

Financial Statements of
Canadian Spirit Resources Inc.

June 30, 2006
(unaudited)

1. BALANCE SHEETS
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NOTICE: The interim financial statements and notes thereto for the three and six month periods ended June 30, 2006 have not been reviewed by the Company's external auditors.

Canadian Spirit Resources Inc.

BALANCE SHEETS

	June 30 2006 <i>(unaudited)</i>	December 31 2005 <i>(audited)</i>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,280,091	\$ 10,688,123
Accounts receivable	125,914	1,039,211
Prepaid expenses and other	80,962	36,921
	<u>3,486,967</u>	<u>11,764,255</u>
Property, plant and equipment (note 2)	<u>26,677,057</u>	<u>22,247,043</u>
	<u>\$ 30,164,024</u>	<u>\$ 34,011,298</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable & accrued trade liabilities	\$ 351,017	\$ 3,722,768
Accrued liability for share appreciation rights (note 4)	1,122,000	1,176,000
Asset retirement obligation (note 3)	87,240	84,395
	<u>1,560,257</u>	<u>4,983,163</u>
Shareholders' equity		
Share capital (note 4)	40,904,444	40,879,476
Contributed surplus	3,111,933	2,616,988
Deficit	(15,412,610)	(14,468,329)
	<u>28,603,767</u>	<u>29,028,135</u>
	<u>\$ 30,164,024</u>	<u>\$ 34,011,298</u>

Nature of operations and going concern (note 1)

ON BEHALF OF THE BOARD:

(signed) "Philip H. Grubbe"

Director

(signed) "J.R. Richard Couillard"

Director

Canadian Spirit Resources Inc.

STATEMENTS OF OPERATIONS AND DEFICIT

For the period ended June 30

(unaudited)

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Revenue				
Interest and other income	\$ 86,933	\$ 75,049	\$ 198,790	\$ 128,583
Expenses				
Consulting fees	76,498	35,995	118,060	75,211
Salaries and benefits	93,023	88,360	188,860	157,165
Other general administration	166,855	119,640	323,342	231,783
Stock-based compensation (note 4)	(309,133)	566,309	449,913	1,486,345
Accretion expense	1,464	519	2,845	1,029
Impairment of conventional natural gas costs (note 2)	14,982	-	36,765	-
Depreciation	11,708	9,281	23,286	16,679
	<u>55,397</u>	<u>820,104</u>	<u>1,143,071</u>	<u>1,968,212</u>
Net Gain (Loss)	31,536	(745,055)	(944,281)	(1,839,629)
Deficit, beginning of period	<u>(15,444,146)</u>	<u>(11,756,487)</u>	<u>(14,468,329)</u>	<u>(10,661,913)</u>
Deficit, end of period	<u>\$(15,412,610)</u>	<u>\$(12,501,542)</u>	<u>\$(15,412,610)</u>	<u>\$(12,501,542)</u>
Loss per share (Basic & Diluted)	<u>\$ -</u>	<u>\$ (0.03)</u>	<u>\$ (0.04)</u>	<u>\$ (0.08)</u>

Nature of operations and going concern (note 1)

Canadian Spirit Resources Inc.

STATEMENTS OF CASH FLOWS

For the period ended June 30

(unaudited)

