

Consolidated Financial Statements of

BLACKHAWK RESOURCE CORP.

For the three and six months ended December 31, 2010

BLACKHAWK RESOURCE CORP.

February 28, 2011

Management's Report to the Shareholders

Management is responsible for the reliability and integrity of these financial statements. The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgment.

The accompanying consolidated financial statements have been prepared using policies and procedures established by management and reflect fairly the Corporation's financial position, results of operations and changes in financial position, within reasonable limits of materiality and within the framework of the accounting policies outlined in the notes to the financial statements. Management has established and maintains a system of internal controls which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and financial information is reliable and accurate.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board is assisted in exercising its responsibilities through the Audit Committee of the Board, which is composed of a majority of non-management directors. The Audit Committee meets periodically with management and the auditors to satisfy itself that management's responsibilities are properly discharged, to review the consolidated financial statements and to recommend approval of the consolidated financial statements to the Board.

Signed "David Antony"
David Antony, CEO

Signed "Charidy Lazorko"
Charidy Lazorko, CFO

BLACKHAWK RESOURCE CORP.

Consolidated Balance Sheets

	December 31, 2010 (Unaudited)	June 30, 2010 (Audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 26,855	\$ 305,959
Accounts receivable (note 13(a))	596,512	528,832
Prepaid expenses and deposits	24,442	195,683
	647,809	1,030,474
Assets held for sale (note 4)	5,189	5,108
Petroleum and natural gas properties (note 6)	6,781,592	5,103,516
	\$ 7,434,590	\$ 6,139,098
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 680,762	\$ 1,451,925
Bank debt (note 15)	2,550,000	-
Asset retirement obligation (note 8)	415,551	399,568
Shareholder loans (note 7)	-	1,000,000
	3,646,313	2,851,493
Shareholders' equity:		
Share capital (note 9)	6,124,352	4,516,166
Contributed surplus (note 10)	439,174	427,706
Performance rights (note 9)	-	853,937
Deficit	(2,775,249)	(2,510,204)
	3,788,277	3,287,605
Future operations (note 1)		
Commitments (note 14)		
	\$ 7,434,590	\$ 6,139,098

See accompanying notes to consolidated financial statements.

On behalf of the Board:

signed "*Raymond Antony*" _____ Director

signed "*David Antony*" _____ Director

BLACKHAWK RESOURCE CORP.

Consolidated Statements of Operations, Comprehensive Loss and Deficit

For the three and six month period ended December 31, 2010 and the three and seven month period ended March 31, 2010

(Unaudited)

	Three Months Ended		Six and Seven Months Ended	
	December 31, 2010	March 31, 2010	December 31, 2010	March 31, 2010
Revenue				
Oil and gas revenue	\$ 910,875	\$ 82,751	\$ 1,821,806	\$ 262,451
Royalties	(23,020)	(2,353)	(169,663)	(13,736)
Interest revenue	—	6,009	331	6,071
	887,855	86,407	1,652,474	254,786
Expenses				
Depletion, depreciation and accretion	403,002	102,081	667,619	199,750
Field operating costs	358,795	41,337	502,374	147,671
General and administrative (note 12)	309,897	164,159	433,191	323,026
Interest and bank charges	24,316	85	50,889	1,224
Professional fees	197,509	8,254	248,370	61,791
Stock based compensation (note 9(c))	—	46,426	11,468	198,773
	1,293,519	362,342	1,913,911	923,235
Loss from operations	(405,664)	(275,935)	(261,437)	(677,449)
Loss from discontinued operations (note 4)	(59)	(477,099)	(3,608)	(498,643)
Net loss, being comprehensive loss	(405,723)	(753,034)	(265,045)	(1,176,092)
Deficit, beginning of period	(2,369,526)	(2,244,258)	(2,510,204)	(1,821,200)
Deficit, end of period	\$ (2,775,249)	\$ (2,997,292)	\$ (2,775,249)	\$ (2,997,292)
Basic and diluted net loss per share (note 11):				
Loss from continuing operations	\$ (0.01)	\$ (0.01)	\$ (0.00)	\$ (0.02)
Loss from discontinued operations	\$ (0.00)	\$ (0.01)	\$ (0.00)	\$ (0.01)
Net loss	\$ (0.01)	\$ (0.02)	\$ (0.00)	\$ (0.03)

See accompanying notes to consolidated financial statements.

