FALL RIVER RESOURCES LTD.

CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005
(Stated in Canadian Dollars)

FALL RIVER RESOURCES LTD.

CHAIRMAN'S REPORT

Fall River has during the 2006 financial year continued establishing a base of oil and gas interests in North America from which to expand and develop.

The 2006 financial year has been one of exciting and significant change and development for Fall River.

During the 2006 financial year Fall River:

- Raised $6,371,650 under prospectus issue
- Listed on the Australian Stock Exchange
- Acquired an interest in Sprowl Gas field in Oklahoma USA
- Acquired an interest in the Baxter Shale interval over twenty-one sections in Wyoming USA
- Commenced its drilling program

Fall River has established a cash flow from its Sprowl Gas field operations and is looking to further develop the field and the related cash flow.

Fall River's interest in the Baxter Shale is looking to be a most exciting acquisition. The Baxter Shale is now attracting significant attention from USA operators and is seen as having most considerable potential.

Of great significance was the recent gas flow from the Baxter Shale following the fracture stimulation of a test well by the operator within the lease-hold interest held by Fall River.

Fall River is looking to expand the Baxter Shale drilling program during the 2007 financial year.

Fall River is also looking to acquire further oil and gas interests in North America during 2007 with a view to significantly expanding cash flow and adding value to the Company.

Together with our management I thank our shareholders, note holders and service providers for their support and contribution to Fall River during this past year.

I look to 2007 as being a year of expanded growth and value increase for shareholders.

Rod Hollingsworth
Chairman

MORGAN & COMPANY
CHARTERED ACCOUNTANTS

AUDITORS' REPORT

To the Shareholders of
Fall River Resources Ltd.

We have audited the consolidated balance sheets of Fall River Resources Ltd. as at September 30, 2006 and 2005, and the consolidated statements of loss and deficit, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 September 30, 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.

Vancouver, Canada — "Morgan & Company"

January 2, 2007 — Chartered Accountants

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FALL RIVER RESOURCES LTD.

CONSOLIDATED BALANCE SHEETS
(Stated in Canadian Dollars)

	SEPTEMBER 30	
	2006	2005
ASSETS		
Current		
Cash	**$ -**	$ 874,444
Restricted cash – prepaid debenture interest	**215,127**	123,337
Accounts receivable	**82,654**	2,166
Loan receivable (Note 3)	**122,374**	-
Prepaid expenses	**-**	5,000
Deferred financing and placement fees	**-**	114,661
	420,155	1,119,608
Natural Gas And Petroleum Property Interests (Note 4)	**5,050,134**	518,448
Equipment (Note 5)	**7,693**	-
Restricted Cash (Note 6)	**266,266**	-
Debenture Sinking Fund (Note 7)	**176,226**	-
Debenture Discount And Financing Costs (Note 7)	**254,487**	215,504
	$ 6,174,961	$ 1,853,560
LIABILITIES		
Current		
Bank indebtedness	**$ 42,300**	$ -
Accounts payable and accrued liabilities	**716,346**	97,198
Due to related parties (Note 9)	**142,417**	169,359
	901,063	266,557
Convertible Debentures (Note 7)	**1,612,773**	874,640
	2,513,836	1,141,197
SHAREHOLDERS' EQUITY		
Share Capital (Note 8(b))	**8,940,260**	2,690,399
Warrants (Note 8(c))	**105,000**	20,400
Equity Portion Of Convertible Debenture (Note 7)	**185,356**	153,942
Subscriptions Received	**-**	1,465,994
Contributed Surplus	**691,992**	598,392
Deficit	**(6,261,483)**	(4,216,764)
	3,661,125	712,363
	$ 6,174,961	$ 1,853,560

Approved on behalf of the Board:

"Ian McBain"	"Stephen Pearce"
Director	Director

The accompanying notes are an integral part of these consolidated financial statements.

FALL RIVER RESOURCES LTD.

