
CANADA ENERGY PARTNERS INC.

FINANCIAL STATEMENTS

FOR THE YEARS ENDED APRIL 30, 2011 AND 2010

(Expressed in Canadian Dollars)

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
Canada Energy Partners Inc.

We have audited the accompanying financial statements of Canada Energy Partners Inc., which comprise the balance sheets as at April 30, 2011 and 2010, and the statements of operations, comprehensive loss and deficit and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Canada Energy Partners Inc. as at April 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Vancouver, B.C.
August 10, 2011

"D&H Group LLP"
Chartered Accountants

CANADA ENERGY PARTNERS INC.

BALANCE SHEETS

AS AT APRIL 30, 2011 AND 2010

(Expressed in Canadian Dollars)

	<u>2011</u>	<u>2010</u>
	\$	\$
ASSETS		
CURRENT ASSETS		
Cash	2,308,180	6,386,141
Accounts receivable, prepaids, and deposits	<u>77,184</u>	<u>99,435</u>
	2,385,364	6,485,576
INVESTMENT (Note 6)	1,287,186	955,479
OIL AND GAS INTERESTS (Note 3)	<u>88,257,438</u>	<u>85,533,420</u>
	<u>91,929,988</u>	<u>92,974,475</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	116,673	141,255
Bank loan (Note 6)	<u>1,376,126</u>	<u>1,376,126</u>
	1,492,799	1,517,381
ASSET RETIREMENT OBLIGATION (Note 4)	297,159	257,468
FUTURE INCOME TAX LIABILITY (Note 8)	<u>10,947,818</u>	<u>11,906,968</u>
	<u>12,737,776</u>	<u>13,681,817</u>
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 5)	79,713,638	79,997,590
CONTRIBUTED SURPLUS (Note 5)	8,446,010	5,422,838
DEFICIT	<u>(8,967,436)</u>	<u>(6,127,770)</u>
	<u>79,192,212</u>	<u>79,292,658</u>
	<u>91,929,988</u>	<u>92,974,475</u>

NATURE OF OPERATIONS (Note 1)

COMMITMENTS (Note 3 and Note 12)

APPROVED BY THE DIRECTORS

“John Proust”, Director “Ben Jones”, Director

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

CANADA ENERGY PARTNERS INC.
STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
(Expressed in Canadian Dollars)

	<u>2011</u>	<u>2010</u>
	\$	\$
GENERAL AND ADMINISTRATIVE EXPENSES		
Administrative and management services (Note 7)	498,024	461,316
Accretion and depreciation	20,597	15,289
Advertising	22,434	12,342
Audit and accounting (Note 7)	70,948	85,229
Corporate development	4,000	88,235
Filing and regulatory	53,463	35,173
General exploration	105,975	99,408
Legal	69,329	67,039
Office and miscellaneous	157,262	144,783
Professional fees	75,752	74,678
Rent	81,072	101,665
Stock-based compensation (Note 5)	2,904,328	267,800
Travel	96,133	45,528
	<u>4,159,317</u>	<u>1,498,485</u>
LOSS BEFORE OTHER ITEMS	<u>(4,159,317)</u>	<u>(1,498,485)</u>
OTHER ITEMS		
Fair value adjustment to investment	331,707	54,794
Foreign exchange	(23)	(1,092)
Interest	28,817	(17,908)
	<u>360,501</u>	<u>35,794</u>
LOSS BEFORE INCOME TAXES	(3,798,816)	(1,462,691)
FUTURE INCOME TAXES RECOVERED (Note 8)	<u>959,150</u>	<u>759,174</u>
NET LOSS AND COMPREHENSIVE LOSS	<u>(2,839,666)</u>	<u>(703,517)</u>
DEFICIT - BEGINNING OF THE YEAR	<u>(6,127,770)</u>	<u>(5,424,253)</u>
DEFICIT - END OF THE YEAR	<u>(8,967,436)</u>	<u>(6,127,770)</u>
LOSS PER SHARE - BASIC AND DILUTED	<u>(0.03)</u>	<u>(0.01)</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC AND DILUTED	<u>82,326,057</u>	<u>82,289,728</u>

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

CANADA ENERGY PARTNERS INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
(Expressed in Canadian Dollars)

