

Financial Statements of

CANADIAN SPIRIT RESOURCES INC.

September 30, 2005

(unaudited)

1. BALANCE SHEETS
2. STATEMENTS OF OPERATIONS AND DEFICIT
3. STATEMENTS OF CASH FLOWS
4. NOTES TO FINANCIAL STATEMENTS

NOTICE: The interim financial statements and notes thereto for the three and nine month periods ended September 30, 2005 have not been reviewed by the Company's external auditors.

Canadian Spirit Resources Inc.

BALANCE SHEETS

	September 30 2005 <i>(unaudited)</i>	December 31 2004 <i>(audited)</i>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 13,087,659	\$ 5,971,330
Accounts receivable	296,489	797,668
Prepaid expenses and other	61,474	45,515
	<u>13,445,622</u>	<u>6,814,513</u>
Property, plant and equipment (note 2)	<u>19,385,229</u>	<u>14,070,160</u>
	<u>\$ 32,830,851</u>	<u>\$ 20,884,673</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable & accrued trade liabilities	\$ 1,319,024	\$ 1,223,229
Accrued liability for share appreciation rights (note 4)	1,258,333	845,333
Asset retirement obligation (note 3)	51,450	26,236
	<u>2,628,807</u>	<u>2,094,798</u>
Shareholders' equity		
Share capital (note 4)	40,879,476	28,613,668
Contributed surplus	2,293,708	838,120
Deficit	(12,971,140)	(10,661,913)
	<u>30,202,044</u>	<u>18,789,875</u>
	<u>\$ 32,830,851</u>	<u>\$ 20,884,673</u>

Nature of operations and going concern (note 1)

ON BEHALF OF THE BOARD:

(signed) "Philip H. Grubbe"

Director

(signed) "J. R. Richard Couillard"

Director

Canadian Spirit Resources Inc.

STATEMENTS OF OPERATIONS AND DEFICIT

For the period ended September 30

(unaudited)

	Three months ended Sept. 30		Nine months ended Sept. 30	
	2005	2004	2005	2004
Revenue				
Interest and other income	\$ 217,952	\$ 19,235	\$ 346,535	\$ 45,273
Expenses				
Consulting fees	35,889	76,625	111,100	167,885
Salaries and benefits	86,005	42,887	243,170	128,565
Other general administration	105,016	76,084	336,799	250,662
Stock-based compensation (note 4)	448,559	382,752	1,934,904	701,253
Accretion expense	848	357	1,877	866
Depreciation	11,233	1,867	27,912	5,192
	<u>687,550</u>	<u>580,572</u>	<u>2,655,762</u>	<u>1,254,423</u>
Net Loss	(469,598)	(561,337)	(2,309,227)	(1,209,150)
Deficit, beginning of period	<u>(12,501,542)</u>	<u>(9,567,906)</u>	<u>(10,661,913)</u>	<u>(8,920,093)</u>
Deficit, end of period	<u><u>\$(12,971,140)</u></u>	<u><u>\$(10,129,243)</u></u>	<u><u>\$(12,971,140)</u></u>	<u><u>\$(10,129,243)</u></u>
Loss per share (Basic & Diluted)	<u><u>\$ (0.02)</u></u>	<u><u>\$ (0.03)</u></u>	<u><u>\$ (0.10)</u></u>	<u><u>\$ (0.08)</u></u>

Nature of operations and going concern (Note 1)

Canadian Spirit Resources Inc.

STATEMENTS OF CASH FLOWS

For the period ended September 30
(unaudited)