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
(Stated in Canadian Dollars)

	YEARS ENDED SEPTEMBER 30 2006	2005
Revenues		
Natural gas and petroleum	**$ 111,184**	$ -
Expenses		
Business development	**-**	32,679
Consulting	**210,185**	224,283
Debenture interest, discount amortization and accretion	**349,165**	23,887
Depletion and equipment amortization	**349,791**	-
Foreign exchange (gain) loss	**(58,459)**	(11,692)
Management fees	**18,000**	219,500
Office	**81,267**	40,885
Professional fees	**21,184**	179,555
Property investigation	**3,520**	57,417
Regulatory and filing fees	**63,512**	27,346
Salaries and benefits	**440,756**	-
Stock based compensation	**93,600**	168,900
Travel and promotion	**276,934**	161,238
	1,849,455	1,123,998
Loss Before Other Items	**(1,738,271)**	(1,123,998)
Other Items		
Natural gas and petroleum properties written off	**(382,724)**	(929,595)
Interest income	**59,876**	2,256
Loss Before Income Tax	**(2,061,119)**	(2,051,337)
Future Income Tax Recovery	**16,400**	-
Net Loss For The Year	**(2,044,719)**	(2,051,337)
Deficit, Beginning Of Year	**(4,216,764)**	(2,165,427)
Deficit, End Of Year	**$ (6,261,483)**	$ (4,216,764)
Net Loss Per Share, Basic and diluted	**$ (0.05)**	$ (0.13)
Weighted Average Number Of Shares Outstanding, Basic and diluted	**44,751,557**	15,918,508

The accompanying notes are an integral part of these consolidated financial statements.

FALL RIVER RESOURCES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Stated in Canadian Dollars)

	YEARS ENDED SEPTEMBER 30	
	2006	2005
Cash Flows Provided By (Used In) Operating Activities		
Net loss for the year	**$ (2,044,719)**	$ (2,051,337)
Adjustment for items not requiring an outlay of cash:		
Debenture discount amortization and accretion	**121,155**	609
Depletion and equipment amortization	**349,791**	-
Unrealized foreign exchange loss	**264,131**	30,590
Future income tax recovery	**(16,400)**	-
Stock based compensation	**93,600**	168,900
Natural gas and petroleum properties written off	**382,724**	929,595
	(849,719)	(921,643)
Changes in non-cash working capital items:		
Accounts receivable	**(80,488)**	2,414
Prepaid expenses	**5,000**	(5,000)
Restricted cash	**(266,266)**	-
Debenture discounts and financing costs	**(112,289)**	-
Accounts payable and accrued liabilities	**619,148**	17,718
	(684,614)	(906,511)
Cash Flows Provided By (Used In) Investing Activities		
Natural gas and petroleum property interest payments	**(5,262,843)**	(973,043)
Equipment purchases	**(9,051)**	-
Loans to related parties	**-**	(179,256)
Loans repaid	**-**	179,256
	(5,271,894)	(973,043)
Cash Flows Provided By (Used In) Financing Activities		
Common shares issued	**5,399,510**	575,174
Share subscriptions received	**-**	1,465,994
Share issuance costs	**(766,743)**	(157,237)
Convertible debenture	**806,996**	925,678
Interest and sinking funds for convertible debentures	**(268,016)**	(123,337)
Loan receivable	**(122,374)**	-
Due to related parties	**(26,942)**	76,859
	5,022,431	2,763,131
Foreign Exchange Gain (Loss) From Holding Cash	**17,333**	(30,823)
(Decrease) Increase In Cash	**(916,744)**	852,754
Cash, Beginning Of Year	**874,444**	21,690
Cash (Bank Indebtedness), End Of Year	**$ (42,300)**	$ 874,444

Supplementary Cash Flow Information (Note 11)

The accompanying notes are an integral part of these consolidated financial statements.

FALL RIVER RESOURCES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

(Stated in Canadian Dollars)

1. NATURE OF OPERATIONS AND GOING CONCERN

a) The Company was incorporated under the Alberta Business Corporations Act as 777231 Alberta Ltd. on February 5, 1998. On April 24, 1998, it changed its name to Trent-Severn Watershed Ltd. and on November 14, 2002, to Fall River Resources Ltd. The Company was continued in British Columbia effective December 23, 2004. The Company registered as a foreign company in Australia on August 29, 2005. The principle business activities include the evaluation, acquisition, exploration and development of natural gas and petroleum properties.

b) At September 30, 2006, the Company had a working capital deficiency of $480,908 and the Company reported losses of $2,044,719 and $2,051,337 for the years ended September 30, 2006 and 2005.

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume the realization of assets and discharge of liabilities in the normal course of business.

The Company's ability to continue as a going concern is dependent upon the successful completion of additional financing, and upon its ability to attain profitable operations. Management intends to seek further funds through public offerings and private placements to finance its ongoing evaluation, acquisition, exploration and development activities. These consolidated financial statements do not give effect to any adjustments that would be necessary should the Company not be able to continue as a going concern.

