



**CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007**

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Auditors' Report

To the Shareholders of
Greentree Gas & Oil Ltd.

We have audited the balance sheets of **Greentree Gas & Oil Ltd.** as at December 31, 2007 and 2006 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 consolidated 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.

Grant Thornton LLP

Hamilton, Ontario
April 28, 2008

Chartered Accountants
Licensed Public Accountants



CONSOLIDATED BALANCE SHEETS
as at December 31,

	2007 (\$)	2006 (\$)
ASSETS		
Current		
Accounts receivable	307,600	633,038
Prepaid expenses and other receivables	161,540	96,559
Current portion of future income taxes (note 11)	36,620	48,254
	<u>505,760</u>	<u>777,851</u>
Property, plant and equipment (note 5)	11,259,792	11,009,938
Asset retirement trust fund (note 6)	73,271	71,928
	<u>11,838,823</u>	<u>11,859,717</u>
LIABILITIES		
Current		
Bank indebtedness (note 7)	2,099,470	2,282,780
Accounts payable and accrued liabilities	992,568	1,171,437
Notes and other payables (note 15)	25,000	-
Income and other taxes payable (note 9)	647,401	295,472
Current portion of long-term debt	149,271	46,130
	<u>3,913,710</u>	<u>3,795,819</u>
Long-term debt (note 8)	260,000	149,271
Income and other taxes payable (note 9)	-	291,202
Asset retirement obligations (note 10)	955,220	446,806
Future income taxes (note 11)	2,096,569	2,432,307
	<u>7,225,499</u>	<u>7,115,405</u>
SHAREHOLDERS' EQUITY		
Capital stock (note 12)	15,567,511	15,277,945
Warrants (note 12)	349,876	334,500
Contributed surplus (note 13)	927,577	617,433
Deficit	<u>(12,231,640)</u>	<u>(11,485,566)</u>
	<u>4,613,324</u>	<u>4,744,312</u>
	<u>11,838,823</u>	<u>11,859,717</u>
Going Concern (note 1)		
Commitments (note 17)		
Subsequent Events (note 18)		
Signed on behalf of the Board:		
"Duncan Hamilton"		Director
"Gary Bean"		Director

See accompanying notes to the consolidated financial statements



CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
For the years ended December 31,

	2007 (\$)	2006 (\$)
Revenue		
Gas sales	1,460,561	1,621,344
Oil sales	307,946	205,584
Other	19,035	19,163
	<u>1,787,542</u>	<u>1,846,091</u>
Royalties	217,633	220,741
	<u>1,569,909</u>	<u>1,625,350</u>
Expenses		
Operations	786,400	764,668
Depletion and depreciation	1,083,722	3,501,721
General and administrative	543,207	616,903
Interest expense	287,219	177,673
Other taxes and related interest	92,383	7,671
Accretion of asset retirement obligations	87,552	38,291
	<u>2,880,483</u>	<u>5,106,927</u>
Loss before income taxes	(1,310,574)	(3,481,577)
Recovery of future income taxes (note 11)	564,500	740,792
Net loss	(746,074)	(2,740,785)
Deficit, beginning of year	(11,485,566)	(8,744,781)
Deficit, end of year	(12,231,640)	(11,485,566)
Net loss per share		
Basic and diluted (note 12)	(0.02)	(0.08)

See accompanying notes to the consolidated financial statements



CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,

	2007 (\$)	2006 (\$)
Operating activities		
Net loss	(746,074)	(2,740,785)
Items not affecting cash:		
Depletion and depreciation	1,083,722	3,501,721
Loss on asset retirement obligations settlement	9,482	-
Gain on disposal of assets	(1,000)	(1,872)
Accretion of asset retirement obligations	87,552	38,291
Stock-based compensation	145,805	161,059
Recovery of future income taxes	(564,500)	(740,792)
Asset retirement costs	(31,519)	(9,225)
	<u>(16,532)</u>	<u>208,397</u>
Net change in non-cash working capital		
Accounts receivable	423,500	(114,283)
Prepaid expenses and other receivables	(64,981)	(28,966)
Accounts payable and accrued liabilities	(762,613)	(814,626)
Income and other taxes payable	60,727	(78,003)
	<u>(359,899)</u>	<u>(827,481)</u>
Financing activities		
Increase (decrease) in bank indebtedness	(183,310)	809,705
Proceeds on issuance of notes payable	126,715	-
Repayment of notes payable	(101,715)	-
Proceeds on issuance of convertible debentures	260,000	-
Repayment of long-term debt	(46,130)	(260,165)
Net proceeds on issuance of common shares	530,039	1,324,398
Change in non-cash working capital relating to issuance of common shares	43,619	20,539
Issuance of common share purchase warrants	162,415	141,000
	<u>791,633</u>	<u>2,035,477</u>
Investing activities		
Acquisition of property, plant and equipment	(873,060)	(1,743,125)
Change in non-cash working capital relating to acquisition of property, plant and equipment	441,669	531,506
Proceeds from sale of assets	1,000	4,701
Asset retirement trust fund	(1,343)	(1,078)
	<u>(431,734)</u>	<u>(1,207,996)</u>
Decrease in cash and cash equivalents	-	-
Cash and cash equivalents, beginning of year	-	-
Cash and cash equivalents, end of year	<u>-</u>	<u>-</u>

