

NORDIC OIL AND GAS LTD.

Financial Statements

**For the years ended December 31, 2005 and
2004**

NORDIC OIL AND GAS LTD.

Financial Statements

For the years ended December 31, 2005 and 2004

Contents

| | |
|--|-----------|
| Auditors' Report | 2 |
| Financial Statements | |
| Balance Sheet | 3 |
| Statement of Deficit | 4 |
| Statement of Operations | 5 |
| Statement of Cash Flows | 6 |
| Summary of Significant Accounting Policies | 7 |
| Notes to Financial Statements | 12 |



BDO Dunwoody LLP/s.r.l.
Chartered Accountants and Advisors
Comptables agréés et conseillers

700 - 200 Graham Avenue
Winnipeg Manitoba Canada R3C 4L5
Telephone/Téléphone: (204) 956-7200
Fax/Télécopieur: (204) 926-7201
Toll Free/Sans frais: 1-800-268-3337
www.bdo.ca

Auditors' Report

**To the Shareholders of
NORDIC OIL AND GAS LTD.**

We have audited the balance sheet of **NORDIC OIL AND GAS LTD.** as at December 31, 2005 and 2004 and the statements of operations, 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 audit.

We conducted our audit 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, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

signed by "BDO Dunwoody LLP"

Chartered Accountants

Winnipeg, Manitoba
April 7, 2006

NORDIC OIL AND GAS LTD.
Balance Sheet

December 31 **2005** **2004**

Assets

Current

| | | |
|---------------------------------|-----------|------------|
| Cash | \$ 52,634 | \$ 734,569 |
| Short-term investments (Note 2) | 1,404,967 | 200,321 |
| Accounts receivable (Note 4) | 187,767 | 321,896 |
| Other current assets | 27,632 | 11,632 |

1,673,000 **1,268,418**

Property and equipment (Note 3)

3,022,849 **2,135,083**

\$ 4,695,849 **\$ 3,403,501**

Liabilities and Shareholders' Equity

Current

| | | |
|---|--------------|------------|
| Accounts payable and accrued liabilities (Note 4) | \$ 1,129,196 | \$ 670,817 |
| Due to related parties (Note 4) | - | 20,283 |

1,129,196 **691,100**

Future income taxes (Note 5)

367,885 **624,083**

Asset retirement obligation (Note 6)

118,298 **84,843**

1,615,379 **1,400,026**

Commitment and Contingency (Note 7 and 10)

Shareholders' Equity

| | | |
|------------------------------|-----------|-----------|
| Equity instruments (Note 8) | 3,334,306 | 2,274,170 |
| Contributed surplus (Note 9) | 662,386 | 368,602 |
| Deficit | (916,222) | (639,297) |

3,080,470 **2,003,475**

\$ 4,695,849 **\$ 3,403,501**

Approved on behalf of the Board:

signed by "Donald Benson"

Donald Benson, Director

signed by "Barry Palka"

Barry Palka, Director

NORDIC OIL AND GAS LTD.
Statement of Deficit

| For the years ended December 31 | 2005 | 2004 |
|---|---------------------|---------------------|
| Deficit , beginning of year, as restated | \$ (639,297) | \$ (443,964) |
| Net loss for the year | (276,925) | (195,333) |
| Deficit , end of year | \$ (916,222) | \$ (639,297) |

NORDIC OIL AND GAS LTD.
Statement of Operations

| For the years ended December 31 | 2005 | 2004 |
|---|---------------------|---------------------|
| Revenue | | |
| Petroleum and natural gas sales (Note 14) | \$ 1,093,807 | \$ 1,775,857 |
| Royalties, net of royalty tax credits | <u>(209,357)</u> | <u>(547,577)</u> |
| | 884,450 | 1,228,280 |
| Expenses | | |
| Depletion and amortization | 621,824 | 757,040 |
| Operating | 212,918 | 341,350 |
| General and administrative | 139,404 | 99,048 |
| Professional fees | 135,775 | 62,850 |
| Management fees | 120,000 | 120,000 |
| Stock based compensation | 77,752 | 74,440 |
| Geological services | 19,709 | 24,457 |
| Regulatory fees | 16,514 | 16,585 |
| Accretion | <u>9,765</u> | <u>10,595</u> |
| | 1,353,661 | 1,506,365 |
| Loss before other item | (469,211) | (278,085) |
| Other Item | | |
| Interest income | <u>12,567</u> | <u>5,283</u> |
| Loss before income taxes | (456,644) | (272,802) |
| Income taxes (Note 5) | | |
| Future tax (recovery) | <u>(179,719)</u> | <u>(77,469)</u> |
| Net loss for the year | \$ (276,925) | \$ (195,333) |
| Loss per share - basic and diluted | | |
| | \$ (0.0231) | \$ (0.0200) |
| Weighted average common shares outstanding | 12,005,176 | 9,773,355 |