BLACKHAWK RESOURCE CORP.

Consolidated Statements of Cash Flows

For the three and six month period ended December 31, 2010 and the three and seven month period ended March 31, 2010

(Unaudited)

	Three Months Ended		Six and Seven Months Ended	
	December 31, 2010	March 31, 2010	December 31, 2010	March 31, 2010
Cash provided by (used in):				
Operations:				
Income (loss) from continuing operations	\$ (405,664)	\$ (275,935)	\$ (261,437)	\$ (677,449)
Items not affecting cash:				
Depletion and accretion	403,002	102,801	667,619	199,750
Stock based compensation	—	46,426	11,468	198,773
	(2,662)	(127,428)	417,650	(278,926)
Net change in non-cash operating working capital	9,347	11,929	(667,683)	(206,879)
	6,685	(115,499)	(250,033)	(485,805)
Discontinued operations:				
Income (loss) from discontinued operations	(59)	(477,099)	(3,608)	(498,643)
Items not affecting cash:				
Write down of petroleum and natural gas assets	—	475,552	—	475,552
	(59)	(1,577)	(3,608)	(23,121)
Financing:				
Issuance of shares pursuant to a private placement	—	—	—	1,700,000
Share issue costs	—	—	—	(92,567)
Increase in bank debt	1,025,000	—	2,550,000	—
Shareholder loan	—	—	(1,000,000)	—
Repayment of debentures	—	—	—	(367,644)
	1,025,000	—	1,550,000	1,239,789
Investing:				
Additions to petroleum and natural gas properties	(1,017,361)	(1,012,039)	(1,575,643)	(1,200,553)
Net Change in non-cash investing working capital	—	411,039	—	551,816
	(1,017,361)	(601,000)	(1,575,463)	(648,737)
Net change in cash and cash equivalents	14,265	(718,076)	(279,104)	82,126
Cash and cash equivalents, beginning of period	12,590	1,298,728	305,959	498,526
Cash and cash equivalents, end of period	\$ 26,855	\$ 580,652	\$ 26,855	\$ 580,652
Supplemental cash flow information:				
Interest paid	\$ 26,573	\$ —	\$ 38,350	\$ —

See accompanying notes to consolidated financial statements.

BLACKHAWK RESOURCE CORP.

Notes to Consolidated Financial Statements, page 1

For the three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

1. Nature of business and future operations:

Blackhawk Resource Corp. (the "Corporation" or "Blackhawk") is incorporated under the Business Corporations Act (Alberta). The Corporation is primarily engaged in the acquisition of and the exploration and development of oil and gas properties in Canada.

On September 1, 2009 the Corporation changed its year end to June 30 from August 31. The year end change was necessary to make the Corporation's financial statements directly comparable to other junior oil and gas corporations on a quarterly basis. This change in year end requires the Corporation to have a transition year with a ten month period ending June 30, 2010. Comparatives for the current period are the three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010.

During the year ended August 31, 2009, the Corporation determined the Brazilian subsidiary was not suited for its future operations program and began to actively market the company to potential buyers (see note 5). The Corporation has refocused its resources on Canadian oil and gas exploration and development.

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assumes the Corporation will continue in operation for the foreseeable future and will be able to realize its assets and discharge its obligations in the normal course of operations.

As at December 31, 2010, the Corporation has net working capital deficit of \$2,582,954 (June 30, 2010 – working capital of \$921,451) and net loss of \$265,045 for the six months ended December 31, 2010 (March 31, 2010 – (\$1,176,092)). The Corporation may deem it necessary, as operations progress, to raise capital through equity markets, debt markets or other financing arrangements. There is no assurance this capital will be available.

The ability of the Corporation to continue as a going concern will depend on achieving and maintaining profitable operations and may also depend on raising additional financing sufficient to meet all obligations. Although in the opinion of management, the use of the going concern assumption is appropriate, there can be no assurance that any steps management is taking will be successful. These consolidated financial statements do not reflect adjustments in the carrying values of the assets and liabilities, expenses and the balance sheet classifications that would be used if the going concern assumption were not appropriate.

