

**Nordic Oil and Gas Ltd.
Financial Statements
For the years ended
December 31, 2006 and 2005**

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Auditors' Report

To the Shareholders
NORDIC OIL AND GAS LTD.

We have audited the balance sheets of Nordic Oil and Gas Ltd. as at December 31, 2006 and 2005 and the statements of operations 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, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

CHARTERED ACCOUNTANTS

Calgary, Alberta
April 27, 2007

**Nordic Oil and Gas Ltd.
Balance Sheets**

As at December 31, **2006**
\$ **2005**
\$

(restated Note 15)

ASSETS

Current Assets

Cash and cash equivalents	433,423	52,634
Short-term investments (Note 3)	211,672	1,404,967
Accounts receivable	122,808	215,399
	767,903	1,673,000

Deferred costs (Note 6)

114,901

Property and equipment (Note 4)

3,426,676

4,309,480

4,448,506

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities

Accounts payable and accrued liabilities (Note 9) 386,451 881,853

Asset retirement obligation (Note 5)

218,961

Convertible debentures (Note 6)

716,374

Future income taxes (Note 14)

544,994

1,866,780

1,368,036

Shareholders' Equity

Equity instruments (Note 7) 2,980,830 3,334,306

Equity portion of convertible debenture (Note 6) 43,090 -

Contributed surplus (Note 8) 842,096 662,386

Deficit (1,423,316) (916,222)

2,442,700

3,080,470

4,309,480

4,448,506

Nature of operations and going concern (Note 1)

Commitments (Note 10)

Contingencies (Note 11)

APPROVED BY THE DIRECTORS:

Don Benson, Director

Keith Peterson, Director

Nordic Oil and Gas Ltd.
Statements of Operations and Deficit

For the years ended December 31,

2006
\$

2005
\$

(restated Note 15)

Revenues

Oil and natural gas sales	667,136	1,093,807
Royalty expense	<u>(162,073)</u>	<u>(209,357)</u>
	<u>505,063</u>	<u>884,450</u>

Expenses

Depletion, amortization and accretion (Note 4 and 5)	523,258	631,589
Operating costs	192,926	212,918
General and administrative (Note 9)	422,439	431,402
Stock based compensation (Note 8)	179,710	77,752
	<u>1,318,333</u>	<u>1,353,661</u>

Loss from operations

(813,270) (469,211)

Interest income

12,714 12,567

Loss before income taxes

(800,556) (456,644)

Future tax (recovery) (Note 14)

(293,462) (179,719)

Loss for the year

(507,094) (276,925)

Deficit, beginning of year

(916,222) (639,297)

Deficit, end of year

(1,423,316) (916,222)

Basic and diluted loss per share (Note 7)

(0.03) (0.02)

Nordic Oil and Gas Ltd.
Statements of Cash Flows

For the years ended December 31,	2006 \$	2005 \$
		(restated Note 15)
Cash flows from (used in) operating activities		
Loss for the year	(507,094)	(276,925)
Items not involving cash:		
Depletion, amortization and accretion	523,258	631,589
Stock based compensation	179,710	77,752
Future tax recovery	(293,462)	(179,719)
	<u>(97,588)</u>	<u>252,697</u>
Changes in non-cash working capital items:		
Accounts receivable	92,591	97,846
Accounts payable and accrued liabilities	(495,402)	(232,643)
	<u>(500,399)</u>	<u>117,900</u>
Cash flows provided by (used in) investing activities		
Property and equipment acquisitions	(1,071,608)	(744,878)
Sale (purchase) of short term investments	1,193,295	(1,204,646)
	<u>121,687</u>	<u>(1,949,524)</u>
Cash flows provided by financing activities		
Issue of share capital - net of costs	117,095	1,149,689
Convertible debenture advance	642,406	-
	<u>759,501</u>	<u>1,149,689</u>
Increase (decrease) in cash during the year	380,789	(681,935)
Cash and cash equivalents, beginning of year	52,634	734,569
Cash and cash equivalents, end of year	<u>433,423</u>	<u>52,634</u>

December 31, 2006 and 2005

1. Nature of Operations and Going Concern

Nordic Oil and Gas Ltd. (the "Company") is a Canadian based oil and gas exploration and development company incorporated under the laws of Manitoba whose oil and gas properties are located in the provinces of Alberta and Saskatchewan.