	Three months ended Sept. 30		Nine months ended Sept. 30	
	2005	2004	2005	2004
Operating Activities:				
Net loss	\$ (469,598)	\$ (561,337)	\$ (2,309,227)	\$ (1,209,150)
Add items not affecting cash				
Depreciation	11,233	2,621	27,912	7,450
Accretion expense	848	357	1,877	866
Stock-based compensation	448,559	382,752	1,934,904	701,253
	(8,958)	(175,607)	(344,534)	(499,581)
Changes in non-cash working capital items	39,719	(439,680)	(59,418)	(443,133)
	30,761	(615,287)	(403,952)	(942,714)
Financing Activities:				
Shares issued for cash	-	5,927,753	12,460,168	14,911,111
Share issue costs	-	-	(260,676)	-
	-	5,927,753	12,199,492	14,911,111
Investing Activities:				
Furniture and office equipment	(5,850)	(60)	(67,745)	(3,336)
Exploration expenditures	(2,489,218)	(106,662)	(3,044,249)	(1,161,261)
Acquisition/retention of natural gas rights	(2,142,684)	(4,950,852)	(2,207,650)	(9,976,171)
	(4,637,752)	(5,057,574)	(5,319,644)	(11,140,768)
Changes in non-cash working capital items	1,744,495	(10,184)	640,433	55,322
	(2,893,257)	(5,067,758)	(4,679,211)	(11,085,446)
Change in cash	(2,862,496)	244,708	7,116,329	2,882,951
Cash position, beginning of period	15,950,155	5,267,808	5,971,330	2,629,565
Cash position, end of period	\$ 13,087,659	\$ 5,512,516	\$ 13,087,659	\$ 5,512,516
Cash taxes paid	\$ -	\$ -	\$ -	\$ -
Interest paid	\$ -	\$ -	\$ -	\$ -

Nature of operations and going concern (Note 1)

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2005

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 unaudited interim 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, 2004. The disclosures included below are incremental to those included with the annual financial statements. These unaudited interim financial statements should be read in conjunction with the audited financial statements and the notes thereto for the year ended December 31, 2004.

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. 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 the operating costs.

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.

2. PROPERTY, PLANT AND EQUIPMENT

	2005	2004
Natural gas properties	\$ 19,279,854	\$ 12,689,621
Mineral property	1	1
Office furniture and equipment	145,696	26,052
Less accumulated depletion, depreciation and amortization	(40,322)	(12,041)
Total property, plant and equipment	\$ 19,385,229	\$ 12,703,633

As the Company had no production or proved reserves at September 30, 2005, there was no depletion charge for the period and a ceiling test was not performed. At September 30, 2005, natural gas properties included \$13,307,245 (2004: \$10,959,655) relating to undeveloped properties. There has been no impairment of undeveloped properties and all costs attributed to natural gas properties are considered to be on unproven properties. During the three and nine month periods ended September 30, 2005, the Company capitalized \$143,910 and \$406,848 respectively (2004: \$35,700 and \$107,100) of overhead directly related to exploration activities.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2005

3. ASSET RETIREMENT OBLIGATION

	2005	2004
Balance, Beginning of Period	\$ 26,236	\$ 8,761
Liabilities incurred	23,337	8,926
Accretion expense	1,877	866
Liabilities settled	-	-
Balance, End of Period	\$ 51,450	\$ 18,553

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 June 30, 2005 the estimated total future liability of \$299,194 has a present value of \$51,450 assuming the liability is settled in 2031 and using an estimated credit-adjusted risk-free interest rate of 7.00 percent.

4. SHARE CAPITAL

The Company has authorized share capital of an unlimited number of common shares of no par value. The issued share capital at September 30 is as follows:

	2005		2004	
	Number	Amount	Number	Amount
Balance – Beginning of period	22,337,348	\$ 28,613,668	11,734,908	\$ 12,808,180
Shares issued for Cash:				
Stock options	125,000	105,000	315,000	142,750
Private Placements	1,341,696	9,056,448	6,450,000	12,980,000
Warrants exercised	1,789,038	3,298,720	3,323,353	2,131,836
Finders' Fees – Private Placements	-	-	30,750	50,738
Share issue costs	-	(260,676)	-	(405,462)
Credit from contributed surplus	-	66,316	-	23,064
Balance – End of period	25,593,082	\$ 40,879,476	21,854,011	\$ 27,731,106

On March 11, 2005, the Company issued 1,341,696 Units at \$6.75 per Unit. Each Unit consisted of one common share and one-half share purchase warrant. Each whole warrant entitles the holder to purchase one share for one year at an exercise price of \$8.00 per share.

Share Purchase Warrants

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

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2005

4. SHARE CAPITAL (continued)

Warrants outstanding at September 30 are as follows:

Exercise Price of Warrants	Outstanding at December 31, 2004	Issued	Exercised	Outstanding at Sept. 30, 2005	Expiry Date
\$0.75	10,000	-	10,000	-	July 4, 2005
\$1.85	1,779,038	-	1,779,038	-	June 22, 2005
\$3.75	750,000	-	-	750,000	¹⁾ January 15, 2006
\$8.00	-	670,848	-	670,848	March 11, 2006
Total	2,539,038	670,848	1,789,038	1,420,848	

Notes:

- 1) The expiry date of these warrants was extended from September 15, 2005 to January 15, 2006.
- 2) There have been no warrants that have expired or were cancelled during the first nine months of 2005.

