2011, the Corporation also capitalized \$67,605 (2010: \$105,237) of share-based compensation expense for those employees of the Corporation directly involved in exploration and development activities. Included in the calculation of depletion for the three months ended March 31, 2011 are future development costs of \$42.5 million (2010: \$Nil).

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

### 8. IMPAIRMENT

The Corporation performed impairment tests as at January 1, 2010 (date of transition to IFRS) and as at January 28, 2011 (date of first natural gas production) to assess the recoverable value of E&E assets and property, plant and equipment within the Corporation's combined CGU's. The estimates of fair value less costs to sell were determined in part using prevailing land tender prices as at those dates. Based on the tender prices and other factors, the estimated recoverable amount was greater than the carrying value of the Corporation's combined CGU's at both dates, and as such there was no impairment.

### 9. MINERAL PROPERTY

The Corporation's mineral property is a Wollastonite project where the Corporation holds a 100% undivided interest, subject to a 10% profits interest, in a mineral claim covering 450 hectares in the Iskut River area of the Liard Mining Division, British Columbia. In a prior year, the book value of the mineral property was written down to \$1 to reflect its present economic value.

### 10. ACCOUNTS RECEIVABLE

	March 31, 2011	December 31, 2010
Receivables from petroleum and natural gas external parties	\$ 69,563	\$ 228,735
Other receivables	29,601	33,780
Accounts receivable	<u>\$ 99,164</u>	<u>\$ 262,515</u>

### 11. DECOMMISSIONING LIABILITY

	March 31, 2011	December 31, 2010
Balance, beginning of year	\$ 1,055,573	\$ 563,352
Liabilities incurred	8,759	79,019
Revisions to estimated future obligation	(19,455)	368,350
Accretion	7,420	44,852
Liabilities settled	-	-
Balance, end of period	<u>\$ 1,052,297</u>	<u>\$ 1,055,573</u>

The total future decommissioning liability, 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 March 31, 2011 the estimated total future liability of \$2,239,827 (2010: \$2,221,099) had a net present value of \$1,052,297 (2010: \$1,055,573) assuming the liability is settled in approximately 20.5 years (2010: 20.75 years), using an estimated risk-free nominal interest rate of 3.75% (2010: 3.65%), and an inflation rate of 2.25% (2010: 2.25%). The total balance of the decommissioning liability is determined to be non-current.

The revisions to the estimated future decommissioning liability for the year ended December 31, 2010 results from the Corporation's assumption of the balance of the reclamation and abandonment costs related to the Gething project effective upon the Corporation receiving title to certain Gething related assets, and assuming operatorship of this project.

Financing costs relate to accretion on the decommissioning liability of \$7,420 for the three months ended March 31, 2011 (2010: \$5,717).

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

### 12. SHAREHOLDERS' CAPITAL

The Corporation has authorized share capital of an unlimited number of common shares with no par value. The Corporation has closed the following share issuances since January 1, 2010:

On June 29, 2010 the Corporation issued 3,000,000 Flow-through Shares at a price of \$1.40 per share. The Flow-through Shares entitled the holder to certain income tax benefits in the form of Canadian Development Expense. The \$4,200,000 of proceeds from the Flow-through Shares placement was allocated between common shares (at the market price on the Exchange of \$1.15 on the date of announcement of the placement) of \$3,450,000 and Flow-through Shares premium liability of \$750,000, and was fully expended on eligible development costs by the end of fiscal 2010. Incurred in relation to the issuance were \$224,716 of share issue costs. Upon renouncement of the resource expenditure deductions to investors in the fourth quarter 2010, the liability was reversed and offset by the recording of a \$750,000 Flow-through Share premium income amount.

On December 14, 2010 the Corporation closed a public offering of common shares of the Corporation by way of a short form prospectus. The offering included 16,670,000 common shares issued on a bought deal basis at \$1.50 per share for gross proceeds of \$25,005,000. The underwriters of the offering also exercised their over-allotment option to purchase an additional 780,500 common shares of the Corporation for gross proceeds of \$1,170,750, thereby bringing the aggregate total to 17,450,500 common shares for total gross proceeds of \$26,175,750. The Corporation paid a fee equal to 6% of the total gross proceeds, or \$1,570,545, to the underwriters of the offering resulting in total net proceeds to the Corporation of \$24,605,205. The Corporation also incurred additional share issue costs of \$232,907 in relation to this public offering.