	<u>2011</u>	<u>2010</u>
	\$	\$
CASH PROVIDED FROM (USED FOR)		
OPERATING ACTIVITIES		
Net loss for the year	(2,839,666)	(703,517)
Items not affecting cash:		
Stock-based compensation	2,904,328	267,800
Accretion and depreciation	20,597	15,289
Fair value adjustment to investment	(331,707)	(54,794)
Future income taxes recovery	(959,150)	(759,174)
Changes in non-cash working capital balances:		
Accounts receivable, prepaids and deposits	(4,132)	235,363
Accounts payable and accrued liabilities	13,244	(101,195)
	<u>(1,196,486)</u>	<u>(1,100,228)</u>
FINANCING ACTIVITIES		
Issuer bid share repurchase	(165,108)	(370,800)
Loan principal repayment	-	(574)
	<u>(165,108)</u>	<u>(371,374)</u>
INVESTING ACTIVITIES		
Principal payment received	-	32,203
Oil and gas interests	(2,716,367)	(2,455,053)
	<u>(2,716,367)</u>	<u>(2,422,850)</u>
DECREASE IN CASH DURING THE YEAR	(4,077,961)	(3,894,452)
CASH - BEGINNING OF THE YEAR	<u>6,386,141</u>	<u>10,280,593</u>
CASH - END OF THE YEAR	<u><u>2,308,180</u></u>	<u><u>6,386,141</u></u>

Supplemental disclosure with respect to cash flows (Note 9)

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

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
(Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS

Canada Energy Partners Inc. (“the Company”) is an independent natural gas exploration and development company primarily focused on unconventional resource opportunities in northeast British Columbia. The Company was formed on May 18, 2006, by Certificate of Incorporation and Notice of Articles pursuant to the provisions of the Business Corporations Act (British Columbia).

The amounts shown as oil and gas interests represent exploration and development expenditures incurred to date and acquisition costs for the working interests in the Company’s prospects and do not necessarily represent present or future values. The underlying value of oil and gas interests is entirely dependent on the existence of economically recoverable reserves, securing and maintaining title and beneficial interest in the Company’s prospects, the ability of the Company to obtain the necessary financing to complete its share of the development, and future profitable production.

The financial statements do not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue operations.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). These financial statements have been prepared on the basis of accounting principles applicable to a “going concern”, which assumes that the Company will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. As with most oil and gas exploration companies, the Company raises financing for its activities using a variety of sources. Based on its current plans, budgeted capital expenditures, and cash requirements, the Company has sufficient cash to finance its current plans for at least 12 months from the date of approval of the financial statements. However, the Company recognizes that exploration expenditures may change with ongoing results and, as a result, it may be required to obtain additional financing. While the company has been successful at securing financing in the past, there can be no assurance that it will be able to do so in the future. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue business.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
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2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of Estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period.

The amounts recorded for the future asset retirement obligation costs, amortization, and accretion are based on estimates of cash flows required to settle the asset retirement obligation, inflation factors, credit adjusted discount rates, and other relevant assumptions. The fair value of the Company's long-term investments is determined based on quoted prices in markets that are not active. The provision for income taxes is based on judgments in applying income tax law and estimates on the timing, likelihood, and reversal of temporary differences between the accounting and tax bases of assets and liabilities. The amount recorded for stock-based compensation expense is based on estimates of risk-free interest rate, expected life of the options, annualized volatility and expected dividend rate.

These estimates are subject to measurement uncertainty, and the impact of changes in such estimates on the financial statements of future period could be material.

Cash

For purposes of reporting cash flows, the Company considers cash and cash equivalents to include amounts held in banks and highly liquid investments with remaining maturities at point of purchase of 90 days or less and Guaranteed Investment Certificates ("GICs") or Term Deposits which are cashable after 30 days. The Company places its cash and cash investments with institutions of high credit worthiness.

Oil and Gas Interests

The Company follows the full cost method of accounting for oil and gas operations. All costs related to the acquisition of, exploration for, and development of oil and gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges of non-producing property, cost of drilling both productive and non-productive wells, oil and gas production equipment, and overhead charges directly related to exploration and development activities.

The recoverability of the amounts shown for oil and gas interests is dependent upon the existence of economically recoverable oil and gas reserves, maintaining title and beneficial interest, the ability of the Company to obtain necessary financing to bring the reserves into production, and upon future profitable production or proceeds from the disposition. The amounts shown as oil and gas interest represent net costs to date and do not necessarily represent present or future values.

Oil and gas interests' acquisition costs include cash costs and the fair value of common shares, based on the trading price of the common shares issued for property interests, pursuant to the terms of the related property acquisition agreements.

For certain acquisitions of oil and gas interests, the Company records a future income tax liability and a corresponding increase to the related asset carrying amount. Where an oil and gas interest is acquired and the tax basis of the interest is less than its cost, the cost of future income taxes recognized at the time of acquisition is added to the cost of the oil and gas interest.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
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2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment

The Company regularly reviews the carrying value of its oil and gas interests, to determine that the costs are recoverable and do not exceed the fair value of the interests. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves and the costs of unproved interests exceed the carrying value of the oil and gas interests.