Supplemental cash flow information (note 16)

See accompanying notes to the consolidated financial statements



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

1. GOING CONCERN

These consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern which assumes that the Company will realize the carrying value of its assets and satisfy its obligations as they become due in the normal course of operations. For the year ended December 31, 2007, the Company had a net loss of \$746,074 (net loss of \$2,740,785 for the year ended December 31, 2006) and negative cash flow from operating activities of \$406,360 (negative cash flow from operating activities of \$827,481 for the year ended December 31, 2006). As a result of recurring losses over the Company's history, the Company had a deficit of \$12.23 million as at December 31, 2007 (\$11.49 million as at December 31, 2006) and had a net working capital deficiency of \$3.41 million at that date (\$3.02 million as at December 31, 2006).

The ability of the Company to continue as a going concern will depend on its ability to raise additional financing and achieve profitable operations sufficient to meet all its obligations:

- The Company's operating facility agreement (see Note 7) requires that the Company meet certain covenants including one relating to working capital ratio. As at December 31, 2007, the Company is in violation of the working capital ratio covenant and no waiver has been granted. On January 18, 2008, the banking agreement was revised and renegotiated to reduce at the rate of \$50,000 per month. This allows the bank to better align the Company's bank indebtedness with risk tolerances. The renegotiated banking agreement is subject to further review by the bank on or before April 30, 2008 (see Note 18, Subsequent events)
- On April 17, 2008, the Federal Department of Finance issued a Letter of Demand for the payment of arrears in the amount of \$520,273. The demand is related to arrears of amounts owing in respect of income and other taxes payable (see Note 9) and the Company has been given fifteen days to either pay the amount in full or respond to the Department of Finance. Greentree has commenced discussion with the Department regarding negotiating a resolution to the matter.

Although in the opinion of Management, the use of the going concern assumption is appropriate, there can be no assurance that any steps Management is taking will be successful.

These consolidated financial statements do not reflect adjustments in the carrying value of the assets and liabilities, expenses, and the balance sheet classifications that would be used if the going concern assumption were not appropriate. Such adjustments could be material.

2. NATURE OF OPERATIONS

The Company is engaged primarily in the exploration for and production of natural gas and petroleum reserves in southwestern Ontario.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada within the framework of the accounting policies summarized below. These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Southwest Petroleum Explorations Inc., together with the Company's proportionate share of the assets, liabilities, revenues, expenses and cash flows of the joint ventures in which it participates.

Measurement uncertainty

The timely preparation of consolidated financial statements requires that Management make estimates and assumptions and use judgment regarding assets, liabilities, revenues and expenses. Such estimates relate primarily to transactions and events that have not been settled as of the date of the consolidated financial statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Amounts recorded for depletion and depreciation, asset retirement obligations and amounts used in impairment test calculations are based upon estimates of petroleum and natural gas reserves and future costs to develop those reserves. Also, amounts recorded for stock-based compensation are based on historical price volatility and assumptions regarding hold periods. The estimated fair value of the equity conversion feature embedded in the convertible debentures was attributed a value of \$nil. This is based upon management's assessment that the 12% interest rate attached to the convertible debentures at the date of issue approximated the market value at that date for similar debentures without a conversion feature.

By their nature, these calculations and estimates are subject to uncertainty, and the impact on the consolidated financial statements of future periods could be material.

Property, plant and equipment

(a) Petroleum and natural gas properties and production equipment

The Company follows the full-cost method of accounting for its petroleum and natural gas operations as determined by the Canadian Institute of Chartered Accountants ("CICA"), Accounting Guideline 16. Under this method, all costs relating to the exploration for and development of oil and gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both producing and non-producing wells, production facilities and asset retirement costs. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion.

Depletion of petroleum and natural gas properties and production equipment is provided using the unit-of-production method based upon estimated proved petroleum and natural gas reserves. The costs of significant undeveloped properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment has occurred. Estimated future costs to be incurred in developing proved reserves are included in costs subject to depletion. For depletion purposes, relative volumes of natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

When a lease of petroleum or natural gas property transfers substantially all of the benefits and risks of ownership related to the leased property from the lessor to the lessee, the Company accounts for the lease as a capital lease. Under this accounting treatment, the Company accounts for a capital lease as an asset and an obligation. The asset is amortized using the unit of production method.