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Operating Activities:				
Net gain (loss)	\$ 31,536	\$ (745,055)	\$ (944,281)	\$ (1,839,629)
Add items not affecting cash				
Depreciation	11,708	8,529	23,286	16,679
Accretion expense	1,464	519	2,845	1,029
Impairment of natural gas costs	14,982	-	36,765	-
Stock-based compensation	(309,133)	566,309	449,913	1,486,345
	(249,443)	(169,698)	(431,472)	(335,576)
Changes in non-cash working capital items	(20,392)	(84,279)	(138,313)	(99,137)
	(269,835)	(253,977)	(569,785)	(434,713)
Financing Activities:				
Shares issued for cash	10,000	3,201,524	16,000	12,460,168
Share issue costs	-	(9,803)	-	(260,676)
	10,000	3,191,721	16,000	12,199,492
Investing Activities:				
Furniture and office equipment	(1,113)	(34,986)	(4,655)	(61,895)
Exploration expenditures	(617,878)	(358,357)	(4,458,152)	(555,031)
Acquisition/retention of natural gas rights	(7,902)	(52,314)	(27,258)	(64,966)
	(626,893)	(445,657)	(4,490,065)	(681,892)
Changes in non-cash working capital items	(2,952,494)	81,039	(2,364,182)	(1,104,062)
	(3,579,387)	(364,618)	(6,854,247)	(1,785,954)
Change in cash	(3,839,222)	2,573,126	(7,408,032)	9,978,825
Cash position, beginning of period	7,119,313	13,377,029	10,688,123	5,971,330
Cash position, end of period	\$ 3,280,091	\$15,950,155	\$ 3,280,091	\$ 15,950,155
Cash taxes paid	\$ -	\$ -	\$ -	\$ -
Interest paid	\$ -	\$ -	\$ -	\$ -

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Six months ended June 30, 2006

The interim unaudited financial statements of Canadian Spirit Resources Inc. (the "Company") have been prepared by management in accordance with accounting policies generally accepted in Canada. The interim unaudited financial statements have been prepared following the same accounting policies and methods of computation as the financial statements for the fiscal year ended December 31, 2005. The disclosures included below are incremental to those included with the annual financial statements. These interim financial statements should be read in conjunction with the audited financial statements and the notes thereto for the year ended December 31, 2005.

1. NATURE OF OPERATIONS AND GOING CONCERN

Canadian Spirit Resources Inc., incorporated in British Columbia, is a public company listed on the TSX Venture Exchange. Since May 2002, the Company has been evaluating the resource potential of certain natural gas from coal exploration properties and is considered to be in its development stage of operations. The recoverability of amounts shown for natural gas properties is dependent upon the determination of economically recoverable reserves. The Company's ability to continue its operations and to realize assets at their carrying values is dependent upon the continued support of its shareholders, obtaining additional financing and generating revenues sufficient to cover its operating costs.

The financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern which may or may not be appropriate. The financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities at amounts different from those reflected in these financial statements.

2. PROPERTY, PLANT AND EQUIPMENT

	June 30, 2006	December 31, 2005
Natural gas properties	\$ 27,758,965	\$ 23,273,556
Mineral property	1	1
Office furniture and equipment	150,985	146,329
	<u>27,909,951</u>	<u>23,419,886</u>
Less: Accumulated depletion, depreciation & amortization	<u>(1,232,894)</u>	<u>(1,172,843)</u>
Total property, plant and equipment	<u>\$ 26,677,057</u>	<u>\$ 22,247,043</u>

As the Company had no production or proved reserves at June 30, 2006, there was no depletion charge for the period. At June 30, 2006, natural gas properties included \$13,336,644 (December 31, 2005: \$13,309,386) relating to undeveloped properties. There has been no impairment of undeveloped properties and all costs incurred on the development of natural gas from coal and shale gas charged to natural gas properties are considered to be on unproven properties. During the three and six month periods ended June 30, 2006, the Company capitalized \$154,433 and \$321,616 respectively (2005: \$129,331 and \$262,938) of overhead directly related to exploration activities.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Six months ended June 30, 2006

2. PROPERTY, PLANT AND EQUIPMENT (continued)

During late 2005 and the first quarter of 2006, the Company attempted to complete and production test two test wells at West Farrell for conventional gas in the Bluesky Formation. Although these wells continue to be prospective for both shale gas in the Gates and Moosebar Formations and natural gas from coal in the Gething Formation, it was determined that the Bluesky formation does not contain commercially recoverable quantities of hydrocarbons. As a result, the Company has made an impairment provision of \$14,982 and \$36,765 respectively during the three and six month periods ended June 30, 2006 (2005: \$Nil and \$Nil) relating to the Bluesky completion and reclamation costs.

