

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

**March 31, 2007**

1. BALANCE SHEETS
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3. STATEMENTS OF CASH FLOWS
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**NOTICE: The interim financial statements and notes thereto for the three month period ended March 31, 2007 have not been reviewed by the Company's external auditors.**

# Canadian Spirit Resources Inc.

## BALANCE SHEETS

	March 31, 2007 <i>(unaudited)</i>	December 31, 2006 <i>(audited)</i>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,733,278	\$ 3,212,878
Accounts receivable	120,072	202,176
Prepaid expenses and other	66,426	39,989
	<u>1,919,776</u>	<u>3,455,043</u>
Property, plant and equipment (note 3)	<u>33,641,366</u>	<u>32,793,986</u>
	<u>\$ 35,561,142</u>	<u>\$ 36,249,029</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable & accrued trade liabilities	\$ 462,038	\$ 857,202
Accrued liability for share appreciation rights (note 5)	372,000	534,000
Asset retirement obligation (note 4)	170,293	158,650
	<u>1,004,331</u>	<u>1,549,852</u>
Shareholders' equity		
Equity instruments (note 5)	46,987,433	46,991,811
Contributed surplus (note 5)	3,392,877	3,250,910
Deficit	(15,823,499)	(15,543,544)
	<u>34,556,811</u>	<u>34,699,177</u>
	<u>\$ 35,561,142</u>	<u>\$ 36,249,029</u>

Nature of operations and going concern (note 1)

ON BEHALF OF THE BOARD:

*(signed) "Philip H. Grubbe"*

\_\_\_\_\_  
Director

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

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Director

# Canadian Spirit Resources Inc.

## STATEMENTS OF OPERATIONS AND DEFICIT

For the Three Months ended March 31

(unaudited)

	2007	2006
<b>Revenue</b>		
Interest and other income	\$ 25,516	\$ 111,857
<b>Expenses</b>		
Consulting fees	48,072	41,562
Salaries and benefits	122,588	95,837
Other general administration	136,473	156,487
Stock-based compensation (note 5)	(20,033)	759,046
Accretion expense	6,989	1,381
Impairment of conventional natural gas costs	-	21,783
Amortization	11,382	11,578
	<u>305,471</u>	<u>1,087,674</u>
<b>Net Loss</b>	(279,955)	(975,817)
<b>Deficit, beginning of period</b>	<u>(15,543,544)</u>	<u>(14,468,329)</u>
<b>Deficit, end of period</b>	<u>\$ (15,823,499)</u>	<u>\$ (15,444,146)</u>
<b>Loss per share (Basic &amp; Diluted)</b>	<u>\$ (0.01)</u>	<u>\$ (0.04)</u>

Nature of operations and going concern (note 1)

# Canadian Spirit Resources Inc.

## STATEMENTS OF CASH FLOWS

For the Three Months ended March 31  
(unaudited)

	2007	2006
<b>Operating Activities:</b>		
Net loss	\$ (279,955)	\$ (975,817)
Add items not affecting cash		
Amortization	11,382	11,578
Accretion expense	6,989	1,381
Impairment of conventional natural gas costs	-	21,783
Stock-based compensation	(20,033)	759,046
	<u>(281,617)</u>	<u>(182,029)</u>
Changes in non-cash working capital items	<u>(69,803)</u>	<u>(117,921)</u>
	<u>(351,420)</u>	<u>(299,950)</u>
<b>Financing Activities:</b>		
Equity instruments issued for cash	-	6,000
Equity instruments issue costs	(4,378)	-
	<u>(4,378)</u>	<u>6,000</u>
<b>Investing Activities:</b>		
Furniture and office equipment	-	(3,542)
Exploration expenditures	(836,418)	(3,840,274)
Acquisition and retention of natural gas rights	(17,690)	(19,356)
	<u>(854,108)</u>	<u>(3,863,172)</u>
Changes in non-cash working capital items	<u>(269,694)</u>	<u>588,312</u>
	<u>(1,123,802)</u>	<u>(3,274,860)</u>
<b>Change in cash</b>	<b>(1,479,600)</b>	<b>(3,568,810)</b>
<b>Cash position, beginning of period</b>	<b>3,212,878</b>	<b>10,688,123</b>
<b>Cash position, end of period</b>	<b>\$ 1,733,278</b>	<b>\$ 7,119,313</b>
<b>Cash taxes paid</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Interest paid</b>	<b>\$ -</b>	<b>\$ -</b>

See the accompanying notes to the financial statements

# Canadian Spirit Resources Inc.

## NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

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### 1. NATURE OF OPERATIONS AND GOING CONCERN

Canadian Spirit Resources Inc. incorporated in British Columbia, is a public company listed on the TSX Venture Exchange (the “Exchange”). Effective June 15, 2004, the Company changed its name from Spirit Energy Corp. to Canadian Spirit Resources Inc.