(b) Equipment

Equipment is stated at cost and is depreciated over its estimated useful life using the straight-line method at the following annual rates:

Field equipment	10 – 20 %
Furniture and equipment	20 %
Automobiles	25 %
Computer hardware and software	30 %

(c) Asset retirement obligations

The Company recognizes the fair value of estimated asset retirement obligations on the consolidated balance sheet when a reasonable estimate of fair value can be made. Asset retirement obligations include those for which a company faces a legal obligation to retire tangible long-lived assets such as well sites, pipelines and facilities. Increases in the asset retirement obligations resulting from the passage of time are recorded as accretion to the asset retirement obligations in the consolidated statements of operations and deficit. Actual expenditures incurred are charged against the accumulated obligations.

The asset retirement cost, equal to the estimated fair value of the retirement obligations, is capitalized as part of the cost of the related long-lived asset. Asset retirement costs are amortized using the unit-of-production method and are included in depletion and depreciation in the consolidated statements of operations and deficit.

(d) Impairment test

The Company performs an impairment test annually to determine the recoverability of capitalized costs associated with reserves. An impairment loss is recognized in net earnings or loss when the carrying amount of a cost center exceeds its fair value. The carrying amount of the cost center is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves plus the costs of unproved properties. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited to the amount by which the carrying amount exceeds the sum of the fair value of proved and probable reserves and the costs of unproved properties that have been subject to a separate impairment test and contain no probable reserves.

Financial instruments

The Company has classified all financial instruments as either held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities. Subsequent measurement of changes in the value of financial instruments depends on their initial classification.

Financial assets and liabilities held-for-trading are measured at fair value with changes in those fair values recognized in net income. Derivatives are required to be classified as held for trading and recorded at fair value.

Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the assets are removed from the balance sheet.

Financial assets held-to-maturity, loans and receivables and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost using the effective interest method of amortization. Investments in equity instruments classified as available-for-sale that do not have quoted market prices in an active market are measured at cost. The Company has implemented the following classifications:

Accounts receivable and other receivables are classified as loans and receivables. Bank indebtedness is classified as held for trading and accounts payable and accrued liabilities, the convertible debentures and the note payable, are classified as other financial liabilities and are measured at amortized cost using the effective interest method of amortization.

Flow-through shares

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. The liability for future income taxes is increased and capital stock is reduced by the estimated tax benefits transferred to shareholders at the time the resource expenditure deductions are renounced.

Loss per share

Basic net loss per common share is determined by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted loss per share is computed by giving effect to the potential dilution that would occur if the stock options, warrants and convertible debenture were exercised. The treasury stock method is used to determine the dilutive effect of stock options and warrants. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market rate for the year. The number of shares issued and purchased, are included in the denominator in calculating diluted earnings per share as the total number of shares outstanding. The "if-converted" method is used to determine the dilutive effect of the convertible debentures. This method assumes the conversion of the convertible securities at the beginning of the reporting period, or at the time of issuance, if later.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities as well as for the benefit of losses available to be carried forward for future years for tax purposes that are more likely than not to be realized. Future assets and liabilities are measured using the substantively enacted tax rates and laws that are expected to be in effect when the temporary differences are expected to reverse.

Revenue recognition

Revenue associated with the production and sale of natural gas and crude oil owned by the Company is recognized in the same period as when the purchaser has taken possession of the commodity. Other revenue is recognized in the period that the service is provided.

Transaction costs

Transaction costs incurred as a result of acquiring a financial asset or incurring a financial are expensed in the statement of operations. Transaction costs related to equity financings are netted against share capital.

Stock-based compensation plan

The Company has a stock option plan for its directors, officers, employees and consultants to purchase common shares as disclosed in Note 12.

The Company uses the fair-value method of accounting for stock options. Compensation costs are recognized over the vesting period. Fair values are determined using the Black-Scholes option-pricing model.

Cash and cash equivalents

Cash and cash equivalents include cash on hand; cash balances with banks and short-term investments with original maturity of 90 days or less. Bank borrowings are considered to be financing activities.

4. NEW ACCOUNTING STANDARDS

Effective January 1, 2007, the Company adopted four new accounting standards relating to financial instruments and derivatives, including Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 1530 "Comprehensive Income", 3855 "Financial Instruments – Recognition and Measurement", 3861 "Financial Instruments – Disclosure and Presentation" and 3865 "Hedges". The Company's policies with regards to these new standards are disclosed in Note 3. No transition adjustment was required to adjust opening carrying values of financial instruments to fair values when the Company adopted these new standards.

Effective January 1, 2007, the Company adopted the replaced Handbook Section 1506 "Accounting Changes" which provides new recommendations for the treatment and disclosure of accounting changes including changes in accounting policies, changes in accounting estimates and correction of errors. The application of these revised standards did not have a significant impact on the consolidated financial statements.

The CICA has issued the following new Handbook Sections that will become effective for the Company on January 1, 2008:

- CICA Handbook Section 1400, "Going Concern"
- CICA Handbook Section 1535, "Capital Disclosures"
- CICA Handbook Section 3862, "Financial Instruments – Disclosures"
- CICA Handbook Section 3863, "Financial Instruments – Presentation"

The Accounting Standards Board ("AcSB") amended CICA Handbook Section 1400, to include requirements for management to assess and disclose an entity's ability to continue as a going concern. This section applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008.