2. Significant accounting policies:

These unaudited interim consolidated financial statements have been prepared by management in accordance with the Canadian generally accepted accounting principles for interim financial statements. They do not include all of the disclosures required by generally accepted accounting principles for annual financial statements and accordingly, the interim financial information should be read in conjunction with the Corporation's annual financial statements. The interim financial information has been prepared using the same accounting policies as set out in note 2 of the Consolidated Financial Statements for the year ended June 30, 2010. The disclosure provided below is incremental to those included in the audited financial statements. In the opinion of management these statements include all adjustments, consisting of normal and recurring items, which are necessary for a fair presentation of the consolidated financial position, results of operations and cash flows.

The preparation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to use estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Actual results may differ from these estimates and assumptions.

BLACKHAWK RESOURCE CORP.

Notes to Consolidated Financial Statements, page 2

Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

3. Future accounting pronouncements:

(a) Business Combinations:

In January 2009, the CICA issued Section 1582, Business Combinations. This Section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after January 1, 2011 for the Corporation. Early adoption is permitted. This Section replaces Section 1581, Business Combinations and harmonizes the Canadian standards with the International Financial Reporting Standards ("IFRS"). The impact of this standard will depend on future business combinations entered into by the Corporation.

(b) Consolidations and non-controlling interests:

In January 2009, CICA issued Section 1601, Consolidations and Section 1602, Non-controlling Interests which replaces the existing standards. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 establishes standards for accounting for non-controlling interests in consolidated financial statements. These standards are effective for fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Corporation is currently assessing the future impact of this new standard on its consolidated financial statements.

(c) International Financial Reporting Standards ("IFRS"):

In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010.

The changeover to IFRS represents a significant change in accounting standards and the transition from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Corporation's reported financial position and reported results of operations.

The Corporation will continue to monitor standards development as issued by the IASB and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators which may affect the timing, nature or disclosure of its adoption of IFRS.

4. Discontinued operations and asset held for sale:

During the year ended August 31, 2009 the Corporation changed its business to focus on oil and gas exploration and development in western Canada (see note 5). As such, the Corporation sold its remaining construction related assets and began to actively market its Brazilian properties. The results of operations of the Corporation's construction operations and Brazilian oil and gas activities have been retroactively reclassified in the statement of operations as discontinued operations, net of income taxes. Details of the Corporation's activities are as follows:

(a) Brazilian Oil and Gas Properties:

Assets held for sale totaling \$5,189 (June 30, 2010 - \$5,108) are comprised of the working capital in Brazil. After receiving notice from the Brazilian Government of expiration of its permits, the Corporation wrote off petroleum and natural gas properties in the amount of \$471,510 as at June 30, 2010.

On August 31, 2009 the Corporation signed a purchase and sale agreement with an arm's length third party in the amount of approximately \$583,000 (U.S. \$550,000). The agreement was effective upon completion of due diligence by the purchaser which occurred on or about November 26, 2009. During the year ended June 30, 2010, the agreement was terminated and a non-refundable deposit was released from trust to the Corporation in the amount of \$113,683 (US\$109,945).

(b) Details of the Results of Discontinued Operations and Assets Held for Sale:

Discontinued operations comprised of the following for the six months ended December 31, 2010 and the seven months ended March 31, 2010:

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Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

4. Discontinued operations and asset held for sale (Continued):

	December 31, 2010	March 31, 2010
Revenue		
Other revenue	\$ -	\$ 84
	-	84
Expenses		
General and administrative	-	14,633
Interest and bank fees	-	518
Professional fees	3,689	7,526
	3,689	22,677
Loss before other items	(3,689)	(22,593)
Other items		
Foreign exchange loss	81	(528)
Write down of petroleum and natural gas assets	-	(475,522)
Loss from discontinued operations	\$(3,608)	\$(498,643)

5. Acquisition of Black Bore Exploration Ltd.:

On September 1, 2009 the Corporation closed the acquisition of all of the issued and outstanding common shares of Black Bore Exploration Ltd. ("Black Bore"), an Alberta, Canada based oil and gas exploration and production company with operations focused in the Western Canadian Sedimentary Basin. The aggregate consideration paid by the Corporation for all of the Black Bore common shares was a total of 7,694,671 units of Blackhawk at a deemed price of \$0.10 per unit. Each unit of Blackhawk was comprised of: (a) one Blackhawk common share; (b) one 75 BOE/D performance right; and (c) 0.6 of one 150 BOE/D performance right. Each whole performance right will entitle the holder to acquire one Blackhawk common share at no additional consideration upon satisfaction of the relevant production threshold.