Since May 2002, the Company has been evaluating the resource potential of certain natural gas from coal exploration properties and is considered to be in its development stage of operations. The recoverability of amounts shown for natural gas properties is dependent upon the determination of economically recoverable reserves. The Company’s ability to continue its operations and to realize assets at their carrying values is dependent upon the continued support of its shareholders, obtaining additional financing and generating revenues sufficient to cover its operating costs.

The Company has incurred losses since inception totaling \$15,823,499, which includes a net loss of \$279,955 for the three months ended March 31, 2007 (2006: net loss of \$975,817). The financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern which may or may not be appropriate. The financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities at amounts different from those reflected in these financial statements; such adjustments could be material.

### 2. SIGNIFICANT ACCOUNTING POLICIES

The interim unaudited financial statements of Canadian Spirit Resources Inc. (the “Company”) have been prepared by management in accordance with accounting policies generally accepted in Canada. The disclosures included below are incremental to those included with the annual financial statements. These interim financial statements should be read in conjunction with the audited financial statements and the notes thereto for the year ended December 31, 2006. The interim unaudited financial statements have been prepared following the same accounting policies and methods of computation as the financial statements for the fiscal year ended December 31, 2006, except for the following new accounting pronouncements which have been adopted effective January 1, 2007.

#### **Financial Instruments**

Canadian Institute of Chartered Accountants Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3861, *Financial Instruments – Disclosure and Presentation*; Section 1530, *Comprehensive Income*; and Section 3251, *Equity*.

As required by the transitional provision of these new standards, the comparative interim unaudited financial statements have not been restated. The primary requirements of these new standards and the resulting financial statement impacts are further discussed below.

# Canadian Spirit Resources Inc.

## NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

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### *Recognition and Measurement*

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. The standards require that all financial instruments be classified either as held-for-trading financial assets or liabilities, available-for-sale financial assets, held-to-maturity financial assets, loans and receivables or other liabilities.

The standards require that all financial instruments, including all derivatives, be measured subsequent to their initial recognition at fair value with the exception of loans and receivables, debt securities classified as held-to-maturity financial assets, available-for-sale financial assets that do not have quoted market prices in an active market and other liabilities.

### *Classification*

The following is a summary of the classification the Company has applied to each of its financial instruments outstanding as of January 1, 2007:

<u>Financial Instrument:</u>	<u>Classification:</u>
Amounts receivable	Loans and receivables
Accounts payable & accrued trade liabilities	Other liabilities

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

### **3. PROPERTY, PLANT AND EQUIPMENT**

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Natural gas properties	\$ 34,764,158	\$ 33,905,396
Mineral property	1	1
Office furniture and equipment	161,387	161,387
	<u>34,925,546</u>	<u>34,066,784</u>
Less: Accumulated depletion, amortization & impairment	<u>(1,284,180)</u>	<u>(1,272,798)</u>
Total property, plant and equipment	<u>\$ 33,641,366</u>	<u>\$ 32,793,986</u>

As the Company had no production or proved reserves at March 31, 2007, there was no depletion charge for the period. At March 31, 2007, natural gas properties included \$13,371,705 (2006: \$13,354,015) relating to undeveloped properties, and \$68,462 (2006: \$10,000) relating to fees and deposits with the Alberta Energy and Utilities Board. There has been no impairment of undeveloped properties and all costs incurred on the development of natural gas from coals and shales charged to natural gas properties are considered to be on unproven properties. During the first three months of 2007, the Company capitalized \$124,088 (2006: \$167,183) of overhead directly related to exploration activities.

# Canadian Spirit Resources Inc.

## NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

The Company's mineral property is the Isk Wollastonite project where the Company holds a 100 percent undivided interest, subject to a 10 percent net profits interest, in ten mineral claims covering 1,425 hectares in the Iskut River area of the Liard Mining Division, British Columbia. In prior years, the book value of the mineral property was written down to \$1 to reflect its present economic value.