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 and probable reserves and the costs of unproved interests. The cash flows are estimated using the future production prices and costs and are discounted using the risk-free interest rate.

Joint Operations

Substantially all of the oil and gas activities of the Company are conducted jointly with others, and these financial statements reflect only the Company's proportionate interest in such activities.

Depletion and Amortization

Capitalized costs of proven reserves and equipment are depleted using a unit-of-production method based upon estimated proved reserves (energy content) net of royalties. Oil and natural gas reserves and production are converted into equivalent units based upon estimated relative energy content of six thousand cubic feet of natural gas to one barrel of oil. The costs of undeveloped properties are excluded from the costs subject to depletion and depreciation until it is determined whether proved reserves are attributable to the properties or impairment occurs.

Asset Retirement Obligations

Asset retirement obligations are recognized when a legal or constructive obligation arises. The fair value of the liability for the Company's asset retirement obligations is recorded in the period it is incurred with a corresponding increase in the carrying value of the related long-lived assets. The fair value is estimated using the present value of the estimated future cash outflows to reclaim and abandon wells and facilities, using the Company's credit-adjusted risk-free interest rate. The capitalized carrying amount of the long-lived asset is depleted on a straight-line basis. The liability is subsequently adjusted due to the passage of time and is recorded as an accretion expense. The liability is also adjusted for revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Actual asset retirement obligations paid are deducted from the liability in the year incurred. Upon settlement of the liability, the Company may incur a gain or loss.

Comprehensive Income

Comprehensive income is the change in the Company's net assets that results from transactions, events, and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in net earnings such as unrealized gains or losses on available-for-sale investments. Other comprehensive income includes the holdings gains and losses from available-for-sale securities, which are not included in net income (loss) until realized.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
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2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign Currency Transactions

Monetary assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at the balance sheet date. Non-monetary assets and liabilities are translated into Canadian dollars at historical rates. Revenues and expenses are translated into Canadian dollars at the exchange rate in effect on the transaction date. Foreign exchange gains and losses are included in earnings.

Revenue Recognition

Revenue from the sale of natural gas, net of transportation costs, is recognized based on the volumes delivered to customers and collectability is reasonably assured. The production costs are recognized in the same period which the related revenue is earned and recorded and the risks are transferred to the buyer. Revenue recognized during the development stage is presented as a reduction of related deferred development costs.

Income Taxes

Income taxes are recorded on a tax allocation basis. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for the estimated income tax consequences attributable to differences between the financial statements carrying amounts of assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are recognized using substantively enacted income tax rates. The effect of changes in effective income tax rates is recognized in income in the period in which the change occurs. Future income tax assets are recognized with respect to deductible temporary differences and loss carry forwards only to the extent their realization is considered more likely than not.

Financial Instruments

CICA Section 3855 requires that all financial assets initially measured at fair value, except those classified as held to maturity, and loans and receivables, must be subsequently measured at fair value. All financial liabilities must be subsequently measured at fair value when they are classified as held-for trading; otherwise, they are measured at amortized cost. Financial assets classified as available-for-sale are reported at fair market value (or marked to market) based on quoted market prices with unrealized gains or losses excluded from earnings and reported as other comprehensive income or loss. When a decline in the fair value of a financial asset is determined to be other-than-temporary, the cumulative loss is recognized in net income. Those instruments classified as held-for-trading, have gains or losses included in earnings in the period in which they arise.

The Company does not use derivative instruments or hedges to manage risks. Transaction costs related to all financial instruments will be expensed in the period incurred. The Company has elected to use settlement date accounting on any regular way contracts.

Cash has been designated as "*Held-for-trading*". Accounts receivable, prepaids and deposits are designated as "*Loans and Receivables*". Investments in asset-backed commercial paper and bank loan are discussed in Note 6. Accounts payable and accrued liabilities, are designated as "*Other Financial Liabilities*".

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
(Expressed in Canadian Dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Stock-Based Compensation

The Company recognizes an expense arising from stock options granted using the fair value method. The fair value of option grants is generally established at the date of grant using the Black-Scholes option pricing model, and the expense is recognized over the period earned, with offsetting amounts recorded as contributed surplus. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital. In the event that vested stock options expire without being exercised, previously recorded compensation costs associated with such stock options are not reversed.

Loss Per Share

Loss per share is calculated based on the weighted average number of common shares outstanding during the period. In periods when a loss is incurred, the effect of potential issuances of shares under options and warrants would be anti-dilutive, and, therefore, basic and diluted losses per share are the same. Information regarding securities that could potentially dilute basic earnings per share in the future is presented in Note 5.