On August 27, 2010, the Corporation announced the vesting of the 75 BOE/D performance rights. The vesting of these rights resulted in the issuance of 7,694,671 common shares, valued at \$0.14 per share.

On November 29, 2010, the Corporation announced the vesting of the 150 BOE/D performance rights. The vesting of these rights resulted in the issuance of 4,616,802 common shares, valued at \$0.115 per share.

Cost of acquisition	September 1, 2009
Common shares issued (7,694,671 common shares)	\$769,467
Total consideration	\$769,467

BLACKHAWK RESOURCE CORP.

Notes to Consolidated Financial Statements, page 4

Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

5. Acquisition of Black Bore Exploration Ltd. (Continued):

Net assets acquired and liabilities assumed	
Petroleum and natural gas assets	\$2,416,411
Working capital	(101,750)
Debenture payable	(267,644)
Shareholder loans	(100,000)
Asset retirement obligation	(323,613)
Contingent performance rights (note 9(d))	(853,937)
	<hr/> <hr/>
	\$769,467

Included in working capital is \$2,839 in cash and cash equivalents.

When a business combination resulting in negative goodwill includes a contingent consideration (eg. performance rights), an amount equal to the lesser of the maximum amount of the fair value of the contingent consideration and the negative goodwill is recognized at the time of acquisition.

The debenture payable and shareholder loans were repaid in the month following the close of the acquisition.

6. Petroleum and natural gas properties:

December 31, 2010	Cost	Accumulated Depletion and Impairment	Net Book Value
Petroleum and natural gas properties - Alberta	\$7,801,694	\$(1,020,102)	\$6,781,592
Total	\$7,801,694	\$(1,020,102)	\$6,781,592

March 31, 2010	Cost	Accumulated Depletion and Impairment	Net Book Value
Petroleum and natural gas properties - Alberta	\$3,582,620	\$(236,592)	\$3,346,028
Total	\$3,582,620	\$(236,592)	\$3,346,028

Included in the Corporation's petroleum and natural gas properties balance is \$285,225 relating to the asset retirement obligation, net of accumulated depletion.

7. Shareholder loans:

During the 10 month period ended June 30, 2010, the Corporation entered into shareholder loan agreements with two shareholders of the Corporation. The loans bore interest at a rate of prime plus 3.5% per annum calculated monthly, were secured by a security agreement against all acquired property and all proceeds thereof and were due on September 30, 2011. On August 9, 2010, the loans were repaid in full.

BLACKHAWK RESOURCE CORP.

Notes to Consolidated Financial Statements, page 5

Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

8. Asset retirement obligation:

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligations associated with the retirement of petroleum and natural gas properties and equipment.

	<u>December 31, 2010</u>	<u>June 30, 2010</u>
Balance, beginning of period	\$399,568	-
Black Bore acquisition (note 5)	-	323,613
Liabilities incurred	-	54,021
Accretion expense	15,983	21,934
<u>Balance, end of period</u>	<u>\$415,551</u>	<u>\$399,568</u>

The Corporation's asset retirement obligations result from net ownership interests in petroleum and natural gas assets, including well sites, gathering systems and processing facilities. The Corporation estimates the total undiscounted amount of cash flow required to settle its asset retirement obligations as at December 31, 2010 is approximately \$482,286, which is expected to be incurred over the next year to 10 years. An inflation factor of 3% per annum was applied to determine the expected future costs and a credit-adjusted risk free rate of 8% was used to calculate the present value of the estimated future asset retirement obligation at December 31, 2010.

