



**Consolidated Financial Statements of**

**Ceres Capital Corp.**

**December 31, 2008 and 2007**



## Management's Responsibility

To the Shareholders of Ceres Capital Corp.:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting principles and ensuring that all information in the annual report is consistent with the consolidated financial statements. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the consolidated financial statements.

The Board of Directors exercises its responsibilities for financial controls through an Audit Committee. The Audit Committee is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

Meyers Norris Penny LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Board and management to discuss their audit findings.

March 18, 2009

*"Paul Moller"*

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Paul Moller  
President

*"John Newman"*

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John Newman  
VP Finance

## Auditors' Report

To the Shareholders of Ceres Capital Corp.:

We have audited the consolidated balance sheets of Ceres Capital Corp. as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive income and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta

March 18, 2009

*Meyers Norris Penny LLP*

Chartered Accountants



Ceres Capital Corp.

**Consolidated Balance Sheets**

<i>As at</i>	<b>December 31, 2008</b>	<b>December 31, 2007</b>
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 8,396,051	\$ 890,405
Accounts receivable	567,376	73,970
Prepaid expenses and deposits	110,955	62,475
Short term investments	-	295,381
Demand notes receivable	26,308	-
	<b>9,100,690</b>	<b>1,322,231</b>
<b>Property and equipment</b> (Note 7)	<b>2,876,801</b>	<b>1,180,352</b>
	<b>\$ 11,977,491</b>	<b>\$ 2,502,583</b>
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accruals	\$ 1,887,527	\$ 488,617
Deferred bonus obligation (Note 9)	-	236,000
Convertible debentures (Note 11)	1,167,481	1,081,198
Asset retirement obligation (Note 12)	254,243	199,831
	<b>3,309,251</b>	<b>2,005,646</b>
<b>Shareholders Equity</b>		
Share capital (Note 13)	18,516,427	8,950,416
Warrants (Notes 9 and 13)	236,000	-
Equity portion of convertible debentures (Note 11)	88,780	85,991
Contributed surplus (Note 14)	459,273	200,573
Deficit	(10,632,240)	(8,740,043)
	<b>8,668,240</b>	<b>496,937</b>
	<b>\$ 11,977,491</b>	<b>\$ 2,502,583</b>

Approved on behalf of the Board:

*Signed "Dennis Nerland"*

*Signed "Brian Hurl"*

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



**Consolidated Statements of Operations, Comprehensive Income and Deficit**

<i>For the Years Ended December 31</i>	<b>2008</b>	<b>2007</b>
<b>Revenue</b>		
Petroleum and natural gas	\$ 278,283	\$ 484,630
Royalties	(62,111)	(107,516)
Interest	18,560	62,315
	<b>234,732</b>	<b>439,429</b>
<b>Expenses</b>		
Operations	225,728	249,453
Administration	1,672,563	1,369,631
Interest and financing charges	183,007	115,279
Depletion, depreciation and accretion	170,406	957,518
Impairment of property and equipment	-	3,178,000
Stock based compensation	47,800	-
	<b>2,299,504</b>	<b>5,869,881</b>
<b>Loss before income taxes</b>	<b>2,064,772</b>	<b>5,430,452</b>
<b>Income Taxes</b>		
Future income tax recovery (Note 10)	(172,575)	(905,545)
<b>Net Loss</b>	<b>1,892,197</b>	<b>4,524,907</b>
Deficit, beginning of year	8,740,043	4,216,469
Change in accounting policy (Note 5)	-	(1,333)
Deficit, end of year	\$ 10,632,240	\$ 8,740,043
Loss per share - basic and diluted (Note 15)	\$ 0.046	\$ 0.131

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



## Consolidated Statements of Cash Flows

<i>For the Years Ended December 31</i>	2008	2007
Cash provided by (used in):		
<b>Operating Activities</b>		
Net loss	\$ (1,892,197)	\$ (4,524,907)
Add back (deduct) non-cash items:		
Depletion, depreciation and accretion	170,406	957,518
Interest expense	89,072	25,737
Impairment of property and equipment	-	3,178,000
Stock based compensation	47,800	-
Future income tax recovery	(172,575)	(905,545)
	(1,757,494)	(1,269,197)
Changes in non-cash working capital (Note 16)	884,915	(558,699)
	(872,579)	(1,827,896)
<b>Financing Activities</b>		
Issue of common shares - net	8,819,013	741,440
Acquisition of Ceres	1,130,473	-
Shareholder loan (Note 13)	-	25,000
Changes in non-cash working capital (Note 16)	(245,496)	(125,988)
	9,703,990	640,452
<b>Investing Activities</b>		
Expenditures on property and equipment	(1,810,497)	(984,175)
Retirement obligations settled	(1,946)	(6,810)
Proceeds on disposal of short term investments	295,381	162,470
Changes in non-cash working capital (Note 16)	191,297	-
	(1,325,765)	(828,515)
<b>Change in cash and cash equivalents</b>	<b>7,505,646</b>	<b>(2,015,959)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>890,405</b>	<b>2,906,364</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 8,396,051</b>	<b>\$ 890,405</b>
<b>Cash and cash equivalents are comprised of:</b>		
Balances with banks	\$ 1,216,077	\$ 67,858
Short-term deposits	7,179,974	822,547