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

NORDIC OIL AND GAS LTD. Statement of Cash Flows

| For the years ended December 31 | 2005 | 2004 |
|---|--------------------|-------------------|
| Cash Flows from Operating Activities | | |
| Net loss for the year | \$ (276,925) | \$ (195,333) |
| Adjustments for | | |
| Depletion and amortization | 621,824 | 757,040 |
| Future income taxes (benefit) | (179,719) | (77,469) |
| Accretion | 9,765 | 10,595 |
| Stock based compensation | 77,752 | 74,440 |
| | <u>252,697</u> | 569,273 |
| Changes in non-cash working capital balances | | |
| Accounts receivable | 134,129 | (134,173) |
| Other current assets | (16,000) | - |
| Accounts payable and accrued liabilities | 14,700 | (360,831) |
| | <u>385,526</u> | 74,269 |
| Cash Flows from Investing Activities | | |
| Property and equipment acquisitions | (992,221) | (464,881) |
| Sale (purchase) of short term investments | (1,204,646) | 267,667 |
| | <u>(2,196,867)</u> | (197,214) |
| Cash Flows from Financing Activities | | |
| Due to related parties | (20,283) | 20,283 |
| Share capital issued net of issue costs | 1,149,689 | 805,246 |
| | <u>1,129,406</u> | 825,529 |
| Increase (decrease) in cash and cash equivalents during the year | (681,935) | 702,584 |
| Cash and cash equivalents, beginning of year | 734,569 | 31,985 |
| Cash and cash equivalents, end of year | \$ 52,634 | \$ 734,569 |

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

NORDIC OIL AND GAS LTD.

Summary of Significant Accounting Policies

December 31, 2005

Nature of Business

The Company is incorporated under the laws of Manitoba and is engaged in the selection, acquisition, exploration and development of oil and gas properties.

Financial Instruments

As part of its normal operations the Company uses a number of financial instruments. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

Short-term Investments

Short-term investments are stated at the lower of cost and market value.

Revenue Recognition

Revenue from the sales of petroleum and natural gas are recognized when the risk and rewards of ownership pass to the purchaser, including delivery of the product, the selling price being fixed or determinable and collectibility being reasonably assured. Settlement adjustments, if any, are reflected in the revenue when the amounts are known. Transportation costs related to the delivery of the product are recorded as an operating expense on the date the product is transported.

NORDIC OIL AND GAS LTD.

Summary of Significant Accounting Policies

December 31, 2005

Petroleum and Natural Gas Property and Equipment

The Company follows the Canadian Institute of Chartered Accountants' Accounting Guideline (AcG) - 16 for the full cost method of accounting for oil and gas properties whereby all costs relating to the acquisition, exploration and development of oil and gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical costs, drilling and other costs related to exploration and development activities. Proceeds from the disposal of oil and gas properties are applied against the capitalized costs of the related property provided such sale would not significantly alter the rate of depletion in which case it would be charged or credited to operations of the current year.

The Company annually applies an impairment test (ceiling test) to capitalized costs, net of accumulated depletion and amortization, to ensure they do not exceed the estimated undiscounted value of future net revenues from proven oil and gas reserves determined by independent engineers, based on third party quoted forward prices adjusted for transportation and quality, less estimated operating and abandonment costs. Should it be determined that impairment has occurred, the amount of the impairment is measured and recorded as the amount by which the carrying amount of the property and equipment exceeds the fair value of proved and probable reserves plus the sale of unproved properties. Fair value is determined based on the present value of future cash flows, after deducting abandonment and site restoration costs, discounted at a risk free interest rate, adjusted for prevailing market conditions. Any reduction of value, as a result of the impairment test (ceiling test), will be charged to operations.

