

Financial Statements of

ARCAN RESOURCES LTD.

Year ended December 31, 2007

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Arcan Resources Ltd. as at December 31, 2007 and 2006 and the statements of operations, comprehensive loss and deficit and cash flows for the year ended December 31, 2007 and for the six month period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

The financial statements as at June 30, 2006 and for the year then ended were audited by other auditors, who expressed an opinion without reservation on those statements in their report dated November 3, 2006.

Chartered Accountants

Calgary, Canada
April 3, 2008

ARCAN RESOURCES LTD.

Balance Sheets

	December 31, 2007	December 31, 2006	June 30, 2006
Assets			
Current assets:			
Cash and cash equivalents	\$ —	\$ —	\$ 14,936,785
Accounts receivable	7,596,971	13,864,690	8,298,897
	<u>7,596,971</u>	<u>13,864,690</u>	<u>23,235,682</u>
Property, plant and equipment (note 5)	115,688,102	68,153,872	34,618,693
	<u>\$123,285,073</u>	<u>\$ 82,018,562</u>	<u>\$ 57,854,375</u>
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 23,832,419	\$ 18,107,588	\$ 12,907,955
Bank loan (note 6)	13,905,831	11,502,221	—
	<u>37,738,250</u>	<u>29,609,809</u>	<u>12,907,955</u>
Asset retirement obligations (note 7)	4,169,384	3,268,469	710,880
Future income taxes (note 8)	1,906,870	1,009,916	1,183,572
	<u>43,814,504</u>	<u>33,888,194</u>	<u>14,802,407</u>
Shareholders' equity:			
Share capital (note 9)	80,761,100	49,047,817	44,028,648
Share purchase loan (note 9(e))	(100,000)	(100,000)	(100,000)
Contributed surplus (note 10)	2,294,064	1,757,255	1,379,779
Deficit	(3,484,595)	(2,574,704)	(2,256,459)
	<u>79,470,569</u>	<u>48,130,368</u>	<u>43,051,968</u>
Commitments (notes 9 and 12)			
	<u>\$123,285,073</u>	<u>\$ 82,018,562</u>	<u>\$ 57,854,375</u>

See accompanying notes to financial statements.

Approved by the Board of Directors:

Director

Director

ARCAN RESOURCES LTD.

Statements of Operations, Comprehensive Loss and Deficit

	Year ended December 31, 2007	Six months ended December 31, 2006	Year ended June 30, 2006
Revenue:			
Petroleum and natural gas	\$ 27,504,615	\$ 6,303,893	\$ 6,698,785
Interest and other revenue	10,282	77,497	178,881
Royalties	(6,519,964)	(1,437,450)	(1,753,002)
	<u>20,994,933</u>	<u>4,943,940</u>	<u>5,124,664</u>
Expenses:			
Operating	5,517,047	790,876	691,339
General and administrative	4,455,739	1,729,436	2,116,827
Interest	804,181	112,548	—
Accretion	289,106	92,511	18,263
Depletion and depreciation	11,753,052	2,706,107	4,115,091
	<u>22,819,125</u>	<u>5,431,478</u>	<u>6,941,520</u>
Loss before income taxes	(1,824,192)	(487,538)	(1,816,856)
Future income tax reduction (note 8)	914,301	169,293	253,465
Net loss and comprehensive loss	(909,891)	(318,245)	(1,563,391)
Deficit, beginning of period	(2,574,704)	(2,256,459)	(693,068)
Deficit, end of period	<u>\$ (3,484,595)</u>	<u>\$ (2,574,704)</u>	<u>\$ (2,256,459)</u>
Net loss per share (note 9):			
Basic	\$ (0.03)	\$ (0.01)	\$ (0.11)
Diluted	\$ (0.03)	\$ (0.01)	\$ (0.11)

See accompanying notes to financial statements.

ARCAN RESOURCES LTD.