The accompanying notes are an integral part of these financial statements



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**1. Nature of Business**

Ceres Capital Corp. ("Ceres" or the "Company") was incorporated under the laws of the province of Alberta on June 5, 2006. On December 24, 2008 the Company completed its qualifying transaction with Reliable Energy Ltd. ("Reliable") whereby Ceres acquired, through its wholly owned subsidiary Ceres Acquisition Corp., all of the outstanding shares of Reliable ("the Transaction"). The Transaction was completed as a three-cornered amalgamation whereby Reliable and Ceres Acquisition Corporation amalgamated under the name of Reliable Energy Ltd., a wholly-owned subsidiary of Ceres Capital Corp. Ceres was a Capital Pool Company on the TSX Venture Exchange ("TSXV") and accordingly, had no assets other than cash and no commercial operations prior to the Transaction. The Company's principal activity is the exploration for and development of oil and gas properties in Western Canada.

The Company is traded on the TSXV under the symbol SRS.

**2. Basis of Presentations and Significant Accounting Policies**

The accompanying financial statements are stated in Canadian dollars, have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies.

**Basis of Consolidation**

The consolidated financial statements include the accounts of the Company and its 100% owned subsidiary, Reliable Energy Ltd. All intercompany transactions have been eliminated on consolidation. These consolidated financial statements are issued under the name of the Company but are deemed to be a continuation of Reliable. The comparative figures for the year ended December 31, 2007 reflect the assets, liabilities and results of operations of Reliable.

**Cash and Cash Equivalents**

Cash and cash equivalents consist of cash in the bank, less outstanding cheques, and short-term deposits with a maturity of less than three months.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**3. Significant Accounting Policies (Continued)**

**Petroleum and Natural Gas Properties**

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

Proceeds from the disposition of petroleum and natural gas properties are applied against capitalized costs except for dispositions that would change the rate of depletion and depreciation by 20% or more in which case a gain or loss would be recorded.

Petroleum and natural gas properties are characterized as long-lived assets held for use and as such, are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of property, plant and equipment or resource properties may not be recoverable. Impairment losses are recognized when the carrying amount of the property and equipment exceeds the non-discounted cash flows expected from the production of proved reserves, undeveloped land and future development projects. If the carrying value is assessed not to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the property and equipment exceeds the sum of the discounted cash flows from proved plus probable reserves, undeveloped land and future development projects. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate. Any impairment is included in earnings for the period.

**Depletion and Depreciation**

Capitalized costs, together with estimated future capital costs associated with proved reserves, are depleted and depreciated using the unit-of-production method based on gross estimated proved reserves of petroleum and natural gas as determined by independent engineers. For purposes of this calculation, reserves and production are converted to equivalent units of oil based on relative energy content of six thousand cubic feet of gas to one barrel of oil. Costs of significant unproved properties, net of impairments, are excluded from the depletion and depreciation calculation.

Non-resource property assets, comprised of office equipment and leasehold improvements, are recorded at cost and depreciated over their useful life on a straight-line basis at various rates between 20% and 45%.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**3. Significant Accounting Policies (Continued)**

**Convertible Debentures**

The Company's convertible debentures are segregated into their debt and equity components at the date of issue, based on the relative fair market values of these components in accordance with the substance of the contractual agreements. The debt component of the instruments, net of financing costs, is classified as a liability, and recorded as the present value of the Company's obligation to make future interest payments in cash, and settle the redemption value of the instrument in cash or in a variable number of shares. The carrying value of the debt component is accreted to the original face value of the instruments, over their deemed life, using the effective interest rate method. The conversion option, which makes up the equity component of the instruments, is recorded using the residual value approach. Upon conversion, any gain or loss arising from extinguishment of the debt is recorded in income of the current period.

Where the exercise date of the conversion option is less than one year from balance sheet date, or the conversion has been triggered, convertible debentures are classified as current liabilities.

**Income Taxes**

The Company follows the asset and liability method of accounting for income taxes. Temporary differences arising from the differences between the tax basis of an asset or liability and its carrying amount are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using enacted tax rates and laws anticipated to apply in the periods that the temporary differences are expected to reverse. In addition, the future benefits of income tax assets, including unused tax losses, are recognized subject to a valuation allowance, to the extent that it is more likely than not that such future benefits will ultimately be realized.

