Financial Statements of

Canadian Spirit Resources Inc.
(Formerly Spirit Energy Corp.)

December 31, 2004

Canadian Spirit Resources Inc.

AUDITORS' REPORT

March 07, 2005

To the Shareholders' of
Canadian Spirit Resources Inc.

We have audited the balance sheets of Canadian Spirit Resources Inc. as at December 31, 2004 and 2003 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"PricewaterhouseCoopers LLP"

Chartered Accountants

Calgary, Alberta

Canadian Spirit Resources Inc.

BALANCE SHEETS

As at December 31

		2004		2003
ASSETS				
Current assets:				
Cash and cash equivalents	$	5,971,330	$	2,629,565
Accounts receivable		797,668		40,212
Prepaid expenses and other		45,515		11,503
		6,814,513		2,681,280
Property, plant and equipment (note 3)		14,070,160		1,561,388
	$	20,884,673	$	4,242,668
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable & accrued trade liabilities	$	1,223,229	$	168,124
Accrued liability for share appreciation rights (note 5)		845,333		78,000
Asset retirement obligation (note 4)		26,236		8,761
		2,094,798		254,885
Shareholders' equity				
Share capital (note 5)		28,613,668		12,808,180
Contributed surplus (note 5)		838,120		99,696
Deficit		(10,661,913)		(8,920,093)
		18,789,875		3,987,783
	$	20,884,673	$	4,242,668

Nature of operations and going concern (note 1)
Commitments (note 8)

ON BEHALF OF THE BOARD:

(signed) "Donald R. Gardner"
Director

(signed) "Phillip D.C. Geiger"
Director

Canadian Spirit Resources Inc.

STATEMENTS OF OPERATIONS AND DEFICIT

For the years ended December 31

	2004	2003
REVENUE		
Interest and other income	$ 74,117	$ 13,304
EXPENSES		
Consulting fees	176,546	98,088
Salaries and benefits	175,748	128,875
Management fees	-	43,500
Other general administration	249,817	302,216
Stock-based compensation (note 5)	1,537,925	177,696
Accretion expense	1,273	-
Depreciation	10,828	3,192
	2,152,137	753,567
Loss before income taxes	(2,078,020)	(740,263)
Future income tax recovery (note 7)	336,200	346,200
Net loss	(1,741,820)	(394,063)
Deficit, beginning of year	(8,920,093)	(8,526,030)
Deficit, end of year	$(10,661,913)	$(8,920,093)
Loss per share (basic & diluted)	$ (0.10)	$ (0.06)

Nature of operations and going concern (note 1)

Canadian Spirit Resources Inc.

STATEMENTS OF CASH FLOWS

For the years ended December 31

	2004	2003
OPERATING ACTIVITIES:		
Net loss	$ (1,741,820)	$ (394,063)
Add items not affecting cash		
Depreciation	10,828	3,192
Accretion expense	1,273	-
Stock-based compensation	1,537,925	177,696
Future income tax recovery	(336,200)	(346,200)
	(527,994)	(559,375)
Changes in non-cash working capital items	(65,041)	48,615
	(593,035)	(510,760)
FINANCING ACTIVITIES:		
Shares issued for cash	16,616,826	4,364,223
Share issue costs	(507,306)	-
	16,109,520	4,364,223
INVESTING ACTIVITIES:		
Furniture and office equipment	(58,245)	(12,899)
Exploration expenditures	(2,336,136)	(551,018)
Acquisition of natural gas rights	(10,109,017)	(983,484)
	(12,503,398)	(1,547,401)
Changes in non-cash working capital items	328,678	-
	(12,174,720)	(1,547,401)
Increase in cash	3,341,765	2,306,062
Cash position, beginning of period	2,629,565	323,503
Cash position, end of period	$ 5,971,330	$ 2,629,565
Cash taxes paid	$ Nil	$ Nil
Interest paid (received)	$ (72,117)	$ (13,304)

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. On June 15, 2004, the Company changed its name from Spirit Energy Corp. to Canadian Spirit Resources Inc.