Upon commencement of production, capitalized costs are depleted using the unit-of-production method, based on estimated gross proven oil and gas reserves determined by independent engineers. Oil and gas reserves are converted to a common unit of measure based on energy content of six thousand cubic feet of gas to one barrel of oil. Costs of undeveloped properties are not included in the costs subject to depletion. These costs are assessed periodically for impairment.

The Company amortizes pipelines on a unit of production method to better reflect the pipelines estimated useful life.

Computers are amortized on a 30% declining balance basis.

NORDIC OIL AND GAS LTD.

Summary of Significant Accounting Policies

December 31, 2005

| | |
|-------------------------------------|--|
| Asset Retirement Obligations | The Company recognizes the present value of legal obligations associated with asset retirement related to petroleum and natural gas properties in the period in which they are acquired or drilled. The related costs are capitalized as part of the carrying value of the asset and depleted in accordance with the Company's policies. Change in the present value of the liability due to the passage of time are adjusted in subsequent periods and charged to expense. Actual costs incurred upon settlement of the obligation are charged against the liability to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the obligation and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which the settlement occurs. |
| Joint Activities | At present, a substantial portion of the Company's activities are conducted jointly with related parties through joint operating agreements. These financial statements reflect only the Company's proportionate interest in such activities. |
| Future Income Taxes | Income taxes are accounted for under the liability method. Future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities) and non-capital loss carry-forwards and are measured using the current tax rates and laws expected to apply when these differences reverse. Future tax benefits, including non-capital loss carry-forwards, are recognized to the extent that realization of such benefits is considered more likely than not. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that substantive enactment or enactment occurs. |
| Cash and Cash Equivalents | Cash and cash equivalents include cash on deposit and term deposits with a maturity date less than 90 days at inception. |
| Earnings per Common Share | Net income per common share has been computed by dividing income applicable to common shareholders by the weighted average number of shares of common stock outstanding during the respective years. Diluted earnings per share is determined by applying the treasury stock method to the exercise of outstanding stock options and share purchase warrants. |

NORDIC OIL AND GAS LTD.

Summary of Significant Accounting Policies

December 31, 2005

Measurement Uncertainty

The amounts recorded for depletion and amortization of property and equipment, ceiling test and asset retirement obligations and accretion expense are based on estimates. They are based on estimates of proven reserves, production rates, future oil and gas prices, discount rates, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

The financial statements include accruals based on the terms of existing joint venture agreements. Due to varying interpretations of the definition of terms in these agreements, the accruals made by management in this regard may be significantly different from those determined by the company's joint venture partners. The effect on the financial statements resulting from such adjustments, if any, will be reflected prospectively.

The valuation of stock options and warrants is based on a number of assumptions. The valuation is significantly affected by the assumptions made with respect to the expected volatility over the expected life of the option at the time of grant. As the assumption is based on management's best estimate, it is subject to measurement uncertainty. The Company does not plan to amend the assumptions used once they have been determined at the grant date.

The capital expenditures classification made with respect to the renouncement of flow-through shares is based on the estimate from geological information obtained. Classification of the expenditures may be challenged by the taxation authorities and in this regard, the assessment may be different from that of management.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles 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 period. Actual amounts could differ from those estimates.

NORDIC OIL AND GAS LTD.

Summary of Significant Accounting Policies

December 31, 2005

Stock Based Compensation

Under the Company's stock option plan, options to purchase common shares may be granted to directors, officers, employees and consultants at current market prices. Stock-based compensation expense is recorded in the statement of operations and deficit for all options granted after January 1, 2002 with a corresponding increase recorded in contributed surplus. The expense is based on the estimated fair value at the time of the grant and recognized over the vesting period of the option. Upon exercise of the options, the amount of the consideration paid together with the amount previously recorded in contributed surplus is recorded as an increase in share capital.

Flow-through Shares

Expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. The future income taxes related to the temporary differences arising when expenditures are renounced are recorded at that time with a corresponding reduction to the carrying value of the shares issued in when the expenditures are renounced.

NORDIC OIL AND GAS LTD.