**Asset Retirement Obligations**

The Company recognizes the fair value of an Asset Retirement Obligation ("ARO") in the year in which it is incurred, when a reasonable estimate of the fair value can be made. Discounted cash flows are used to measure fair value, using industry guidelines and management estimates on a property-by-property basis. The fair value of the estimated ARO is recorded as a long-term liability, with a corresponding increase in the carrying value of the related petroleum and natural gas properties. The capitalized amount is depleted on a unit-of-production basis over the life of the reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the ARO. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which the settlement occurs.

**Flow-through Shares**

The Company finances a portion of its exploration activities through the issue of flow-through shares, whereby tax deductions relating to Canadian exploration expenditures are renounced to the investors in accordance with Canadian income tax legislation. When these expenditures are renounced, temporary taxable differences created by the renunciation reduces share capital. Proceeds received on the issue of flow-through shares are credited to share capital.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**3. Significant Accounting Policies (Continued)**

**Joint Operations**

Exploration, development and production activities may be conducted jointly with others and accordingly, the Company only reflects its proportionate interest in such activities.

**Revenue Recognition**

Revenue from the sale of petroleum and natural gas are recorded when title passes to an external party.

**Stock-Based Compensation**

The fair value for each stock option granted is estimated on the date of the grant using the Black-Scholes option pricing model. These fair value costs are recognized in current earnings with a corresponding increase to contributed surplus over the vesting period of the grant. As the options are exercised, the consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. In the event that unvested options are cancelled, previously recognized compensation expense associated with such options is reversed.

**Per share amounts**

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are calculated based on the treasury stock method which assumes that any proceeds obtained on the exercise of options would be used to purchase common shares at the average market price during the year. Where the effect of options and warrants are anti-dilutive, they are not included in the calculation of diluted earnings per share.

**Measurement Uncertainty**

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

The amounts recorded for depletion and depreciation of property and equipment and accretion of the asset retirement obligations are based on estimates. The property and equipment impairment test is based on estimates of proved reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. Accounts receivable are stated after evaluation as to their collectibility and an appropriate allowance for doubtful accounts is provided where considered necessary.

By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***For the years ended December 31, 2008 and 2007***4. Reverse Takeover Accounting**

The acquisition of Reliable was accounted for as a reverse takeover (“RTO”) as the control of the Company was acquired by the former shareholders of Reliable. Although, legally, Ceres is regarded as the parent or continuing company, Reliable, whose shareholders now hold the majority of the voting shares of the Company, is treated as the acquirer under Canadian generally accepted accounting principles. The Transaction has been accounted for as an issuance of shares and options by Reliable for the net monetary assets of Ceres, accompanied by a recapitalization of the Company. The fair value of the net assets acquired is as follows:

Cash	\$1,347,211
Other receivables	34,778
Current liabilities	(59,600)
Net assets acquired	\$1,322,389

Pursuant to the RTO, Ceres issued the following to the stakeholders of Reliable:

Common shares (6 Ceres shares for each Reliable share outstanding)	116,594,622
Stock options	2,940,000
Broker’s warrants	5,857,674
Convertible debentures (replacing an equal amount of Reliable debentures)	\$1,260,000

All references to share numbers and per share amounts in these financial statements and notes are on the basis of post acquisition numbers.

**5. Changes in Accounting Policies**

On January 1, 2008 the Company adopted the following new CICA handbook Sections:

***Comprehensive Income***

Section 1530 – “Comprehensive Income”

Section 3251 – “Equity”

Comprehensive income is the change in shareholders’ equity during a period from transactions and other events and circumstances from non-owner sources and includes unrealized gains and losses on financial assets classified as available for sale. When related amounts are recorded in accordance with this standard, the Company will report a statement of comprehensive income combined with the statement of operations and a new category, accumulated other comprehensive income, in the shareholders’ equity section of the balance sheet.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**5. Changes in Accounting Policies (Continued)**

***Financial Instruments***

Section 3855 – “Financial Instruments - Recognition and Measurement”

Section 3862 – “Financial Instruments – Disclosures”

Section 3863 – “Financial Instruments – Presentation”

The new standards require all financial instruments within its scope, including all derivatives, to be recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities except those held-for-trading and available for sale are measured at amortized cost determined using the effective interest rate method. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to earnings when derecognized or impaired.