3. OIL AND GAS INTERESTS

	Peace River Project \$	Monias Prospect \$	Moberly Prospect \$	Total \$
For the year ended April 30, 2011				
Acquisition costs				
Leases acquisitions and rental costs	1,962,744	27,732	10,347	2,000,823
Balance, beginning of year	56,593,657	1,849,696	693,274	59,136,627
Balance, end of the year	58,556,401	1,877,428	703,621	61,137,450
Exploration costs				
Drilling and completion	422,418	300	-	422,718
Geological and consulting	44,927	40,052	-	84,979
Reports and other	42,021	6,136	1,836	49,993
	509,366	46,488	1,836	557,690
Balance, beginning of year	9,620,967	4,536,513	54,263	14,211,743
Balance, end of year	10,130,333	4,583,001	56,099	14,769,433
Development costs				
Drilling and completion	142,184	-	-	142,184
Gas plant	24,658	-	-	24,658
Less: net revenue received in development stage	(1,337)	-	-	(1,337)
	165,505	-	-	165,505
Balance, beginning of year	12,185,050	-	-	12,185,050
Balance, end of year	12,350,555	-	-	12,350,555
Total deferred oil and gas interests	81,037,289	6,460,429	759,720	88,257,438

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED APRIL 30, 2011 AND 2010
(Expressed in Canadian Dollars)

3. OIL AND GAS INTERESTS (continued)

For the year ended April 30, 2010	Peace River Project \$	Monias Prospect \$	Moberly Prospect \$	Total \$
Acquisition costs				
Leases acquisitions and rental costs	1,428,365	22,648	-	1,451,013
Balance, beginning of year	55,165,292	1,827,048	693,274	57,685,614
Balance, end of the year	56,593,657	1,849,696	693,274	59,136,627
Exploration costs				
Asset retirement costs	14,590	-	-	14,590
Drilling and completion	15,290	21,004	-	36,294
Geological and consulting	55,780	64,557	1,543	121,880
Reports and other	35,605	7,314	439	43,358
	121,265	92,875	1,982	216,122
Balance, beginning of year	9,499,702	4,443,638	52,281	13,995,621
Balance, end of year	9,620,967	4,536,513	54,263	14,211,743
Development costs				
Drilling and completion	951,376	-	-	951,376
Gas plant	353,926	-	-	353,926
Less: net revenue received in development stage	(182,795)	-	-	(182,795)
	1,122,507	-	-	1,122,507
Balance, beginning of year	11,062,543	-	-	11,062,543
Balance, end of year	12,185,050	-	-	12,185,050
Total deferred oil and gas interests	78,399,674	6,386,209	747,537	85,533,420

Included in acquisition costs is \$107,000 security bond held by the Company in favour of the regulatory agency to ensure that the Company can complete the reclamation, including shut-down, closure, and post-closure. The security will be released back to the Company once the reclamation has been completed according to the plan and the site is returned to an acceptable state.

During the year ended April 30, 2010 the Company purchased a 1.5% overriding royalty interest on certain portions of the Company's Peace River Project from two arm's-length parties in consideration for the issuance of 800,000 common shares of the Company at an estimated fair value of \$0.77 per share for total consideration of \$616,000.

Peace River Project, British Columbia

The Company has working interests in the oil and gas leases located in Peace River area near Hudson's Hope in northeast British Columbia. Peace River Project consists of shallow rights (from the surface to the base of Gething formation) and deep rights (from the base of Gething to the basement).

Shallow rights

Shallow rights include Peace River coalbed methane "CBM" Project and Moosebar Shale rights. The Company owns 50% working interest and an additional 3.71% after payout working interest in the Peace River CBM Project. The operator of the Peace River CBM Project is GeoMet, Inc. The Company's interest in the Peace River CBM Project is subject to Crown royalties and for certain acreage to geological overriding royalties of up to 0.05%.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
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3. OIL AND GAS INTERESTS (continued)

In November 2008 Canada Energy entered into a farm-in agreement (the "Agreement") with GeoMet, Inc. for Moosebar Shale shallow rights on its Peace River Project. The Company drilled an initial Moosebar horizontal test well and has earned an 87.5% interest in 2 sections (approximately 2 square miles), subject to final completion or plug and abandonment. The Company has relinquished further drilling rights under the Agreement. The Company's interest in the Moosebar Shale is subject to Crown royalties and for certain acreage to geological overriding royalties of up to 0.05%.