#### Common Shares

The issued and outstanding common shares of the Corporation are summarized as follows:

	March 31, 2011		December 31, 2010	
	Number of Shares	Amount of Shares	Number of Shares	Amount of Shares
Balance, beginning of year	74,598,861	\$ 90,932,625	48,653,401	\$ 56,672,226
Common shares issued for cash:				
Exercise of stock options	-	-	197,500	135,550
Private placements	-	-	3,000,000	3,450,000
Public financings	-	-	17,450,500	26,175,750
Exercise of share purchase warrants	-	-	6,566,660	6,001,324
Common shares cancelled:				
Issuer bid share purchases	(37,800)	(46,046)	(1,269,200)	(1,479,444)
Credit from contributed surplus	-	-	-	64,460
Credit from share purchase warrants	-	-	-	1,940,927
Share issue costs	-	(978)	-	(2,028,168)
Balance, end of period	74,561,061	\$ 90,885,601	74,598,861	\$ 90,932,625

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

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### Normal Course Issuer Bids

On April 14, 2010, the Corporation received approval from the Exchange to commence a Normal Course Issuer Bid (the "2010-2011 NCIB") through the facilities of the Exchange beginning on April 16, 2010. Pursuant to the 2010-2011 NCIB, the Corporation had the ability to acquire up to 2.5 million common shares of the Corporation, representing 4.6% of the total number of common shares outstanding at the commencement of the 2010-2011 NCIB, until April 16, 2011. From January 1, 2011 to March 31, 2011 (2010: April 16, 2010 to December 31, 2010) the Corporation purchased for cancellation a total of 37,800 (2010: 1,269,200) common shares of the Corporation for total cash consideration of \$54,740 (2010: \$1,865,297) at an average price of \$1.45 (2010: \$1.47) per common share, representing 0.07% (2010: 2.34%) of the total number of common shares outstanding at the commencement of the 2010-2011 NCIB. Since the average carrying value of common shares outstanding at the time of repurchase was lower than the actual repurchase price per common share, the calculated difference per common share for the three months ended March 31, 2011 of \$8,694 (year ended December 31, 2010: \$385,853) was recorded as a decrease to contributed surplus.

On April 18, 2011, the Corporation received approval from the Exchange to commence a further Normal Course Issuer Bid (the "2011-2012 NCB") through the facilities of the Exchange beginning on April 19, 2011. Pursuant to the 2011-2012 NCIB, the Corporation may acquire up to 3.7 million common shares of the Corporation until April 18, 2012. Purchases in the market will be conducted by the Corporation's agent in accordance with the Exchange rules and all common shares acquired under the 2011-2012 NCIB will be cancelled.

For each of the Corporation's Normal Course Issuer Bids, all common shares of the Corporation purchased during any given month are returned to treasury and cancelled in the month subsequent to acquisition.

### Share Purchase Warrants

In conjunction with previous financings, the Corporation issued warrants with terms between one to two years to acquire common shares at specific exercise prices as summarized below:

	March 31, 2011		December 31, 2010	
	Number of Warrants	Amount of Warrants	Number of Warrants	Amount of Warrants
Balance, beginning of year	-	\$ -	6,566,660	\$ 1,940,927
Issued through private placements	-	-	-	-
Exercised prior to expiry	-	-	(6,566,660)	(1,940,927)
Expired unexercised	-	-	-	-
Balance, end of period	-	\$ -	-	\$ -

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

Issue Date	Weighted Average Exercise Price	Number of Warrants Outstanding at March 31, 2011	Weighted Average Fair Value (Rounded)	Weighted Average Fair Value at March 31, 2011	Expiry Date
Feb. 19, 2008	\$0.80	-	\$0.234	\$ -	Feb. 19, 2010 <sup>(1)</sup>
July 9, 2008	\$1.40	-	\$0.559	\$ -	August 9, 2010 <sup>(2) (3)</sup>
	\$ -	-	\$ -	\$ -	