9. Share capital:

(a) Authorized:

Unlimited number of common voting shares and preferred shares

(b) Issued:

	<u>December 31, 2010</u>		<u>June 30, 2010</u>	
	<u>Number of Shares</u>	<u>Amount</u>	<u>Number of Shares</u>	<u>Amount</u>
Balance, beginning of period	47,727,671	\$4,516,166	30,033,000	\$2,569,821
Shares issued pursuant to a private placement	-	-	10,000,000	1,700,000
Share issue costs	-	-	-	(98,122)
Future income tax	-	-	-	(425,000)
Shares issued pursuant to Black Bore acquisition (note 5)	-	-	7,694,671	769,467
<u>Shares issued pursuant to performance rights</u>	<u>12,311,473</u>	<u>1,608,186</u>	<u>-</u>	<u>-</u>
<u>Balance, end of period</u>	<u>60,039,144</u>	<u>\$6,124,352</u>	<u>47,727,671</u>	<u>\$4,516,166</u>

On August 27, 2010 the Corporation announced the vesting of the 75 BOE/D performance rights. The vesting of these rights resulted in the issuance of 7,694,671 common shares of the Corporation at a value of \$0.14 per share.

On November 29, 2010, the Corporation announced the vesting of the 150 BOE/D performance rights. The vesting of these rights resulted in the issuance of 4,616,802 common shares, valued at \$0.115 per share.

On December 10, 2009 the Corporation issued 10,000,000 common shares on a flow-through basis at a price of \$0.17 per Flow-Through Share. Gross proceeds of the private placement totaled \$1,700,000 and \$98,122 in share issue costs were incurred.

BLACKHAWK RESOURCE CORP.

Notes to Consolidated Financial Statements, page 6

Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

9. Share capital (Continued):

(c) Stock options:

The Corporation has implemented a stock option plan for Directors, Officers, employees, and consultants. The exercise price of each option approximates the market price for the common shares on the date the option was granted. Options granted under the plan generally vest over an eighteen month period from the date of the grant and expire five years after the grant date. The maximum number of common shares to be issued upon the exercise of options granted under the plan is 6,003,914 (June 30, 2010 – 4,772,767) common shares. The details of this plan are as follows:

	<u>December 31, 2010</u>		<u>June 30, 2010</u>	
	<u>Number of</u>	<u>Weighted</u>	<u>Number of</u>	<u>Weighted</u>
	<u>Options</u>	<u>Average</u>	<u>Options</u>	<u>Average</u>
		<u>Exercise Price</u>		<u>Exercise Price</u>
Options outstanding, beginning of period	3,085,000	\$0.14	1,035,000	\$0.14
Expired	(800,000)	\$0.15	(275,000)	\$0.20
Granted	-	-	2,325,000	\$0.15
Options outstanding, end of period	2,285,000	\$0.14	3,085,000	\$0.14
Exercisable, end of period	2,285,000	\$0.14	2,310,000	\$0.14

The following table summarizes information about stock options outstanding and exercisable at December 31, 2010:

<u>Exercise Prices</u>	<u>Number</u>	<u>Weighted Average</u>	<u>Weighted Average</u>
		<u>Remaining Life</u>	<u>Exercise Price</u>
\$0.10	575,000	3.15 years	\$0.10
\$0.15	185,000	3.35 years	\$0.15
\$0.15	1,325,000	2.14 years	\$0.15
\$0.15	200,000	0.28 years	\$0.15
	2,285,000	2.33 years	\$0.14

During the period the Corporation recorded stock based compensation of \$11,468 (June 30, 2010 - \$206,442) for the outstanding stock options.

(d) Performance rights:

On September 1, 2009 the Corporation closed the acquisition of all of the issued and outstanding common shares of Black Bore Exploration Ltd. The aggregate consideration paid by the Corporation for all of the Black Bore common shares was a total of 7,694,671 units of Blackhawk at a deemed price of \$0.10 per unit. Each unit of Blackhawk was comprised of: (a) one Blackhawk common share; (b) one 75 BOE/D performance right; and (c) 0.6 of one 150 BOE/D performance right. Each whole performance right will entitle the holder to acquire one Blackhawk common share upon satisfaction of the relevant production threshold. This transaction resulted in the issuance of performance rights to acquire a further 12,311,473 Blackhawk common shares.

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Notes to Consolidated Financial Statements, page 7

Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

9. Share capital (Continued):

Each whole BOE/D performance right will entitle the holder to acquire at any time before the 18 month anniversary from issuance of such BOE/D performance right, without action or payment of any additional consideration, one Blackhawk Share, provided the relevant production threshold is for three consecutive months, measured on a monthly average basis.

On August 27, 2010 the Corporation announced the vesting of the 75 BOE/D performance rights. The vesting of these rights resulted in the issuance of 7,694,671 common shares of the Corporation valued at \$0.14 per share.

