

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

December 31, 2007

1. REPORT OF MANAGEMENT
2. AUDITORS' REPORT
3. BALANCE SHEETS
4. STATEMENTS OF OPERATIONS,
COMPREHENSIVE LOSS AND DEFICIT
5. STATEMENTS OF CASH FLOWS
6. NOTES TO FINANCIAL STATEMENTS

Canadian Spirit Resources Inc.

REPORT OF MANAGEMENT

The accompanying Financial Statements of Canadian Spirit Resources Inc. are the responsibility of Management.

Management has prepared the Financial Statements in accordance with accounting principles generally accepted in Canada. If alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has ensured that the Financial Statements are presented fairly in all material respects.

Canadian Spirit Resources Inc. maintains internal accounting and administrative controls designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for reviewing and approving the Financial Statements and Management's Discussion and Analysis and, primarily through its Audit Committee, ensures that management fulfills its responsibilities for financial reporting.

The Audit Committee is appointed by the Board and is entirely composed of Directors who are independent of the Company. The Audit Committee meets regularly with management, and periodically with the external auditors, to discuss internal controls and reporting issues and to satisfy itself that each party is properly discharging its responsibilities. It reviews the Financial Statements and the external auditors' report. The Audit Committee also considers, for review by the Board and approval by the shareholders, the engagement or reappointment of the external auditors.

PricewaterhouseCoopers LLP, the external auditors, have audited the Financial Statements in accordance with auditing standards generally accepted in Canada on behalf of the shareholders. PricewaterhouseCoopers LLP have full and free access to the Audit Committee.

(signed) "Donald R. Gardner"

Donald R. Gardner,
Chief Executive Officer

(signed) "Phillip D.C. Geiger"

Phillip D.C. Geiger,
President & Chief Operating Officer

Canadian Spirit Resources Inc.

AUDITORS' REPORT

April 22, 2008

To the Shareholders of Canadian Spirit Resources Inc.

We have audited the balance sheets of Canadian Spirit Resources Inc. as at December 31, 2007 and 2006 and the statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"PricewaterhouseCoopers LLP"

Chartered Accountants

Calgary, Alberta

Canadian Spirit Resources Inc.

BALANCE SHEETS

As at December 31	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,063,490	\$ 3,212,878
Accounts receivable	89,447	202,176
Prepaid expenses and other	52,542	39,989
	<u>1,205,479</u>	<u>3,455,043</u>
Property, plant and equipment (note 3)	<u>37,543,148</u>	<u>32,793,986</u>
	<u>\$ 38,748,627</u>	<u>\$ 36,249,029</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued trade liabilities	\$ 854,444	\$ 857,202
Current portion of accrued liability for share appreciation rights (note 5)	18,000	-
	<u>872,444</u>	<u>857,202</u>
Accrued liability for share appreciation rights (note 5)	-	534,000
Asset retirement obligation (note 4)	198,685	158,650
Shareholders' equity		
Equity instruments (note 5)	49,168,204	46,991,811
Contributed surplus (note 5)	4,928,402	3,250,910
Deficit	<u>(16,419,108)</u>	<u>(15,543,544)</u>
	<u>37,677,498</u>	<u>34,699,177</u>
	<u>\$ 38,748,627</u>	<u>\$ 36,249,029</u>

Nature of operations and going concern (note 1)

Commitments (note 8)

Fair values of financial assets and liabilities (note 9)

ON BEHALF OF THE BOARD:

(signed) "Philip H. Grubbe"

Director

(signed) "J.R. Richard Couillard"

Director

Canadian Spirit Resources Inc.

STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

For the year ended December 31	2007	2006
Revenue		
Interest and other income	\$ 90,522	\$ 277,305
Expenses		
Consulting fees	186,664	222,563
Salaries and benefits	427,344	416,731
Other general administration	491,503	593,098
Stock-based compensation (note 5)	(197,290)	4,782
Accretion expense	11,621	15,391
Impairment of conventional natural gas costs (note 3)	-	51,744
Amortization	46,244	48,211
	<u>966,086</u>	<u>1,352,520</u>
Net loss and comprehensive loss	(875,564)	(1,075,215)
Deficit, beginning of period	<u>(15,543,544)</u>	<u>(14,468,329)</u>
Deficit, end of period	<u>\$ (16,419,108)</u>	<u>\$ (15,543,544)</u>
Loss per share (Basic & Diluted)	<u>\$ (0.03)</u>	<u>\$ (0.04)</u>

Nature of operations and going concern (note 1)

Canadian Spirit Resources Inc.