CICA Handbook Section 1535 establishes standards for disclosing information about an entity's capital and how it is managed. The entity's disclosure should include information about its objectives, policies and processes for managing capital and disclose whether or not it has complied with any capital requirements to which it is subject and the consequences of non-compliance.

CICA Handbook Section 3862 modifies the disclosure requirements for CICA Handbook Section 3861, "Financial Instruments – Disclosure and Presentation", including required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the extent of risks arising from financial instruments to which the Company is exposed and how the Company manages those risks. CICA Handbook Section 3863 carries forward the presentation requirements of CICA Handbook Section 3861.

The adoption of these standards is expected to increase the disclosure in future financial statements.

On January 10, 2006, the CICA AcSB ratified a new strategic plan that would see the convergence of Canadian Generally Accepted Accounting Principles ("GAAP") with International Financial Reporting Standards ("IFRS") within 5 years. In March 2007, the AcSB released an "Implementation Plan for Incorporating IFRS into Canadian GAAP", which assumed a convergence date of January 1, 2011. The AcSB confirmed this date in February 2008. The Company continues to monitor and assess the consequences of the convergence on the consolidated financial statements as they could have a material impact.

5. PROPERTY, PLANT AND EQUIPMENT

	Cost (\$)	Accumulated depletion and amortization (\$)	Net book value (\$)
December 31, 2007			
Petroleum and natural gas properties and equipment	22,927,392	11,870,362	11,057,030
Production equipment under capital lease	220,000	58,817	161,183
Other	361,074	319,495	41,579
	<u>23,508,466</u>	<u>12,248,674</u>	<u>11,259,792</u>

	Cost (\$)	Accumulated depletion and amortization (\$)	Net book value (\$)
December 31, 2006			
Petroleum and natural gas properties and equipment	21,595,009	10,823,137	10,771,872
Production equipment under capital lease	220,000	33,364	186,636
Other	368,520	317,090	51,430
	<u>22,183,529</u>	<u>11,173,591</u>	<u>11,009,938</u>

Petroleum and natural gas properties included costs of \$4,524,154 (December 31, 2006 - \$4,492,686) related to unproved properties, which are not being depleted and are not impaired.

Future asset retirement costs of \$668,529 December 31, 2006 - \$235,114) have been capitalized as part of the cost of petroleum and natural gas properties.

Future capital expenditures of \$10,000 (December 31, 2006 - \$45,000), as estimated by independent engineers, relating to the development of proved reserves have been included in costs subject to depletion.

An impairment calculation was performed on the Company's property, plant and equipment at December 31, 2007 in which the estimated undiscounted future net cash flows associated with the proved reserves exceeded the carrying amount of the Company's property, plant and equipment. At December 31, 2006, an impairment of \$2,259,569 was recorded.

The prices used in the evaluation of the carrying value of the Company's reserves for the purposes of the impairment test are as follows:

Year	Natural Gas (Cdn. \$/mcf)	Crude Oil (Cdn \$/bbl)
2008	8.12	84.83
2009	8.64	83.49
2010	8.82	82.12
2011	8.99	80.12
2012 and thereafter escalated at 2%	9.17	78.13

6. ASSET RETIREMENT TRUST FUND

The Company is required, under the provisions of the Oil, Gas and Salt Resources Act of Ontario, to maintain a drilling and abandonment security deposit. The amount of the deposit is determined by regulations set by the Minister of Natural Resources (Ontario).

7. BANK INDEBTEDNESS

The total operating facility provides the Company with a \$1,950,000 revolving demand loan bearing interest payable monthly at the bank's prime lending rate plus 2.00% and, a non-revolving demand loan of \$300,000 bearing interest payable monthly at the bank's prime lending rate plus 5.00%. As at December 31, 2007, the bank's prime lending rate is 6.00% and the entire facility is subject to the bank's further review on or before April 30, 2008. The Company's operating facility agreement requires that the Company meet certain covenants including one relating to a working capital ratio. As at December 31, 2007, the Company is in violation of the working capital ratio covenant.

The bank has not waived its right to demand repayment of the outstanding principal balance prior to December 31, 2007 and consequently the entire balance has been shown as a current liability.

The loan is collateralized by a \$10 million debenture with a floating charge over all assets of the Company with a negative pledge and undertaking to provide fixed charges on the Company's major producing petroleum and natural gas reserves at the request of the lender, a general assignment of book debts, insurance assignment showing the lender as first loss payee, an assignment of revenues and monies under material contracts, and a guarantee from Southwest Petroleum Explorations Inc., supported by debenture security.