### 4. ASSET RETIREMENT OBLIGATION

	March 31, 2007	December 31, 2006
Balance, beginning of year	\$ 158,650	\$ 84,395
Liabilities incurred	4,654	20,466
Revisions in estimated future obligation	-	38,398
Accretion expense	6,989	15,391
Less: liabilities settled	-	-
Balance, end of period	<u>\$ 170,293</u>	<u>\$ 158,650</u>

The total future asset retirement obligation including costs to reclaim and abandon wells and facilities plus the year in which such costs are expected to be incurred is estimated by management. At March 31, 2007 the estimated total future liability of \$863,447 has a present value of \$170,293 assuming the liability is settled in approximately 24.5 years, using an estimated credit-adjusted risk-free interest rate of 7.0 percent, and an inflation rate of 2.0 percent.

### 5. EQUITY INSTRUMENTS

The Company has authorized share capital of an unlimited number of common shares of no par value.

On August 11, 2006, the Company issued 3,200,000 Units at \$2.05 per Unit. Each Unit consisted of one common share and one share purchase warrant. Each warrant entitles the holder to purchase one share for one year at an exercise price of \$2.50 per share. The fair value of the warrants was estimated at the date of closing using the Black-Scholes pricing model, under which the Company has assigned a value of \$0.64 per warrant or \$1,358,782 of the proceeds to the warrants, with the remaining \$5,201,218 of the proceeds assigned to the common shares.

# Canadian Spirit Resources Inc.

## NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

The equity instruments are as follows:

	March 31, 2007		December 31, 2006	
	Number of shares	Amount of shares and warrants	Number of shares	Amount of shares and warrants
Balance - beginning of year	28,833,082	\$ 46,991,811	25,593,082	\$ 40,879,476
Shares issued for cash:				
Stock options	-	-	40,000	16,000
Private placements	-	-	3,200,000	6,560,000
Warrants exercised	-	-	-	-
Equity instruments issue costs	-	(4,378)	-	(472,633)
Credit from contributed surplus	-	-	-	8,968
Balance - end of period	28,833,082	\$ 46,987,433	28,833,082	\$ 46,991,811

### Share Purchase Warrants

In conjunction with previous financings, the Company issued warrants with terms of one year to acquire common shares at specific exercise prices. Warrants outstanding at period-end are:

Exercise Price of Warrants	Outstanding at Dec. 31, 2006	Issued	Expired	Outstanding at March 31, 2007	Expiry Date
\$2.50	3,200,000	-	-	3,200,000	August 11, 2007

### Stock Options

The Company has stock option plans for directors, officers, employees and consultants which provides for the granting of options to acquire common shares. Under the terms of each plan, options vest over periods as determined by the Company and expire after a maximum of five years. At March 31, 2007, there were 2,700,000 common shares reserved for issuance under the plans of which options to acquire 2,521,000 common shares were outstanding (2,078,750 vested and 442,250 unvested).

## Canadian Spirit Resources Inc.

### NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

Exercise Price of Option	Out-standing at Dec. 31, 2006	Granted	Exercised or Cancelled	Out-standing at March 31, 2007	Vested at March 31, 2007	Year of Expiry
\$0.40 to \$0.41	465,000	-	-	465,000	465,000	2008
\$1.10	-	25,000	-	25,000	-	2009
\$1.24	-	70,000	-	70,000	6,250	2009/12
\$1.50 to \$1.72	680,000	-	-	680,000	680,000	2009
\$2.05	195,000	-	-	<sup>2)</sup> 195,000	65,000	2009/10
\$2.05	41,000	-	-	41,000	-	2011
\$2.15	100,000	-	-	100,000	-	2011
\$2.50	50,000	-	-	50,000	12,500	2008
\$3.30	75,000	-	-	75,000	75,000	2009
\$3.65	450,000	-	-	<sup>1)</sup> 450,000	450,000	2008
\$4.50	50,000	-	-	50,000	50,000	2009
\$4.15	140,000	-	-	140,000	140,000	2010
\$7.15	180,000	-	-	180,000	135,000	2010
<b>Total</b>	<b>2,426,000</b>	<b>95,000</b>	<b>-</b>	<b>2,521,000</b>	<b>2,078,750</b>	

Notes:

- 1) The exercise of these vested stock options are subject to the Company achieving certain minimum production or profit thresholds.
- 2) These stock options were re-priced on September 19, 2006 with no change to the original expiry date.

Options granted after January 1, 2003 are accounted for using the fair value method. The compensation cost charged in the first three months of 2007 against earnings for stock options granted was \$141,967 (2006: \$297,213).

