

Financial Statements of
Canadian Spirit Resources Inc.

September 30, 2006
(unaudited)

1. BALANCE SHEETS
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NOTICE: The interim financial statements and notes thereto for the three and nine month periods ended September 30, 2006 have not been reviewed by the Company's external auditors.

Canadian Spirit Resources Inc.

BALANCE SHEETS

	September 30 2006 <i>(unaudited)</i>	December 31 2005 <i>(audited)</i>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 7,659,534	\$ 10,688,123
Accounts receivable	258,306	1,039,211
Prepaid expenses and other	54,170	36,921
	<u>7,972,010</u>	<u>11,764,255</u>
Property, plant and equipment (note 2)	<u>30,714,913</u>	<u>22,247,043</u>
	<u>\$ 38,686,923</u>	<u>\$ 34,011,298</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable & accrued trade liabilities	\$ 2,996,817	\$ 3,722,768
Accrued liability for share appreciation rights (note 4)	690,000	1,176,000
Asset retirement obligation (note 3)	119,662	84,395
	<u>3,806,479</u>	<u>4,983,163</u>
Shareholders' equity		
Share capital (note 4)	47,010,275	40,879,476
Contributed surplus	3,108,687	2,616,988
Deficit	(15,238,518)	(14,468,329)
	<u>34,880,444</u>	<u>29,028,135</u>
	<u>\$ 38,686,923</u>	<u>\$ 34,011,298</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	
	2006	2005	2006	2005
Revenue				
Interest and other income	\$ 36,970	\$ 217,952	\$ 235,760	\$ 346,535
Expenses				
Consulting fees	54,399	35,889	172,459	111,100
Salaries and benefits	100,605	86,005	289,465	243,170
Other general administration	104,562	105,016	427,904	336,799
Stock-based compensation (note 4)	(431,560)	448,559	18,353	1,934,904
Accretion expense	7,615	848	10,460	1,877
Impairment of conventional natural gas costs (note 2)	14,979	-	51,744	-
Depreciation	12,278	11,233	35,564	27,912
	<u>(137,122)</u>	<u>687,550</u>	<u>1,005,949</u>	<u>2,655,762</u>
Net Gain (Loss)	174,092	(469,598)	(770,189)	(2,309,227)
Deficit, beginning of period	<u>(15,412,610)</u>	<u>(12,501,542)</u>	<u>(14,468,329)</u>	<u>(10,661,913)</u>
Deficit, end of period	<u><u>\$(15,238,518)</u></u>	<u><u>\$(12,971,140)</u></u>	<u><u>\$(15,238,518)</u></u>	<u><u>\$(12,971,140)</u></u>
Gain (Loss)/share (Basic & Diluted)	<u>\$ 0.01</u>	<u>\$ (0.02)</u>	<u>\$ (0.03)</u>	<u>\$ (0.10)</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	
	2006	2005	2006	2005
Operating Activities:				
Net gain (loss)	\$ 174,092	\$ (469,598)	\$ (770,189)	\$ (2,309,227)
Add items not affecting cash				
Depreciation	12,278	11,233	35,564	27,912
Accretion expense	7,615	848	10,460	1,877
Impairment of natural gas costs	14,979	-	51,744	-
Stock-based compensation	(431,560)	448,559	18,353	1,934,904
	(222,596)	(8,958)	(654,068)	(344,534)
Changes in non-cash working capital items	76,887	39,719	(61,426)	(59,418)
	(145,709)	30,761	(715,494)	(403,952)
Financing Activities:				
Shares issued for cash	6,560,000	-	6,576,000	12,460,168
Share issue costs	(454,169)	-	(454,169)	(260,676)
	6,105,831	-	6,121,831	12,199,492
Investing Activities:				
Furniture and office equipment	(10,985)	(5,850)	(15,640)	(67,745)
Exploration expenditures	(3,986,180)	(2,489,218)	(8,444,332)	(3,044,249)
Acquisition/retention of natural gas rights	(43,141)	(2,142,684)	(70,399)	(2,207,650)
	(4,040,306)	(4,637,752)	(8,530,371)	(5,319,644)
Changes in non-cash working capital items	2,459,627	1,744,495	95,445	640,433
	(1,580,679)	(2,893,257)	(8,434,926)	(4,679,211)
Change in cash	4,379,443	(2,862,496)	(3,028,589)	7,116,329
Cash position, beginning of period	3,280,091	15,950,155	10,688,123	5,971,330
Cash position, end of period	\$ 7,659,534	\$13,087,659	\$ 7,659,534	\$13,087,659
Cash taxes paid	\$ -	\$ -	\$ -	\$ -
Interest paid	\$ -	\$ -	\$ -	\$ -

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2006

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 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, 2005. 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, 2005.

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 unconventional natural gas 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 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.