Notes to Financial Statements

December 31, 2005

1. Change in Accounting

a) Asset Retirement Obligation

Effective January 1, 2004 the Company retroactively adopted the CICA section 3110, "Asset Retirement Obligations". The new recommendations required that the recognition of the present value of obligations associated with the retirement of petroleum and natural gas properties be recorded in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is adjusted over time for changes in the value of the obligation through accretion charges which are included in accretion expense. The costs capitalized to the related assets are amortized to income in a manner consistent with the depletion and depreciation of the underlying asset.

b) Stock Based Compensation

Effective January 1, 2004 the Company adopted the CICA section 3870, "Stock Based Compensation and Other Stock-Based Payments", retroactively with restatement of prior periods. The recommendation required the Company to record a compensation expense over the vesting period based on the fair value of options granted to employees and directors.

2. Short-term Investments

| | <u>2005</u> | 2004 |
|-----------------------|---------------------|-------------------|
| Marketable securities | <u>\$ 1,404,967</u> | <u>\$ 200,321</u> |

Marketable securities are comprised of guaranteed investment certificates from a chartered bank with effective interest rates of 2.25% - 3.00% (2004 - 2.20%), maturing between August and December 2006. Interest is receivable on maturity.

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

3. Property and Equipment

| | 2005 | | | 2004 | | |
|--|---------------------|-----------------------|---------------------|---------------------|-----------------------|-------------------------|
| | Cost | Accumulated Depletion | Net Book Value | Cost | Accumulated Depletion | Net Book Value (Note 1) |
| Petroleum and natural gas properties and equipment | \$ 4,515,909 | \$ 1,498,172 | \$ 3,017,737 | \$ 3,012,433 | \$ 877,616 | \$ 2,134,817 |
| Computers | 6,724 | 1,612 | 5,112 | 610 | 344 | 266 |
| | \$ 4,522,633 | \$ 1,499,784 | \$ 3,022,849 | \$ 3,013,043 | \$ 877,960 | \$ 2,135,083 |

No administrative expenses have been capitalized to property and equipment. As at December 31, 2005, costs amounting to \$1,801,002 (2004 - \$746,360) that were incurred on unproven properties have been excluded from costs subject to depletion.

The Company applied the ceiling test to its capitalized assets at December 31, 2005 and determined that there was no impairment of costs requiring a write-down.

For the purposes of the December 31, 2005 impairment test of property and equipment, the following benchmark prices were used:

| | AECO Hub (\$CDN/Mcf) |
|-----------------------------|-------------------------|
| 2006 | \$ 11.50 |
| 2007 | 10.50 |
| 2008 | 8.90 |
| 2009 | 8.50 |
| 2010 | 8.70 |
| Average % change thereafter | 2% |

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

4. Related Party Transactions

The Company has a joint operating agreement with Desoto Resources Limited whereby it has an 85% interest in certain assets including crown leases, gas lines, oil and gas leases, and certain property and equipment. The Company directors and officers have an interest in Desoto Resources Limited.

The Company has a joint operating agreement with Western Warner Oils Ltd. whereby it has an 80% interest in certain assets including crown leases, gas lines, oil and gas leases, and certain property and equipment. The Company directors and officers have an interest in Western Warner Oils Ltd. The company also has a 50/50 joint operating agreement with Western Warner Oils Ltd. at Kamsack, Saskatchewan on the Cote Indian Reserve.

As described above, substantially all of the Company's activities are undertaken jointly with related parties by joint venture agreement.

The Company has a services agreement established with Nordic Management Ltd. for various services. Nordic Management Ltd. receives \$10,000 per month for management services, \$1,850 per month for accounting services and \$4,000 per month for Investor Relations services. The contract expires November 14, 2007. Certain of the Company's directors and officers control Nordic Management Ltd.

These transactions are in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties).

At the end of the year, the amounts due from (to) related parties are as follows:

| | <u>2005</u> | <u>2004</u> |
|---|-------------|-------------|
| Amounts included in accounts receivable | \$ 155,480 | \$ 189,855 |
| Amounts included in accounts payable | (1,000,899) | (543,475) |
| Due to related parties | - | (20,283) |

The balances included in trade accounts receivable and payable are non-interest bearing, payable on demand and have arisen from the sales of product and provision of services referred to above.