STATEMENTS OF CASH FLOWS

For the year ended December 31	2007	2006
Operating Activities:		
Net loss	\$ (875,564)	\$ (1,075,215)
Add (deduct) items not affecting cash:		
Amortization	46,244	48,211
Accretion expense	11,621	15,391
Impairment of conventional natural gas costs	-	51,744
Stock-based compensation	(197,290)	4,782
	<u>(1,014,989)</u>	<u>(955,087)</u>
Changes in non-cash working capital items	<u>(25,998)</u>	<u>(29,341)</u>
	<u>(1,040,987)</u>	<u>(984,428)</u>
Financing Activities:		
Equity instruments issued for cash	3,744,700	6,576,000
Equity instruments issue costs	(209,525)	(472,633)
	<u>3,535,175</u>	<u>6,103,367</u>
Investing Activities:		
Furniture and office equipment	(3,251)	(15,058)
Exploration and development expenditures	(4,679,288)	(10,528,347)
Acquisition/retention of natural gas rights	(84,453)	(44,629)
	<u>(4,766,992)</u>	<u>(10,588,034)</u>
Changes in non-cash working capital items	<u>123,416</u>	<u>(2,006,150)</u>
	<u>(4,643,576)</u>	<u>(12,594,184)</u>
Change in cash	(2,149,388)	(7,475,245)
Cash position, beginning of period	<u>3,212,878</u>	<u>10,688,123</u>
Cash position, end of period	<u>\$ 1,063,490</u>	<u>\$ 3,212,878</u>
Cash taxes paid	<u>\$ -</u>	<u>\$ -</u>
Interest paid	<u>\$ -</u>	<u>\$ -</u>

See the accompanying notes to the financial statements

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

1. NATURE OF OPERATIONS, GOING CONCERN AND BASIS OF PRESENTATION

Canadian Spirit Resources Inc. (the “Company”) 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 unconventional natural gas 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 \$16,419,108 which includes a net loss after income taxes of \$875,564 for the year ended December 31, 2007 (2006: loss of \$1,075,215). 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.

Certain comparative figures have been reclassified to conform with the current year presentation.

2. SIGNIFICANT ACCOUNTING POLICIES

Measurement Uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The amounts recorded for amortization, asset retirement obligation, impairment of unproved properties, stock based compensation and future income taxes are based upon estimates. Actual results could differ from those estimates.

Joint Interests

Exploration, development and production activities may be conducted jointly with external parties and, accordingly, the Company only reflects its proportionate interest in such activities.

Cash and Cash Equivalents

Cash and short term deposits include investments with an original maturity of three months or less.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Financial Instruments and Derivatives

(a) Classification:

GAAP requires 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 financial liabilities. The Company has classified each of its financial instruments as a) cash and cash equivalents as held-for-trading financial assets; b) accounts receivable as loans and receivables; and c) accounts payable and accrued trade liabilities as other financial liabilities.

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

(b) Recognition and Measurement:

GAAP requires that all financial instruments including derivatives and most embedded derivatives be measured at fair value, with the exception of loans and receivables, debt securities classified as held-to-maturity financial assets, and other financial liabilities which may be measured at amortized cost.

The Company does not have any financial instruments designated as hedges and therefore does not present a separate statement of other comprehensive income.

Property, Plant and Equipment

(a) Natural Gas Interests:

The Company follows the full cost method of accounting for exploration and development expenditures whereby all costs relating to the acquisition of, exploration for and development of natural gas reserves are capitalized. Such costs include lease acquisitions, geological and geophysical, lease rentals on undeveloped properties, drilling both productive and non-productive wells, production equipment, and overhead charges directly related to acquisition, exploration and development activities. Proceeds received from disposals of properties and equipment are credited against capitalized costs unless the disposal would alter the rate of depletion and amortization by more than 20 percent, in which case a gain or loss on disposal is recorded.

Upon commencement of commercial production all costs of acquisition, exploration and development of natural gas reserves, associated tangible plant and equipment costs, asset retirement obligations and estimated costs of future development of proved undeveloped reserves are depleted and/or amortized by the unit of production method based on estimated gross proved reserves before royalties as determined by independent evaluators. Natural gas reserves are converted to equivalent units using their relative energy content of six thousand cubic feet of natural gas to one barrel of oil.

The costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion calculations. These properties are assessed annually to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Natural gas assets are evaluated annually to determine that the costs are recoverable and do not exceed the fair value of the properties. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves plus the lower of cost and market of unproved properties exceed the carrying value of the petroleum and natural gas assets. If the carrying value of the petroleum and natural gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market of unproved

properties. The cash flows are estimated using future product prices and costs and are discounted using the risk-free interest rate.

(b) **Mineral Property:**

Expenditures incurred on properties identified as having development potential are recorded at cost and are deferred on a project basis until the viability of the project is determined. If a project is successful, the project costs are amortized using the unit of production method based on recoverable mineral reserves. If a project is abandoned or it is determined that the mineral property is uneconomic to produce, the accumulated project costs are charged to earnings in the period in which the determination is made.

(c) **Office Equipment:**

Computer and 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.

Asset Retirement Obligation

The Company follows the accounting methodology outlined in Section 3110 of the Canadian Institute of Chartered Accountants (“CICA”) Handbook with respect to asset retirement obligations. The Company records the present value of legal obligations associated with the retirement of long-lived tangible assets, such as producing well sites and natural gas processing plants, in the period in which they are incurred with a corresponding increase in the carrying amount of the related long-lived asset. The liability accretes until the Company settles the retirement obligation. The carrying amounts of the long-lived assets are depleted using the unit of production method. Actual costs to retire tangible assets are deducted from the liability as incurred.

Revenue Recognition

Revenues from the sale of natural gas and other hydrocarbons are recorded when title passes to an external party.

Stock-based Compensation

Stock options are accounted for based on the fair value method. The fair value is measured at the grant date and charged to earnings over the vesting period with a corresponding increase in contributed surplus. Consideration paid to the Company on exercise of all options is credited to share capital.

Changes in intrinsic value between the grant date and each measurement date result in a change in the measure of compensation cost.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Compensation cost attributable to awards to employees that call for settlement in cash is measured at intrinsic value and charged to stock-based compensation expense on a straight-line basis over the vesting period with a corresponding increase in accrued liabilities.

Comprehensive Income

Comprehensive Income is defined as the change in equity from transactions and other events from non-owner sources and other comprehensive income comprises revenues, expenses, gains and losses that, in accordance with GAAP, are recognized in comprehensive income but excluded from net earnings or loss.

Earnings per Share

Basic earnings per common share are calculated on the net earnings using the weighted average number of shares outstanding during the fiscal period. Diluted earnings per share information is calculated using the treasury stock method which assumes that proceeds obtained upon exercise of options and warrants would be used to purchase common shares at the average market price for the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

Flow-Through Shares

The Company has financed a portion of its exploration and development activities through the issue of Flow-Through Shares. Under the terms of these share issues, the related resource expenditure deductions for income tax purposes are renounced to investors. Accordingly, when the expenditures are renounced and upon filing of documents with the taxation authorities, share capital is reduced and a recovery of future income taxes is recorded by the estimated value of the renounced tax deductions.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using substantively enacted income tax rates. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period the change occurs. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

Changes in Accounting Policies and Practices

The following new accounting pronouncements have been adopted retrospectively by the Company effective January 1, 2007:

CICA Handbook: Section 3855, *Financial Instruments – Recognition and Measurement*; Section 3861, *Financial Instruments – Disclosure and Presentation*; Section 1530, *Comprehensive Income*; Section 3865, *Hedges*; Section 1506, *Accounting Changes*; and Section 3251, *Equity*.

The adoption of these Handbook sections had no impact on opening deficit and other comprehensive income.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Under the revised Accounting Changes standards, voluntary changes in accounting policies are permitted only if they result in financial statements which provide more reliable and relevant information. Accounting policy changes are applied retrospectively unless it is impractical to determine the period or cumulative impact of the change. Corrections of prior period errors are applied retrospectively and changes in accounting estimates are applied prospectively by including these changes in earnings or loss. These standards are effective for all changes in accounting policies, changes in accounting estimates and corrections of prior period errors initiated in periods beginning on or after January 1, 2007.

Future Changes in Accounting Policies

The following is an overview of accounting standard changes that the Company will be required to adopt in the near future:

CICA Handbook: Section 1535, *Capital Disclosures*; Section 3862, *Financial Instruments – Disclosures*; and Section 3863 *Financial Instruments – Presentation*.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 will replace Section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

These new standards are effective for fiscal years beginning on or after October 1, 2007 and therefore the Company plans to adopt them on January 1, 2008.