2. PROPERTY, PLANT AND EQUIPMENT

	September 30, 2006	December 31, 2005
Natural gas properties	\$ 31,813,094	\$ 23,273,556
Mineral property	1	1
Office furniture and equipment	161,969	146,329
	<u>31,975,064</u>	<u>23,419,886</u>
Less: Accumulated depletion, depreciation & amortization	<u>(1,260,151)</u>	<u>(1,172,843)</u>
Total property, plant and equipment	<u>\$ 30,714,913</u>	<u>\$ 22,247,043</u>

As the Company had no production or proved reserves at September 30, 2006, there was no depletion charge for the period. At September 30, 2006, natural gas properties included \$13,379,784 (December 31, 2005: \$13,309,386) relating to undeveloped properties. There has been no impairment of undeveloped properties and all costs incurred on the development of natural gas from coal and shale gas charged to natural gas properties are considered to be on unproven properties. During the three and nine month periods ended September 30, 2006, the Company capitalized \$132,864 and \$454,480 respectively (2005: \$143,910 and \$406,848) of overhead directly related to exploration activities.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2006

2. PROPERTY, PLANT AND EQUIPMENT (continued)

During late 2005 and the first quarter of 2006, the Company attempted to complete and production test two test wells at West Farrell for conventional gas in the Bluesky formation. Although these wells continue to be prospective for both shale gas in the Gates and Moosebar formations and natural gas from coal and shale in the Gething formation, it was determined that the Bluesky formation does not contain commercially recoverable quantities of hydrocarbons. As a result, the Company has made an impairment provision of \$14,979 and \$51,744 respectively during the three and nine month periods ended September 30, 2006 (2005: \$Nil and \$Nil) relating to the Bluesky completion costs.

3. ASSET RETIREMENT OBLIGATION

	September 30, 2006	December 31, 2005
Balance, beginning of year	\$ 84,395	\$ 26,236
Liabilities incurred	24,807	55,090
Accretion expense	10,460	3,069
Less: liabilities settled	-	-
Balance, end of period	<u>\$ 119,662</u>	<u>\$ 84,395</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 September 30, 2006 the estimated total future liability of \$617,860 has a present value of \$119,662 assuming the liability is settled in approximately 25 years, using an estimated credit-adjusted risk-free interest rate of 7 percent, and an inflation rate of 2 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 is as follows:

	<u>September 30, 2006</u>		<u>December 31, 2005</u>	
	Number of shares	Amount	Number of shares	Amount
Balance - beginning of year	25,593,082	\$ 40,879,476	22,337,348	\$ 28,613,668
Shares issued for cash:				
Stock options	40,000	16,000	125,000	105,000
Private placements	3,200,000	6,560,000	1,341,696	9,056,448
Warrants exercised	-	-	1,789,038	3,298,720
Share issue costs	-	(454,169)	-	(260,676)
Credit from contributed surplus	-	8,968	-	66,316
Balance - end of period	<u>28,833,082</u>	<u>\$ 47,010,275</u>	<u>25,593,082</u>	<u>\$ 40,879,476</u>

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2006

4. SHARE CAPITAL (continued)

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. During January 2006, the Company extended the expiry date of these warrants to July 11, 2006 at which time they expired.

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 Company has not assigned proceeds to the warrants as the Units were issued at a discount to the market price of the Company's share price on the TSX Venture Exchange on the date of issue.

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, 2006, there were 2,700,000 common shares reserved for issuance under the plans of which options to acquire 2,401,000 common shares were outstanding (1,972,750 vested and 428,250 unvested).

Exercise Price of Option	Out-standing at Dec. 31, 2005	Granted	Exercised or Cancelled	Out-standing at Sept. 30, 2006	Vested at Sept. 30, 2006	Year of Expiry
\$0.40 to \$0.41	505,000	-	40,000	465,000	465,000	2008
\$1.50 to \$1.72	680,000	-	-	680,000	567,500	2009
\$2.05	-	³⁾ 195,000	-	195,000	97,500	2009/10
\$2.05	-	41,000	-	41,000	10,250	2011
\$2.50	-	50,000	-	50,000	12,500	2008
\$3.15	-	25,000	²⁾ 25,000	-	-	2008
\$3.30	75,000	-	-	75,000	75,000	2009
\$3.65	450,000	-	-	450,000	¹⁾ 450,000	2008
\$4.50	100,000	-	³⁾ 100,000	-	-	2009
\$4.50 to \$4.60	250,000	-	²⁾ 125,000	125,000	100,000	2009/10
\$4.15 to \$4.50	165,000	-	³⁾ 25,000	140,000	105,000	2010
\$7.15	250,000	-	³⁾ 70,000	180,000	90,000	2010
Total	2,475,000	311,000	385,000	2,401,000	1,972,750	

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 forfeited and cancelled during the first nine months of 2006.
- 3) These stock options were re-priced on September 19, 2006 with no change to the original expiry date.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2006

4. SHARE CAPITAL (continued)

On September 19, 2006, the Company granted options to acquire 41,000 shares of the Company at a price of \$2.05 per share to non-executive employees and re-priced 195,000 existing options at \$2.05 per share with no change to the original expiry date. None of the re-priced options were held by officers or directors.