**Notes:**

- (1) Prior to expiry, all remaining 5,320,000 of the \$0.80 warrants were exercised by holders resulting in gross proceeds to the Corporation of \$4,256,000.
- (2) Effective December 23, 2009, the expiry date of the \$1.40 warrants was extended by the Exchange from January 9, 2010 to July 9, 2010, and effective June 29, 2010 the expiry date was further extended by the Exchange from July 9, 2010 to August 9, 2010.
- (3) Prior to expiry, all remaining 1,231,660 of the \$1.40 warrants were exercised by holders resulting in gross proceeds to the Corporation of \$1,724,324.

### 13. SHARE-BASED COMPENSATION PLANS

#### Stock Options

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

At March 31, 2011, there were 5,350,000 (2010: 5,350,000) common shares reserved for issuance under the plan. Options to acquire 2,934,500 (2010: 2,444,500) common shares were outstanding at March 31, 2011, of which 2,468,250 (2010: 2,147,000) had vested and 466,250 (2010: 297,500) remained unvested, as follows:

	March 31, 2011		December 31, 2010	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	2,444,500	\$ 1.06	2,267,000	\$ 1.34
Granted	510,000	1.69	725,000	1.80
Exercised prior to expiry	-	-	(197,500)	0.69
Forfeited or expired	(20,000)	2.05	(350,000)	4.57
Outstanding, end of period	2,934,500	\$ 1.17	2,444,500	\$ 1.06
Options vested, end of period	2,468,250	\$ 1.06	2,147,000	\$ 0.96

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

### Three months ended March 31, 2011 and 2010

The following table summarizes the information about stock options outstanding and vested as at March 31, 2011:

Range of Exercise Price	Options Outstanding			Options Exercisable		
	Number of Options Outstanding	Remaining Contractual Life (in Yrs)	Weighted Average Exercise Price	Number of Vested Options	Remaining Vested Contractual Life (in Yrs)	Weighted Average Exercise Price
\$0.50 - \$0.79	1,419,500	2.33	\$ 0.62	1,419,500	2.33	\$ 0.62
\$0.80 - \$1.72	700,000	4.02	1.49	381,250	3.28	1.32
\$1.73 - \$3.65	815,000	3.41	1.84	667,500	3.33	1.85
	<u>2,934,500</u>	<u>3.03</u>	<u>\$ 1.17</u>	<u>2,468,250</u>	<u>2.75</u>	<u>\$ 1.06</u>

Options granted are accounted for using the fair value method. Prior to capitalization of \$67,605 (2010: \$105,237), the total compensation cost charged against earnings for share-based compensation expense during the three months ended March 31, 2011 was \$309,001 (2010: \$365,567).

The fair value of all option grants during the first three months of 2011 and 2010 are estimated on the date of grant using the Black-Scholes option pricing model with the following annualized weighted average assumptions:

	Three Months 2011	Three Months 2010
Risk free interest rate	2.31%	2.48%
Expected forfeiture rate	5.49%	6.04%
Expected stock price volatility	82.83%	82.67%
Expected time to exercise	4.15 years	4.19 years
Fair value of options granted	\$1.13	\$1.20
Term of options granted	5.0 years	5.0 years

#### 14. CONTRIBUTED SURPLUS

	March 31, 2011	December 31, 2010
Balance, beginning of year	\$ 6,233,108	\$ 5,909,962
Share-based compensation, gross	309,001	773,459
Stock options exercised and transferred to common shares	-	(64,460)
Issuer bid share purchases	<u>(8,694)</u>	<u>(385,853)</u>
Balance, end of period	<u>\$ 6,533,415</u>	<u>\$ 6,233,108</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

### 15. PER SHARE AMOUNTS

The basic and diluted weighted average number of common shares outstanding used in the per share calculations are reconciled as follows:

For the three month periods ended March 31	2011	2010
Weighted average number of common shares - basic	74,590,570	51,064,705
Dilutive effect of share-based compensation plans	1,447,148	3,077,953
	<hr/>	<hr/>
Weighted average number of common shares - diluted	<u>76,037,718</u>	<u>54,142,658</u>

For the three months ended March 31, 2011, the existence of stock options and share purchase 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.