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 of not less than eighteen months and expire after a maximum of five years. At September 30, 2005, there were 2,740,000 common shares reserved for issuance under the plans of which options to acquire 2,475,000 common shares were outstanding (1,363,750 vested and 1,111,250 unvested).

Exercise Price of Option	Out-standing at Dec. 31, 2004	Granted	Exercised	Out-standing at Sept. 30, 2005	Vested at Sept. 30, 2005	Year of Expiry
\$0.40 to \$0.41	580,000	-	75,000	505,000	505,000	2008
\$1.50 to \$1.72	730,000	-	50,000	680,000	386,250	2009
\$3.30	75,000	-	-	75,000	56,250	2009
\$3.65	450,000	-	-	450,000	¹⁾ 225,000	2008
\$4.50	-	300,000	-	300,000	75,000	2009
\$7.15	-	250,000	-	250,000	62,500	2010
\$4.15 to \$4.60	-	215,000	-	215,000	53,750	2010
Total	1,835,000	765,000	125,000	2,475,000	1,363,750	

Notes:

- 1) The exercise of these vested stock options are subject to the Company achieving certain minimum production or profit thresholds.
- 2) There have been no stock options that have expired or were cancelled during the first nine months of 2005.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2005

4. SHARE CAPITAL (continued)

In the three and nine month periods ended September 30, 2005 the compensation cost charged against earnings for stock options granted was \$352,559 and \$1,521,904 respectively (2004: \$95,890 and \$358,237). The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2005	2004
Risk free interest rate	3.17%	3.60%
Expected dividend yield	0%	0%
Expected stock price volatility	84%	90%
Expected life of options	3 years	3 years

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. The SARs vest in three equal amounts on the first, second and third anniversary of the date of grant and the exercise of vested SARs is subject to achieving certain minimum production or profit thresholds.

Exercise Price	Out-standing at Dec. 31, 2004	Granted or (Cancelled)	Exercised or Expired	Out-standing at Sept. 30, 2005	Vested at Sept. 30, 2005	Expiry Date
\$0.48	600,000	-	-	600,000	400,000	Aug. 28, 2008

Total compensation expense for share appreciation rights for the three and nine month periods ended September 30, 2005 was \$96,000 and \$413,000 respectively (2004: \$286,863 and \$343,016) based on a closing price of \$3.50 per share on the TSX Venture Exchange on September 30, 2005. The Company has accrued a long term liability of \$1,258,333 at September 30, 2005 relating to share appreciation rights.

Per Share Amounts

The weighted average number of shares outstanding during the three and nine month periods ended September 30, 2005 was Basic 25,593,082 and 24,150,287 respectively (2004: 19,794,839 and 15,178,959) and Diluted 26,572,838 and 25,913,475 respectively (2004: 22,321,814 and 18,140,481).

For the three and nine month periods ended September 30, 2005, 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 information has not been shown.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2005

5. RELATED PARTY TRANSACTIONS

During 2004 and 2005, the Company had transactions with directors of the Company, persons related to them or companies controlled by them in the normal course of business as follows:

	2005	2004
Consulting fees	\$ 58,400	\$ 62,850
Salaries and benefits	\$ 70,500	\$ 63,000
Administration and accounting fees	\$ -	\$ 1,940

Consulting fees in the nine month period ended September 30, 2005 included \$58,400 (2004: \$62,850) paid or payable to a director and senior officer of the Company. Accounts payable includes \$5,816 (2004: \$7,223) due to a director for consulting fees earned during the period.

Salaries and benefits of \$70,500 (2004: \$63,000) was the compensation paid to a director and senior officer of the Company during the nine month period ended September 30, 2005.

Accounting fees of \$Nil (2004: \$1,940) were paid to a company controlled by the spouse of a director and senior officer for accounting services during the nine month period ended September 30, 2005.

Transactions with related parties are recorded at cost, which represent fair market value for services provided. In addition during 2005, certain directors, relatives of directors, or companies controlled by directors subscribed for 14,354 (2004: 15,000) shares or units in private placement offerings of the Company under the same terms as other investors.