The Company has classified its financial assets and liabilities as follows:

<u>Held-for-trading</u>	<u>Loans and receivables</u>	<u>Other liabilities</u>
Cash and equivalents	Accounts receivable	Accounts payable and accruals
	Demand notes receivable	Convertible debentures

The Company may use various types of derivative financial instruments to manage risks associated with crude oil and natural gas price fluctuations. These instruments are not used for trading or speculative purposes. Proceeds and costs realized from holding the related contracts are recognized in petroleum and natural gas revenues at the time that each transaction under a contract is settled. For the unrealized portion of such contracts, the Company utilizes the fair value method of accounting. The fair value is based on an estimate of the amounts that would have been paid to or received from counterparts to settle these instruments given future market prices and other relevant factors. The method requires the fair value of the derivative financial instruments to be recorded at each balance sheet date with the unrealized gains or losses on these contracts recorded through the statement of operations.

The Company has elected to account for its commodity sales and other non-financial contracts, which were entered into and continue to be held for the purpose of receipt of delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts on an accrual basis rather than as non-financial derivatives. Prior to adoption of the new standards, physical receipt and delivery contracts did not fall within the scope of the definition of a financial instrument and were also accounted for as executory contracts.

Financing fees attributable to financial instruments classified as other than held-for-trading are included in the recognized amount of the related financial instrument and recognized over the life of the resulting financial instrument. Prior to January 1, 2007, financing fees were recorded as deferred financing charges and recognized in the statement of operations on a straight-line basis over the life of the financial instrument. On adoption, financing fees are recognized as if the effective interest rate method had always been applied whereby the amount recognized varies over the life of the financial instrument based on the principal outstanding. For the Company, the adoption of the effective interest rate method required adjustments to deferred financing charges and the convertible debentures as disclosed below.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**5. Changes in Accounting Policies (Continued)**

At January 1, 2007, the following adjustments were made to the balance sheet to adopt the new standards:

Deficit – increase	1,333
Deferred financing charges - decrease	62,870
Convertible debentures - decrease	64,203

**Section 3865 – “Hedges”**

This Section specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed. On adoption of these standards, the Company did not have any agreements or contracts which are following hedge accounting.

**Other Disclosures**

**Section 1535 – “Capital Disclosures”**

This Section establishes standards for disclosing information about an entity’s capital and how it is managed. It describes the disclosure requirements of the entity’s objectives, policies and processes for managing capital, the quantitative data relating to what the entity regards as capital, whether the entity has complied with capital requirements, and if it has not complied, the consequences of such non-compliance.

**Section 1400 – “General Standards of Financial Statement Presentation”**

This Section was amended and is effective for interim periods beginning on or after January 1, 2008, to include requirements to assess and disclose the Company’s ability to continue as a going concern.

Apart from additional disclosure contained in Note 6 – Capital Management, the adoption of these new standards has not had a material impact on the Company’s financial statements.

**Future Accounting Changes**

On February 13, 2008, the Accounting Standards Board of Canada confirmed that the transition date to International Financial Reporting Standards (“IFRS”) from Canadian GAAP will be January 1, 2011 for publicly accountable enterprises. The Company will be required to report its results in accordance with IFRS starting in 2011, with comparative IFRS information for the 2010 fiscal year. The Company is currently reviewing the requirements of IFRS but has yet to assess the impact the change will have on the Company’s accounting policies, financial statements, information systems, internal controls over financial reporting, disclosure controls and procedures, including investor relations, training requirements and business activities.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***For the years ended December 31, 2008 and 2007***6. Capital Management**

The Company's capital structure is comprised of Shareholders' Equity, Convertible Debentures and working capital. The Company's objectives when managing its capital structure are to maintain financial flexibility so as to preserve access to capital markets and its ability to meet its financial obligations and to finance internally generated growth and potential strategic acquisitions. To manage its capital structure the Company may adjust spending, issue new shares, issue new debt or repay existing debt.

The Company prepares an annual budget, which is updated periodically for any significant acquisitions, changes in economic circumstances, and successes or failures of its capital program.

At December 31, 2008 the Company has working capital of \$7,213,163 which when combined with its ongoing cash flows from operations will be sufficient to fund operations and the Company's capital expenditure program for the next twelve months.

**7. Property and Equipment**

December 31, 2008			
	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties	\$ 3,868,715	\$ 1,051,760	\$ 2,816,955
Leasehold and office equipment	326,490	266,644	59,846
	<b>\$ 4,195,205</b>	<b>\$ 1,318,404</b>	<b>\$ 2,876,801</b>

  

December 31, 2007			
	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties	\$ 2,020,823	\$ 955,630	\$ 1,065,193
Leasehold and office equipment	324,885	209,726	115,159
	<b>\$ 2,345,708</b>	<b>\$ 1,165,356</b>	<b>\$ 1,180,352</b>

At December 31, 2008, the Company excluded \$2,020,330 (2007 – \$160,539) of resource properties relating to unproved properties from the depletion calculation. Unproved properties have been separately evaluated by management for impairment.