### 16. GENERAL AND ADMINISTRATIVE

Included within general and administrative expense are employee salaries and benefits (gross) of \$296,309 for the three months ended March 31, 2011 (2010: \$300,262).

### 17. DEFERRED INCOME TAXES

The reconciliation of income tax expense (recovery) as computed by applying the combined statutory Canadian Federal and Provincial tax rates to losses before taxes is as follows:

For the three month periods ended March 31	2011	2010
Income / (loss) before taxes	\$ (702,752)	\$ (625,489)
Rate	<u>26.5%</u>	<u>28.0%</u>
Computed / expected income taxes	(186,229)	(175,137)
Increase (decrease) in income taxes resulting from:		
Non-deductible share-based compensation	63,970	72,892
Non-deductible expenses	3,286	5,133
Effect of change in deferred tax rate	6,734	10,405
Unrecognized deferred tax benefits	<u>112,239</u>	<u>86,707</u>
Recovery of deferred taxes	<u>\$ -</u>	<u>\$ -</u>

### 18. COMMITMENTS

#### **Office Lease Arrangements**

The Corporation had entered into an office sub-lease agreement which expired on May 30, 2011. Under the terms of the sub-lease agreement, the Corporation was obligated to pay base annual rent of \$28.00 per square foot plus operating costs on 6,793 square feet. The Corporation leases a small field office location on a month-to-month basis.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

### Three months ended March 31, 2011 and 2010

Operating lease payments represent monthly rent payables for both the Corporation's head office and the field office location. The table below shows the expense recorded:

#### Operating Leases

For the three month periods ended March 31	2011	2010
Minimum lease payments	\$ 71,081	\$ 69,458

In January 2011, the Corporation signed an office lease agreement for the same premises as described above for a subsequent two year period, expiring May 31, 2013, at a base annual rent of \$12.00 per square foot plus operating costs on 7,187 square feet.

The following is a summary of the estimated costs required to fulfill the Corporation's remaining operating lease contractual commitments as at March 31, 2011:

#### Future minimum lease payments

	March 31, 2011	December 31, 2010
Payable within 12 months	\$ 198,997	\$ 117,179
Payable from 1 to 4 years subsequent	\$ 212,975	\$ -
Thereafter	\$ -	\$ -

#### Letter of Credit

The Corporation is required for operations in British Columbia to provide a deposit towards future abandonment and reclamation costs based on the number of wells and facilities for which the Corporation is the primary permit holder. Based on a Liability Management Rating ("LMR") review performed by the BCOGC, the Corporation was assessed an LMR of \$1,235,829. On January 24, 2011 the Corporation issued a standby Letter of Credit for the LMR amount with the BCOGC as beneficiary. The standby Letter of Credit is irrevocable, bears a commission rate of 1.0%, expires on June 24, 2011, and renews on a semi-annual basis thereafter.

## 19. CHANGES IN NON-CASH WORKING CAPITAL

For the three month periods ended March 31	2011	2010
Operating cash provided by (used for):		
Accounts receivable	\$ 163,351	\$ (9,534)
Prepaid expenses and other	(36,786)	(16,481)
Accounts payable and other accrued liabilities	(11,662,473)	(114,902)
	<u>\$ (11,535,908)</u>	<u>\$ (140,917)</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

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### 20. FINANCIAL INSTRUMENTS

The Corporation 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 Corporation if a counterparty to a financial instrument fails to meet its contractual obligations. The maximum exposure to credit risk at March 31, 2011 is the carrying amount of the Corporation's cash and cash equivalents, term deposits and accounts receivable balances. The Corporation did not incur any write-offs relating to accounts receivable balances during the first three months of 2011 or during 2010. The accounts receivable balance as at March 31, 2011 is comprised of amounts due from the Corporation's joint venture partners, and is proactively collected by the Corporation on a timely basis.