8. LONG-TERM DEBT

	2007 (\$)	2006 (\$)
Total long-term debt		
Vehicle financing	-	12,251
Obligation under capital lease	149,271	183,150
12% Convertible debenture	260,000	-
	<u>409,271</u>	<u>195,401</u>
Less current portion:		
Vehicle financing	-	(12,251)
Obligations under capital lease	(149,271)	(33,879)
	<u>(149,271)</u>	<u>(46,130)</u>
	<u>260,000</u>	<u>149,271</u>

Under the terms of the lease, combined principal and interest payments of \$4,573 per month are made, plus a final instalment of \$121,000 due September 15, 2008. Interest is computed at an incremental borrowing rate of 12.5% per annum.

On September 28, 2007, a non-brokered private placement of convertible debentures was closed. The debentures bear interest at the rate of 12% per annum, payable quarterly and will mature on July 1, 2012. The debentures are convertible at the option of the holder into common shares of the Company at \$0.24 per common share during the first two years, \$0.27 during the third year, \$0.30 during the fourth year and \$0.33 per share in the last year before maturity. The Company may redeem the debentures on thirty (30) days' notice provided that its common shares have traded at prices not less than \$0.50 per common share in the 30 days immediately preceding the date of such notice if notice is given before July 1, 2009, at \$0.55 per common share if notice is given in the third year, \$0.60 per common share if notice given in the fourth year, and \$0.65 per share if notice is given in the last year before maturity.

9. INCOME AND OTHER TAXES PAYABLE

The current portion of income and other taxes payable consists of the following:

	2007 (\$)	2006 (\$)
Capital taxes payable	124	6,780
Other taxes payable:		
Current year	32,607	27,737
Prior years	614,670	260,955
	<u>647,401</u>	<u>295,472</u>

The long-term portion of income and taxes payable consists of the following:

	2007 (\$)	2006 (\$)
Other taxes payable – prior years	-	291,202

During the second quarter of 2006, the Company negotiated long-term payment terms with respect to Part XII.6 tax arrears resulting from over-renouncing amounts to its investors holding flow-through shares which resulted in a shortfall of eligible resource expenditures. The Company voluntarily disclosed these matters to the Federal Department of Finance and accordingly no penalties were levied by the Department. The shortfall in expenditures occurred from 1996 to 2001 and interest is accrued at the Canada Revenue Agency's prescribed rates of interest as published on a quarterly basis. During 2007, the Company was unable to comply with the agreed upon monthly instalments of \$25,000 and only one monthly instalment was made pursuant to the long-term repayment negotiation. Interest on the outstanding debt continues to accrue. (see Note 18, Subsequent Events).

10. ASSET RETIREMENT OBLIGATIONS

The following table presents the reconciliation of the aggregate carrying amount of the obligations associated with the retirement of natural gas and oil assets:

	2007 (\$)	2006 (\$)
Asset retirement obligations, beginning of the year	446,806	404,946
Liabilities incurred	9,482	17,155
Liabilities settled	(31,519)	(9,225)
Accretion expense	87,552	38,291
Revisions in estimated cash flows	442,899	(4,361)
Asset retirement obligations, end of the year	<u>955,220</u>	<u>446,806</u>

The total undiscounted amount of estimated cash flows required to settle the obligations is \$1,816,720 (December 31, 2006 - \$1,404,420), which has been discounted using a credit-adjusted risk-free rate of 8.5%. Over the next 5 years, approximately 38% of the costs will be incurred with the remaining costs incurred through from 2013 - 2053.

11. INCOME TAXES

The recovery for income taxes differs from the amount anticipated based on the statutory combined Federal and provincial tax rates.

	2007 (\$)	2006 (\$)
Statutory rate	36.12%	36.12%
Anticipated income tax recovery	473,379	1,257,546
Increase (decrease) in tax recovery resulting from:		
Resource allowance	19,953	34,312
Non-deductible tax and interest	(21,750)	6,974
Adjustment to loss carry-forwards and other tax pools and allowances	-	(674,579)
Warrant and stock-based compensation	(52,665)	(71,373)
Adjustments to net future tax liabilities for tax rate reduction	153,801	133,617
Other	(8,218)	54,295
	<u>564,500</u>	<u>740,792</u>

The provision (recovery) of income taxes comprises the following:

	2007 (\$)	2006 (\$)
Recovery of (provision for) current income taxes		
Recovery of (provision for) future income taxes		
Current	(11,634)	9,871
Long term	576,134	730,921
	<u>564,500</u>	<u>740,792</u>

The future income tax liability is comprised of:

	2007 (\$)	2006 (\$)
Property, plant and equipment (excess of book value over tax value)	2,444,987	2,625,305
Share issue costs	(72,265)	(77,657)
Asset retirement obligations	(301,850)	(153,724)
Other	(10,923)	(9,871)
	<u>2,059,949</u>	<u>2,384,053</u>
Add: current portion of asset	36,620	48,254
	<u>2,096,569</u>	<u>2,432,307</u>

As at December 31, 2007, the Company had accumulated non-capital loss carried-forwards of approximately \$1.89 million for Federal tax purposes and \$2.25 million for provincial tax purposes, which expire between 2008 and 2027. As they are expected to expire without being utilized, the benefit associated with the accumulated non-capital loss carry-forwards has not been recognized in these consolidated financial statements.