During 2008, the Company capitalized \$39,000 (2007 - \$20,000) related to the asset retirement obligation of property and equipment. The Company did not capitalize any general and administrative costs during 2008 or 2007 other than to the extent of the Company's working interest in operated capital expenditure programs on which operator's fees have been charged in accordance with standard industry agreements.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***For the years ended December 31, 2008 and 2007***7. Property and Equipment (Continued)**

At December 31, 2008, no impairment write-down was required. The impairment test was calculated using the following benchmark reference prices:

	Natural Gas Cdn \$/Mcf
2009	6.48
2010	7.22
2011	7.50
2012	8.04
2013	8.86
After 2013 (inflation %)	2%/yr

**8. Bank Loans**

In order to release the cash securing its bank lines of credit, the Company has closed its credit facility with one Canadian bank and reduced the other to a nominal \$1. The remaining facility will, when reinstated, bear interest at the bank's prime lending rate and be secured by charges against term deposits. Previously, the Company had established maximum credit facilities in the amount of \$215,000 by way of revolving loan facilities, secured by an assignment of term deposits. Amounts drawn under the facilities bear interest at prime. The balance outstanding at December 31, 2008 is nil (2007 – nil). In addition the Company has issued letters of guarantee amounting to \$nil (2007 - \$75,000).

**9. Deferred Bonus Obligation**

As part of the Ceres acquisition, 505,716 warrants having a value of approximately \$0.47 per warrant were issued to settle the deferred bonus obligation.

**10. Future Income Taxes**

The components of the net future income tax liability are as follows:

	2008	2007
<b>Future income tax assets (liabilities)</b>		
Property and equipment	\$ 140,757	\$ 306,715
Share issue, RTO and financing costs	392,549	142,134
Asset retirement obligations	75,002	64,186
Non-capital losses	1,894,970	1,337,212
Valuation allowance	(2,503,278)	(1,850,247)
Net future income tax asset	\$ -	\$ -

Due to the uncertainty surrounding realization of the tax asset a valuation allowance has been recorded for the full amount of the asset.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***For the years ended December 31, 2008 and 2007***10. Future Income Taxes (Continued)**

The income tax expense differs from the amount that would be expected by applying the current tax rates for the following reasons:

	2008	2007
<b>Loss before income taxes</b>	<b>\$ (2,064,772)</b>	<b>\$ (5,430,452)</b>
<b>Expected tax recovery at 29.50% (2007 - 32.12%)</b>	<b>(609,108)</b>	<b>(1,745,879)</b>
<b><i>Increase (decrease) in provision resulting from:</i></b>		
Tax effect of change in rate	150,786	-
Stock-based and deferred compensation	14,101	(57,174)
Share issue costs	(323,617)	-
Change in valuation allowance	540,972	899,843
Other	54,291	(2,335)
<b>Future tax recovery</b>	<b>\$ (172,575)</b>	<b>\$ (905,545)</b>

The change in valuation allowance includes \$112,059 relating to tax pools held by Ceres Capital on acquisition.

The Company has the following estimated tax pools available for deduction against future taxable income.

	2008	2,007
Canadian exploration expense	\$ 1,937,766	\$ 955,771
Canadian development expense	60,765	267,164
Canadian oil & gas property expense	888,736	447,251
Undepreciated capital cost	466,675	465,070
Share issuance and deferred financing costs	1,371,065	491,664
Non-capital losses	6,423,625	4,163,176
<b>Total estimated tax pools</b>	<b>\$ 11,148,632</b>	<b>\$ 6,790,096</b>

The non-capital losses will expire in the following years:

2014	\$ 87,125
2015	898,677
2026	1,726,892
2027	1,565,791
2028	2,145,140

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***For the years ended December 31, 2008 and 2007***11. Convertible Debentures**

In August 2006, Reliable issued \$1,200,000 of Convertible Unsecured Subordinated Debentures maturing July 31, 2011. The Debentures bear interest at 7.5% and are convertible to common shares of the Company at the option of the holder at a conversion price of \$1.40 per common share. The Debentures are redeemable by the Company at face value under certain circumstances prior to July 31, 2009. After that time, they can be redeemed in whole or in part at the rates indicated below:

July 31, 2009	105.0% of face value
July 31, 2010	102.5% of face value

The terms of the Debentures required Reliable to complete a defined Liquidity Event prior to February 15, 2008. The Liquidity Event was not completed and Reliable was required to issue an additional \$60,000 of debentures for no additional consideration. This was recorded as a charge to interest and financing charges.

As the Debentures are considered to be compound financial instruments, the principal amount has been allocated between liability and equity components, which are then classified separately on the balance sheet. The liability component has been determined using an interest rate for comparable debt instruments having no conversion rights. The difference between the liability component and the principal amount of the Debentures has been allocated to shareholders' equity.