Market risk is the risk that changes in market indices, such as foreign exchange rates, interest rates and commodity prices, will affect the Corporation's income or the value of its held financial instruments. Since, as at March 31, 2011, the Corporation held no debt, held its cash and cash equivalents in the form of bank deposits and had limited dealings with foreign currency exchange, the Corporation's exposure to market risk is minimal. However, the Corporation's production is currently not hedged under forward contracts and therefore is exposed to market risk.

Liquidity risk is the risk that the Corporation will not be able to meet its obligations as they become due. The Corporation manages its liquidity risk by synchronizing its forecasted cash requirements for operations with its anticipated capital financing activities and maintaining significant cash balances. The impacts on the Corporation's liquidity risk due to current equity and commodity price market conditions include a) increased uncertainty in raising additional funds on reasonable terms for future capital projects and b) a reduction in the Corporation's ability to generate sufficient revenues from the sale of natural gas to cover administrative and operating costs. As such, the Corporation held significant cash balances as at March 31, 2011, which are expected to be sufficient to cover the budgeted capital spending for the balance of the fiscal year.

### 21. CAPITAL MANAGEMENT

The Corporation defines capital as shareholders' capital plus working capital based on the Corporation's financial statements as follows:

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
Working capital		
Current assets	\$ 19,798,347	\$ 34,285,708
Current liabilities	<u>(1,621,705)</u>	<u>(13,284,179)</u>
	18,176,642	21,001,529
Shareholders' capital	<u>74,900,078</u>	<u>75,349,547</u>
Total capital	<u>\$ 93,076,720</u>	<u>\$ 96,351,076</u>

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

## Canadian Spirit Resources Inc.

### NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

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

- (a) targeting a minimum working capital position of \$4.0 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% of capital requirements through the issue of equity instruments until such time as cash generated from operations exceeds anticipated overhead expenses prior to capitalization; and
- (c) holding the proceeds of equity funding in deposit accounts of major financial institutions providing for immediate access.

The Corporation 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.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

### 22. TRANSITION FROM CANADIAN GAAP TO IFRS

#### RECONCILIATION OF STATEMENT OF FINANCIAL POSITION AS AT DATE OF TRANSITION - JANUARY 1, 2010 *(unaudited)*

	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>			
Non-current assets:			
Exploration and evaluation assets (note a)	\$ -	\$ 35,214,311	\$ 35,214,311
Property, plant and equipment (note a)	35,251,947	(35,214,311)	37,636
Mineral property	1	-	1
	<u>35,251,948</u>	<u>-</u>	<u>35,251,948</u>
Current assets:			
Cash and cash equivalents	9,647,890	-	9,647,890
Term deposits	-	-	-
Accounts receivable	203,995	-	203,995
Prepaid expenses and other	51,290	-	51,290
	<u>9,903,175</u>	<u>-</u>	<u>9,903,175</u>
	<u>\$ 45,155,123</u>	<u>\$ -</u>	<u>\$ 45,155,123</u>
<b>LIABILITIES AND SHAREHOLDERS' CAPITAL</b>			
Non-current liabilities:			
Decommissioning liability (note b)	\$ 288,095	\$ 275,257	\$ 563,352
Current liabilities:			
Accounts payable and other accrued liabilities	418,095	-	418,095
Shareholders' capital:			
Common shares (note d)	56,775,426	(103,200)	56,672,226
Share purchase warrants	1,940,927	-	1,940,927
Contributed surplus (note c)	5,865,418	44,544	5,909,962
Deficit	(20,132,838)	(216,601)	(20,349,439)
	<u>44,448,933</u>	<u>(275,257)</u>	<u>44,173,676</u>
	<u>\$ 45,155,123</u>	<u>\$ -</u>	<u>\$ 45,155,123</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