2. SIGNIFICANT ACCOUNTING POLICIES

Management in accordance with Canadian generally accepted accounting principles has prepared the consolidated financial statements of the Company. The preparation of financial statements in conformity with Canadian generally accepted accounting principles 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) Consolidation

The consolidated financial statements include the accounts of the Company, and its wholly owned subsidiary, Spring River Resources Ltd., a company incorporated to carry out the Company's resource operations in the United States of America.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Use of Estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

c) Financial Instruments

Financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, loan receivable, debenture sinking fund, accounts payable and accrued liabilities, amounts due to related parties and convertible debentures. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from the financial instruments. The fair value of these financial instruments approximates their carrying value.

d) Foreign Currency Translation

The Company's reporting currency is the Canadian dollar. Transactions in foreign currencies are translated into Canadian dollars using the temporal method as follows:

I) Monetary items at the rate prevailing at the balance sheet date;
II) Non-monetary items at the historical exchange rate;
III) Revenue and expense at the rate in effect at the time of the transaction.
IV) Gains or losses arising on translation are included in the statement of operations.

e) Cash and Cash Equivalents

Cash and cash equivalents consist of balances with banks and investments in financial instruments with maturities within 90 days, or redemption availability after 30 days of notice, held for the purpose of meeting short-term cash commitments rather than for investing or other purposes.

f) Measurement uncertainty

The amounts recorded for write down of resource properties are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes and estimates in future periods could be significant.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

g) Natural Gas and Petroleum Property Interests

The Company follows the full cost method of accounting for natural gas and petroleum property interests whereby all costs of acquisitions, exploring for and developing natural gas and petroleum reserves are initially capitalized. Such costs include land acquisition costs, geological and geophysical expenses, and carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

Costs capitalized, together with the costs of production equipment, are depleted and amortized on the unit-of-production method based on the estimated gross proved reserves as determined by independent petroleum engineers. Petroleum products and reserves are converted to a common unit of measure, using six thousand cubic feet of natural gas to one barrel of oil.

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

Proceeds from a sale of petroleum and natural gas properties will be applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion by more than 20%. Royalties paid net of any tax credits received are netted with oil and gas sales.

In applying the full cost method, the Company performs a ceiling test on properties which restricts the capitalized costs less accumulated depletion from exceeding an amount equal to the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and market value of unproved properties, as determined by independent engineers, based on sales prices achievable under existing contracts and posted average reference prices in effect between the end of the year and the finalization of the year end audit and current costs, and after deducting estimated future general and administrative expenses, production related expenses, financing costs, future site restoration costs and income taxes.

e) Equipment

Equipment is stated at cost less accumulated amortization, which is recorded over the useful lives of the assets on the declining balance basis at the rate of 30%.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

f) Impairment of Long-Lived Assets

Long-lived assets include natural gas and petroleum properties. Long-lived assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Impairment or write downs are recorded in the event the net book value of such assets exceeds the estimated indicated future cash flows attributable to such assets.

h) Asset Retirement Obligations

The Company applies CICA accounting standard 3110 – "Asset Retirement Obligations" to account for the obligations to reclaim and remediate oil and gas properties. Under the standard, the estimated fair value of the legal obligations are recognized in the period incurred, at the net present value of the cash flows required to settle the future obligations. A corresponding amount is capitalized to the related asset and asset retirement obligations are subject to accretion over time for increases in the fair value of the liabilities.

It is possible that the Company's estimates of its ultimate asset retirement obligations could change as a result of changes in regulations, the extent of environmental remediation required, and the means of reclamation or cost estimates. Changes in estimates are accounted for prospectively from the period the estimate is revised.

i) Financing fees

Discount and deferred financing fees rising from debt issues are accreted and amortized over the term of debt applying the effective interest method.

j) Earnings (Loss) Per Share

Earnings (loss) per share is calculated based on the weighted average number of shares outstanding. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and other similar instruments. Under this method, the dilutive effect on earnings per share is calculated to reflect on the use of the proceeds that could be obtained upon the exercise of options and warrants. It assumes that the proceeds would be used to purchase common shares at the average market price during the period. Basic and diluted losses per share are equal as the assumed conversion of outstanding options and warrants would be anti-dilutive.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

k) Stock Based Compensation

The Company follows the recommendations of CICA Handbook Section 3870 – "Stock Based Compensation and Other Stock Based Payments" to account for stock based transactions with officers, directors, employees, and outside consultants. The fair value of stock options granted is charged to operations at the date of grant, with an offsetting credit to contributed surplus. Any consideration received on exercise of stock options together with the related portion of contributed surplus is credited to share capital.

l) Income taxes

Income taxes are calculated using the liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future tax assets are recognized to the extent that they are considered more likely than not to be realized. Future income tax liabilities or assets are calculated using the tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

m) Flow-through common 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. In 2005, the Company adopted CICA EIC-146 – "Flow-Through Shares" requiring that share capital be reduced and future income tax liability be increased by the estimated tax benefit renounced, when the expenditures are renounced. Tax benefits of any available future tax assets may be recognized to the extent of future income tax liabilities resulting from flow-through share renouncements.