As a consequence of adopting the new financial instruments standards, the Company made certain adjustments to deferred financing charges and the convertible debentures as disclosed in Note 4. Financing charges are now netted against the convertible debentures and are amortized to interest and financing charges in the statement of operations using the effective interest rate method.

On December 24, 2008, Ceres assumed Reliable's obligations under the Debentures. Holders of the Debentures are now entitled to convert the principal amount of their Debentures into common shares of Ceres as \$1.40 per share.

The following table shows the Debenture activities:

	<b>Number of Debentures</b>	<b>Debt Component</b>	<b>Equity Component</b>
Balance, December 31, 2006	1,200	\$ 1,119,664	\$ 85,991
Accretion	-	17,056	-
Balance, December 31, 2007, as previously stated	1,200	\$ 1,136,720	\$ 85,991
Adoption of new accounting policy	-	(55,522)	-
Balance, December 31, 2007, as restated	1,200	\$ 1,081,198	\$ 85,991
Non-performance penalty issuance	60	57,211	2,789
Accretion	-	29,072	-
Balance, December 31, 2008	1,260	\$ 1,167,481	\$ 88,780



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

**12. Asset Retirement Obligations**

	<b>2008</b>	<b>2,007</b>
Asset retirement obligations, beginning of year	\$ 199,831	\$ 197,063
Liabilities incurred	39,000	20,000
Liabilities settled	-	(10,405)
Change in estimated cash flows	-	(23,000)
Accretion	15,412	16,173
Asset retirement obligations, end of year	\$ 254,243	\$ 199,831

The future estimated undiscounted cash flows required to settle the obligation are \$467,090 (2007 - \$400,512), which has been discounted using a credit-adjusted risk free rate of 5.5% (2007 - 8.0%) and inflated at a rate of 1.7% (2007 - 2%) per year. Most of these obligations are not expected to be paid for 10 to 12 years in the future and will be funded from general Company resources at that time.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2008 and 2007

**13. Share Capital****a. Authorized**

Unlimited voting common shares without nominal or par value.

**b. Issued (i)**

<b>Common shares</b>	<b>Number</b>	<b>Value</b>
Balance, January 1, 2007	34,148,676	\$ 9,091,488
Private placement (ii)	194,142	147,224
Private placement (iii)	145,710	110,500
Private placement (iv)	3,510,000	585,000
Share issue costs, net of tax of \$32,532	-	(70,719)
Effect of future income taxes on renounced resource expenditures (v)	-	(938,077)
Shareholder loan	-	25,000
<b>Balance at December 31, 2007</b>	<b>37,998,528</b>	<b>\$ 8,950,416</b>
Share issue costs	-	(8,154)
Effect of future income taxes on renounced resource expenditures (vi)	-	(172,575)
Adjust total of converted shares due to rounding	186	-
Non-performance penalty issuance (vii)	126,264	-
Private placement (viii)	74,119,644	9,739,760
Shares issued as advisory fees (viii)	4,350,000	507,500
Share issue costs	-	(1,630,993)
Ceres Capital shares acquired through RTO (ix)	10,261,250	1,322,389
Transaction costs	-	(191,916)
<b>Balance at December 31, 2008</b>	<b>126,855,872</b>	<b>\$ 18,516,427</b>

(i.) All share numbers are post acquisition (Note 4).

(ii.) During 2007, the Company agreed to issue 194,142 shares in settlement of third party services rendered at a price of \$0.76 per share.

(iii.) As part of a private placement that commenced in 2006, the Company issued 145,710 common shares at \$0.76 in 2007. Share issuance costs were \$48,854 plus the Company issued 33,000 stock options to the brokers with exercise prices ranging from \$0.76 to \$0.91 per share having a value of \$1,001.

(iv.) During 2007 the Company issued 3,510,000 flow-through common shares at \$0.17. Share issuance costs were \$54,397 plus the Company issued 12,600 stock options to the brokers exercisable at \$0.17 per share having a value of \$nil. An additional 122,850 stock options were issued to the brokers in 2008 exercisable at \$0.17 per share having a value of \$nil.

(v.) During 2007 the Company renounced resource expenditures required under the flow-through shares issued in 2006. The future income tax effect reduces the book value of the shares issued.

(vi.) During 2008 the Company renounced \$585,000 of resource expenditures required under the flow-through shares issued in 2007.