Options granted after January 1, 2003 are accounted for using the fair value method. The compensation cost charged against earnings in the three and nine month periods ended September 30, 2006 was (\$3,246) and \$500,667 respectively (2005: \$352,559 and \$1,521,904). The weighted average fair value of stock options granted during the period January 1 to September 30, 2006 was \$0.96 per option (2005: \$2.92) using the Black-Scholes option pricing model with the following weighted average assumptions:

	2006	2005
Risk free interest rate	4.06%	3.17%
Expected dividend yield	0%	0%
Expected stock price volatility	61%	84%
Expected life of options	2.5 years	3 years

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. Warrants outstanding at September 30, 2006 are as follows:

Exercise Price of Warrants	Outstanding at December 31, 2005	Issued	Expired	Outstanding at Sept. 30, 2006	Expiry Date
\$3.75	750,000	-	750,000	-	¹⁾ January 15, 2006
\$8.00	670,848	-	670,848	-	²⁾ July 11, 2006
\$2.50	-	3,200,000	-	3,200,000	August 11, 2007
Total	1,420,848	-	1,420,848	3,200,000	

Notes:

- 1) The expiry date of these warrants was extended from September 15, 2005 to January 15, 2006 at which time all 750,000 warrants expired.
- 2) The expiry date of these warrants was extended from March 11, 2006 to July 11, 2006 at which time all 670,848 warrants expired.

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.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2006

4. SHARE CAPITAL (continued)

Exercise Price	Out-standing at Dec. 31, 2005	Granted or (Cancelled)	Exercised or Expired	Out-standing at Sept. 30, 2006	Vested at Sept. 30, 2006	Expiry Date
\$0.48	600,000	-	-	600,000	600,000	Aug. 28, 2008

Total compensation expense for share appreciation rights for the three and nine month periods ended September 30, 2006 was (\$432,000) and (\$486,000) (2005: \$96,000 and \$413,000) based on a closing price reducing from \$3.00 per share on December 31, 2005 to \$1.63 per share on the TSX Venture Exchange on September 29, 2006. The Company has accrued a long term liability of \$690,000 at September 30, 2006 (\$1,176,000 at December 31, 2005) relating to share appreciation rights.

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 first of January 2007, 2008, and 2009. The four independent directors of the Company were granted a total of 16,000 performance units with vesting at the first of the month following the performance period ending December 2008. 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 calendar year 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 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.

Outstanding at Dec. 31, 2005	Granted or (Cancelled)	Exercised and Paid	Outstanding at Sept. 30, 2006	Expiry Date
-	55,000	-	55,000	Jan. 1, 2009

The total compensation expense for Performance Units for the three and nine month periods ended September 30, 2006 was \$3,686 and \$3,686 (2005: \$Nil and \$Nil) based on a closing share price at September 30, 2006 of \$1.63 per share. The Company has accrued a short term liability of \$3,686 at September 30, 2006 (December 31, 2005: \$Nil) relating to Performance Units.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Nine months ended September 30, 2006

4. SHARE CAPITAL (continued)

Contributed Surplus

	September 30, 2006	December 31, 2005
Balance, beginning of year	\$ 2,616,988	\$ 838,120
Value of options granted	909,654	1,845,184
Value of options forfeited and cancelled	(408,987)	-
Options exercised and transferred to share capital	<u>(8,968)</u>	<u>(66,316)</u>
Balance, end of period	<u>\$ 3,108,687</u>	<u>\$ 2,616,988</u>

Per Share Amounts

The weighted average number of shares outstanding during the three and nine month periods ended September 30, 2006 was Basic 27,339,604 and 26,187,954 respectively (2005: 25,593,082 and 24,150,287) and Diluted 27,716,379 and 26,795,475 (2005: 26,572,838 and 25,913,475).

For the nine month period ended September 30, 2006 and 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. For the three month period ended September 30, 2006 the gain of \$0.01 per share is the same for both Basic and Diluted amounts.

5. RELATED PARTY TRANSACTIONS

During the first nine months of 2005 and 2006, 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:

For the nine month periods ended September 30	2006	2005
Consulting fees	\$ 63,900	\$ 58,400
Salaries and benefits	\$ 87,395	\$ 70,500

Consulting fees in the nine month period ended September 30, 2006 included \$63,900 (2005: \$58,400) paid or payable to a director and senior officer of the Company. Accounts payable includes \$13,362 (2005: \$5,816) due to a director for consulting fees earned during the period.

Salaries and benefits of \$87,395 (2005: \$70,500) was the compensation paid to a director and senior officer of the Company during nine month period ended September 30, 2006.

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