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

5. Income Taxes

The income tax expense differs from the amount that would be obtained by applying the statutory income tax rate to income before income taxes. The principal reasons for the difference between the "expected" income tax expense and the amount recorded are as follows:

| | 2005 Amount | 2004 Amount |
|---------------------------------|------------------------|----------------|
| Corporate tax rate | 37.62 % | 38.87 % |
| "Expected" income tax provision | \$ (171,789) | \$ (108,092) |
| Stock based compensation | 29,250 | 28,935 |
| Resource adjustments | - | (11,329) |
| Rate adjustment | (34,599) | 1,172 |
| Other | (2,581) | 11,845 |
| | \$ (179,719) | \$ (77,469) |

The components of the net future income tax liability are as follows:

| | 2005 | 2004 |
|---|---------------------|-----------|
| Property and equipment | \$ (477,288) | (383,350) |
| Flow-through share renouncements to be incurred | - | (323,733) |
| Share issue costs | 109,403 | 83,000 |
| | \$ (367,885) | (624,083) |

The Company has available the following tax pool balances which may be deducted in determining taxable income of future years.

| | 2005 | 2004 |
|------------------------------|---------------------|--------------|
| Oil and gas property expense | \$ 262,249 | \$ 270,618 |
| Undepreciated capital cost | 461,937 | 460,787 |
| Development expense | 175,983 | 251,405 |
| Share issue costs | 279,913 | 220,472 |
| | \$ 1,180,082 | \$ 1,203,282 |

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

5. Income Taxes (continued)

The Company is committed to spending an additional \$784,958 in qualifying expenditures pursuant to a flow-through financing completed in 2005 (\$860,534 in 2004).

6. Asset Retirement Obligation

The schedule below is a reconciliation of the Company's liability:

| | <u>2005</u> | <u>2004</u> |
|----------------------|-------------------|------------------|
| Beginning balance | \$ 84,843 | \$ 56,151 |
| Liabilities incurred | 23,690 | 18,097 |
| Accretion | 9,765 | 10,595 |
| | <u>\$ 118,298</u> | <u>\$ 84,843</u> |

The undiscounted amount of expected cash flows required to settle the asset retirement obligations is estimated to be \$153,493 (2004 - \$123,934) as at December 31, 2005. The liability for the expected cash flows, as reflected in the financial statements, has been discounted at 8%. The estimated dates of abandonment are between 2008 and 2017.

Costs attributable to these commitments and contingencies are expected to be incurred over an extended period of time and are to be funded mainly from the Company's cash provided by operating activities. Although the ultimate impact of these matters on net earnings cannot be determined at this time, it could be material for any one quarter or year.

7. Contingency

In 2004, the Company was advised by its joint venture partner in Joffre, Desoto Resources Limited, that Desoto Resources Limited has filed a statement of claim against an independent oil and gas producer to preserve its right in petroleum and natural gas leases that the independent oil and gas producer has stated are terminated by virtue of the fact that the lands in question are not capable of production. The statement of claim seeks damages and asks the court to confirm the validity of the leases. The two and a half sections of leases in question do not include any wells currently producing and are not reflected as proven reserves in the Company's reserves report completed by an independent engineering company. Desoto Resources Limited holds in trust an 85% portion of the interest in the leases on behalf of Nordic Oil and Gas Ltd. As at April 7, 2006, the likelihood of the claim is indeterminable.

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

8. Equity Instruments

The authorized capital of the Company is an unlimited number of class A common shares.

The issued capital is as follows:

| | 2005 | | 2004 | |
|---|---------------------|---------------------|---------------------|---------------------|
| | Number of Shares | Amounts | Number of Shares | Amounts |
| Common Shares | | | | |
| Balance, beginning of year | 11,808,194 | \$ 2,058,138 | 9,615,627 | \$ 1,917,520 |
| Issued for services | 111,111 | 50,000 | - | - |
| Issued as flow through shares | 3,424,175 | 1,204,811 | 2,109,598 | 742,017 |
| Stock options exercised | 75,000 | 7,500 | 75,000 | 7,500 |
| Warrants exercised | - | - | 7,969 | 6,820 |
| Future income tax effect on flow-through share | - | - | - | (531,395) |
| Share issue costs (net of future taxes of \$76,479 - 2005, \$50,854 - 2004) | - | (205,683) | - | (84,324) |
| Balance, end of year | 15,418,480 | \$ 3,114,766 | 11,808,194 | \$ 2,058,138 |
| Warrants | | | | |
| Balance, beginning of year | 2,399,769 | \$ 216,032 | 600,833 | \$ 137,245 |
| Issued as flow through shares | 1,712,088 | 164,859 | 2,109,598 | 166,361 |
| Issued as agent warrants | 333,934 | 54,681 | 147,671 | 19,845 |
| Warrants exercised | - | - | (7,969) | (2,119) |
| Warrants expired | (2,399,769) | (216,032) | (450,364) | (105,300) |
| Balance, end of year | 2,046,022 | \$ 219,540 | 2,399,769 | \$ 216,032 |
| Balance, end of year, all equity instruments | - | \$ 3,334,306 | - | \$ 2,274,170 |