3. PROPERTY, PLANT AND EQUIPMENT

	2007	2006
Unproved natural gas properties	\$ 38,697,551	\$ 33,905,396
Mineral property	1	1
Office furniture and equipment	164,638	161,387
	<u>38,862,190</u>	<u>34,066,784</u>
Less: Accumulated depletion, amortization & impairment	<u>(1,319,042)</u>	<u>(1,272,798)</u>
Total property, plant and equipment	<u>\$ 37,543,148</u>	<u>\$ 32,793,986</u>

As the Company had no production or proved reserves at December 31, 2007, there was no depletion charge for the year. There has been no impairment of unproved properties in 2007 (2006: \$51,744).

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

During the twelve months ended December 31, 2007, the Company capitalized \$644,675 (2006: \$604,174) of overhead directly related to exploration and development activities.

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 a mineral claim covering 450 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

	2007	2006
Balance, beginning of year	\$ 158,650	\$ 84,395
Liabilities incurred	14,029	20,466
Revisions in estimated future obligation	14,385	38,398
Accretion expense	11,621	15,391
Less: liabilities settled	-	-
Balance, end of year	<u>\$ 198,685</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 December 31, 2007 the estimated total future liability of \$991,567 has a present value of \$198,685 assuming the liability is settled in approximately 24 years, using an estimated credit-adjusted risk-free interest rate of 7.00 percent, and an inflation rate of 2.25 percent.

5. EQUITY INSTRUMENTS

The Company has authorized share capital of an unlimited number of common shares of no par value. The Company has closed the following private placements during the past two years:

On December 28, 2007, the Company issued 250,000 Flow-Through Shares at \$0.80 per share. The Flow-Through Shares entitle the holder to certain income tax benefits in the form of Canadian Development Expense. The full proceeds of the Flow-Through Shares placement, or \$200,000, has been assigned to common shares and has been fully expended on eligible development costs as of December 31, 2007.

On July 18, 2007, the Company issued 3,053,000 Units at \$1.00 per Unit and 447,000 Flow-Through Shares at \$1.10 per share. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for one year at an exercise price of \$1.10 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 assigned a value of \$0.21 per whole warrant or \$534,275 of the Unit proceeds to warrants, with the remaining \$2,518,725 of the Unit proceeds assigned to common shares. The Flow-Through Shares entitle the holder to certain income tax benefits in the form of Canadian Development Expense. The full proceeds of the Flow-Through Shares placement, or \$491,700, has been assigned to common shares and has been fully expended on eligible development costs as of the end of 2007.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

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 entitled 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 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. The warrants expired unexercised on December 14, 2007.

The equity instruments are as follows:

	2007		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
Equity instruments issued for cash:				
Stock options	-	-	40,000	16,000
Private placements	3,750,000	3,744,700	3,200,000	6,560,000
Warrants exercised	-	-	-	-
Warrants expired	-	(1,358,782)	-	-
Equity instruments issue costs	-	(209,525)	-	(472,633)
Credit from contributed surplus	-	-	-	8,968
Balance - end of year	32,583,082	\$ 49,168,204	28,833,082	\$ 46,991,811

Subsequent to the year-end, the Company issued 11,220,000 Units at \$0.50 per Unit. Each Unit consists of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one share for two years at an exercise price of \$0.80 per share. Prior to expiry, if the common shares of the Company close at a price of \$1.20 per share or greater for twenty consecutive trading days, then the Company shall have the option upon thirty days written notice to require the exercise of the warrants by the end of such period at which time any unexercised warrants shall expire. The fair value of the warrants was estimated at the date of closing, February 19, 2008, using the Black-Scholes pricing model, under which the Company assigned a value of \$0.18 per whole warrant or \$1,311,618 of the Unit proceeds to warrants, with the remaining \$4,298,382 of the Unit proceeds assigned to common shares.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

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.

Exercise Price of Warrants	Outstanding at Dec. 31, 2006	Issued	Expired	Outstanding at Dec. 31, 2007	Expiry Date
\$2.50	3,200,000	-	3,200,000	-	¹⁾ December 14, 2007
\$1.10	-	1,526,500	-	1,526,500	July 18, 2008
Total	3,200,000	1,526,500	3,200,000	1,526,500	

Note:

1) Effective July 18, 2007, the expiry date of these warrants was extended from August 11, 2007 to December 14, 2007, at which time all 3,200,000 warrants expired.