3. ASSET RETIREMENT OBLIGATION

	June 30, 2006	December 31, 2005
Balance, beginning of year	\$ 84,395	\$ 26,236
Liabilities incurred	-	55,090
Accretion expense	2,845	3,069
Less: liabilities settled	-	-
Balance, end of period	<u>\$ 87,240</u>	<u>\$ 84,395</u>

The total future asset retirement obligation including costs to reclaim and abandon wells and facilities plus the year in which such costs are expected to be incurred is estimated by management. At June 30, 2006 the estimated total future liability of \$482,216 has a present value of \$87,240 assuming the liability is settled in approximately 26 years, using an estimated credit-adjusted risk-free interest rate of 7.00 percent, and an inflation rate of 1.75 percent.

4. SHARE CAPITAL

The Company has authorized share capital of an unlimited number of common shares of no par value. The issued share capital is as follows:

	June 30, 2006		December 31, 2005	
	Number of shares	Amount	Number of shares	Amount
Balance - beginning of year	25,593,082	\$ 40,879,476	22,337,348	\$ 28,613,668
Shares issued for cash:				
Stock options	40,000	16,000	125,000	105,000
Private placements	-	-	1,341,696	9,056,448
Warrants exercised	-	-	1,789,038	3,298,720
Share issue costs	-	-	-	(260,676)
Credit from contributed surplus	-	8,968	-	66,316
Balance - end of period	<u>25,633,082</u>	<u>\$ 40,904,444</u>	<u>25,593,082</u>	<u>\$ 40,879,476</u>

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Six months ended June 30, 2006

4. SHARE CAPITAL (continued)

On March 11, 2005, the Company issued 1,341,696 Units at \$6.75 per Unit. Each Unit consisted of one common share and one-half share purchase warrant. Each whole warrant entitled the holder to purchase one share for one year at an exercise price of \$8.00 per share. During January 2006, the Company extended the expiry date of these warrants to July 11, 2006 at which time all 670,848 warrants expired.

Stock Options

The Company has stock option plans for directors, officers, employees and consultants which provides for the granting of options to acquire common shares. Under the terms of each plan, options vest over periods of not less than eighteen months and expire after a maximum of five years. At June 30, 2006, there were 2,700,000 common shares reserved for issuance under the plans of which options to acquire 2,410,000 common shares were outstanding (1,818,750 vested and 591,250 unvested).

Exercise Price of Option	Out-standing at Dec. 31, 2005	Granted	Exercised or Cancelled	Out-standing at June 30, 2006	Vested at June 30, 2006	Year of Expiry
\$0.40 to \$0.41	505,000	-	40,000	465,000	465,000	2008
\$1.50 to \$1.72	680,000	-	-	680,000	567,500	2009
\$3.15	-	25,000	²⁾ 25,000	-	-	2008
\$3.30	75,000	-	-	75,000	75,000	2009
\$3.65	450,000	-	-	450,000	¹⁾ 300,000	2008
\$4.50	300,000	-	-	300,000	150,000	2009
\$4.15 to \$4.60	215,000	-	²⁾ 25,000	190,000	136,250	2010
\$7.15	250,000	-	-	250,000	125,000	2010
Total	2,475,000	25,000	90,000	2,410,000	1,818,750	

Notes:

- 1) The exercise of these vested stock options are subject to the Company achieving certain minimum production or profit thresholds.
- 2) These stock options were cancelled during the first six months of 2006.