### RECONCILIATION OF STATEMENT OF FINANCIAL POSITION AS AT MARCH 31, 2010 (unaudited)

	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>			
Non-current assets:			
Exploration and evaluation assets (note a)	\$ -	\$ 36,193,478	\$ 36,193,478
Property, plant and equipment (note a)	36,223,722	(36,186,558)	37,164
Mineral property	<u>1</u>	<u>-</u>	<u>1</u>
	36,223,723	6,920	36,230,643
Current assets:			
Cash and cash equivalents	12,666,321	-	12,666,321
Term deposits	-	-	-
Accounts receivable	213,529	-	213,529
Prepaid expenses and other	<u>67,771</u>	<u>-</u>	<u>67,771</u>
	12,947,621	-	12,947,621
	<u>\$ 49,171,344</u>	<u>\$ 6,920</u>	<u>\$ 49,178,264</u>
<b>LIABILITIES AND SHAREHOLDERS' CAPITAL</b>			
Non-current liabilities:			
Decommissioning liability (note b)	\$ 293,136	\$ 284,231	\$ 577,367
Current liabilities:			
Accounts payable and other accrued liabilities	303,193	-	303,193
Shareholders' capital:			
Common shares (note d)	62,460,982	(103,200)	62,357,782
Share purchase warrants	688,781	-	688,781
Contributed surplus (note c)	6,181,447	44,622	6,226,069
Deficit	<u>(20,756,195)</u>	<u>(218,733)</u>	<u>(20,974,928)</u>
	48,575,015	(277,311)	48,297,704
	<u>\$ 49,171,344</u>	<u>\$ 6,920</u>	<u>\$ 49,178,264</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

### RECONCILIATION OF STATEMENT OF FINANCIAL POSITION AS AT DECEMBER 31, 2010 (unaudited)

	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>			
Non-current assets:			
Exploration and evaluation assets (note a)	\$ -	\$ 55,383,734	\$ 55,383,734
Property, plant and equipment (note a)	55,078,820	(55,058,964)	19,856
Mineral property	<u>1</u>	<u>-</u>	<u>1</u>
	55,078,821	324,770	55,403,591
Current assets:			
Cash and cash equivalents	33,941,607	-	33,941,607
Term deposits	-	-	-
Accounts receivable	262,515	-	262,515
Prepaid expenses and other	<u>81,586</u>	<u>-</u>	<u>81,586</u>
	34,285,708	-	34,285,708
	<u>\$ 89,364,529</u>	<u>\$ 324,770</u>	<u>\$ 89,689,299</u>
<b>LIABILITIES AND SHAREHOLDERS' CAPITAL</b>			
Non-current liabilities:			
Decommissioning liability (note b)	\$ 445,066	\$ 610,507	\$ 1,055,573
Current liabilities:			
Accounts payable and other accrued liabilities	13,284,179	-	13,284,179
Shareholders' capital:			
Common shares (note d)	90,792,004	140,621	90,932,625
Share purchase warrants	-	-	-
Contributed surplus (note c)	6,179,344	53,764	6,233,108
Deficit	<u>(21,336,064)</u>	<u>(480,122)</u>	<u>(21,816,186)</u>
	75,635,284	(285,737)	75,349,547
	<u>\$ 89,364,529</u>	<u>\$ 324,770</u>	<u>\$ 89,689,299</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

### RECONCILIATION OF STATEMENT OF INCOME / (LOSS) AND COMPREHENSIVE INCOME / (LOSS)

For the Three Months ended March 31, 2010  
*(unaudited)*

	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>Revenue</b>			
Petroleum and natural gas sales, net of royalties	\$ -	\$ -	\$ -
<b>Interest and other income</b>	10,925	-	10,925
<b>Expenses</b>			
Operating and production	-	-	-
Transportation	-	-	-
Exploration and evaluation (note a)	-	1,378	1,378
Depletion, depreciation and amortization	6,415	-	6,415
Finance costs, accretion (note b)	5,041	676	5,717
General and administrative, net	362,574	-	362,574
Share-based compensation, net (note c)	260,252	78	260,330
	634,282	2,132	636,414
<b>Net income / (loss) and comprehensive income / (loss)</b>	<u>\$ (623,357)</u>	<u>\$ (2,132)</u>	<u>\$ (625,489)</u>
<b>Basic income / (loss) per share</b>	<u>\$ (0.01)</u>	<u>\$ -</u>	<u>\$ (0.01)</u>
<b>Diluted income / (loss) per share</b>	<u>\$ (0.01)</u>	<u>\$ -</u>	<u>\$ (0.01)</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