12. CAPITAL STOCK

AUTHORIZED

Unlimited number of common shares.

ISSUED

Common shares	Number of shares	Amount (\$)
December 31, 2005	33,125,299	14,332,881
Future income tax effect – prior year flow-through shares	-	(316,050)
Issued to related parties in private placement	754,286	195,000
Issued in private placements	4,484,662	1,066,114
December 31, 2006	38,364,247	15,277,945
Future income tax effect – prior year flow-through shares	-	(283,588)
Issued to related party in share for debt settlement	320,000	78,900
Issued to related parties in private placements	1,479,155	162,707
Issued in private placements	5,123,327	331,547
December 31, 2007	45,286,729	15,567,511

On July 14, 2006, the Company closed a private placement in which 1,116,363 common shares were issued on a flow-through basis for gross proceeds of \$368,400. The amount from the issue of these shares is presented net of future income tax effects of \$111,611 (renouncement on \$309,000 of these proceeds occurred November 30, 2006), proceeds allocated to share purchase warrants of \$37,000 and share issue costs of \$47,151 net of future income taxes of \$17,031.

On September 18, 2006, the Company closed a private placement in which 1,923,467 common shares were issued on a flow-through basis and 646,832 common shares were issued on a non-flow-through basis for gross proceeds totaling \$828,794. The amount from the issue of these shares are presented net of proceeds allocated to share purchase warrants of \$104,000 and share issue costs of \$65,627 net of future income taxes of \$23,704.

On December 22, 2006, as part of 464,286 flow-through shares and 1,088,000 non-flow-through shares issued in a private placement, the Company issued 214,286 flow-through shares and 540,000 non-flow-through shares to related parties for gross proceeds of \$195,000. Other shares issued on this private placement for gross proceeds of \$207,000, are presented net of share issue costs of \$21,018 net of future taxes of \$7,592.

On January 31, 2007, the Company closed a share-for-debt settlement in which 320,000 common shares were issued to settle an outstanding amount due to a related party of \$80,000 less filing fees in the amount of \$1,100.

In December 2007, the Company closed a private placement consisting of three separate tranches during the month. In aggregate, 6,036,217 non flow-through common shares and 566,625 flow-through shares were issued at \$0.11 and \$0.15 respectively. Gross proceeds of \$748,924 are presented net of share issue costs of \$135,447, net of future income taxes of \$43,115 and the fair value of warrant costs of \$162,338.

STOCK OPTION PLAN

Under the terms of the Plan, the Board of Directors may authorize the granting of options to purchase up to 3,868,424 common shares, provided that no individual may be granted options exceeding 5% of the issued and outstanding common shares of the Company. The option price per common share granted under the plan may not be less than the closing market price on the date the option is granted less allowable discounts as permitted under the policies of the TSX Venture Exchange. The maximum term of any option is five years from the date the option is granted. Options are immediately exercisable upon granting.

The status of the Company's stock option plan as at December 31, 2007 and December 31, 2006 and during the years then ended is presented below:

	Effective date	Common shares	Weighted Average Exercise Price
Outstanding, December 31, 2005		1,260,000	\$0.58
Granted during the year			
	13-Apr-06	675,000	\$0.35
	2-Nov-06	50,000	\$0.30
Forfeited during the year	12-May-06	(85,000)	\$1.50
Outstanding, December 31, 2006		1,900,000	\$0.45
Granted during the year:			
	31-Jan-07	575,000	\$0.25
	31-Jul-07	125,000	\$0.18
	20-Dec-07	50,000	\$0.11
Forfeited during the year			
	25-Jun-07	(100,000)	\$0.35
	25-Jun-07	(100,000)	\$0.50
	25-Jun-07	(50,000)	\$0.25
Expired during the year			
	02-Dec-07	(25,000)	\$1.03
Outstanding, December 31, 2007		2,375,000	\$0.38

The following table outlines information related to the stock options at December 31, 2007:

Exercise Price	Number of options outstanding	Weighted average remaining contractual life (yrs)
\$0.50	1,050,000	0.82
\$0.35	575,000	3.28
\$0.30	50,000	3.84
\$0.25	525,000	4.08
\$0.18	125,000	4.58
\$0.11	50,000	1.00
	2,375,000	2.39

The fair value of each option granted is estimated at the date of grant using the Black-Scholes option pricing model. The weighted average fair value per option granted in 2007 was \$0.16 (2006 – \$0.37). Under the Black-Scholes model, the weighted average assumptions for grants were as follows:

	2007	2006
Risk free interest	4.11%	4.28%
Expected life (years)	4.73	5.00
Expected volatility	85.57%	91.00%
Expected dividend yield	0.00%	0.00%

On January 11, 2008, the Company granted 50,000 common share purchase options to Big Picture Geoscience Inc. in accordance with an agreement dated October 19, 2007 between the Company, Big Picture Geoscience Inc. and Capital Street Group Investment Services Inc. These options have been recorded as outstanding at December 31, 2007 pursuant to the agreement date and have the rights of exercise as follows:

- 12,500 vest immediately upon granting;
- 12,500 vest on April 10, 2008;
- 12,500 vest on July 10, 2008; and
- 12,500 vest on October 10, 2008.