Statements of Cash Flows

	Year ended December 31, 2007	Six months ended December 31, 2006	Year ended June 30, 2006
Cash provided by (used in):			
Operating:			
Net loss	\$ (909,891)	\$ (318,245)	\$ (1,563,391)
Add (deduct) items not affecting cash:			
Depletion and depreciation	11,753,052	2,706,107	4,115,091
Stock-based compensation	709,267	377,476	1,019,872
Accretion	289,106	92,511	18,263
Future income tax reduction	(914,301)	(169,293)	(253,465)
	10,927,233	2,688,556	3,336,370
Change in non-cash working capital	501,387	(341,046)	(454,680)
	11,428,620	2,347,510	2,881,690
Financing:			
Bank loan	2,403,610	11,502,221	—
Issue of common shares, net of costs	25,190,864	5,014,806	41,187,229
	27,594,474	16,517,027	41,187,229
Investing:			
Property, plant and equipment	(46,772,372)	(24,186,931)	(25,292,316)
Business acquisition, net of costs (note 4)	707,353	—	—
Property acquisitions	(3,499,751)	(9,589,277)	(8,856,949)
Change in non-cash working capital	10,541,676	(25,114)	4,887,713
	(39,023,094)	(33,801,322)	(29,261,552)
Increase (decrease) in cash	—	(14,936,785)	14,807,367
Cash, beginning of period	—	14,936,785	129,418
Cash, end of period	\$ —	\$ —	\$ 14,936,785
Supplementary disclosure:			
Interest paid	\$ 855,047	\$ 112,548	\$ 1,997
Cash is comprised of:			
Cash in bank	\$ —	\$ —	\$ 436,785
Term deposits	—	—	14,500,000
	\$ —	\$ —	\$ 14,936,785

Cash is defined as cash and cash equivalents.

See accompanying notes to financial statements.

ARCAN RESOURCES LTD.

Notes to Financial Statements

Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

1. Basis of presentation:

Arcan Resources Ltd. ("Arcan" or the "Company") is a publicly listed company (see note 4) involved in the business of oil and natural gas exploration, development and production in Canada.

2. Significant accounting policies:

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of these financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the statements and accompanying notes. As a result, actual amounts could differ from estimated amounts.

Specifically, the amounts recorded for depletion and depreciation of petroleum and natural gas properties and the provision for asset retirement obligations and abandonment costs are based on estimates. The ceiling test is based on estimates of reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. The amounts for stock-based compensation are based on estimates of risk-free rates, expected lives and volatility. Future income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. 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.

(a) Property, plant and equipment:

The Company's activities are related to the acquisition of, exploration for and development of petroleum and natural gas properties. The Company follows the full cost method of accounting for petroleum and natural gas operations.

All costs of exploring for and developing petroleum and natural gas properties and related reserves are capitalized into a cost centre. Such costs include those related to lease acquisition, geological and geophysical activities, lease rentals on non-producing properties, drilling of productive and non-productive wells, tangible production equipment, asset retirement costs, and that portion of general and administrative expenses directly attributable to exploration and development activities. Proceeds received from the disposal of properties are normally deducted from the full cost pool without recognition of a gain or loss. When a significant portion of properties is sold, resulting in a change to the depletion rate of 20 percent or more, a gain or loss is recorded and reflected in the statement of operations.

Depletion of petroleum and natural gas properties and depreciation of production equipment, excluding costs related to unproved properties, are calculated using the unit-of-production method based upon estimated proved reserves, before royalties, as determined by independent petroleum engineers. For purposes of the calculation, natural gas reserves and

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

production are converted to equivalent volumes of petroleum based upon relative energy content.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

2. Significant accounting policies (continued):

(a) Property, plant and equipment (continued):

Costs of acquiring unproved properties are initially excluded from the full cost pool and are assessed each reporting period to ascertain whether impairment has occurred. When proved reserves are assigned to the property or the property is considered to be impaired, the cost of the property or the amount of impairment is added to the full cost pool.

Petroleum and natural gas properties are evaluated in each reporting period to determine whether the carrying amount in a cost centre is recoverable and does not exceed the fair value of the properties in the cost centre.

The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying amount of the cost centre. When the carrying amount is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Computer and office equipment are recorded at cost and amortized on a declining balance basis using rates of 30% and 20%, respectively per annum.

(b) Interests in joint operations:

A portion of the Company's exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(c) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and all investments that are highly liquid in nature and generally have a maturity date of three months or less.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

2. Significant accounting policies (continued):

(d) Assets retirement obligations:

The Company uses the asset retirement obligation method of recording the future cost associated with removal, site restoration and asset retirement costs. The fair value of the liability for the Company's asset retirement obligations is recorded in the period in which it is incurred, discounted to its present value using the Company's credit-adjusted, risk-free interest rate and the corresponding amount is recognized by increasing the carrying amount of petroleum and natural gas properties. 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 could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligations are charged against the obligation to the extent of the liability recorded.