On November 29, 2010, the Corporation announced the vesting of the 150 BOE/D performance rights. The vesting of these rights resulted in the issuance of 4,616,802 common shares, valued at \$0.115 per share.

10. Contributed surplus:

The following table reconciles the Corporation's contributed surplus:

	December 31, 2010	June 30, 2010
Balance, beginning of period	\$427,706	\$221,264
Stock-based compensation – expensed	11,468	206,442
Balance, end of period	\$439,174	\$427,706

11. Per share amounts:

Loss per share on a diluted weighted average basis is the same as that presented for basic as all factors are anti-dilutive. The number of shares that would have been included in the computation of diluted earnings per share would have been as follows:

Six and Seven Months Ended	December 31, 2010	March 31, 2010
Weighted average shares outstanding basic	53,841,589	42,927,224
Stock options	161,920	181,623
Fully Diluted	54,003,509	43,108,847

Three Months Ended	December 31, 2010	March 31, 2010
Weighted average shares outstanding basic	57,028,186	47,727,671
Stock options	132,061	194,271
Fully Diluted	57,160,247	47,921,942

In calculating diluted earnings (loss) per common share the Corporation excluded 1,710,000 options for the six months ended December 31, 2010 (Three months – 1,710,000) and 2,510,000 options for the seven months ended March 31, 2010 (three months – Nil) as the exercise price is greater than the average market price of the common shares for the period.

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Notes to Consolidated Financial Statements, page 8

Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

12. Related party transactions:

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties, and are comparable in terms, rates and conditions in the oil and gas industry.

During the six months ended December 31, 2010, companies controlled by officers and directors of the Corporation were paid \$134,211 (March 31, 2010 - \$162,500) in consulting and professional fees in relation to the operations of the Corporation, which are included in general and administrative expenses in the statement of operations. At December 31, 2010 no amount was outstanding.

During the period ended December 31, 2010, the Corporation incurred legal costs of \$8,871 (March 31, 2010 - \$25,623) with a law firm in which the Corporate secretary is a Partner. The legal costs incurred were in the normal course of operations and were based on the exchange value of the service provided. Of the legal services provided, \$Nil were included in accounts payable at December 31, 2010.

13. Financial instruments:

The Corporation's financial instruments as at December 31, 2010 include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and bank debt. The Corporation records its financial instruments at their carrying amounts which approximates fair value, unless otherwise disclosed in the consolidated financial statements. The carrying amounts approximate fair values due to the short term maturities of these financial instruments.

The Corporation adopted the amendments to CICA Section 3862, Financial Instruments in 2009. The amendments require additional disclosure about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements.

Level 1

- This category includes assets and liabilities measured at fair value based on unadjusted quoted prices for identical assets and liabilities in active markets. An active market for an asset or liability is considered to be a market where transactions occur with sufficient frequency and volume to provide information on an ongoing basis. As at December 31, 2010, the Corporation has cash and cash equivalents which qualify as Level 1.

Level 2

- This category includes valuations determined using directly or indirectly observable inputs other than quoted prices included within Level 1. Derivative instruments in the category are valued using models or other industry standard valuation techniques derived from observable market data. Such valuation techniques include inputs such as quoted forward prices, time value, volatility factors and broker quotes that can be observed or corroborated in the market for the entire duration of the derivative instrument. As at December 31, 2010, the Corporation has no instruments which qualify as Level 2.

Level 3

- This category of financial instruments are those with inputs for the asset or liability that are not based on observable market data (unobservable inputs). As at December 31, 2010, the Corporation has no instruments which qualify as Level 3.

(a) Credit risk:

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations. As at December 31, 2010 the Corporation's receivables consisted of \$369,411 due from petroleum and natural gas marketers, \$162,170 due from the Canadian government for the refund of GST paid, and \$20,443 due from joint interest partners and \$44,488 due from other receivables.

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Notes to Consolidated Financial Statements, page 9

Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

13. Financial instruments (Continued):

The Corporation's receivables are normally collected within a 60-90 day period. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Corporation has not experienced any collection issues with its petroleum and natural gas marketers. The Corporation attempts to mitigate the risk from joint-venture receivables by obtaining partner approval of significant capital expenditures prior to the expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint-venture partners as disagreements occasionally arise that increases the potential for non-collection. The Corporation does not typically obtain collateral from petroleum and natural gas marketers or joint-venture partners. The Corporation is also exposed to credit risk with regards to its customers refusing payment and the government denying the Corporation claims as filed. The maximum exposure to credit risk is the carrying value of accounts receivable.