WARRANTS

	Number of warrants	Amount (\$)
Outstanding, December 31, 2005	833,333	193,500
Issued during the year:		
Flow through share warrants	1,176,603	104,500
Non flow through share warrants	323,416	36,500
Outstanding, December 31, 2006	2,333,352	334,500
Flow through share purchase warrants expired during the year	(833,333)	(193,500)
Issued during the year:		
Non flow through share warrants	6,536,217	208,876
Outstanding, December 31, 2007	8,036,236	349,876

On July 5, 2006, as part of a private placement that closed on July 14, 2006, the Company issued a total of 439,103 flow-through share purchase warrants to subscribers and finders. Each of the flow-through share purchase warrants entitles the holder to acquire one flow-through common share of the Company at a price of \$0.66 per common share until July 5, 2008. The fair value of these warrants was calculated using the Black-Scholes option pricing model.

On August 15, 2006, as part of a private placement that closed on September 18, 2006, the Company issued a total of 631,328 flow-through share purchase warrants and 190,833 non-flow-through share purchase warrants to subscribers and finders. Each of the flow-through share purchase warrants entitles the holder to acquire one flow-through common share of the Company at a price of \$0.66 per common share until August 15, 2008. Each of the non-flow-through share purchase warrants entitles the holder to acquire one non-flow-through common share of the Company at a price of \$0.50 per common share until August 15, 2008. The fair value of these warrants was calculated using the Black-Scholes option pricing model.

On September 18, 2006, as part of a private placement that closed on that date, the Company issued a total of 106,172 flow-through share purchase warrants and 132,583 non-flow-through share purchase warrants to subscribers and finders. Each of the flow-through share purchase warrants entitles the holder to acquire one flow-through common share of the Company at a price of \$0.66 per common share until September 18, 2008. Each of the non-flow-through share purchase warrants entitles the holder to acquire one non-flow-through common share of the Company at a price of \$0.50 per common share until September 18, 2008. The fair value of these warrants was calculated using the Black-Scholes option pricing model unless otherwise stated.

On July 31, 2007, the Company issued 500,000 share purchase warrants as additional compensation for revisions to the bank credit facility. Each of the share purchase warrants entitles the holder to acquire one common share of the Company at a price of \$0.18 per common share until July 31, 2009. The fair value of these warrants is \$46,461 using the Black-Scholes option pricing model.

In December 2007, as part of a private placement with three closings during the month, the Company issued an aggregate of 6,036,217 share purchase warrants exercisable for a term of one year at \$0.16 per share. The fair value of these warrants in aggregate is \$162,338.

In respect of all the above warrants, fair value was calculated using the Black-Scholes option pricing model at the date of issuance. The weighted average assumptions at date of grant used for the issuance of warrants were as follows:

	<u>2007</u>	<u>2006</u>
Risk free interest	3.88%	4.22%
Expected life (years)	1.08	2.00
Expected volatility	88.42%	98.00%
Expected dividend yield	0.00%	0.00%

BASIC AND DILUTED SHARE AMOUNTS

The calculation for weighted average diluted common shares outstanding includes all stock options and all share purchase warrants that are in the money from the date of grant or, the beginning of the year, and the convertible debentures converted to common shares as per the conversion terms of the debt. For the years ending December 31, 2007 and 2006, the weighted average shares for the basic and diluted calculations are the same, as the Company is in a loss position and any inclusions would be anti-dilutive.

	<u>2007</u>	<u>2006</u>
Weighted average number of shares outstanding	39,061,904	34,643,598

13. CONTRIBUTED SURPLUS

	<u>2007 (\$)</u>	<u>2006 (\$)</u>
Balance, beginning of the year	617,433	419,833
Flow through share purchase warrants expired during the year	193,500	-
Stock based compensation, options issued and capitalized during the year	17,300	-
Stock based compensation, options issued and expensed during the year	99,344	197,600
Balance, end of the year	<u>927,577</u>	<u>617,433</u>

14. FINANCIAL INSTRUMENTS

It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from its financial instruments except as disclosed below. The fair values of accounts receivable, bank indebtedness, accounts payable and accrued liabilities and notes and other payables approximate their carrying values because of their short terms to maturity.

Interest rate risk

The Company is exposed to interest rate risk arising from fluctuations in interest rates on its operating facility. The Company's bank borrowings are subject to floating rates.

Credit risk

The Company is exposed to financial risk that arises from the credit quality of the entities to which it provides its natural gas, crude oil, other by-products and services. Credit risk arises from the possibility that the entities to which the Company provides these commodities and services may experience financial difficulty and be unable to fulfill their obligations. The Company's revenues are dependent on a selective customer base and bad debts have not been significant. As such, concentrations of credit risk are considered to be minimal.