The fair value of each option grant or re-pricing in 2007 and 2006 was estimated on the date of grant using the Black-Scholes pricing model with the following weighted average assumptions:

	Three Months 2007	Twelve Months 2006
Risk free interest rate	4.06%	4.02%
Expected dividend yield	0%	0%
Expected stock price volatility	63.86%	63.81%
Expected life of options	3.4 years	2.6 years
<b>Weighted average fair value of options granted during the period</b>	<b>\$0.55</b>	<b>\$0.71</b>

## Canadian Spirit Resources Inc.

### NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

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#### Performance Units

On September 19, 2006, the Company implemented a full value performance unit incentive plan for senior officers and directors of the Company. Three senior officers of the Company were granted a total of 39,000 performance units with vesting in equal amounts at the end of performance periods ending on the 1<sup>st</sup> of January 2007, 2008, and 2009. The four independent directors of the Company were granted a total of 16,000 performance units with vesting on January 1, 2009. A performance factor ranging from zero to three will be determined for each performance period based on the average closing price of the Company's shares over the last ten trading days of each performance period relative to a share price scale established at the date of grant. Awards under this plan are paid in cash within 60 days of the end of each performance period. Payments for vested units are determined by multiplying the number of units vested by the performance factor achieved during that performance period and multiplying the product by the 10 day average closing price of the Company's shares at the end of the performance period. For the purpose of calculating the performance factor associated with the 2006 grant, minimum and maximum 10 day average closing share prices were set at \$2.50 and \$5.00 per share for all performance periods. The 2006 total compensation expense for the 2006 Performance Unit grant was therefore \$Nil as the 10 day average closing share price on the Exchange as at December 31, 2006 was \$1.43 per share, resulting in a performance factor of zero.

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.

The total compensation expense for the 2006 and 2007 Performance Unit grants for the first three months of 2007 was therefore \$Nil as the 10 day average closing share price on the Exchange as at March 31, 2007 was \$1.09 per share.

Grant Date	Outstanding at Dec. 31, 2006	Granted, (Expired) or (Cancelled)	Exercised and Paid	Outstanding at March 31, 2007	Expiry Date
Sept. 19, 2006	55,000	-	-	55,000	March 2, 2009
Jan. 18, 2007	-	119,000	-	119,000	March 2, 2010
Total	55,000	119,000	-	174,000	

# Canadian Spirit Resources Inc.

## NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

### Contributed Surplus

	March 31, 2007	December 31, 2006
Balance, beginning of year	\$ 3,250,910	\$ 2,616,988
Value of options granted	141,967	642,890
Options exercised and transferred to share capital	-	(8,968)
Balance, end of period	<u>\$ 3,392,877</u>	<u>\$ 3,250,910</u>

### Share Appreciation Rights

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

Exercise Price	Out-standing at Dec. 31, 2006	Granted or (Cancelled)	Exercised or Expired	Out-standing at March 31, 2007	Vested at March 31, 2007	Expiry Date
\$0.48	600,000	-	-	600,000	600,000	Aug. 28, 2008

Total compensation recovery for share appreciation rights for the first three months of 2007 was \$162,000 (2006: expense of \$461,833) based on a closing price of \$1.10 per share on the Exchange at March 30, 2007. The Company has accrued a long term liability of \$372,000 at March 31, 2007 (2006: \$534,000) relating to share appreciation rights.

### Per Share Amounts

The weighted average number of shares outstanding during the first three months of 2007 was Basic 28,833,082 (2006: 25,594,249) and Diluted 28,894,600 (2006: 26,071,831).

For the period ended March 31, 2007, the existence of stock options and warrants affects the calculation of loss per share on a diluted basis. As the effect of this dilution is to reduce the reported loss per share, diluted loss per share equals basic loss per share.

## Canadian Spirit Resources Inc.

### NOTES TO FINANCIAL STATEMENTS

Three months ended March 31, 2007

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#### 6. RELATED PARTY TRANSACTIONS

During 2007 and 2006, 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:

For the three month periods ended March 31	2007	2006
Consulting fees	\$ 25,050	\$ 20,300
Salaries and benefits	\$ 30,561	\$ 27,250

Consulting fees in the first three months of 2007 included \$25,050 (2006: \$20,300) paid or payable to a director and senior officer of the Company. Accounts payable includes \$9,116 (2006: \$11,847) due to a director and senior officer of the Company.

Salaries and benefits of \$30,561 (2006: \$27,250) was the compensation paid or payable to a director and senior officer of the Company during the first three months of 2007.

Transactions with related parties are recorded at exchange amounts for services provided. In addition during the first three months of 2007, certain directors, relatives of directors, or companies controlled by directors subscribed for Nil (2006: Nil) shares or units in private placement offerings of the Company under the same terms as other investors.