Deep rights

The Company owns 50% working interest, subject to a joint venture agreement with Crew Energy Inc. ("Crew"). According to the joint venture agreement, Crew operates the project and has earned a 50% working interest in the subject lands upon paying 100% of the costs of the exploration program. The Company's interest in the deep rights of the Peace River Project will be subject to Crown royalties, geological overriding royalties of up to 0.85% and back-in interest of 6.6% after project payout plus \$2,000,000 on approximately 3,500 acres. During fiscal 2011, the Company and Crew acquired an additional 14 sections of deep rights in Peace River.

Monias Prospect, British Columbia

The Company owns a 100% working interest in the shallow rights in 7 sections, a 70% working interest in the shallow rights on 2 sections, and a 35% working interest in 1 section. With regard to the Deep Rights, the Company owns 100% working interest in 3 sections, a 40% working interest in 4 sections, and a 35% in one section.

Deep rights on 4 sections of Monias Prospect were subject to a joint venture agreement with West Energy Ltd. ("West"), which was later acquired by Daylight Energy Ltd. ("Daylight"). During the year ended April 30, 2011, the Company and Daylight mutually settled the legal dispute over the Seismic Option Agreement on the Company's Monias Prospect. Under the terms of the settlement, Daylight is deemed to have earned a 60% working interest in the four sections and the 13-30-81-21 wellbore with the Company retaining the other 40% interest. Daylight will have no further earning rights in the Monias Prospect. The Company will retain a 100% interest in three remaining sections in the Monias Prospect and the Company preserves a 35% interest in the eighth section at Monias Prospect, in a license grouping arrangement with Terra Energy.

The Company's interest in the deep rights of the Monias Prospect will be subject to Crown royalties, geological overriding royalties of up to 1% and back-in interest of 12.5% after project payout plus \$2,000,000. The Company's interest in the shallow rights of the Monias Prospect will be subject to Crown royalties, one section is subject to a 10% royalty on gas, a 5% - 10% royalty on oil production and two sections are subject to a back-in interest of 4.375% after project payout plus \$2,000,000.

Moberly Prospect, British Columbia

The Company owns 100% working interest subject to a joint venture agreement with Crew. According to the joint venture agreement, Crew operates the prospect and will earn a 50% working interest in two sections upon completion of the initial test well. The initial program consisted of the drilling of one exploratory well (drilled).

The Company's interest in the Moberly Prospect will be subject to Crown royalties, geological overriding royalties of 0.93% and back-in interest of 10.5% after project payout plus \$1,000,000.

CANADA ENERGY PARTNERS INC.
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4. ASSET RETIREMENT OBLIGATION

Total future asset retirement obligations were estimated by management based on the Company's working interest in its wells and facilities, estimated costs to remediate, reclaim, and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company estimated the total undiscounted amount of cash flows required to settle the asset retirement obligation to be approximately \$698,629 which will be incurred from 2019 to 2033. To calculate the net present value of its asset retirement obligations, the Company used a credit-adjusted risk free rate of 8% and an inflation rate of 2%. The credit-adjusted risk free rate of 8% was based on the cost of borrowing for similar companies in the industry. The following table summarizes the Company's asset retirement obligations:

	2011	2010
	\$	\$
Balance, beginning of period	257,468	227,588
Liabilities incurred	19,094	18,076
Accretion expense	20,597	11,804
Balance, end of period	297,159	257,468

The present value of the reclamation liability may be subject to change in future periods. Such changes will be recorded in the accounts of the Company as they occur.

5. SHARE CAPITAL AND CONTRIBUTED SURPLUS

	Number of shares	Amount \$	Contributed Surplus \$
Authorized:			
Unlimited common shares without par value			
Unlimited preferred shares without par value			
Issued common shares			
As at April 30, 2009	82,356,284	79,974,557	4,932,872
Stock-based compensation	-	-	267,800
Shares issued for royalty interest acquisition	800,000	616,000	-
Issuer bid share repurchases	(609,000)	(592,967)	222,166
As at April 30, 2010	82,547,284	79,997,590	5,422,838
Issuer bid share repurchases	(291,500)	(283,952)	118,844
Stock-based compensation	-	-	2,904,328
As at April 30, 2011	82,255,784	79,713,638	8,446,010

During the year ended April 30, 2011, the Company:

- a) received approval from the TSX Venture Exchange (the "Exchange") to commence a normal course issuer bid (the "Bid") to purchase up to 4,121,664 of its common shares ("Shares"), representing 5% of the Company's 82,433,284 issued and outstanding Shares, as at May 28, 2010. Under the Exchange's policies, the Bid commenced on June 4, 2010, and will end on the earlier of June 3, 2011, or at such time as the Bid has been completed or the Bid is terminated at the Company's discretion. The price paid by the Company for any acquired shares will be the market price at the time of acquisition. All shares purchased under the Bid will be cancelled. Funding for the "Bid" will be from the Company's working capital.

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5. SHARE CAPITAL AND CONTRIBUTED SURPLUS (continued)

- b) purchased 291,500 common shares for \$165,108 under a normal course issuer bid. The price paid by the Company for the acquired shares was the market price at the time of acquisitions. All shares purchased under the Bid are cancelled. The difference between the average equity cost of the Company's shares on the repurchase date and the repurchase price was recorded as an increase to contributed surplus.

During the year ended April 30, 2010, the Company:

- c) purchased 609,000 common shares for \$370,800 under a normal course issuer bid (the "Bid"). The price paid by the Company for the acquired shares was the market price at the time of acquisitions. All shares purchased under the Bid are cancelled. The difference between the average equity cost of the Company's shares on the repurchase date and the repurchase price was recorded as an increase to contributed surplus;
- d) purchased a 1.5% overriding royalty interest on certain portions of the Company's land base in northeast British Columbia from two arm's-length parties in consideration for the issuance of 800,000 common shares of the Company at an estimated fair value of \$0.77 per share.

Stock options and stock-based compensation

The Company grants stock options in accordance with the policies of the Exchange. Under the plan up to 10% of outstanding Common Shares are reserved for the issuance of stock options to directors, officers, employees and consultants. The terms of the option, including the vesting terms and the option price are fixed by the directors at the time of grant subject to the price not being less than the market price of the Company's stock on the date of grant. The stock options granted are exercisable for a period of five years.

A summary of the status of the Company's stock options as at April 30, 2011 and 2010, and changes during the period then ended are presented below:

	Number of Options	Weighted Average Exercise Price, \$
Balance, outstanding – April 30, 2009	5,600,000	1.23
Granted	650,000	0.51
Expired	(912,500)	1.61
Exercised	-	-
Balance, outstanding – April 30, 2010	5,337,500	1.08
Granted	3,230,000	0.63
Expired	(900,000)	0.70
Exercised	-	-
Balance outstanding – April 30, 2011	7,667,500	0.63

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5. SHARE CAPITAL AND CONTRIBUTED SURPLUS (continued)

During the year ended April 30, 2011, the Company granted incentive stock options for the purchase of up to 3,230,000 common shares of the Company at a price of \$0.63 per share for a five year period to certain directors, employees and consultants of the Company. During the year ended April 30, 2011, the Company modified 4,437,500 previously granted stock options which had exercise prices ranging from \$1.00 to \$1.66 per share and were set to expire between fiscal year 2011 and 2014. The modified stock options have an exercise price of \$0.63 per share for a period of five years. The stock-based compensation of \$2,904,328 was charged to operations and credited to shareholder's equity to reflect the fair value of stock options granted, modified and vested during the period.

During the year ended April 30, 2010 the Company granted 650,000 stock options. The stock-based compensation of \$267,800 (\$0.41 per share) was charged to operations and credited to shareholder's equity to reflect the fair value of stock options granted and vested during the year.

The weighted average fair value of options granted during 2011 was \$0.49 (2010 - \$0.41). The weighted average fair value of options modified during the year was \$0.30. The fair value of stock options granted is estimated on the dates of grants using the Black-Scholes option pricing model with the following assumptions used for the grants made during the period:

	2011	2010
Risk-free interest rate	1.66%	2.01%
Expected life	5 years	5 years
Annualized volatility	105%	114%
Dividend rate	0.00%	0.00%

Option pricing models require the use of estimates and assumptions including the expected volatility. Changes in the underlying assumptions can materially affect the fair value estimates.

Stock options outstanding and exercisable as at April 30, 2011, are as follows:

Number of Options Outstanding and Exercisable	Weighted Average Exercise Price, \$	Expiry Date
7,667,500	0.63	October 8, 2015

Warrants

There are no warrants outstanding as at April 30, 2011 and 2010. There were no warrants exercised or expired during the period ended April 30, 2011 and 2010.

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6. INVESTMENT AND BANK LOAN

At April 30, 2010, long-term investments included Master Asset Vehicle II notes received in exchange for Canadian third-party asset backed commercial paper (“ABCP”) held by the Company. When the ABCP matured but was not redeemed in 2007, it became the subject of a restructuring process that replaced the ABCP with long-term asset backed securities. These investments were designated as held-for-trading and are accounted for at their fair value.