15. RELATED PARTY TRANSACTIONS

During the year, the following transactions occurred in the normal course of business between the Company and a law firm of which a partner is a director and shareholder of the Company.

	2007 (\$)	2006 (\$)
Balance due to related party, beginning of the year	117,820	335,057
Common shares for debt settlement	(80,000)	(135,000)
Administrative expenses and share issue costs incurred	129,483	36,095
Directors' fees incurred	-	7,213
Payments made during the year	(62,379)	(125,545)
Balance due to related party, end of the year	104,924	117,820

During the year, the following transactions occurred in the normal course of business between the Company and non-management directors of the Company.

Directors' fees	2007 (\$)	2006 (\$)
Balance due to related parties, beginning of the year	20,500	-
Directors' fees recorded	24,800	20,500
Payments made in respect of directors' fees	(45,300)	-
Balance due to related parties, end of the year	-	20,500

Notes payable	2007 (\$)	2006 (\$)
Balance, beginning of the year	-	-
Notes payable issued during the year	125,000	-
Accrued interest during the year	1,715	-
Payments made in respect of notes payable	(101,715)	-
Balance, end of the year	25,000	-

The notes payable are unsecured and payable on demand with interest payable monthly at the rate of 12% per annum.

These transactions were recorded at the exchange amount, which is the amount agreed to by the transacting parties. The balances are included in accounts payable and accrued liabilities and notes and other payables in the consolidated balance sheets.

Transactions with directors/shareholders

On September 28, 2007, a non-brokered private placement of convertible debentures was closed in the amount of \$260,000. Included in the total is an amount of \$250,000 received from an individual related to a Director of the Company.

16. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the year for:	2007	2006
Interest paid during the year	215,497	196,466
Income and other taxes	30,776	270,298

Non-cash transactions:

During 2007 and 2006, the Company had no additional non-cash transactions other than the following:

	2007	2006
	(\$)	(\$)
Asset retirement costs – additions		17,155
Asset retirement costs – revisions in estimated cash flows	485,950	(4,361)
Common shares issued to settle accounts payable and accrued liabilities	80,000	135,000

17. COMMITMENTS

Flow-through share commitments

Pursuant to the terms of private placements that closed during the year, the Company has a remaining obligation as at December 31, 2007 to incur \$138,389 in qualified exploration and/or development expenditures by December 31, 2008.

Investor relations commitments

Subject to an agreement with Big Picture Geoscience Inc. and Capital Street Group Investments Services, Inc. dated October 19, 2007, the Company has engaged Big Picture Geoscience Inc. to provide Newsletter writer coverage for a period of six months with payments of \$3,500 per month commencing January 2008.

Office lease commitments

As at December 31, 2007, the Company is obligated to make annual future minimum lease payments under an operating lease (excluding additional rent for operating cost recoveries) for its administrative offices as follows:

Year	Amount (\$)
2008	9,167
2009	9,309
2010	6,289

18. SUBSEQUENT EVENTS

On January 18, 2008, the Company's bank amended the credit facility to a revolving reducing demand loan with a total credit availability of \$2,250,000. Interest will accrue at the bank's prime rate plus 2% and is payable monthly. As at January 18, 2008, the bank's prime

rate was 5.25%. The credit facility will reduce at the rate of \$50,000 per month commencing February 1, 2008 and is subject to the bank's review on or before April 30, 2008.

On March 11, 2008, the Company granted incentive stock options to purchase an aggregate of 450,000 common shares pursuant to the Company stock option plan. The options are exercisable at \$0.12 per option, expire on March 10, 2013 and, are subject to a four month hold period commencing March 12, 2008. The options were granted to consultants of the Company.

On April 10, 2008, the Company closed the first tranche of a private placement offering announced on February 26, 2008. The closing consisted of 1,524,999 units at a price of \$0.12 per unit for aggregate gross proceeds of \$183,000. Each unit consisted of one flow-through common share and one-half of one common share purchase warrant. Each whole warrant issued entitles the holder to purchase one common share of the Company at a price of \$0.15 per common share at any time until October 9, 2009. All the securities issued pursuant to the first tranche of the private placement are subject to a four month hold period expiring August 11, 2008. Finder's fees of \$12,810 (7% of the gross proceeds of the Offering) are payable in cash to Howco Ventures Inc. and 45,750 common shares were issued to Howco Ventures Inc. (representing 3% of the number of Units sold).

On April 17, 2008, the Federal Department of Finance issued a Letter of Demand for the payment of arrears in the amount of \$520,273. The demand is related to arrears of amounts owing in respect of Part XII.6 taxes as described in note 9, and the Company has been given fifteen days to either pay the amount in full or respond to the Department of Finance. Greentree has commenced discussion with the Department regarding negotiating a resolution to the matter.