(e) Financial Instruments:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Upon initial recognition all financial instruments, including all derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents as held for trading which are measured at fair value. Accounts receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities and bank debt are classified as other liabilities which are measured at amortized cost, which is determined using the effective interest method.

The Company is exposed to market risks resulting from fluctuations in commodity prices, foreign exchange rates and interest rates in the normal course of operations. A variety of derivative instruments may be used by the Company to reduce its exposure to fluctuations in commodity prices, foreign exchange rates, and interest rates. The Company does not use these derivative instruments for trading or speculative purposes. The Company considers all of these transactions to be economic hedges, however, the majority of the Company's contracts do not qualify or have not been designated as hedges for accounting purposes. As a result, all derivative contracts are classified as held for trading and are recorded on the balance sheet at fair value, with changes in the fair value recognized in net income, unless specific hedge criteria are met. The fair values of these derivative instruments are based on an estimate of the amounts that would have been received or paid to settle these instruments prior to maturity given future market prices and other relevant factors. Proceeds and costs realized from holding the derivative contracts are recognized in earnings at the time each transaction under a contract is settled.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

2. Significant accounting policies (continued):

(e) Financial Instruments (continued):

The Company has elected to account for its physical delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts on an accrual basis rather than as non-financial derivatives.

The Company measures and recognizes embedded derivatives separately from the host contracts when the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, when it meets the definition of a derivative and when the entire contract is not measured at fair value. Embedded derivatives are recorded at fair value.

The Company nets all transaction costs incurred, in relation to the acquisition of a financial asset or liability, against the related financial asset or liability. Bank debt is presented net of deferred interest payments, with interest recognized in earnings on an effective interest basis.

The Company applies trade-date accounting for the recognition of a purchase or sale of cash equivalents and derivative contracts.

(f) Future income taxes:

The Company uses the asset and liability method for calculating future income taxes. Temporary differences arising from the differences between the tax basis of an asset or liability and the carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using the currently enacted, or substantively enacted, tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

(g) Flow-through shares:

The resource 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 tax legislation. The future tax liability and share capital are adjusted by the estimated cost of the renounced tax deductions when the expenditures are renounced.

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Notes to Financial Statements, page 6

Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

2. Significant accounting policies (continued):

(h) Stock-based compensation:

The Company uses the fair value method for valuing stock option grants and warrants. Under this method, compensation cost attributable to all share options and warrants granted is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

(i) Revenue recognition:

Petroleum and natural gas revenues are recognized when the title and risks pass to the purchaser.

(j) Per share amounts:

Basic per share information is computed by dividing earnings by the weighted average number of common shares outstanding for the period. The weighted average shares that are issued in consideration for a share loan agreement are deducted from the weighted average common shares outstanding for the period. The treasury stock method is used to determine the diluted per share amounts, whereby any proceeds from the stock options, warrants or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

(k) Comparative figures:

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

3. Changes in accounting policies:

On January 1, 2007, the Company adopted the new Canadian accounting standards for financial instruments – recognition and measurement, financial instruments – presentations and disclosures, hedging and comprehensive income. Adopting these standards had no impact on the measurement of existing financial assets and liabilities.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

3. Changes in accounting policies (continued):

Effective January 1, 2008, the Company will be required to adopt three new accounting standards: Section 1535, Capital Disclosures, Section 3862, Financial Instruments – Disclosures and Section 3863, Financial Instruments – Presentation. Section 1535, requires disclosure of an entity's objectives, policies and processes for managing capital, including: quantitative data about what the entity considers capital, whether the entity has complied with any capital requirements and the consequences of non-compliance if the entity has not complied. Sections 3862 and 3863 specify standards of presentation and enhanced disclosures on financial instruments. Although the Company is currently assessing the impact of these standards on its financial statements, it is not anticipated that the adoption of these new standards will impact the amounts reported in the Company's financial statements as they primarily relate to disclosure.