3. LOAN RECEIVABLE

On May 19, 2006 and July 30, 2006 the Company advanced CDN$41,699 (AUS$50,000) and CDN$136,016 (AUS$160,000) to another company. The loan is secured by a mortgage over certain property of the borrower. The borrower repaid CDN$55,242 (AUS$65,000) by September 30, 2006 and repaid the balance in October 2006 with interest.

(Stated in Canadian Dollars)

4. NATURAL GAS AND PETROLEUM PROPERTY INTERESTS

	BAXTER WY, USA (4(a))	SPROWL, OK USA (4(b))	USA	LAKE DAVID, AB CANADA (4(c))	SUNKEN LAKE, AB CANADA (4(d))	SOUTH WILDWOOD SK, CANADA (4(e))	ROSE CREEK, AB CANADA	TOTAL 2006
Balance, of year	$ -	$ -	$ -	$ 195,411	$ 162,285	$ 160,752	$ -	$ 518,448
Current costs	698,548	4,181,200	-	78,591	82,532	68,852	153,120	5,262,843
Write-off	-	-	-	-	-	(229,604)	(153,120)	(382,724)
Depletion	-	(348,433)	-	-	-	-	-	(348,433)
Balance, end of year	$ 698,548	$ 3,832,767	$ -	$ 274,002	$ 244,817	$ -	$ -	$ 5,050,134

	BAXTER WY, USA (4(a))	SPROWL, OK USA (4(b))	USA	LAKE DAVID, AB CANADA (4(c))	SUNKEN LAKE, AB CANADA (4(d))	SOUTH WILDWOOD SK, CANADA (4(e))	ROSE CREEK, AB CANADA	TOTAL 2005
Balance, of year	$ -	$ -	$ 475,000	$ -	$ -	$ -	$ -	$ 475,000
Current costs	-	-	75,113	195,411	162,285	160,752	379,482	973,043
Write-off	-	-	(550,113)	-	-	-	(379,482)	(929,595)
Balance, end of year	$ -	$ -	$ -	$ 195,411	$ 162,285	$ 160,752	$ -	$ 518,448

The Company entered into a series of agreements, including:

a) Baxter Agreement – By an agreement dated November 14, 2005, the Company's wholly owned subsidiary, Spring River and a private company agreed on the terms of a participation agreement involving (i) a farmin with respect to an initial well using the Green Canyon 27-3 well bore on the oil and gas leases itemized in the agreement and known as the Green Canyon Prospect; (ii) an option to farmin with respect to a phase 2 well on the oil and gas leases itemized in the agreement and known as the Green Canyon Prospect; and (iii) an option to farmin with respect to the oil and gas leases itemized in the agreement and known as the Flaming Gorge Prospect; all the leases forming part of the Baxter Field in the county of Sweetwater, Wyoming.

4. NATURAL GAS AND PETROLEUM PROPERTY INTERESTS (Continued)

a) Baxter Agreement (Continued)

The agreement includes provisions that:

I) Initial Well

i) AFE for Initial Well: Spring River is to be responsible for funding an Authorization for Expenditures (AFE) for an initial well within 30 days of receipt of the AFE from the private company.

ii) Interest Earned in Initial Well: Upon drilling of the initial well to the contracted depth and completing the well, Spring River will earn 25% of the private company's working interest and operating rights in the Baxter leases only insofar as the Baxter leases cover the Baxter Shale underlying certain specified land, up to initial well payout (in summary, the recovery of the cost of drilling the initial well and any royalty interests), and 15% after initial well payout (completed).