Prior to May 2002, the Company's primary activity was to evaluate its 100 percent interest in six mineral claims covering 2,750 hectares known as the Isk Wollastonite mineral property. The Company determined that its mineral property contains significant reserves, however, that they are uneconomic to produce at current prices due to lack of lack of access and infrastructure. During 2001 and 2002 the Company impaired the carrying value of the mineral property to $1 from $4,788,596. During this exploration and evaluation phase of operations, the Company had incurred approximately $8.0 million of losses, including the impairment of this mineral property.

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 the operating costs.

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 and at amounts different from those reflected in the accompanying financial statements. The Company has incurred losses since inception totaling $10,661,913, which includes an operating loss of $1,741,820 for the year ended December 31, 2004 (2003 - loss of $394,063).

2. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of 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 date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The amounts recorded for depreciation, asset retirement obligations, and stock based compensation are based upon estimates. Actual results could differ from those estimates.

Cash and Cash Equivalents

For the purpose of cash flow statements, cash and short term deposits include investments with an original maturity of three months or less.

Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable and accrued expenses. It is management's opinion that the Company is not exposed to significant interest, currency or credit risk arising from its financial instruments and that their fair values approximate their carrying values, unless otherwise noted.

Property, Plant and Equipment

(a) Natural Gas Operations:

The Company follows the full cost method of accounting for exploration and development expenditures whereby all costs relating to the acquisition of, exploration for and development of natural gas reserves are capitalized. Such costs include lease acquisitions, geological and geophysical, lease rentals on undeveloped properties, drilling both productive and non-productive wells, production equipment, and overhead charges directly related to acquisition, exploration and development activities. Proceeds received from disposals of properties and equipment are credited against capitalized costs unless the disposal would alter the rate of depletion and depreciation by more than 20 percent, in which case a gain or loss on disposal is recorded.

All costs of acquisition, exploration and development of natural gas reserves, associated tangible plant and equipment costs, and estimated costs of future development of proved developed reserves are depleted and depreciated by the unit of production method based on estimated gross proved reserves before royalties as determined by independent evaluators. Natural gas reserves are converted to equivalent units using their relative energy content of six thousand cubic feet of natural gas to one barrel of oil.

The costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion calculations. These 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 the costs subject to depletion.

Natural gas assets are evaluated in each reporting period to determine that the costs are recoverable and do not exceed the fair value of the properties. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves plus the lower of cost and market of unproved properties exceed the carrying value of the petroleum and natural gas assets. If the carrying value of the petroleum and natural gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved reserves and the lower of cost and market of unproved properties. The cash flows are estimated using future product prices and costs and are discounted using the risk-free interest rate.

(b) Mineral Property:

Expenditures incurred on properties identified as having development potential are recorded at cost and are deferred on a project basis until the viability of the project is determined. If a project is successful, the project costs are amortized using the unit of production method based on recoverable mineral reserves. If a project is abandoned or it is determined that the mineral property is uneconomic to produce, the accumulated project costs are charged to earnings in the period in which the determination is made.

(c) Office Equipment:

Computer and office equipment are recorded at cost and depreciated over its estimated useful life on a straight line basis over three years. Furniture and fixtures are recorded at cost and depreciated over its estimated useful life on a straight line basis over five years.

Asset Retirement Obligation
The Company follows the accounting methodology outlined in Section 3110 of the Canadian Institute of Chartered Accountants ("CICA") handbook with respect to asset retirement obligations. The Company records the present value of legal obligations associated with the retirement of long-lived tangible assets, such as producing well sites and natural gas processing plants, in the period in which they are incurred with a corresponding increase in the carrying amount of the related long-lived asset. The liability accretes until the Company settles the retirement obligation. The carrying amounts of the long-lived assets are depleted using the unit of production method. Actual costs to retire tangible assets are deducted from the liability as incurred.

Stock-based Compensation
During the fourth quarter of 2003, the Company adopted a new accounting policy for stock-based compensation related to common share options. Stock options granted on or after January 1, 2003 have been accounted for based on the fair value method pursuant to new transitional rules approved by the CICA. The fair value is measured at the grant date and charged to earnings on a pro-rata basis over the vesting period with a corresponding increase in contributed surplus. Consideration paid to the Company on exercise of all options is credited to share capital.