4. Business acquisition:

On January 1, 2007, Arcan Resources Ltd. ("Arcan Privateco"), a private oil and gas company, and Desco Energy Ltd. ("Desco"), a publicly traded oil and gas company, completed an amalgamation of the two companies. The amalgamated company continued as a public oil and gas company under the name Arcan Resources Ltd. ("Arcan"). Pursuant to the amalgamation Desco shareholders received 2,373,331 common shares and Arcan Privateco shareholders received 26,534,045 common shares, respectively of Arcan. Immediately prior to the amalgamation two officers of Arcan Privateco owned 994,400 or 15.2% of the outstanding shares of Desco.

In addition, each Desco shareholder received one performance share of Arcan totaling 6,550,400. Each performance share issued to the Desco shareholders will, on or before November 1, 2008, be either redeemed and cancelled for a nominal amount or converted into a fraction of an Arcan share. In the event that the total proved and probable reserves attributed to certain properties held by Arcan and located in the Hamburg area of Alberta effective June 30, 2008 are determined by an independent firm of qualified oil and natural gas reserves evaluators to be less than 2,216,466 barrels of oil equivalent ("BOE") the Arcan performance shares will not be converted into Arcan shares and will be redeemed and cancelled by Arcan. If the reserves attributable to the Hamburg properties are to be equal to or greater than 2,216,466 BOE but less than 3,324,700 BOE, the Arcan performance shares would convert into 863,031 Arcan shares and, if determined to be equal to or greater than 3,324,700 BOE the Arcan performance shares would convert into 1,335,005 Arcan shares. The performance shares have been assigned no value at the date of the acquisition as the ultimate outcome, as it pertains to conversion or cancellation, could not be determined beyond a reasonable doubt.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

4. Business acquisition (continued):

The Arcan Privateco shareholders following the amalgamation hold 92% of the outstanding shares of Arcan, resulting in a substantive change in ownership. As a result, Arcan Privateco is deemed to be the acquirer of Desco and consequently has accounted for the acquisition of Desco at exchange values under the purchase method of accounting. The operating results of Desco have been included with Arcan Privateco commencing January 1, 2007. For comparative purposes the financial information of Arcan Privateco has been disclosed.

Net assets acquired:

Working capital (including cash of \$1,422,956)	\$ 473,469
Property, plant and equipment	8,464,246
Asset retirement obligations	(60,896)
Future income taxes	(1,515,889)
Total net assets acquired	\$ 7,360,930

Consideration:

Common shares issued to Desco shareholders (2,373,331)	\$ 6,645,327
Transaction costs	715,603
Total consideration	\$ 7,360,930

Subsequent to year-end, the 6,550,400 performance shares were converted into 1,335,005 common shares. In the first quarter of 2008 Arcan will record \$2.1 million to share capital, \$0.8 million to future income taxes and \$2.9 million to property, plant and equipment as a result of the conversion.

5. Property, plant and equipment:

	December 31, 2007	December 31, 2006	June 30, 2006
Petroleum and natural gas properties	\$134,300,352	\$ 75,013,070	\$ 38,771,784
Accumulated depletion and depreciation	(18,612,250)	(6,859,198)	(4,153,091)
	\$115,688,102	\$ 68,153,872	\$ 34,618,693

At December 31, 2007, petroleum and natural gas properties included undeveloped properties of \$9.5 million (December 31, 2006 - \$4.6 million and June 30, 2006 - \$13.2 million), which have been excluded from the depletion calculation. Future development costs of proved reserves of \$23.4 million (December 31, 2006 - \$21.7 million and June 30, 2006 - \$20.9 million) have been included in the depletion calculation.

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Notes to Financial Statements, page 9

Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

5. Property, plant and equipment (continued):

During the year ended December 31, 2007, the Company acquired certain working interests in petroleum and natural gas properties for cash of \$3,499,751, with associated asset retirement obligations of \$196,891.

On August 25, 2006, the Company acquired certain petroleum and natural gas properties for \$9,589,277 with associated asset retirement obligations of \$2,317,339.

The Company applied the ceiling test to its capitalized assets at December 31, 2007 and determined that there was no impairment of costs requiring a write-down. For the purposes of the December 31, 2007 impairment test of petroleum and natural gas properties, the following benchmark prices were used:

	WTI Oil (\$US/bbl)	Foreign Exchange Rate	WTI Oil (\$Cdn/bbl)	Arcan Price Oil & NGL	AECO Gas (\$Cdn/mcf)	Arcan Price Gas
2008	\$ 92.00	1.00	\$ 92.00	\$ 86.94	\$ 6.75	\$ 6.66
2009	88.00	1.00	88.00	82.84	7.55	7.41
2010	84.00	1.00	84.00	78.88	7.60	7.52
2011	82.00	1.00	82.00	76.90	7.60	7.58
2012	82.00	1.00	82.00	76.88	7.60	7.64
2013	82.00	1.00	82.00	76.84	7.60	7.65
2014	82.00	1.00	82.00	76.80	7.80	7.87
2015	82.00	1.00	82.00	76.45	7.97	8.07
2016	82.02	1.00	82.02	76.07	8.14	8.30
2017	83.66	1.00	83.66	77.86	8.31	8.49
2018	+2.0%/yr	1.00	+2.0%/yr	79.60	+2.0%/yr	8.70

6. Bank loan:

	December 31, 2007	December 31, 2006	June 30, 2006
Bank loan	\$ 13,905,831	\$ 11,502,221	\$ –

Arcan has a \$40 million operating revolving loan facility. Interest on the facility is calculated at the bank prime rate of interest, plus an applicable facility margin depending upon the Company's Net Debt to Trailing Cash Flow ratio. A re-determination of the borrowing base will occur on or before April 30, 2009. The loan facility is secured by a general security agreement, and is payable in full on demand. This facility had an effective interest rate of 6.25% at December 31, 2007 (December 31, 2006 – 6.20% and June 30, 2006 – 6.20%).

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

7. Asset retirement obligations:

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at December 31, 2007 is \$9.6 million (December 31, 2006 - \$8.4 million and June 30, 2006 - \$1.5 million), which will be incurred between 2008 and 2019. The majority of the costs will be incurred between 2010 and 2016. An inflation rate of 2% (December 31, 2006 – 2% and June 30, 2006 – 2%) was used to inflate the costs, and a credit-adjusted risk-free rate of 8% (December 31, 2007 – 8% and June 30, 2006 – 8%) was used to calculate the fair value of the asset retirement obligations.

	December 31, 2007	December 31, 2006	June 30, 2006
Balance, beginning of period	\$ 3,268,469	\$ 710,880	\$ 52,295
Liabilities incurred	354,022	147,739	549,446
Liabilities incurred on acquisitions (notes 4 and 5)	257,787	2,317,339	90,876
Accretion expense	289,106	92,511	18,263
Balance, end of period	\$ 4,169,384	\$ 3,268,469	\$ 710,880

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

8. Taxes:

The difference between the expected income tax provision based on the combined federal and provincial statutory tax rate and the amount actually provided for is as follows:

	December 31, 2007	December 31, 2006	June 30, 2006
Combined federal and provincial statutory rate	32.12%	34.50%	16.12%
Expected future income tax recovery	\$ (585,930)	\$ (168,201)	\$ (292,877)
Non-deductible crown payments (net of provincial credits)	—	68,064	107,750
Stock-based compensation	227,817	130,229	164,403
Resource allowance	—	(76,126)	(76,626)
Future tax rate reductions and other	(556,188)	(123,259)	(139,901)
Change in valuation allowance	—	—	(16,214)
Future income tax reduction	\$ (914,301)	\$ (169,293)	\$ (253,465)

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

	December 31, 2007	December 31, 2006	June 30, 2006
Share issue costs	\$ (706,868)	\$ (497,466)	\$ (585,608)
Asset retirement obligations	(1,042,346)	(971,324)	(223,700)
Non-capital losses	(839,308)	—	—
Property, plant and equipment	4,495,392	2,478,706	1,992,880
Future income tax	\$ 1,906,870	\$ 1,009,916	\$ 1,183,572

The Company has recognized the benefit of \$3.2 million of non-capital losses which are available for carry forward to reduce future taxable income in future years. These losses expire between 2014 and 2026.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

9. Share capital:

(a) Authorized:

Unlimited number of common shares without nominal or par value.