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 December 31, 2007, there were 2,700,000 common shares reserved for issuance under the plans of which options to acquire 2,485,000 common shares were outstanding (2,135,416 vested and 349,584 unvested).

Exercise Price of Option	Out-standing at Dec. 31, 2006	Granted	Exercised ⁽³⁾ or Cancelled	Out-standing at Dec. 31, 2007	Vested at Dec. 31, 2007	Year of Expiry
\$0.40 to \$0.41	465,000	-	-	465,000	465,000	2008
\$0.83	-	75,000	-	75,000	18,750	2012
\$0.85	-	75,000	-	75,000	18,750	2012
\$1.00	-	51,000	25,000	26,000	18,750	2009/12
\$1.10	-	25,000	25,000	-	-	2009
\$1.24	-	70,000	16,000	54,000	12,500	2009/12
\$1.50 to \$1.72	680,000	-	-	680,000	680,000	2009
\$2.05	195,000	-	100,000	⁽²⁾ 95,000	31,666	2010
\$2.05	41,000	-	21,000	20,000	6,666	2011
\$2.15	100,000	-	-	100,000	33,334	2011
\$2.50	50,000	-	-	50,000	50,000	2008
\$3.30	75,000	-	-	75,000	75,000	2009
\$3.65	450,000	-	-	⁽¹⁾ 450,000	450,000	2008
\$4.50	50,000	-	50,000	-	-	2009
\$4.15	140,000	-	-	140,000	140,000	2010
\$7.15	180,000	-	-	180,000	135,000	2010
Total	2,426,000	296,000	237,000	2,485,000	2,135,416	

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.
- (3) There were no stock options exercised during 2007.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Options granted are accounted for using the fair value method. The compensation cost charged in 2007 against earnings for stock options granted was \$318,710 (2006: \$642,890).

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:

	2007	2006
Risk free interest rate	4.00%	4.02%
Expected dividend yield	0%	0%
Expected stock price volatility	64.33%	63.81%
Expected life of options	4.0 years	2.6 years

Weighted average fair value of options granted during the year	\$0.48	\$0.71
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Performance Units

In 2006, the Company implemented a full value performance unit incentive plan for senior officers and directors of the Company. 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, meaning that upon each vesting date the units either pay out or expire. 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.

On September 19, 2006, three senior officers of the Company were granted a total of 39,000 performance units vesting in equal amounts at performance periods ending on the 1st of January 2007, 2008, and 2009. Independent directors of the Company were granted a total of 16,000 performance units vesting on January 1, 2009. 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 respectively for all performance periods. Based on the 10 day average closing share price on the Exchange as at December 31, 2006 of \$1.43 per share and the 10 day average closing share price on the Exchange as at December 31, 2007 of \$0.55 per share, the resultant performance factor for both years equals zero and therefore the total compensation expense for the 2006 grant for both the years ended December 31, 2007 and 2006 is \$Nil.

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 vesting in equal amounts at performance periods ending on the 1st of January 2008, 2009 and 2010. Independent directors were granted 25,600 performance units which vest on January 1, 2010. The criterion for the 2007 grant 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 minimum and maximum average share prices of \$1.75 and \$4.25 per share respectively. Payout of vested units is made in cash following the end of each performance period.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

The total compensation expense for the 2007 grant for the year ended December 31, 2007 was \$Nil as the 10 day average closing share price on the Exchange as at December 31, 2007 was \$0.55 per share.

Grant Date	Outstanding at Dec. 31, 2006	Granted or (Expired)	Exercised and Paid	Outstanding and Unvested at Dec. 31, 2007	Expiry Date
Sept. 19, 2006	55,000	(13,000)	-	42,000	March 2, 2009
Jan. 18, 2007	-	119,000	-	119,000	March 2, 2010
Total	55,000	106,000	-	161,000	

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

Total compensation recovery for share appreciation rights for 2007 was \$516,000 (2006: recovery of \$642,000) based on a closing price of \$0.51 per share on the Exchange at December 31, 2007. The Company has accrued a liability of \$18,000 at December 31, 2007 (2006: \$534,000) relating to share appreciation rights.