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

8. Equity Instruments (continued)

During the year, the Company issued on separate private placement basis, 3,424,175 units of the Company at \$0.40 per share for gross proceeds of \$1,369,670. Each unit of the Company consists of one class A flow through common share and one half share purchase warrant. Each one half share purchase warrant entitles the holder to purchase one half of a regular class A common share of the Company at \$0.60 - \$0.80. The purchase warrants expire in November 2006 and June 2007. In conjunction with the placement, 333,934 broker warrants were issued. One broker's warrant entitles the holder to purchase one class A common share at a price of \$0.40 and \$0.80. The warrants expire in May and June 2007. These private placements were arm's length. The fair value of the warrants was estimated using the Black-Scholes option-pricing model with the following assumptions:

| | |
|-------------------------|---------|
| Risk-free interest rate | 3% |
| Expected life (years) | 1 to 1½ |
| Expected volatility | 101.15% |
| Expected dividend yield | 0% |

During the prior year, the Company issued on a private placement basis, 2,109,598 class A flow through common shares at \$0.44 per share for gross proceeds of \$908,378. In conjunction with the placement, 147,671 agent warrants were issued. One agent's warrant entitles the holder to purchase one Class A common share at a price of \$0.44. These warrants expired in the period of November to December 2005. The fair value of the warrants were estimated using the Black-Scholes option-pricing model with the following assumptions:

| | |
|-------------------------|---------|
| Risk-free interest rate | 5% |
| Expected life (years) | 1 |
| Expected volatility | 101.15% |
| Expected dividend yield | 0% |

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

8. Equity Instruments (continued)

Stock Options

The Company has a Stock Option Plan for the issuance of common shares to employees, officers, directors and other key personnel based on approval of the Board of Directors and regulatory authorities. The total number of authorized and unissued common shares allocated to and made available to such participants under the plan shall not exceed 10% of the issued and outstanding class A common shares at the time of the granting of the option. Options vest at the determination of the Board of Directors at time of granting and expire after five years. The Company's policy is to set the exercise price in excess of the trading price of the company's shares on the date options are granted.

As at December 31, 2005 the Company has the following stock options outstanding:

| | Number of Shares | Option Price per Share Range | Wtd Average Exercise Price |
|--|---------------------|------------------------------------|----------------------------------|
| Options outstanding, beginning of year | 935,000 | \$ 0.10 - 0.40 | \$ 0.38 |
| Awarded ⁽¹⁾ | 260,000 | 0.45 | 0.45 |
| Exercised | (75,000) | 0.10 | 0.10 |
| Cancelled | (50,000) | 0.40 | 0.40 |
| Options outstanding, end of year | 1,070,000 | \$ 0.40 - 0.45 | \$ 0.41 |

⁽¹⁾ Options awarded during the year to Directors and Officers vested immediately.

The following table summarizes information about the stock options outstanding at December 31, 2005:

| Options Outstanding | Option Price | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Number of Options Currently Exercisable | Weighted Average Exercise Price of Options Currently Exercisable |
|------------------------|--------------|--|--|--|---|
| 650,000 | 0.40 | 0.40 | 2.13 | 650,000 | 0.40 |
| 160,000 | 0.40 | 0.40 | 3.07 | 160,000 | 0.40 |
| 260,000 | 0.45 | 0.45 | 4.08 | 260,000 | 0.45 |
| 1,070,000 | 0.41 | 0.41 | - | 1,070,000 | 0.41 |

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

8. Equity Instruments (continued)

As at December 31, 2004 the Company had the following stock options outstanding:

| | Number of Shares | Option Price per Share Range | Wtd Average Exercise Price |
|--|---------------------|------------------------------------|----------------------------------|
| Options outstanding, beginning of year | 800,000 | 0.10 - 0.40 | \$ 0.34 |
| Awarded ⁽¹⁾ | 210,000 | 0.40 | 0.40 |
| Cancelled | (75,000) | 0.10 | 0.10 |
| Options outstanding, end of year | 935,000 | \$ 0.10 - 0.40 | \$ 0.38 |

⁽¹⁾ Options awarded during the year to Directors and Officers vested immediately.