Cash and cash equivalents, when outstanding, consist of cash bank balances and short-term deposits maturing in 90 days or less. The Corporation manages the credit exposure related to short term investments by selecting counter parties based on credit ratings and monitors all investments to ensure a stable return.

The carrying amount of accounts receivable represent the maximum credit exposure. The Corporation does not have an allowance for doubtful accounts as at December 31, 2010.

The Corporation considers the receivables to be aged as follows:

	0 – 90 days	> 90 days
Accounts receivable	\$437,807	\$158,705

(b) Liquidity risk:

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risking harm to the Corporation's reputation.

The following are the contractual maturities of financial liabilities as at December 31, 2010:

Financial Liabilities	< One Year	> One Year
Accounts payable and accrued liabilities	\$680,762	-
Bank debt	\$ 2,550,000	-
Total	\$3,230,762	-

(c) Market risk:

Market risk is the risk that changes in market prices, such as foreign exchange rates and commodity prices will affect the Corporation's net earnings or the value of financial instruments. The objective of market risk management is to control market risk exposures within acceptable limits, while maximizing returns.

- Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange risks. The Corporation is exposed to foreign exchange rate risk since the exploration and development costs of its Brazil operations were mostly denominated in Brazilian Reals (BRL). As at August 31, 2009 the Corporation had decided to dispose of the Brazilian subsidiary so future currency exchange risk is expected to continue to be minimal. The Corporation does not engage in active hedging to minimize exchange rate risk.

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Three and six months ended December 31, 2010 and the three and seven months ended March 31, 2010

13. Financial instruments (Continued):

- Interest rate risk is the risk that future cash flows will fluctuate as a result in changes in market interest rates. The Corporation is exposed to interest rate risk to the extent the changes in market interest rates will impact the Corporation's bank debt, which has a rate of prime plus 2%. The Corporation has not entered into any interest rate swaps or financial contracts to date. With regards to interest rate risk, a change of 1% in the effective interest rate would have an insignificant impact on net income.

(d) Capital management:

The Corporation manages the following as capital:

	December 31, 2010	June 30, 2010
Shareholders' capital	\$6,124,352	\$4,516,166
Working capital (deficiency)	(2,582,954)	(421,451)
Total	\$3,541,398	\$4,094,715

The Corporation's objectives when managing capital are:

- to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders.

The Corporation sets the amount of capital in proportion to risk. The Corporation manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Corporation may issue new shares, or engage in debt financing.

(e) Fair value of financial instruments:

The Corporation's financial instruments as at December 31, 2010 include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and bank debt. The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximates their carrying amounts due to the short term maturities of these financial instruments.

14. Commitments:

On December 10, 2009, the Corporation issued 10,000,000 flow-through common shares at \$0.17 per share for gross proceeds of \$1,700,000. As at December 31, 2010, the Corporation had incurred \$1,700,000 in exploration and development costs towards this flow-through share obligation satisfying the terms of this flow-through share offering.

The Brazilian properties required the completion of a minimum exploration program ("MEP") work unit commitments on the properties over a two year period commencing March 2008. MEP work units are satisfied through completion of seismic programs and other exploratory survey methods. MEP commitments over the two-year period could cost up to \$692,000, for which a financial guarantee was provided. After the expiry of the licenses on the Brazilian properties, the Corporation was informed that there may be a claim in regards to this guarantee.

15. Credit facility:

The Corporations demand operating facility was increased from \$2.6 million to \$3.3 million during the period. The Corporation may borrow via Prime-based loans bearing interest at the prime bank rate plus 2 percent per annum. The credit facility is subject to industry standard covenants and periodic review, with the next required in November 2011. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lender, based primarily on reserves and using commodity prices estimated by the lender, as well as other factors. A decrease in the borrowing base could result in a reduction to the credit facility which may require a repayment to the lender. As of December 31, 2010, the Corporation was in compliance with all the covenants of the facility and \$2,550,000 had been drawn against it.