(vii.) Certain of the share subscriptions issued in 2006 required the Company to complete a defined 'Liquidity Event' on or before February 15, 2008. The Liquidity Event did not occur and as a result the Company issued 126,264 shares for no additional consideration.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**13. Share Capital (Continued)**

- (viii.) As part of a private placement, the Company issued 8,571,444 common shares at \$0.1167 and 65,548,200 flow-through common shares at \$0.1333 for gross proceeds of \$9,739,760. Share issuance costs were \$1,630,993 which included 4,350,000 common shares at a deemed price of \$0.1167. The Company also issued 5,722,224 options to the brokers exercisable at \$0.12 per share having a value of \$258,700 (Note 13(d)).
- (ix.) Shares deemed to be issued to the existing shareholders of Ceres as part of the reverse takeover transaction.

**c. Escrowed Shares**

At December 31, 2008, 17,070,548 issued and outstanding shares were in escrow pursuant to the requirements of the TSXV. Upon issuance of the final Exchange bulletin subsequent to the completion of the Transaction, 10% of the escrowed securities will be released immediately and thereafter 15% of the escrowed securities will be released at the completion of each six month period. The final bulletin was issued on January 29, 2009.

**d. Stock Options**

The Company has a stock option plan under which the Board of Directors may grant options to directors, officers, other employees and key consultants. Under the plan the aggregate number of shares that may be reserved for issuance pursuant to stock options may not exceed 10% of the issued shares of the Company at the time of granting. Options have a maximum term of five years and terminate ninety days following the termination of the optionee's employment or service to the Company. All options currently issued vested 100% at the time of granting.

The Company has also issued stock options to several brokerage firms in regards to financing activities of the Company. These options have various terms up to a maximum of two years and vested 100% at the time of granting.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2008 and 2007

**13. Share Capital (Continued)**

	Number of Options	Weighted average exercise price	Expiry
Outstanding, January 1, 2007	4,668,660	\$ 0.499	2007-2011
Granted to:			
Directors, management and employees	2,970,000	0.167	2012
Brokers	28,800	0.758	2008
Brokers	4,200	0.910	2008
Brokers	12,600	0.167	2008
Exercised	-	-	-
Expired	(1,548,090)	0.473	
Cancelled	(2,940,822)	0.467	
Outstanding, January 1, 2008	3,195,348	0.235	2008-2012
Granted to:			
Directors, management and employees	870,000	0.180	2013
Brokers	122,850	0.167	2009
Brokers	5,722,224	0.120	2010
Ceres Capital options acquired on RTO	1,025,000	0.200	2011
Exercised	-	-	-
Expired	(255,348)	1.017	
Outstanding, December 31, 2008	10,680,074	\$ 0.147	2009-2013

December 31, 2008			
Exercise price	Number outstanding	Weighted-average remaining contractual life (years)	Number exercisable
\$0.120	5,722,224	1.46	5,722,224
\$0.170	3,062,850	3.79	3,062,850
\$0.180	870,000	4.98	870,000
\$0.200	1,025,000	2.89	1,025,000
\$0.147	10,680,074	2.55	10,680,074

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***For the years ended December 31, 2008 and 2007***13. Share Capital (Continued)***Stock based compensation*

The Company has recorded stock-based compensation for all stock options granted. The compensation expense is calculated based on the fair value of stock options on the date of the grant using the Black-Scholes option pricing model using the following assumptions:

Date of issue	Risk free interest rate	Expected life (in years)	Expected dividend yield	Expected volatility
January 12, 2007	4.02%	1.0	0.0%	0.0%
November 27, 2007	3.74%	2.5	0.0%	0.0%
December 31, 2007	3.78%	1.0	0.0%	0.0%
August 12, 2008	2.81%	1.0	0.0%	0.0%
December 11, 2008	1.30%	1.5	0.0%	65%
December 23, 2008	1.22%	1.5	0.0%	65%
December 24, 2008	1.74%	5.0	0.0%	65%

As all stock options issued vest immediately, the full amount of the compensation cost has been recorded. The fair value of granted and vested options during the year was \$258,700 (2007 - \$nil), of which \$47,800 (2007 - \$nil) was expensed and an additional \$210,900 (2007 - \$1,967) for broker options has been charged to share issue costs.

**e. Common share purchase warrants**

The Company has 1,362,858 common share purchase warrants outstanding (2007 – 857,142). Of this amount, 857,142 warrants entitle the holder to acquire 857,142 common shares of the Company at an exercise price of \$0.47 per share expiring October 20, 2009 and 505,716 warrants entitle the holder to acquire 505,716 common shares of the Company at an exercise price of \$nil expiring December 31, 2013.