II) Phase 2 Well

i) Second Well Participation: Within 60 days of release of the rig from the initial well, the private company must send Spring River an AFE for a well for a second location on the Baxter leases.

ii) Option: Spring River has the option to participate in the second well (the "Phase 2 Well") within 30 days of receipt of the AFE. The Phase 2 Well depth is not defined.

iii) Failure to Participate: If Spring River elects not to participate, the agreement terminates and it loses its rights in the initial well and its option to participate in the Flaming Gorge Prospect.

iv) Interest Earned in Phase 2 Well: Upon drilling of the Phase 2 Well and completing the well, Spring River will earn 25% of the private company's working interest and operating rights in the Baxter leases only insofar as the Baxter leases cover the Baxter Shale underlying certain specified land, up to initial well payout (in summary, the recovery of the cost of drilling the initial well and any royalty interests), and 15% after initial well payout.

4. NATURAL GAS AND PETROLEUM PROPERTY INTERESTS (Continued)

a) Baxter Agreement (Continued)

III) Flaming Gorge Option

i) Option: If Spring River participates and fulfils its obligations with respect to the initial well and the Phase 2 Well, Spring River has the option to acquire 15% of the company's working interest in the Flaming Gorge leases.

ii) Initial Flaming Gorge Well Participation: The private company must send Spring River an AFE for a well on the Flaming Gorge leases within 90 days of release of the rig from the initial well, and must send Spring River an AFE for a well for a second location on the Baxter leases.

iii) Interest Earned in Flaming Gorge Leases: Upon drilling of the initial Flaming Gorge well and completing the well, Spring River will earn 25% of the private company's working interest and operating rights in the Flaming Gorge leases, up to initial well payout (in summary, the recovery of the cost of drilling the initial well and any royalty interests), and 15% after initial well payout.

b) Sprowl Agreement – By agreement dated October 15, 2005 (as amended by an Amendment dated November 16, 2005 and January 14, 2006), between the Company's wholly owned subsidiary Spring River Resources Ltd. and a private company agreed on the terms of an option over a 50% interest in the private company's 40% interest in the oil and gas leases ("Sprowl Leases") known as the Sprowl Gas Field, forming part of the South East Middleberg Field in Grady County, Oklahoma.

The agreement includes provisions that:

I) Option: The private company grants to Spring River an option to acquire a 50% interest in the private company's 40% interest in the Sprowl Leases; (completed)

II) Exercise Price: To exercise the option and acquire the interest, Spring River must:

i) Pay to the private company US$2,600,000; (completed)
ii) Pay to the private company any AFE payments paid by the private company for the Sprowl Leases after the date of the agreement and prior to settlement within seven days of presentation of proof of payment; (completed)
iii) Issue to the private company 1,500,000 common shares of the Company; (completed) and
iv) Issue to the private company 500,000 share purchase warrants, on the same terms as the share purchase options are to be issued under the prospectus issued in connection with the financing for this acquisition (completed).

4. NATURAL GAS AND PETROLEUM PROPERTY INTERESTS (Continued)

b) Sprowl Agreement (Continued)

III) Joint Operating Agreement: Spring River must join as a party the joint operating agreement for operation of the Sprowl Leases (completed).

IV) Due Diligence: during the currency of the agreement, Spring River may undertake due diligence (completed).

V) Costs arising from Delayed Settlement: Spring River must pay interest at 9% on any moneys borrowed from the private company to fund the operating costs incurred in relation to the interest that Spring River would have acquired if it had settled on January 31, 2006 for the period from February 1, 2006 until settlement plus a payment for the cost of operations to the private company for the months of February and March 2006 agreed at AUS$37,500 per month, to cover additional costs incurred arising from the delayed settlement (completed).

c) Lake David Agreement - By an agreement dated July 20, 2005, the Company and another company as farmees ("Farmee") agreed with two companies as farmors ("Farmor") on the terms of a farmin over Farmor's 50% interest in the petroleum and natural gas lease P&NG Lease No. 0405060737 at Lake David in the province of Alberta, Canada.

The agreement includes provisions that:

I) Test Well: Farmee is to be responsible for spudding a test well within 90 days of the date of the agreement (completed).

II) Test Well Earning: Upon having drilled the test well, Farmee earns 100% of Farmor's working interest before payout, subject to a convertible overriding royalty, and 50% after payout. The Company's working interest before payout was 30% and its working interest after payout and interest in the balance of the land in the lease will be 15%.

III) Plant Participation: Each party has a right to participate in construction for the purposes of treating, processing or transporting petroleum substances from the farmout lands.

d) Sunken Lake Agreement - By an agreement dated July 20, 2005, the Company and two company's as farmees ("Farmee") agreed with two companies as farmors ("Farmor") on the terms of a farmin over Farmor's 50% interest in the petroleum and natural gas lease P&NG Lease No. 0403010183 at Sunken Lake in the province of Alberta, Canada.

4. NATURAL GAS AND PETROLEUM PROPERTY INTERESTS (Continued)

d) Sunken Lake Agreement (Continued)

The agreement includes provisions that:

I) Test Well: Farmee is responsible for spudding a test well within 60 days of the date of the agreement (completed).

II) Test Well Earning: Upon having drilled the test well, Farmee earns 100% of Farmor's working interest before payout, subject to a convertible overriding royalty and 50% after payout. The Company's working interest before payout was 25% and its working interest after payout and interest in the balance of the land in the lease will be 12.5%.

III) Plant Participation: Each party has a right to participate in construction for the purposes of treating, processing or transporting petroleum substances from the farmout lands.

e) South Wildwood Agreement - By an agreement dated July 12, 2005, the Company as farmee ("Farmee") agreed with a company as farmor ("Farmor") and another company on the terms of a farmin over Farmor's 50% interest in the oil and gas leases itemized in the agreement at South Wildwood in the province of Saskatchewan, Canada.

The agreement includes provisions that:

I) Test Well: Operator is responsible for spudding a test well by 9 November 2005 with the Company to pay 50% of the cost (completed).

II) Test Well Earning: Upon having drilled the test well, Farmee earns 100% of Farmor's working interest before payout, subject to a convertible overriding royalty of 5%, and 60% after payout. The Company's working interest before payout will be 50% and its working interest after payout and interest in the balance of the lands in the lease will be 30%.

III) Plant Participation: Each party has a right to participate in construction for the purposes of treating, processing or transporting petroleum substances from the farmout lands.

The Company abandoned this agreement during the year ended September 30, 2006 and wrote off its exploration costs.

(Stated in Canadian Dollars)

5. EQUIPMENT

	2006			2005
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE	NET BOOK VALUE
Office Equipment	$ 9,051	$ 1,358	$ 7,693	$ -

6. RESTRICTED CASH

On March 23, 2006 the Company purchased CDN$266,266 (AUS$320,000) of non-refundable trade dollars from a public Australian company engaged in bartering services including such items as accounting, legal, printing, office supplies and office space in addition to offering the Company's shares to its members for investment. As at September 30, 2006 the trade dollars had not been utilized.

7. CONVERTIBLE DEBENTURES

	2006	2005
Convertible debentures	**$ 1,835,578**	$ 1,028,530
Equity portion of convertible debentures	**(185,356)**	(153,942)
Equity accretion	**40,854**	284
Foreign exchange gain	**(78,303)**	(232)
Liability portion of convertible debentures	**$ 1,612,773**	$ 874,640

a) On September 23, 2005 the Company closed a convertible note financing for a total of CDN$1,028,530 (AUS$1,158,776, AUS$1.00 notes). The Company received gross proceeds of CDN$925,678 (AUS$1,042,900), a discount of CDN $102,852. Notes bear simple interest of 12% payable quarterly, and mature November 30, 2008. At the discretion of the note holder, notes may be converted into share capital units comprised of one common share of the Company and one half of one share purchase warrant exercisable for one year from date of issue, subject to an expiry no later than November 30, 2008. Note conversion prices range from $0.20 to $0.35 per unit over their life and whole warrants are exercisable at prices ranging from $0.24 to $0.42 per unit over their life. Fees amounting to CDN$112,976 were recorded and deferred in connection with the offering, including CDN$20,400 recorded for agent's warrants. A total of 245,026 agent's warrants were issued exercisable until September 23, 2007 at a price of $0.20.

(Stated in Canadian Dollars)

7. CONVERTIBLE DEBENTURES (Continued)

b) On April 24, 2006 the Company closed a convertible note financing for a total of CDN$806,996 (AUS$953,333, AUS$1.00 notes). The Company received gross proceeds of CDN$726,297 (AUS$858,000), a discount of CDN$80,699. Notes bear simple interest of 12% payable quarterly, and mature November 30, 2008. At the discretion of the note holder, notes may be converted into share capital units comprised of one common share of the Company and one half of one share purchase warrant exercisable for one year from date of issue, subject to an expiry no later than November 30, 2008. Note conversion prices range from $0.20 to $0.35 per unit over their life and whole warrants are exercisable at prices ranging from $0.24 to $0.42 per unit over their life. Fees amounting to CDN$62,976 were recorded and deferred in connection with the offering, including CDN$17,300 recorded for agent's warrants. A total of 331,760 agent's warrants were issued exercisable until April 24, 2007 at a price of $0.20 and until April 24, 2008 at a price of $0.25.