Compensation cost attributable to awards to employees that call for settlement in cash is measured at intrinsic value and charged to stock-based compensation expense on a straight-line basis over the vesting period with a corresponding increase in accrued liabilities. Changes in intrinsic value between the grant date and each measurement date result in a change in the measure of compensation cost.

Earnings per Share
Basic earnings per common share are calculated on the net earnings using the weighted average number of shares outstanding during the fiscal period. Diluted earnings per share information is calculated using the treasury stock method which assumes that proceeds obtained upon exercise of options and warrants would be used to purchase common shares at the average market price for the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

Flow-Through Shares
The Company has financed a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of these share issues, the related resource expenditure deductions for income tax purposes are renounced to investors. Accordingly, when the expenditures are renounced, share capital is reduced and future income tax liabilities are increased by the estimated value of the renounced tax deductions.

Income Taxes
The Company follows the liability method of accounting for income taxes. Under this method, future income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases, using substantively enacted income tax rates. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period that the change occurs.

3. PROPERTY, PLANT AND EQUIPMENT

	2004	2003
Natural gas properties	$ 14,004,618	$ 1,543,263
Mineral property	1	1
Office furniture and equipment	77,951	22,716
Less accumulated depletion, depreciation and amortization	(12,410)	(4,592)
Total property, plant and equipment	$ 14,070,160	$ 1,561,388

As the Company had no production or proved reserves at December 31, 2004, there was no depletion charge for the period and a ceiling test was not performed. At December 31, 2004, natural gas properties included $11,099,595 (2003 - $983,484) relating to undeveloped properties. There has been no impairment of undeveloped properties and all costs attributed to natural gas properties are considered to be on unproven properties. During 2004, the Company capitalized $220,947 (2003 - $98,690) of overhead directly related to exploration activities.

The Company's mineral property is the Isk Wollastonite project where the Company holds a 100 percent undivided interest, subject to a 10 percent net profits interest, in six mineral claims covering 2,750 hectares in the Iskut River area of the Liard Mining Division, British Columbia. In prior years, the book value of the mineral property was written down from $4,788,596 to $1 to reflect its present economic value.

The Company is a party to an option agreement which grants an unrelated party the sole and exclusive right and option to acquire a 50 percent undivided interest, subject to a 3 percent Net Smelter Return, in the Isk Wollastonite property. To earn its interest, the optionee must incur $3,500,000 in exploration expenditures over a three year period with the initial $500,000 expenditure required on or before December 31, 2005.

4. ASSET RETIREMENT OBLIGATION

	2004	2003
Balance, Beginning of Year	$ 8,761	$ -
Liabilities incurred	16,202	8,761
Accretion expense	1,273	-
Liabilities settled	-	-
Balance, End of Year	$ 26,236	$ 8,761

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 December 31, 2004 the estimated total future liability of $166,367 has a present value of $26,236 assuming the liability is settled in 2029 and using an estimated credit-adjusted risk-free interest rate of 7.50 percent.

5. 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:

	2004		**2003**	
	Number	**Amount**	**Number**	**Amount**
Balance – Beginning of Year	11,734,908	$ 12,808,180	3,835,473	$ 8,403,157
Shares issued for Cash -				
Stock options	320,000	150,500	-	-
Private Placements	6,610,000	13,980,000	6,221,666	3,994,750
Warrants exercised	3,641,690	2,486,326	1,292,629	756,473
Finders' Fees – Private Placements	30,750	50,738	385,140	203,224
Share issue costs	-	(558,044)	-	(203,224)
Credit from contributed surplus	-	32,168		
Tax effect of flow-through shares	-	(336,200)	-	(346,200)
Balance – End of Year	22,337,348	$ 28,613,668	11,734,908	$ 12,808,180

Canadian Spirit Resources Inc. has closed the following non-brokered Private Placements during the past two years:

On December 29, 2004, the Company issued 160,000 flow-through common shares at $6.25 per share.