These financial statements have been prepared on a going concern basis that contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. At December 31, 2006 the Company had an operating loss before income taxes of \$807,801, and used \$500,399 cash in its 2006 operations. As described in Note 10(a), the Company has an unexpended flow through obligation of \$122,000 to be incurred by December 31, 2007. The Company's ability to continue as a going concern is dependent upon the Company achieving and maintaining profitable results, receiving support from its lenders and attracting sufficient resources to explore for and develop oil and natural gas properties. There is no certainty that management will be able to resolve these matters. These financial statements do not reflect the adjustments that would be necessary if the going concern assumption was not appropriate and these adjustments may be material.

2. Significant Accounting Policies

The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

(a) 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 alter the rate of depletion by more than 20% in which case it would be charged or credited to operations of the current year.

December 31, 2006 and 2005

2. Significant Accounting Policies - continued

(a) Property and equipment - continued

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 cost net of impairment 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 included in depletion, amortization and accretion.

(b) Depletion and amortization

Upon commencement of production, or abandonment of property, 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.

Computers are amortized on a 30% declining balance basis.

(c) 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 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.

(d) Asset retirement obligation

The Company recognizes the estimated fair value of an Asset Retirement Obligation (ARO) in the period in which it is incurred when a reasonable estimate of fair value can be made. The fair value of the estimated ARO is recorded as a liability with a corresponding increase in the carrying amount of the related asset. ARO obligations are initially measured at fair value and subsequently adjusted for the accretion of discount and any changes to the underlying cash flows. The capitalized amount is depleted on a unit-of-production basis over the life of the proven reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the ARO with an offsetting amount to the related property. Actual costs incurred are charged against the ARO to the extent of the recorded liability. Any difference between the actual costs incurred and the recorded liability is recognized as a gain or loss in the period in which the costs are incurred.

December 31, 2006 and 2005

2. Significant Accounting Policies - continued

(e) Joint Activities

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.

(f) Per share amounts

Basic loss per common share is computed by dividing income applicable to common shareholders by the weighted average number of common shares outstanding for the period.

The Company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that proceeds received from the exercise of in-the-money stock options and other instruments, are used to repurchase common shares at the average market price of the period. Basic net earnings (loss) per common share are determined by dividing net earnings (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share are computed by giving effect to the potential dilution that would occur if stock options and other dilutive instruments were exercised.

(g) Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income taxes are based on the differences between assets and liabilities reported for accounting purposes from those reported for income tax purposes. The rates used in the future income tax calculation are enacted or substantively enacted at the time of the calculation. The effect of a change in rates on future tax assets and liabilities is recognized in income in the period in which the change occurs. Future income tax assets are calculated and if realization is not considered likely, a valuation allowance is provided.

(h) Financial instruments

As part of its normal operations the Company carries a number of financial instruments. In the opinion of management, the Company is not exposed to significant credit or interest risk, except as disclosed.

(i) Stock-based compensation and other stock-based payments

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 employee options and over the period that would have been recognized had the Company paid cash for consultant options. 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.

December 31, 2006 and 2005

2. Significant Accounting Policies - continued

(j) Measurement uncertainty

Amounts recorded for depletion, amortization and accretion and amounts used for the ceiling test calculation and impairment of unproven properties are based on estimates of crude oil and natural gas reserves and future costs required to develop and reclaim and abandon those reserves and explore unproven properties.

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 Black Scholes option valuation model was developed for use in estimating the fair value of traded options and warrants which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options and warrants have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options and warrants.

The Company has estimated the debt and equity components of its convertible debenture based on its best estimate of the rate for comparable instruments at the time of issue.

The capital expenditures classification made by the Company with respect to the renouncement of flow-through shares is based on estimates from geologic information obtained and the classification of the expenditures may be challenged by the taxation authorities and in this regard the assessments may be different from that of management.

The operations of the Company are complex, and related tax interpretations, regulations and legislation affecting the Company are continually changing.

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.

(k) Flow through shares

Resource expenditure deductions for income tax purposes related to exploratory activities funded by flow through share arrangements are renounced to investors in accordance with income tax legislation. The Company provides for the future effect on income taxes related to flow-through shares as a reduction of share capital and an increase in future income tax at the date of the renunciation.

(l) Short-term Investments

Short-term investments are comprised of guaranteed investment certificates and term deposits with initial terms to maturity of over ninety days but less than one year

December 31, 2006 and 2005

2. Significant Accounting Policies - continued

(m) Cash and cash equivalents

Short-term investments with maturities less than three months are considered to be cash equivalents and are recorded at cost, which approximate market value.