(b) Common shares issued and outstanding:

	Number of Shares	Amount
Balance, June 30, 2005	4,920,545	\$ 4,250,847
Issued pursuant to private placement	5,187,600	8,300,160
Issued pursuant to flow-through private placement	3,228,400	5,972,540
Exercise of warrants	5,560	8,896
Issued pursuant to private placement	6,800,000	17,000,000
Issued pursuant to private placement	4,400,000	12,100,000
Share issue costs	—	(2,166,758)
Tax effect of share issue costs	—	706,486
Tax effect of flow-through shares in 2005	—	(2,143,523)
Balance, June 30, 2006	24,542,105	44,028,648
Issued pursuant to conditional unit rights	315,492	—
Issued pursuant to private placement	838,224	2,347,027
Issued pursuant to flow-through private placement	838,224	2,682,317
Share issue costs	—	(14,538)
Tax effect of share issue costs	—	4,363
Balance, December 31, 2006	26,534,045	49,047,817
Issued pursuant to business acquisition (note 4)	2,373,331	6,645,327
Issued pursuant to private placement	4,000,000	15,200,000
Issued pursuant to private placement	1,500,000	5,175,000
Issued pursuant to flow-through private placement	1,200,000	5,220,000
Exercise of warrants	689,179	974,715
Exercise of stock options	195,000	312,000
Stock-based compensation on exercise of warrants and stock options	—	172,458
Share issue costs	—	(1,690,851)
Tax effect of share issue costs	—	501,819
Tax effect of flow-through shares issued in 2006	—	(797,185)
Balance, December 31, 2007	36,491,555	\$ 80,761,100

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

9. Share capital (continued):

(c) Warrants:

The Company has outstanding warrants that were issued to investors and agents, as commission, in certain equity financings. Each warrant is exercisable into one common share of the Company.

	Weighted average Exercise Price (\$)	Number of Warrants
Balance, June 30, 2005	1.68	886,930
Warrants issued	1.60	406,440
Exercise of warrants	1.60	(5,560)
Balance, June 30, 2006 and December 31, 2006	1.65	1,287,810
Exercise of warrants	1.41	(689,179)
Balance, December 31, 2007	1.93	598,631

The following table indicates the number of exercisable warrants with exercise prices:

	Exercise Price (\$)	Number of Warrants
Issued July 2004	2.00	493,000
Issued April 2005	1.60	105,631
	1.93	598,631

The warrants expire 12 months after the date on which the final receipt for a prospectus is filed by the Company.

(d) Flow-through shares:

On September 27, 2007, the Company issued 1,200,000 flow-through common shares for gross proceeds of \$5,220,000. Under the terms of the flow-through share agreements, the Company is required to renounce the \$5,220,000 of qualifying oil and natural gas expenditures effective December 31, 2007 and has until December 31, 2008 to incur the expenditures. As at December 31, 2007, the Company has \$2,974,000 of qualifying expenditures remaining to incur.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

9. Share capital (continued):

(e) Share purchase loan:

A share purchase loan of \$100,000 (December 31, 2006 - \$100,000 and June 30, 2006 - \$100,000) is due from an officer of the Company for the purchase of 40,000 common shares at a price of \$2.50 per common share. This loan is repayable, with interest calculated at the "Prescribed Rate" as determined by the Canada Revenue Agency, currently 5%, on or before April 3, 2009. This loan is secured by the underlying shares. Stock based compensation of \$11,716 was charged to income and contributed surplus for the loan during the year ended June 30, 2006.

(f) Stock options:

The Company's stock option plan provides for granting of options to directors and employees to a maximum of ten percent of the total issued and outstanding common shares of the Company. These options have a term of five years to expiry. Some of the options vest immediately, others vest one-third as of the date of grant, and one-third on each of the first two anniversary dates, and others vest one-third on each of the first three anniversary dates. The Company has reserved common shares for issuance under the stock option plan in the amount of the stock options outstanding from time to time.