On September 15, 2004, the Company issued 1,500,000 Units at $3.25 per Unit. Each Unit consists of one common share and one-half share purchase warrant. Each whole warrant entitles the holder to purchase one share for one year at an exercise price of $3.85 per share.

On June 22, 2004, the Company issued 3,700,000 Units at $1.65 per Unit. Each Unit consists of one common share and one-half share purchase warrant. Each whole warrant entitles the holder to purchase one share for one year at an exercise price of $1.85 per share. Finders' fees of 30,750 Units were issued in conjunction with this placement.

On April 30, 2004 the Company issued 1,250,000 common shares at $1.60 per share.

On December 30, 2003, the Company issued 666,666 flow-through common shares at $1.50 per share.

On October 3, 2003, the Company issued 3,700,000 Units at $0.60 per Unit. Each Unit consists of one common share and one-half share purchase warrant. Each whole warrant entitles the holder to purchase one share for one year at an exercise price of $0.75 per share. Finders' fees of 236,740 Units were issued in conjunction with this placement.

On July 4, 2003, the Company issued 655,000 Units at $0.45 per Unit. Each Unit consists of one common share and one share purchase warrant. Each whole warrant entitles the holder to purchase one share for two years at a price of $0.50 per share in the first year and $0.75 per share in the second year. Finders' fees of 36,400 Units were issued in conjunction with this placement.

On February 7, 2003, the Company issued 567,500 flow-through common shares at $0.40 per share and 632,500 Units at $0.40 per Unit. Each Unit consists of one common share and one-half a share purchase warrant. Each whole warrant entitles the holder to purchase one share at $0.50 per share for one year. Finders' fees of 112,000 Units were issued in conjunction with this placement.

Share Purchase Warrants
In conjunction with financings in 2003 and 2004, the Company issued warrants with terms of one to two years to acquire common shares at specific exercise prices. Warrants outstanding at year-end are:

Exercise Price of Warrants	Outstanding at December 31, 2003	Granted or (Cancelled)	Exercised or Expired	Outstanding at December 31, 2004	Expiry Date
$0.50	372,250	-	372,250	-	February 7, 2004
$0.60	533,333	-	533,333	-	May 24, 2004
$0.50/$0.75	691,400	-	681,400	10,000	July 4, 2005
$0.75	1,968,370	-	1,968,370	-	October 3, 2004
$1.85	-	1,865,375	86,337	1,779,038	June 22, 2005
$3.85	-	750,000	-	750,000	Sept. 15, 2005
Total	3,565,353	2,615,375	3,641,690	2,539,038	

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 December 31, 2004, there were 2,683,311 common shares reserved for issuance under the plans of which options to acquire 1,835,000 common shares were outstanding (848,750 vested and 986,250 unvested).

Exercise Price of Option	Out-standing at Dec. 31, 2003	Granted or (Cancelled)	Exercised or Expired	Out-standing at Dec. 31, 2004	Vested at Dec. 31, 2004	Expiry Date
$0.48	200,000	-	200,000	-	-	June 07, 2004
$0.40	380,000	-	40,000	340,000	340,000	Jan. 23, 2008
$0.41	315,000	-	75,000	240,000	240,000	June 18, 2008
$1.55	-	10,000	5,000	5,000	-	Jan. 06, 2009
$1.50	-	450,000	-	450,000	112,500	Jan. 21, 2009
$1.72	-	50,000	-	50,000	25,000	Apr. 20, 2009
$1.65	-	225,000	-	225,000	112,500	May 27, 2009
$3.30	-	75,000	-	75,000	18,750	Aug. 18, 2009
$3.65	-	450,000	-	450,000	-	Aug. 28, 2008
Total	895,000	1,260,000	320,000	1,835,000	848,750	

Options granted after January 1, 2003 are accounted for using the fair value method. The compensation cost charged against earnings for stock options granted in 2004 was $770,592 (2003: $99,696). The fair value of each option grant in 2004 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2004	2003
Risk free interest rate	3.32%	3.60%
Expected dividend yield	0%	0%
Expected stock price volatility	97%	90%
Expected life of options	3 years	3 years

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, 2003	Granted or (Cancelled)	Exercised or Expired	Out-standing at Dec. 31, 2004	Vested at Dec. 31, 2004	Expiry Date
$0.48	600,000	-	-	600,000	200,000	Aug. 28, 2008

Total compensation expense for share appreciation rights for 2004 was $767,333 (2003: $78,000) based on a closing price being in excess of $3.65 per share on the TSX Venture Exchange on December 31, 2004.