Contributed Surplus

	2007	2006
Balance, beginning of year	\$ 3,250,910	\$ 2,616,988
Value of options granted	792,500	1,051,876
Recovery of cancelled options	(473,790)	(408,986)
Options exercised and transferred to equity instruments	-	(8,968)
Warrants expired	1,358,782	-
Balance, end of year	<u>\$ 4,928,402</u>	<u>\$ 3,250,910</u>

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Per Share Amounts

The weighted average number of shares outstanding during 2007 was Basic 30,426,918 (2006: 26,854,671) and Diluted 30,964,153 (2006: 30,731,209).

For the year ended December 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.

6. RELATED PARTY TRANSACTIONS

During 2007, 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:

	2007	2006
Consulting fees	\$ 111,700	\$ 97,650

Consulting fees in 2007 included \$111,700 (2006: \$90,450) and accounts payable at December 31, 2007 included \$17,928 (2006: \$14,157) paid or payable to a director and senior officer of the Company.

Transactions with related parties are recorded at exchange amounts for services provided. In addition during 2007, certain directors, relatives of directors, or companies controlled by directors subscribed for 20,250 (2006: Nil) shares or units in private placement offerings of the Company under the same terms as other investors.

7. FUTURE INCOME TAXES

The provision for future income taxes differs from the amount computed by applying the combined statutory Canadian Federal and Provincial tax rates to earnings before taxes. The reasons for these differences are as follows:

	2007	2006
Loss before income taxes	\$ (875,564)	\$ (1,075,215)
Rate	32.12%	34.50%
Computed / expected income taxes	\$ (281,231)	\$ (370,895)
Increase (decrease) in income taxes resulting from:		
Non-deductible stock-based compensation	102,370	223,107
Non-deductible expenses	6,985	8,212
Effect of change in tax rate	637,370	6,795
Allowable resource allowance deduction	-	40,885
Unrecognized future tax benefits	(465,494)	91,896
Recovery of future income taxes	\$ -	\$ -

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Despite the Flow-Through Share issues that occurred during 2007 (see note 5), the resultant recovery of future income taxes will not be booked until 2008 since that is the date the actual renouncement applications were filed with the appropriate authorities.

At December 31, 2007, the Company had estimated tax assets of \$2,400,073 (2006: \$2,865,567) against which a valuation allowance has been applied and therefore no tax recovery has been recognized as follows:

	2007	2006
Property, plant and equipment	\$ 944,603	\$ 1,235,023
Asset retirement obligation	49,671	50,958
Stock-based compensation	4,500	171,521
Equity instruments issue costs	166,770	258,140
Tax loss carryforwards	1,234,529	1,149,925
	<u>2,400,073</u>	<u>2,865,567</u>
Less: Valuation allowance	(2,400,073)	(2,865,567)
Future income tax asset	<u>\$ -</u>	<u>\$ -</u>

The following estimated tax deductions are available to reduce future taxable income:

Non-capital losses	\$ 4,909,210
Capital losses	25,932
Canadian exploration expense	3,691,301
Canadian development expense	23,576,854
Canadian oil and gas property expense	13,189,542
Foreign exploration and development expense	120,908
Undepreciated capital cost	742,950
Cumulative eligible capital	2,970
Equity instruments issue expense	667,079
	<u>\$ 46,926,747</u>

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Years ended December 31, 2007 and 2006

Non-capital losses as at December 31, 2007 are available to reduce future taxable income as follows, until the end of:

2008	\$	127,522
2009		599,379
2010		455,973
2014		592,574
2015		543,450
2026		1,166,271
2027		1,424,041
	\$	<u>4,909,210</u>

8. COMMITMENTS

The Company has entered into an office sub-lease agreement which expires on May 30, 2011. Under the terms of the sub-lease agreement, the Company is obligated to pay base annual rent of \$28.00 per square foot on 6,793 square feet as well as its share of the operating costs. The Company has an option, upon six months notice, at December 31, 2008 to terminate the sub-lease agreement without penalty.

9. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments of the Company consist of accounts receivable and accounts payable and accrued trade liabilities both of which are included in these financial statements. At December 31, 2007, the classification of financial instruments and the carrying amounts reported and their estimated fair values are as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>
Classification		
Held-for-trading instruments (cash and cash equivalents)	\$ 1,063,490	\$ 1,063,490
Available-for-sale financial assets	-	-
Held-to-maturity investments	-	-
Loans and receivables (accounts receivable)	89,447	89,447
Other financial liabilities (accounts payable and accrued trade liabilities)	(854,444)	(854,444)
Total	<u>\$ 298,493</u>	<u>\$ 298,493</u>