Notes	April 30, 2011		April 30, 2010		Expected maturity ⁽¹⁾
	Face value \$	Fair value \$	Face Value, \$	Fair Value \$	
MAV II Class A-1	1,437,261	1,149,809	1,437,261	1,015,005	July 15, 2056
MAV II Class C	44,594	12,932	44,594	4,459	July 15, 2056
MAV II Class 13 (Ineligible Asset Tracking Notes)	226,263	124,445	226,263	22,626	March 20, 2014
Interest received				(86,611)	
Total	1,708,118	1,287,186	1,708,118	955,479	

⁽¹⁾ Maturity date reflects legal maturity date.

To date, the Company received an interest payment of \$98,378 on the notes and a payment of \$4,619 as partial redemption of the MAV II Class A-1 tracking notes.

At April 30, 2011, the notes have been valued based on bid prices for these assets received from dealers and brokers active in the notes market. The Company receives the bid prices on a regular and recurring basis from a number of sources. The bid prices received for the MAV II Class A-1 notes have ranged from 80% to 81% of face value. The Company believes that 80% is the best estimate of fair value for these notes. The bid prices received for the MAV II Class C notes have ranged from 29% to 31% of face value. The Company believes that 29% is the best estimate of fair value for these notes. The bid prices received for the MAV II Class 13 notes have ranged from 55% to 60% of face value. The Company believes that 55% is the best estimate of fair value for these notes.

The fair value of the Company’s investment in the ABCP is classified as Level 2 within the fair value hierarchy established by CICA section 3862.

The Company secured a \$1,376,126 demand non-revolving bridge loan from its bank pending any possible long-term solution to the current liquidity issues affecting the Company’s investment in ABCP. The bridge loan is secured by the Company’s investment in ABCP, cash, credit balances and deposit instruments. Interest on direct advances is paid at the Bank’s prime rate. The Company paid \$42,217 (2010 - \$24,512) in interest and stamping fees during the year ended April 30, 2011.

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7. RELATED PARTY TRANSACTIONS

- a) During the year ended April 30, 2011, \$288,700 (2010 – \$267,900) was paid to a private company controlled by a director of the Company for management, administrative and accounting services rendered.
- b) During the year ended April 30, 2011, \$232,126 (2010 – \$193,016) was paid to a private company controlled by the CEO and the president of the company for management and administrative services rendered.
- a) As at April 30, 2011, accounts receivable, prepaids, and deposits included \$nil (2010 – \$13,516) of advances made to a private company controlled by a Director of the Company.

The related party transactions incurred during the period were in the normal course of operations and were measured at the exchange value, which represented the amount of consideration established and agreed by the related parties.

8. INCOME TAXES

A reconciliation of income taxes at Canadian statutory rates with reported taxes is as follows:

	2011	2010
	<u>\$</u>	<u>\$</u>
Loss before income taxes for the period	<u>(3,798,816)</u>	<u>(1,462,691)</u>
Expected income tax recovery	1,057,337	431,494
Item not deductible for income tax purposes	(543,947)	(71,458)
Tax rate reduction	394,221	395,136
Previous unrecognized benefits	<u>51,539</u>	<u>4,002</u>
Future income tax recovery	<u>959,150</u>	<u>759,174</u>

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

	2011	2010
	<u>\$</u>	<u>\$</u>
Future income tax assets		
Financing costs	192,233	395,053
Investment	53,649	-
Closure cost obligations	74,290	66,942
Non-capital losses	<u>1,900,597</u>	<u>1,501,841</u>
	<u>2,220,769</u>	<u>1,963,836</u>
Future income tax liabilities		
Oil and gas interests	<u>(13,168,587)</u>	<u>(13,870,804)</u>
	<u>(10,947,818)</u>	<u>(11,906,968)</u>

The Company has Canadian non-capital loss carry forwards of approximately \$7,600,000, which expire in 2027 through to 2031, and approximately \$36,000,000 in certain resource related deductions which may be available to offset future taxable income.

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9. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

During the years ended April 30, 2011 and 2010, the Company had the following significant non-cash transactions:

- a) allocated \$118,844 (April 30, 2010 - \$222,166) to contributed surplus for the shares repurchased for cancellation under the normal course issuer bid;
- b) included in investing activities \$35,366 (April 30, 2010 - \$73,192) of accounts payable related to the oil and gas interest expenditures;
- c) included in investing activities \$nil (April 30, 2010 - \$26,383) of accounts receivable related to revenue from the sale of petroleum and natural gas;
- d) during the year ended April 30, 2010, the Company issued 800,000 shares with a fair value of \$616,000 to acquire an aggregate 1.5% overriding royalty interest;
- e) included in investing activities \$nil (April 30, 2010 - \$723,776) related to future income tax liability arising from current year acquisitions.

10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Canadian GAAP requires disclosure about fair market value measurements for financial instruments and liquidity risk using a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. The three-level hierarchy is as follows:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 - Inputs that are not based on observable market data.