Per Share Amounts
The weighted average number of shares outstanding during 2004 was Basic 16,944,310 (2003: 6,853,822) and Diluted 19,644,102 (2003: 7,707,122).

For the year ended December 31, 2004, 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.

6. RELATED PARTY TRANSACTIONS

During 2003 and 2004, 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:

	2004	**2003**
Consulting fees	$ 79,800	$ 69,325
Salaries and benefits	$ 97,901	$ 72,000
Management fees	$ -	$ 43,500
Administration and accounting fees	$ 1,940	$ 5,560

Consulting fees in 2004 included $79,800 (2003: $60,000) paid or payable to a director and senior officer of the Company and $Nil (2003: $9,325) to a former director and a company controlled by the former director for management and consulting services provided to the Company. Accounts payable includes $6,765 (2003: $12,870) due to a director for consulting fees earned during 2004.

Salaries and benefits of $97,901 (2003: $72,000) was the compensation paid or payable to a director and senior officer of the Company during 2004. Accrued liabilities includes a bonus accrual of $6,000.00.

Management fees of $Nil (2003: $43,500) were paid to a former director and former officer of the Company for management and administrative services during 2004.

Accounting fees of $1,940 (2003: $5,560) were paid to a company controlled by the spouse of a director and senior officer for accounting services during 2004.

Transactions with related parties are recorded at cost, which represent fair market value for services provided. In addition during 2004, certain directors, relatives of directors, or companies controlled by directors subscribed for 15,000 (2003: 456,000) shares or units in private placement offerings of the Company under the same terms as to other investors.

7. FUTURE INCOME TAXES

The provision for future income taxes differs from the amount computed by applying the combined statutory Canadian Federal and Provincial tax rates to earnings before taxes. The reasons for these differences are as follows:

	2004	**2003**
Earnings (loss) before income taxes	$ (2,078,020)	$ (740,263)
Rate	38.87%	40.62%
Computed expected provision for future income taxes	(807,726)	(300,695)
Increase (decrease) in taxes resulting from:		
Stock-based compensation	299,529	40,497
Non-deductible expenses	4,567	2,865
Effect of change in tax rate	135,422	115,935
Resource allowance loss	47,205	49,401
Recognition of previously unrecognized tax benefit	(15,197)	(254,203)
Income tax expense (recovery)	$ (336,200)	$ (346,200)

At December 31, 2004, the Company had estimated tax assets of $2,590,825 (2003: $2,554,087) of which a valuation allowance has been applied. The following estimated tax deductions are available to reduce future taxable income:

Non-capital losses	$ 2,402,300
Capital losses	25,932
Canadian exploration expense	3,605,454
Canadian development expense	3,032,052
Canadian oil and gas property expense	11,041,763
Foreign exploration and development expense	120,908
Undepreciated capital costs	79,561
Share issue expenses	593,130
	$ 20,901,100

The non-capital losses available at December 31, 2004 to reduce future taxable income expire as follows:

2005	$ 380,449
2006	165,378
2007	65,797
2008	127,522
2009	599,379
2010	455,973
2011	607,802
	$ 2,402,300

8. COMMITMENTS

The Company has the following financial commitments:

	2005	**2006**	**2007**
Office Sub-Lease	$ 159,620	$ 159,620	$ 159,620
Telephone Equipment Lease	1,905	-	-

The Company has an obligation to make $1,000,000 of qualifying exploration and development expenditures before December 31, 2005 pursuant to a flow-through share issue which closed December 29, 2004. The Company has issued a letter of credit in lieu of a security deposit in the amount of $42,745 to the BC Oil and Gas Commission that allows for the withdrawal of funds to remedy deficiencies in the drilling or operating of wells in British Columbia.

9. COMPARATIVE BALANCES

Certain comparatives were restated to conform with current year's presentation.