### RECONCILIATION OF STATEMENT OF INCOME / (LOSS) AND COMPREHENSIVE INCOME / (LOSS)

For the Twelve Months ended December 31, 2010  
*(unaudited)*

	Canadian GAAP	Effect of Transition to IFRS	IFRS
<b>Revenue</b>			
Petroleum and natural gas sales, net of royalties	\$ -	\$ -	\$ -
<b>Interest and other income</b>	92,509	-	92,509
<b>Flow-through Shares premium</b> (note d)	-	750,000	750,000
<b>Expenses</b>			
Operating and production	-	-	-
Transportation	-	-	-
Exploration and evaluation (note a)	-	5,093	5,093
Depletion, depreciation and amortization	25,266	-	25,266
Finance costs, accretion (note b)	39,465	5,387	44,852
General and administrative, net	1,670,810	-	1,670,810
Share-based compensation, net (note c)	554,015	9,220	563,235
	<u>2,289,556</u>	<u>19,700</u>	<u>2,309,256</u>
<b>Income / (loss) before taxes</b>	<u>(2,197,047)</u>	<u>730,300</u>	<u>(1,466,747)</u>
Deferred tax expense / (recovery)	(993,821)	993,821	-
<b>Net income / (loss) and comprehensive income / (loss)</b>	<u>\$ (1,203,226)</u>	<u>\$ (263,521)</u>	<u>\$ (1,466,747)</u>
<b>Basic income / (loss) per share</b>	<u>\$ (0.02)</u>	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>
<b>Diluted income / (loss) per share</b>	<u>\$ (0.02)</u>	<u>\$ (0.01)</u>	<u>\$ (0.03)</u>

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS (unaudited)

Three months ended March 31, 2011 and 2010

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### Transition Elections

The Corporation has applied the following exceptions and exemptions against full retrospective application of IFRS effective as of the transition date of January 1, 2010:

Exemption / Election	Impact
Use of estimates.	Estimates made under Canadian GAAP are consistent with estimates made under IFRS, after adjustments for any changes in accounting policies.
Deemed cost of property, plant and equipment.	Full cost asset pool under Canadian GAAP transfers to E&E assets under IFRS.
Decommissioning liability additions included in the cost of property, plant and equipment.	Decommissioning liability additions for periods prior to the transition date remain within property, plant and equipment. The offset for the retrospective increase to decommissioning liability upon transition is recognized as an adjustment to retained earnings as of the transition date.
Share-based payment transactions.	Share-based compensation expense for options that vested prior to the transition date under Canadian GAAP is not required to be recalculated under IFRS.

### Notes to the Reconciliations

a. IFRS 1 election for full cost oil and gas entities:

CSRI elected an IFRS 1 exemption whereby the Corporation's previous Canadian GAAP full cost asset pool consisting of all pre-development costs was reclassified, upon transition to IFRS, to exploration and evaluation assets at the amount that was recorded previously under Canadian GAAP. This resulted in a \$35,214,311 increase in exploration and evaluation assets with a corresponding decrease in property, plant and equipment as of the transition date.

IFRS requires that all pre-exploration costs be expensed. During the three months ended March 31, 2010, the Corporation recognized \$1,378 of exploration and evaluation expense as a result of this change. The amount expensed for the twelve months ended December 31, 2010 as a result of applying this pre-exploration costs policy was \$5,093.

b. Decommissioning liability:

Under Canadian GAAP, the Corporation's asset retirement obligations were discounted at a credit-adjusted risk free rate of 9.0%. Under IFRS, the estimated cash flow to abandon and remediate the Corporation's wells and facilities has been calculated at a risk free nominal interest rate of 4.31%. Upon transition to IFRS, this resulted in a \$275,257 increase in decommissioning obligations with a corresponding decrease in retained earnings. The further impact of such change in discount rate to 4.24% for the three months ended March 31, 2010 was \$8,298. For the twelve months ended December 31, 2010, the impact of such change in discount rate to 3.65% was \$329,863.