Options granted after January 1, 2003 are accounted for using the fair value method. The compensation cost charged against earnings in the three and six month periods ended June 30, 2006 was \$206,700 and \$503,913 respectively (2005: \$407,810 and \$1,169,345). The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2006	2005
Risk free interest rate	3.89%	3.20%
Expected dividend yield	0%	0%
Expected stock price volatility	61%	84%
Expected life of options	2 years	3 years

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Six months ended June 30, 2006

4. SHARE CAPITAL (continued)

Share Purchase Warrants

In conjunction with previous financings, the Company issued warrants with terms of one to two years to acquire common shares at specific exercise prices. Warrants outstanding at June 30, 2006 are as follows:

Exercise Price of Warrants	Outstanding at December 31, 2005	Issued	Expired	Outstanding at June 30, 2006	Expiry Date
\$3.75	750,000	-	750,000	-	¹⁾ January 15, 2006
\$8.00	670,848	-	-	670,848	²⁾ July 11, 2006
Total	1,420,848	-	750,000	670,848	

Notes:

- 1) The expiry date of these warrants was extended from September 15, 2005 to January 15, 2006 at which time all 750,000 warrants expired.
- 2) The expiry date of these warrants was extended from March 11, 2006 to July 11, 2006 at which time all 670,848 warrants expired.

Share Appreciation Rights

On August 28, 2003, three senior employees were granted share appreciation rights ("SARs") entitling them to cash payments equal to the excess of the then current price of the common shares (to a maximum of \$3.65, as amended) over the exercise price of the right. Terms of the SARs are similar to the provisions of the stock option plans. The SARs vest in three equal amounts on the first, second and third anniversary of the date of grant and the exercise of vested SARs is subject to achieving certain minimum production or profit thresholds.

Exercise Price	Out-standing at Dec. 31, 2005	Granted or (Cancelled)	Exercised or Expired	Out-standing at June 30, 2006	Vested at June 30, 2006	Expiry Date
\$0.48	600,000	-	-	600,000	400,000	Aug. 28, 2008

Total compensation expense for SARs for the three and six month periods ended June 30, 2006 was (\$515,833) and (\$54,000) (2005: \$158,500 and \$317,000) based on the closing price declining from in excess of the maximum price of \$3.65 per share on March 31, 2006 to \$2.46 per share on the TSX Venture Exchange on June 30, 2006. The Company has accrued a long term liability of \$1,122,000 at June 30, 2006 (\$1,176,000 at December 31, 2005) relating to share appreciation rights.

Canadian Spirit Resources Inc.

NOTES TO FINANCIAL STATEMENTS

Six months ended June 30, 2006

4. SHARE CAPITAL (continued) Contributed Surplus

	June 30, 2006	December 31, 2005
Balance, beginning of year	\$ 2,616,988	\$ 838,120
Value of options granted	503,913	1,845,184
Options exercised and transferred to share capital	<u>(8,968)</u>	<u>(66,316)</u>
Balance, end of period	<u>\$ 3,111,933</u>	<u>\$ 2,616,988</u>

Per Share Amounts

The weighted average number of shares outstanding during the three and six month periods ended June 30, 2006 was Basic 25,610,829 and 25,602,585 respectively (2005: 24,105,803 and 23,416,929) and Diluted 26,114,714 and 26,166,192 (2005: 25,285,460 and 23,561,739).

For the six month period ended June 30, 2006, the existence of stock options and warrants affects the calculation of loss per share on a diluted basis. As the effect of this dilution is to reduce the reported loss per share, diluted loss per share information has not been shown.

5. RELATED PARTY TRANSACTIONS

During the first six months of 2005 and 2006, the Company had transactions with directors of the Company, persons related to them or companies controlled by them in the normal course of business as follows:

	2006	2005
Consulting fees	\$ 45,100	\$ 43,600
Salaries and benefits	\$ 58,611	\$ 45,000

Consulting fees in the six month period ended June 30, 2006 included \$45,100 (2005: \$43,600) paid or payable to a director and senior officer of the Company. Accounts payable includes \$12,918 (2005: \$3,716) due to a director for consulting fees earned during the period.

Salaries and benefits of \$58,611 (2005: \$45,000) was the compensation paid to a director and senior officer of the Company during six month period ended June 30, 2006.

Transactions with related parties are recorded at cost, which represents exchange amounts for services provided. In addition during the first six months of 2005, certain directors, relatives of directors, or companies controlled by directors subscribed for 14,354 (2006: Nil) for shares or units in private placement offerings of the Company under the same terms as to other investors.