(n) Debt instrument

On issue of convertible debt instruments, the cost of the liability portion is initially calculated using the market interest rate for an equivalent non-convertible instrument. The remainder of the net proceeds is allocated to the equity conversion option, which is reported in equity. The liability element is subsequently reported at amortized cost. Amortization of the debt discount is recognized in the statement of operations over the duration of the debt instrument. The value of the equity conversion option is not changed in future periods.

Costs incurred related to the convertible debt instruments have been allocated to the debt and equity component on a pro rata basis. The portion allocated to the debt component has been deferred and amortized over the term of the debt. The portion allocated to the equity component has been recorded as a reduction of the equity component.

3. Short-Term Investments

	<u>2006</u>	<u>2005</u>
Short term investments	<u>\$ 211,672</u>	<u>\$ 1,404,967</u>

Short term investments are comprised of guaranteed investment certificates from a chartered bank with effective interest rates of 3.3% (2005 - 2.25% - 3.00%) maturing November 2007. Interest is received on maturity.

The Company has pledged short term investments with its bank as collateral for a \$200,000 overdraft facility at the bank's overdraft borrowing rate.

December 31, 2006 and 2005

4. Property and Equipment

December 31, 2006	Cost	Accumulated depletion and amortization	Net Book Value
Petroleum and natural gas properties and equipment	\$ 5,419,726	\$ 2,007,057	\$ 3,412,669
Computer equipment	18,369	4,362	14,007
	\$ 5,438,095	\$ 2,011,419	\$ 3,426,676

December 31, 2005	Cost	Accumulated depletion and amortization	Net Book Value (Restated Note 15)
Petroleum and natural gas properties and equipment	\$ 4,268,566	\$ 1,498,172	\$ 2,770,394
Computer equipment	6,724	1,612	5,112
	\$ 4,275,290	\$ 1,499,784	\$ 2,775,506

Depletion of petroleum and natural gas properties is determined using the unit of production method based upon proved reserves. No administrative expenses have been capitalized to property and equipment in 2006 and 2005. As at December 31, 2006, costs amounting to \$1,227,556 (2005 - \$1,575,342) 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, 2006 and 2006 and determined that there was no impairment of costs requiring a write-down.

The following table outlines the benchmark prices used in the impairment test at December 31, 2006:

<u>Year</u>	<u>AECO Natural Gas CDN\$/mmbtu</u>
2007	7.50
2008	8.00
2009	7.95
2010	7.55
Thereafter	+2%/yr

All barrels of oil equivalent conversions are derived by converting natural gas to crude oil in the ratio of six thousand cubic feet of natural gas to one barrel of crude oil.

December 31, 2006 and 2005

5. Asset Retirement Obligation

The following table presents the continuity of the beginning and ending obligation associated with the retirement of oil and gas properties.

	December 31, 2006	December 31, 2005
Asset retirement obligation, beginning of year	\$ 118,298	\$ 84,843
Liabilities incurred	91,198	23,690
Accretion expense	9,465	9,765
Asset retirement obligation, end of year	\$ 218,961	\$ 118,298

The undiscounted amount of cash flows, required over the estimated reserve life of the underlying assets, to settle the obligation, adjusted for inflation, is estimated at \$359,109 (December 31, 2005 - \$153,493). The obligation was calculated using a credit-adjusted risk free discount rate of 8% and an inflation rate of 2%. It is expected that this obligation will be funded from general Company resources at the time the costs are incurred with the majority of costs expected to occur between 2008 and 2017.

6. Convertible Debentures

On November 30, 2006, the Company issued convertible debentures in the amount of \$766,000 maturing on November 30, 2008 and bearing interest at an annual rate of 8%, payable semi-annually on each of the six and twelve month anniversary of the initial date of closing. The debenture is collateralized by all the present and future property and assets of the Company. The debentures are convertible, at the option of the holder at any time, into Class A common shares of the Company at a conversion price of \$0.25. The maximum aggregate principal amount of convertible debentures authorized under the Company's Trust Indenture is \$1,000,000.