The change in discount rate resulted in an increase in accretion expense for the three months ended March 31, 2010 of \$676 and for the twelve months ended December 31, 2010 of \$5,387, respectively, with a corresponding increase to the decommissioning liability.

Under Canadian GAAP accretion was grouped and presented with depletion and depreciation. Under IFRS accretion is presented as a financing cost.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

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c. Share-based payments:

Under Canadian GAAP, CSRI recognized the expense related to share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture multiple. Under IFRS, the Corporation is required to recognize share-based compensation expense using graded vesting and an estimated forfeiture rate.

CSRI elected an IFRS 1 exemption for all options issued whereby the share-based compensation expense and contributed surplus for options that had vested prior to the transition date were not required to be restated. As a result of applying graded vesting and a calculated forfeiture rate to options that were not fully vested as of the transition date, an increase of \$44,544 in contributed surplus and a corresponding decrease in retained earnings were recorded.

For the three months ended March 31, 2010, the impact of using graded vesting and a calculated forfeiture rate resulted in an increase in share-based compensation expense and contributed surplus of \$78. The impact of graded vesting and a calculated forfeiture rate for the twelve months ended December 31, 2010 was \$9,220.

d. Flow-through Shares:

Under Canadian GAAP, the full proceeds from Flow-through Share issuances were recorded as share capital. Under IFRS, any premium (calculated as the excess of issue price over market price at the time of issue) is recorded as a liability, with the market value of the Flow-through Shares being recorded as share capital. Upon the outlay of the appropriate expenditures and renouncement to investors of the related resource expenditure deductions, the liability is reversed and a Flow-through Shares premium is recorded as an income item in the period.

As of the transition date to IFRS, a premium of \$103,200 was calculated from all prior Flow-through Share issuances and was recorded as a reduction in common shares with a corresponding increase in retained earnings. In relation to the June 2010 Flow-through Share issuance that was renounced in December 2010, a Flow-through Shares premium income amount of \$750,000 (calculated as the excess of issue price over market price) was recorded in the fourth quarter 2010 with the offset being recorded against the Flow-through Shares premium liability.

e. Income taxes:

In accordance with Canadian GAAP, the Corporation had presented certain future income tax assets and liabilities as current assets or current liabilities. Under IFRS, all deferred tax assets and liabilities are presented as non-current.

# Canadian Spirit Resources Inc.

## NOTES TO INTERIM FINANCIAL STATEMENTS *(unaudited)*

Three months ended March 31, 2011 and 2010

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### **Additional Reconciliations of Canadian GAAP to IFRS**

IFRS 1 also requires the Corporation to reconcile shareholders' capital and cash flows for prior comparative periods. However, CSRI's first time adoption of IFRS did not have any impact on cash flows from total operating, investing, or financing activities, and therefore no such cash flow reconciliations are provided. The following represents the reconciliation from Canadian GAAP to IFRS for the respective prior comparative periods for shareholders' capital:

#### **RECONCILIATION OF STATEMENTS OF CHANGES IN SHAREHOLDERS' CAPITAL**

*(unaudited)*

	As at December 31, 2010	As at March 31, 2010	As at January 1, 2010
Shareholders' capital per Canadian GAAP	\$ 75,635,284	\$ 48,575,015	\$ 44,448,933
Exploration and evaluation expense	(5,093)	(1,378)	-
Revision in estimate of decommissioning liability	329,863	8,298	-
Decommissioning liability	(610,507)	(284,231)	(275,257)
Shareholders' capital per IFRS	<u>\$ 75,349,547</u>	<u>\$ 48,297,704</u>	<u>\$ 44,173,676</u>