In accordance with Canadian generally accepted accounting principles the convertible notes have been split between their liability and equity components. The components of the convertible debenture outstanding are as follows:

In accordance with the terms of the debentures, the Company is required to deposit, in trust, a minimum amount equivalent to one year's interest on the debenture outstanding at the time of the deposit.

In addition, the Company is required to accumulate, in trust, minimum sinking fund balances calculated as a percentage of the principal amount of debentures then outstanding as follows:

SINKING FUND CONTRIBUTION DATE	SINKING FUND BALANCE
June 30, 2006	10%
June 30, 2007	20%
June 30, 2008	30%

(Stated in Canadian Dollars)

8. SHAREHOLDERS' EQUITY

a) Authorized

Unlimited number of common voting shares

b) Common Shares Issued and Outstanding

	NUMBER		CONSIDERATION	
	2006	2005	**2006**	2005
Issued for cash, private placements and prospectus financing	**41,806,547**	4,324,471	**$ 6,865,504**	$ 648,671
Oil and gas property interest	**1,500,000**	-	**217,500**	-
Tax benefits on flow-through shares	**-**	-	**(16,400)**	-
Share issue costs	**-**	-	**(816,743)**	-
	43,306,547	4,324,471	**6,249,861**	648,671
Balance, beginning of year	**18,676,503**	14,352,032	**2,690,399**	2,041,728
Balance, end of year	**61,983,050**	18,676,503	**$ 8,940,260**	$ 2,690,399

During the year ended September 2006, the Company issued:

I) 9,948,297 shares for gross proceeds of CDN$1,492,244. In conjunction with this private placement, the Company issued 4,974,149 warrants, each of which entitles the holder to purchase a common share at CDN$0.20 per share on or before October 19, 2007.

II) 31,858,250 shares for gross proceeds of CDN$5,373,260 (AUS$6,371,650). In conjunction with this prospectus financing, the Company issued 12,243,301 warrants, each of which entitles the holder to purchase a common share at AUS$0.25 per share on or before November 30, 2007.

During the year ended September 2005, the Company issued the following shares on a private placement basis:

I) 2,246,731 shares for gross proceeds of CDN$337,010. In conjunction with this private placement, the Company issued 1,123,366 warrants, each of which entitles the holder to purchase a common share at CDN$0.20/share on or before December 14, 2005.

II) 2,077,740 shares for gross proceeds of CDN$311,661. In conjunction with this private placement, the Company issued 1,038,870 warrants, each of which entitles the holder to purchase a common share at CDN$0.20/share on or before May 2, 2006.

(Stated in Canadian Dollars)

8. SHAREHOLDERS' EQUITY (Continued)

c) Warrants

	NUMBER		CONSIDERATION	
	2006	2005	**2006**	2005
Expired	**-**	(2,779,018)	**$ -**	$ (35,750)
Issued in debenture financing	**767,168**	245,026	**84,600**	20,400
Issued for property acquisition	**500,000**	-	**-**	-
Issued in private placement	**17,217,450**	2,162,236	**-**	-
	18,484,618	(371,756)	**84,600**	(15,350)
Balance, beginning of year	**2,407,262**	2,779,018	**20,400**	35,750
Balance, end of year	**20,891,880**	2,407,262	**$ 105,000**	$ 20,400

As at September 30, 2006, the Company has the following share purchase warrants outstanding:

EXPIRY DATE	NUMBER	EXERCISE PRICE
October 19, 2006	680,434	CDN$ 0.20
December 14, 2006	1,123,366	CDN$ 0.20
May 2, 2007	1,038,870	CDN$ 0.20
October 19, 2007	4,974,149	CDN$ 0.20
April 24, 2007	331,760	CDN$ 0.20
April 24, 2008		Or CDN$ 0.25
November 30, 2007	12,743,301	AUS$ 0.25
	20,891,880	

d) Stock Options

The Company adopted its current stock option plan (the "Plan") effective December 19, 2005. Under the Plan, the Company may grant options to acquire common shares to a maximum of 10% of the issued and outstanding common shares at the date of grant. The fair value of share options were estimated using the Black-Scholes option-pricing model with the following assumptions:

	DIVIDEND YIELD	EXPECTED VOLATILITY	RISK-FREE INTEREST RATE	EXPECTED AVERAGE LIFE
2006	Nil	154%	3.9%	3 years
2005	Nil	154% - 173%	3.5% - 3.8%	3 years

The weighted average fair value of options granted during the year is $0.09 (2005: $0.10).