December 31, 2006 and 2005

6. Convertible Debenture - continued

The debenture is a financial instrument that contains both a liability and equity component. The liability component and the equity component must be presented separately, as determined at initial recognition. The Company has valued the equity component of this debenture using the residual value of equity component method, whereby the liability component is valued first using management's best estimate of the current market rate for comparable instruments, at the time of issuance. The difference between the proceeds of the issued convertible debentures and the fair value of the liability is assigned to the equity component. In 2006, the resulting liability and equity values determined using this method based on an estimated 12% interest rate were as follows:

Total proceeds of convertible debenture net of issue costs	\$ 766,000
Value of liability component	<u>(714,217)</u>
	51,783
Equity component issue costs	<u>(8,693)</u>
Value of equity component	<u>\$ 43,090</u>

Total accretion expense related to the liability component of the convertible debenture is \$2,157 in fiscal 2006. The carrying value of the debenture will be accreted up to its face value over the term to maturity. Total convertible debenture issue costs of \$128,590 have been allocated to the debt and equity components on a pro rata basis. Amortization of the deferred debenture costs related to the liability component of \$119,897 amounted to \$4,996 in 2006 leaving an unamortized balance of \$114,901.

December 31, 2006 and 2005

7. Equity Instruments

(a) Authorized

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

(b) Issued

The issued share capital is as follows:

	Year ended December 31, 2006		Year ended December 31, 2005	
	Number of shares	Amount	Number of shares	Amount
Common shares				
Balance, beginning of year	15,418,480	\$ 3,114,766	11,808,194	\$ 2,058,138
Issued for services	-	-	111,111	50,000
Issued as flow-through units (Note 7(d))	406,665	92,488	3,424,175	1,204,811
Issued from treasury (Note 7(c))	169,062	31,276	-	-
Stock options exercised	-	-	75,000	7,500
Share issue costs (net of future taxes in the amount of \$1,169 (2005 -\$76,479))	-	(3,214)	-	(205,683)
Tax effect of flow-through shares	-	(472,262)	-	-
Warrant revaluation (Note 7(j))		(40,000)		
Amounts due for issued shares (Note 7(c))		(31,276)		
Balance, end of year	15,994,207	\$ 2,691,778	15,418,480	\$ 3,114,766

	Year ended December 31, 2006		Year ended December 31, 2005	
	Number of warrants	Amount	Number of warrants	Amount
Warrants				
Balance, beginning of year	2,046,022	\$ 219,540	2,399,769	\$ 16,032
Issued as flow through units (Note 7(d))	203,333	29,512	1,712,088	164,859
Issued as agent warrants	-	-	333,934	54,681
Warrant revaluation (Note 7(j))	-	40,000	(2,399,769)	(216,032)
Balance, end of year	2,249,355	\$ 289,052	2,046,022	\$ 219,540
Total equity instruments		\$ 2,980,830		\$ 3,334,306

December 31, 2006 and 2005

7. Equity Instruments - continued

- (c) During the year the Company issued 169,062 common shares to a company that certain of the directors and officers of the Company have an interest in. No cash was received for these shares and a receivable was recognized as a reduction of share capital for the fair value of the shares on the issue date. Subsequent to year end, the shares were cancelled.
- (d) During the year, the Company issued on a private placement basis, 406,665 units of the Company at \$0.30 per share for gross proceeds of \$122,000. Each unit consists of one class A flow through common share and one half share purchase warrant. Each whole share purchase warrant entitles the holder to purchase one regular class A common share of the Company at \$0.40. The purchase warrants expire in November 2008.

In accordance with the terms of the offerings and certain provisions of the Income Tax Act (Canada), the Company will renounce for income tax purposes, exploration expenditures of \$122,000 to subscribers of the flow through common shares in the current year private placement, for which the Company will have to incur eligible expenditures by December 31, 2007.

During the prior year, on December 12, 2005, the Company issued on a private placement basis, 3,424,175 units of the Company at \$0.40 per share for gross proceeds of \$1,369,670. Each unit consisted of one class A flow through common share and one half share purchase warrant. Each whole share purchase warrant entitled the holder to purchase one whole regular class A common share of the Company at \$0.60 - \$0.80. The purchase warrants have expiry dates in November 2006 and June 2007. In conjunction with the placement, 333,934 broker warrants were issued. One broker 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 non-arm's length.

The fair value of the warrants was estimated using the Black-Scholes option-pricing model with the following assumptions:

Year ended December 31,	2006	2005
Risk free interest rate	4%	3%
Expected life (years)	2	1 to 1.5
Expected volatility	145%	101%
Expected dividend yield	0%	0%

(e) 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 the approval of the Board of Directors and regulatory authorities. The total number of authorized 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 the options are granted.

December 31, 2006 and 2005

7. Equity Instruments - continued

(f) As at December 31, 2006 the Company has the following stock options outstanding:

	Number of common options	Option price range per share	Weighted average exercise price
Options outstanding, December 31, 2005	1,070,000	\$0.40 - 0.45	\$0.41
Granted ⁽¹⁾	540,000	\$0.25 - 0.40	\$0.35
Cancelled	(100,000)	\$0.40 - 0.45	\$0.43
Options outstanding, December 31, 2006	1,510,000	\$0.25 - 0.45	\$0.41

⁽¹⁾Options granted during the year vested immediately.

The following table summarizes information about the stock options outstanding at December 31, 2006:

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	1.13	650,000	\$0.40
160,000	0.40	0.40	2.07	160,000	0.40
210,000	0.45	0.45	3.08	210,000	0.45
300,000	0.40	0.40	4.06	300,000	0.40
190,000	0.25	0.25	4.95	190,000	0.25
1,510,000	\$0.41	\$0.41	-	1,510,000	\$0.41

December 31, 2006 and 2005

7. Equity Instruments - continued

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

	Number of common shares	Option price per share range	Weighted aver age exercise price
Options outstanding, December 31, 2004	935,000	\$0.10 - 0.40	\$0.38
Granted (1)	260,000	0.45	0.45
Exercised	(75,000)	0.10	0.10
Cancelled	(50,000)	0.40	0.40
Options outstanding, December 31, 2005	1,070,000	\$0.40 - 0.45	\$0.41

⁽¹⁾ Options granted 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

During the year ended December 31, 2006, under the fair-value-based method, \$179,710 (2005 – \$77,752) in compensation expense was recorded in the statement of operations and deficit and credited to contributed surplus for options granted to directors, officers, employees and consultants.

December 31, 2006 and 2005

7. Equity Instruments - continued

The fair value of share options used to calculate compensation expense has been estimated using the Black-Scholes option pricing model with the following assumptions:

Year ended December 31,	2006	2005
Risk free interest rate	4%	5%
Expected life (years)	5	5
Expected volatility	142% - 170%	101%
Expected dividend yield	0%	0%
Fair value per option	\$0.27 – 0.37	\$0.30

(g) Escrow Shares

As of the year end there are 676,253 (2005 - 1,014,376) common shares held in escrow.

(h) Dividends

Under the terms of the convertible debenture agreement (Note 6) the Company will not make any capital distribution with respect to any Shares, or redeem any other debentures of the Corporation at any time that the Corporation is in arrears in payment of any principal or interest on the debentures. At December 31, 2006 the Company was not in arrears regarding the payment of interest.

(i) Per share amounts

Per share calculations are based on the weighted average number of common shares outstanding during the year of 15,480,296 (2005- 12,005,176). For 2006 and 2005, diluted loss per share has not been disclosed as the effects of the debenture conversions and option exercises are anti-dilutive.

(j) Warrant Revaluation

At December 1, 2006, the Company extended the life of the warrants issued on December 31, 2005. The warrants have been revalued using the Black Scholes option pricing model with the following assumptions: exercise price of \$0.60; expected volatility 0.95; risk free rate of 4% and life of 1 year. This revaluation resulted in a \$40,000 increase in the amount attributed to warrants and a corresponding decrease to share capital with no change in total equity instruments.

8. Contributed Surplus

	2006	2005
Balance, beginning of year	\$ 662,386	\$ 368,602
Stock based compensation (Note 7(f))	179,710	77,752
Warrants Expired	-	216,032
Balance, end of year	\$ 842,096	\$ 662,386

December 31, 2006 and 2005

9. Related Party Transactions

Except as disclosed elsewhere in these financial statements, the Company had the following 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 costs for the first three wells drilled under the joint operating agreement were incurred 100% by the Company. As at December 31, 2006, the three wells have been drilled. 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 costs for the first five wells drilled in the joint operating agreement were incurred 100% by the Company. As at December 31, 2006, only two of the five wells have been drilled. The Company, directors and officers have an interest in Western Warner Oils Ltd.

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, \$2,500 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:

	2006	2005
Amounts included in accounts payable	\$ 209,949	\$ 598,076

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.

During the year, the Company issued on a private placement basis, 406,665 units of the Company at \$0.30 per share for gross proceeds of \$122,000. Included in the private placement, was 166,000 units for gross proceeds of \$49,800 issued to directors and officers of the Company.

December 31, 2006 and 2005

10. Commitments

In addition to commitments disclosed elsewhere in these financial statements, the Company has the following commitments:

- (a) Pursuant to the flow-through common shares issued, the Company is committed to spending \$122,000 on qualified expenditures by December 31, 2007. As of December 31, 2006, the Company expended \$nil of the qualified expenditures leaving a balance of \$122,000 due by December 31, 2007.
 - (b) In the normal course of operations, the Company enters into contractual agreements to drill wells on third party lands.
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11. Contingencies

The Company is subject to various regulatory and statutory requirements relating to the protection of the environment. These requirements, in addition to contractual agreements and management decisions, result in the accrual of estimated future removal and site restoration costs. Any changes in these estimates will affect future operations.

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 operations cannot be determined at this time, it could be material.

The Company has been 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 24, 2007, the likelihood of the claim is not determinable.

December 31, 2006 and 2005

12. Financial Instruments

The Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to commodity price risk and credit 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. The Company may manage and minimize the risk by entering into various joint ventures with subparticipants. As at December 31, 2006, the Company has not entered into any commodity contracts.

(b) Credit Risk

Substantially all of the Company's trade accounts receivable are from working interest partners in the oil and gas industry and, as such, the Company is exposed to all the risks associated with that industry. At December 31, 2006 substantially all of the Company's cash was held at one financial institution and, as such the Company is exposed to concentration of credit risk.

13. Indemnities and Guarantees

- (a) In the ordinary course of business, the Company enters into contracts which contain indemnification provisions, such as loan agreements, purchase contracts, service agreements, licensing agreements, asset purchase and sale agreements, operating agreements, leasing agreements, asset use agreements etc. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. 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 cannot be estimated.
 - (b) Under the terms of certain agreements and the Company's by-laws the Company indemnifies individuals who have acted at the Company's request to be a director and/or officer of the Company, to the extent permitted by law, against any and all damages, liabilities, costs, charges or expenses suffered by or incurred by the individuals as a result of their service. The claims covered by such indemnifications are subject to statutory and other legal limitation periods. The nature of the indemnification agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to beneficiaries of such indemnification agreements.
 - (c) The fair value of the Company's short term financial instruments is approximated by the carrying amount due to the short term nature of the instruments. The fair value of the Company's convertible debenture is approximated by the instrument's carrying amount as rates have not substantially changed since the debentures were issued.
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December 31, 2006 and 2005

14. Income Taxes

- (a) Significant components of the future income tax liability at December 31, 2006 and 2005 include the following:

	2006	2005
Property and equipment and asset retirement obligations	\$ (663,997)	\$ (477,288)
Share issuance costs	53,959	109,403
Non-capital losses	65,044	-
	\$ (544,994)	\$ (367,885)

- (b) Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial 2006 income tax rates of 34.48% (2005 – 37.62%) to loss before income taxes as follows:

	2006	2005
Loss before income taxes	\$ (800,556)	\$ (469,211)
Combined federal and provincial tax rate	34.48%	37.62%
Expected income tax (recovery)	\$ (276,116)	\$ (171,789)
Increase (decrease) resulting from:		
Resource allowance	6,772	-
Tax rate change	(93,665)	(34,599)
Stock based compensation	61,964	29,250
Other	7,583	(2,581)
Provision for income taxes (recovery)	\$ (293,462)	\$ (179,719)

- (c) At the end of the year, subject to confirmation by income tax authorities, the Company has approximately the following undeducted tax pools:

	2006	2005
Cumulative Canadian oil and gas property expenses	\$ 262,249	\$ 262,249
Cumulative Canadian development expenses	182,248	175,983
Undepreciated capital cost	473,582	461,937
Non-capital loss carryforwards	217,080	-
Undeducted share issue costs carried forward	309,659	325,408
	\$ 1,444,818	\$ 1,225,577

These pools are deductible from future income at rates prescribed by the Canadian Income Tax Act.

December 31, 2006 and 2005

15. Prior Period Adjustment

During the year the Company determined that the division of interest with regard to the acquisition of certain oil and gas properties was not appropriate. As a result of the above the following 2005 accounts were increased (decreased) to reflect the prior period adjustment.

Property and equipment	\$ (247,344)
Accounts payable	\$ 247,344

As the affected property and equipment were included in unproven properties there is no impact on depletion

16. Subsequent Event

On March 2, 2007, the shareholders approved an amendment to the Articles of the Corporation that authorize a new convertible preferred class of shares. The convertible preferred share price and conversion ratio will be determined at the time of issue by the Company's Board of Directors.