The following table summarizes information about the stock options outstanding at December 31, 2004:

| Options Outstanding | Option Price | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Number of Options Currently Exercisable | Weighted Average Exercise Price of Options Currently Exercisable |
|------------------------|--------------|--|--|--|---|
| 75,000 | 0.10 | 0.10 | 0.97 | 75,000 | 0.10 |
| 650,000 | 0.40 | 0.40 | 3.13 | 650,000 | 0.40 |
| 210,000 | 0.40 | 0.40 | 4.07 | 210,000 | 0.40 |
| 935,000 | 0.38 | 0.38 | - | 935,000 | 0.38 |

The Company recorded stock based compensation expense of \$77,752 (\$74,440 in 2004) for stock options granted during the year. The fair value of stock options was estimated using the Black-Scholes option-pricing model with the following assumptions:

| | 2005 | 2004 |
|-------------------------|---------|---------|
| Risk-free interest rate | 5% | 5% |
| Expected life (years) | 5 | 5 |
| Expected volatility | 101.15% | 95% |
| Expected dividend yield | 0% | 0% |
| Fair value per option | \$ 0.30 | \$ 0.35 |

NORDIC OIL AND GAS LTD. Notes to Financial Statements

December 31, 2005

8. Equity Instruments (continued)

Escrow Shares

During the 2002 year the Company issued 1,690,625 class A common shares at a value of \$0.40 per share on the acquisition of an 85% interest in oil and gas properties of a related party (Note 4). These shares are held in escrow and they are to be released as to 5% of the original balance semi-annually from the date of issue (November 12, 2002) for the first two years. After the first two years the amount to be released increases to 10% of the original balance semi-annually. As of the year end there are 1,014,376 (2004 - 1,352,563) common shares held in escrow.

There were also 666,667 issued class A shares held in escrow December 31, 2004. These shares were released from escrow November 12, 2005.

9. Contributed Surplus

| | <u>2005</u> | <u>2004</u> |
|----------------------------|-------------------|-------------------|
| Balance, beginning of year | \$ 368,602 | \$ 188,862 |
| Stock based compensation | 77,752 | 74,440 |
| Warrants expired | <u>216,032</u> | <u>105,300</u> |
| Balance, end of year | <u>\$ 662,386</u> | <u>\$ 368,602</u> |

10. Indemnification

In the ordinary course of business, the Company enters into contracts which contain indemnification provisions, such as letter agreements, service agreements and purchase and sale agreements. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. In some cases the Company requires indemnities from its service providers, related to the Company's indemnification obligations to customers. These indemnification provisions vary on an agreement by agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay can not be estimated.

NORDIC OIL AND GAS LTD.

Notes to Financial Statements

December 31, 2005

11. Financial Instruments

As discussed in the Significant Accounting Policies, the Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to commodity price, credit, and interest rate risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

a) Commodity price risk

The Company will be subject to commodity price risk for the delivery of natural gas and crude oil.

b) Credit risk

A significant portion of the Company's cash is currently held with the same financial institution and, as such, the Company is exposed to concentration of credit risk. Substantially all the Company's accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks.

12. Subsequent Event

Subsequent to year end, on January 23, 2006, the Company granted 280,000 stock options to directors and 70,000 stock options to three of the Company's consultants. The options fully vested January 23, 2006 and are exercisable at \$0.40 for a term of five years.

13. Commitments

In the normal course of operations, the Company enters into contractual agreements to drill wells on third party lands.

14. Petroleum and Natural Gas Sales Adjustment

The company and its joint venture partner Desoto Resources Ltd. have since inception, had the wells contract operated by a third party which processes their natural gas. In the fourth quarter of 2005, the operator adjusted the gas analysis of the wells and made an adjustment for amounts paid for natural gas liquids and for the heat value of natural gas. This resulted in a reduction to the gross revenue in 2005 in the amount of \$303,000.