(Stated in Canadian Dollars)

8. SHAREHOLDERS' EQUITY (Continued)

d) Stock Options (Continued)

The Company has the following history of stock options outstanding:

	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Balance, September 30, 2004	400,000	$ 0.23
Granted	1,670,000	$ 0.18
Expired	(200,000)	$ 0.44
Balance, September 30, 2005	1,870,000	$ 0.18
Granted	1,040,000	$ 0.18
Expired	(70,000)	$ 0.18
Balance, September 30, 2006	2,840,000	$ 0.18

On November 4, 2005 the Company granted options at a price of $0.15 (repriced to $0.18), total options 1,040,000 of which 990,000 granted to directors, 50,000 granted to management company employees.

On November 10, 2004 the Company granted options at prices of $0.15, $0.20, $0.30, $0.50 and $0.75 ($0.15 options repriced to $0.18 subsequent to September 30, 2005) total options 1,202,000 of which 750,000 granted to directors, 200,000 to consultants and 70,000 to management company employees.

On September 23, 2005 the Company granted options at a price of $0.15 (repriced to $0.18 subsequent to September 30, 2005) total options 650,000 all granted to directors.

All options granted had exercise prices higher than market on the day of grant.

The following table summarizes information about the stock options outstanding at September 30, 2006:

EXERCISE PRICE	NUMBER OF OPTIONS OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	NUMBER OF OPTIONS EXERCISABLE
$ 0.18	2,690,000	3.58	2,710,000
$ 0.20	150,000	1.12	150,000
$ 0.18	2,840,000	3.45	2,860,000

(Stated in Canadian Dollars)

9. RELATED PARTY TRANSACTIONS

Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Amounts due to related parties are unsecured with no specific terms for repayment.

During the year legal fees of $Nil (2005 - $5,000), consulting fees of $45,000 (2005 – $206,387) and salaries of $514,350 (2005 - $Nil) were paid by the Company to three directors.

Directors or parties related to directors hold $244,306 of the face value of convertible debentures. Interest paid or accrued on convertible debentures owing to the related parties amounted to $29,317 during the year.

10. INCOME TAXES

The Company is subject to income taxes on its unconsolidated financial statements in Canada and the USA. The consolidated provision for income taxes varies from the amount that would be computed from applying the aggregate federal and provincial income tax rates to the loss before income taxes as follows:

	2006	2005
Combined Canadian federal and provincial tax rates	**34%**	36%
Expected income tax recovery at statutory rates	**$ (824,000)**	$ (731,000)
Temporary differences	**196,000**	316,000
Effect of change in tax rate	**44,000**	19,000
Non-deductible stock based compensation	**32,000**	60,000
Increase in valuation allowance	**535,600**	336,000
	$ (16,400)	$ -

The significant components of the Company's future income tax assets are as follows:

	2006	2005
Non-capital losses carried forward	**$ 1,764,000**	$ 1,212,000
Resource deductions	**517,000**	343,000
Share issue costs carried forward	**169,000**	57,000
Valuation allowance for future income tax assets	**(2,450,000)**	(1,612,000)
	$ -	$ -

10. INCOME TAXES (Continued)

The Company has available tax losses of approximately $5,095,000 expiring by 2016, which may be offset against future Canadian taxable income.

The Company has resource pools of approximately $6,543,000 available to offset future taxable income. The tax benefit of these amounts is available for carry-forward indefinitely.

The issuance of flow-through shares requires the renunciation of resource expenditures in an amount of equal value to the shares issued. In accordance with income tax legislation, the Company must incur these resource expenditures in the year of renunciation or in the subsequent year. During the year ended September 2006 the Company renounced $47,500 in flow-through expenditures. The tax credits of $16,400 associated with these expenditures have been used to recognize benefits of current and historical tax losses.

11. SUPPLEMENTARY CASH FLOW INFORMATION

Interest paid $228,011 (2005 - $23,888). Income and withholding taxes paid $Nil (2005 - $Nil). Non-cash financing and investing activities: 500,000 warrants were issued to agents as part of fees for share capital financing and 767,168 warrants were issued to agents as part payment of fees for the convertible debenture financing (2005 – 245,026 warrants were issued to agents as part payment of fees for the convertible debenture financing.