The Company estimates the fair value of its financial instruments based on current interest rates, market value and pricing of financial instruments with comparable terms. Unless otherwise indicated, the carrying value of these financial instruments approximates their fair market value because of the near maturity of those instruments.

As at April 30, 2011 and April 30, 2010, the carrying amount of current financial assets and liabilities approximated the fair value because of the near maturity of those instruments and the carrying value of the demand non-revolving bridge loan (Note 6) is considered to approximate fair value since it bears interest at current rates for similar types of borrowing arrangements.

Financial instruments measured at fair value on the balance sheet are summarized in levels of fair value hierarchy as follows:

	Level 1	Level 2	Level 3
Assets			
Cash	\$ 2,308,180	\$ -	\$ -
Long-term investment	\$ -	\$ 1,287,186	\$ -
Bank loan	\$ -	\$ (1,376,126)	\$ -

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10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

Risk Factors

The Company may be exposed to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives. The Company manages risks to minimize potential losses. The main objective of the Company's risk management process is to ensure that the risks are properly identified and that the capital base is adequate in relation to those risks. The principal risks to which the Company is exposed are described below.

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of cash and accounts receivable. Management's assessment of the Company's risk for cash is low as it is attributable to cash held in major banks. The Company limits its exposure to credit loss by placing its cash with major financial institutions and invests only in short-term obligations.

A portion of the Company's accounts receivable, prepaids and deposits consists of harmonized sale tax (HST) due from the Federal Government of Canada. The remaining part of Company's accounts receivable, prepaids, and deposits consists of receivables from customers in the energy industry and other miscellaneous receivables and prepaids and are subject to normal industry credit risk. To date the Company has not experienced any collection issues with its oil and natural gas partners.

Credit risk with respect to investments in Canadian Asset-Backed Commercial Paper ("ABCP") is discussed in Note 6.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to evaluate current and expected liquidity requirements under both normal and stressed conditions to ensure that it maintain sufficient reserves of cash and cash equivalents or have an available credit facility to meet its liquidity requirements in the short and long term. As the industry in which the Company operates is very capital intensive, the majority of the Company's spending is related to its capital programs. The Company prepares annual budgets, which are regularly monitored and updated as considered necessary.

The Company's short-term financial liabilities are comprised of accounts payable and accrued liabilities which have expected maturities of less than one year and the bank loan which is secured by the Company's investment in ABCP, resulting in their current classification on the balance sheet.

As at April 30, 2011, the Company had a cash balance of \$2,308,180 (2010 - \$6,386,141) to settle current liabilities of \$1,492,799 (2010 - \$1,517,381). The Company intends to settle these with funds from its positive working capital position. The Company's \$1,376,126 bank loan, which matures on May 13, 2011, is expected to be extended at its maturity date.

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10. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risks: interest rate risk, foreign exchange risk and price risk.

a) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows from a financial instrument will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that the cash maintained at the financial institutions is subject to a floating rate of interest. If the interest rate on the Company's cash held at the financial institutions decreased by 1%, the Company's net income would have decreased by approximately \$23,091.

The interest rate risks on the Company's accounts payable and accrued liabilities are not considered significant.

The Company is exposed to interest rate risk to the extent that the Company's loan is subject to a floating rate of interest. If the interest rate on the Company's floating rate bank loan increased by 1%, the Company's net income would have decreased by approximately \$13,761.

b) Price risk

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movement in the level of the stock market.

Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatility. The supply and demand for natural gas, the level of interest rates, the rate of inflation, investment decisions by large holders of commodities can all cause significant fluctuations in commodity prices. The Company closely monitors commodity prices or resources, individual equity movements, and the stock market to determine the appropriate course of actions to be taken by the Company.

c) Foreign exchange risk

The Company incurs operating expenses and capital expenditures mostly in Canadian dollars. The Company's exposure to assets and liabilities denominated in foreign currencies is nominal. Accordingly, the Company does not have a significant exposure to losses arising from fluctuations in exchange rates.

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11. CAPITAL DISCLOSURE

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the exploration and development of its properties and to maintain a flexible capital structure. The Capital structure of the Company consists of shareholders' equity and working capital, including bank debt. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

In order to carry out the planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed and if available. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the year.

12. COMMITMENTS

- a) The Company has committed to rent office space in the amount of \$73,452 during fiscal 2012, and \$17,284 during fiscal 2013;
- b) Asset retirement obligations (Note 4).

13. SUBSEQUENT EVENT

As discussed in Note 5. a), the Company had approval for a normal course issuer bid which commenced on June 4, 2010, and ended on June 3, 2011. The bid terminated without the repurchase of further shares after April 30, 2011.