	December 31, 2007		December 31, 2006		June 30, 2006	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of period	2,483,500	\$1.95	2,263,500	\$ 1.87	462,500	\$ 1.00
Granted	1,176,500	3.59	220,000	2.75	1,801,000	2.10
Exercised	(195,000)	1.60	—	—	—	—
Forfeited	(200,000)	2.87	—	—	—	—
Balance, end of period	3,265,000	\$2.51	2,483,500	\$ 1.95	2,263,500	\$1.87
Exercisable, end of period	1,805,167	\$1.83	1,676,833	\$ 1.68	1,576,833	\$ 1.61

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

9. Share capital (continued):

Range of Exercise prices	Number of options outstanding	Outstanding		Exercisable options	
		Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$1.00	462,500	4.01	\$1.00	462,500	\$1.00
\$1.60	676,000	4.01	1.60	642,667	1.60
\$2.50 – \$3.05	1,474,000	4.09	2.69	700,000	2.59
\$4.00 – \$4.15	652,500	4.34	4.11	–	–
Balance, end of period	3,265,000	4.11	\$2.51	1,805,167	\$1.83

(g) Stock-based compensation:

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	December 31, 2007	December 31, 2006	June 30, 2006
Fair value of options granted (\$/option)	\$ 1.49	\$ 0.98	\$ 0.45
Expected life of options (years)	5	10	10
Expected volatility (%)	40	–	–
Risk free rate of return (%)	4.1	4.2	3.3
Expected dividend yield (%)	nil	nil	nil

(h) Performance options:

	December 31, 2007	December 31, 2006	June 30, 2006
Number outstanding	1,500,000	1,500,000	1,500,000
Exercisable	1,500,000	–	–
Weighted average remaining contractual life (years)	1.75	2.75	8.26
Weighted average exercise price (\$/share)	1.00	1.00	1.00

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

9. Share capital (continued):

(i) Per share amounts:

The following table summarizes the basis for the determination of basic and diluted per share amounts:

	December 31, 2007	December 31, 2006	June 30, 2006
Weighted average shares outstanding:			
Basic	32,724,403	25,294,604	14,507,604
Diluted	32,724,403	25,294,604	14,507,604

In computing diluted per share amounts at December 31, 2007, 3,265,000 (December 31, 2006 – 2,483,500 and June 30, 2006 – 2,263,500) options, 1,500,000 (December 31, 2006 – 1,500,000 and June 30, 2006 - 1,500,000) performance options, and 598,631 (December 31, 2006 – 1,287,810 and June 30, 2006 - 1,287,810) warrants were excluded from the calculation as their effect was anti-dilutive.

10. Contributed surplus:

	December 31, 2007	December 31, 2006	June 30, 2006
Balance, beginning of period	\$ 1,757,255	\$ 1,379,779	\$ 287,516
Stock-based compensation	709,267	377,476	1,019,872
Fair value of broker warrants	—	—	72,391
Transfer to share capital on exercise of warrants and options	(172,458)	—	—
Balance, end of period	\$ 2,294,064	\$ 1,757,255	\$ 1,379,779

11. Related party transactions:

In October 2005, the Company sold a 0.5% Unit interest for cash consideration of \$88,000 to a company owned by the President and CEO of Arcan (the "Purchaser"). The Company had the option to repurchase the 0.5% Unit interest for a period of 30 months for \$88,000 plus any additional costs or charges incurred by the Purchaser, less any related cash flow accruing to the Purchaser. On April 1, 2007 the Company exercised this option at cost plus additional charges incurred by the Purchaser totaling \$204,025.

In conjunction with the equity issuance during the year certain officers and directors acquired 480,000 common shares at \$3.80 per share and 150,500 flow-through common shares at \$4.35 per share.

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Year ended December 31, 2007, six months ended December 31, 2006 and year ended June 30, 2006

12. Commitments:

- (a) Future minimum lease payments relating to operating lease commitments are:

2008	\$ 238,500
2009	238,500
2010	238,500
2011	244,125
2012	249,750
2013 and thereafter	874,125

- (b) As a requirement of a sublease for office premises, the Company has provided a letter of Guarantee in favour of the lessor for a five year period on a declining basis as follows:

March 2007 to February 2008	\$ 240,000
March 2008 to February 2009	180,000
March 2009 to February 2010	120,000
March 2010 to February 2011	60,000

13. Financial instruments:

- (a) Foreign currency exchange risk:

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices received are referenced to U.S. dollar denominated prices.

- (b) Credit risk:

A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the oil and natural gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment.

- (c) Interest rate risk:

The Company is exposed to interest rate risk to the extent that bank debt is at a floating rate of interest.

- (d) Fair value of financial instruments:

The fair values of accounts receivable and accounts payable and accrued liabilities approximate their carrying values due to their short-terms to maturities. The Company's bank debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.