**14. Contributed Surplus**

	2008	2,007
Balance, beginning of year	\$ 200,573	\$ 198,606
Stock based compensation:		
Options issued to directors and management	47,800	-
Brokers warrants	210,900	1,967
Balance, end of year	\$ 459,273	\$ 200,573

**15. Per Share Amounts**

The weighted average number of shares outstanding was:

	2008	2007
Basic and diluted	41,113,427	34,464,318

The effect of options and warrants has not been included in the calculation of diluted earnings per share as the effect is anti-dilutive in 2008 and 2007.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***For the years ended December 31, 2008 and 2007***16. Supplemental Cash Flow Information**

	2008	2007
Accounts receivable	\$ (493,406)	\$ 322,460
Prepaid expenses and deposits	(48,480)	22,156
Demand notes receivable	(26,308)	-
Accounts payable and accruals	1,398,910	(845,303)
Deferred bonus obligation	-	(184,000)
Changes in non-cash working capital	<b>830,716</b>	(684,687)
Allocated to:		
Financing activities	\$ (245,496)	\$ (125,988)
Investing activities	191,297	-
Operating activities	<b>884,915</b>	(558,699)

**17. Commitments**

The Company is committed to payments under an operating lease for office space through April 2011 totalling \$450,000 (2009 - \$192,000; 2010 - \$193,000; 2011 - \$65,000).

In August, 2008 Reliable entered into a farm-in agreement to explore 48,000 acres of land in southeast Saskatchewan and southwest Manitoba. Under the terms of the agreement, the Company must, on an ongoing basis, spud a well within 75 days from the rig release date of the last preceding well.

Under the flow-through share agreements entered into in 2008, the Company is required to incur eligible resource expenditures of \$8,739,760 prior to December 23, 2009. These expenditures will be renounced to the flow-through share investors effective December 31, 2008. As of December 31, 2008, a total of \$8,583,965 remains to be incurred on eligible expenditures.

**18. Related Party Transactions**

- (a) During the year the Company had the following transactions with companies controlled by certain of the Company's Directors and Officers:

	2008	2007
Management consulting fees charged to:		
General and administrative	\$ 715,067	\$ 571,274
Operating expenses	69,000	67,149
Property and equipment	3,000	16,815

As at December 31, 2008, accounts payable and accruals includes a balance of \$35,210 (2007 - \$nil) relating to the above transactions.

These transactions were in the normal course of business and valued at the exchange amount, which is the amount of consideration established and agreed to by the related parties.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**18. Related Party Transactions (Continued)**

- (b) During 2006 the Company accepted a promissory note from a related party shareholder in the amount of \$75,000 regarding the purchase of shares. The note bears interest at 6% and is repayable in annual installments of \$25,000 beginning on July 1, 2007. However, the 2008 annual payment was not made as acknowledged by the Board. The note is secured by the borrower's shares in the Company.
- (c) The Company has paid certain costs on behalf of related parties. At December 31, 2008, accounts receivable includes a balance of \$10,106 (2007 - \$10,076) relating to these transactions.

**19. Financial Instruments**

The Company's financial instruments consist of accounts receivable, short term investments, accounts payable and accruals, commodity contracts and convertible debentures. The main financial risks affecting the Company are discussed below:

*Fair value*

The carrying amount of accounts receivable, short term investments and accounts payable and accruals approximates their fair value due to the short-term maturities of these items. The fair value of the convertible debentures as of December 31, 2008 was estimated by discounting future cash flows at a rate that approximated the interest rate that would have been applicable to non-convertible debt. The fair value approximated the carrying value at that time.

*Credit concentration*

Credit risk is the risk of a financial loss occurring as a result of a default of a counterparty on its obligation to the Company. The Company's financial instruments that are exposed to credit risk consist primarily of accounts receivable with customers in the oil and gas industry and are subject to normal industry credit risks. The Company continuously monitors and evaluates credit risk to third parties.

At December 31, 2008, accounts receivable included \$301,225 related to the private placement completed in December. All of these amounts have subsequently been collected.

The Company does not have an allowance for doubtful accounts nor was it required to write-off any receivables during the period ended December 31, 2008. The Company does not consider any receivables to be past due.

*Commodity price risk*

The Company is exposed to fluctuations in commodity prices for natural gas. Commodity prices are affected by many factors including supply and demand. The Company monitors these risks and when appropriate, utilizes financial instruments to manage its exposure to these risks.

At December 31, 2008 the Company has no outstanding derivative contracts.

*Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in the interest rates. In seeking to minimize the risks from interest rate fluctuations, the Company manages exposure through its normal operating and financing activities. The Company is exposed to interest rate risk primarily through its floating interest rate credit facilities (Note 8). To date, the Company has not made any draws on its credit facilities.



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*For the years ended December 31, 2008 and 2007*

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**19. Financial Instruments (Continued)**

*Liquidity risk*

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with the financial liabilities. The Company's operating cash requirements, including amounts projected to complete the Company's existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include but are not limited to, available credit, production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects and regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. As these variables change, liquidity risks may necessitate the Company to conduct equity issues or obtain project debt financing. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses.