KENARTHA OIL AND GAS COMPANY LIMITED

FINANCIAL STATEMENTS

MARCH 31, 2004

Hilborn Ellis Grant LLP
Chartered Accountants
Toronto, Ontario

Auditors' Report

To the Shareholders of
Kenartha Oil and Gas Company Limited

We have audited the balance sheets of **Kenartha Oil and Gas Company Limited** as at March 31, 2004 and March 31, 2003 and the statements of income, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

Toronto, Ontario (Signed) HILBORN ELLIS GRANT LLP
July 14, 2004 Chartered Accountants

Balance Sheet

March 31, 2004	2004 $	2003 $
ASSETS		
Current Assets		
Cash	**9,263**	11,350
Accounts receivable	**23,762**	52,821
Deposits	**11,150**	11,150
Prepaid expenses	**4,645**	1,856
	48,820	77,177
Long-term Assets		
Equipment *(note 3)*	**72,062**	40,814
	120,882	117,991
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities *(notes 1 and 4)*	**108,395**	131,597
Note payable *(note 5)*	**140,500**	140,500
	248,895	272,097
SHAREHOLDERS' EQUITY (DEFICIENCY IN ASSETS)		
Capital stock *(note 6)*	**2,427,000**	2,427,000
Deficit	**(2,555,013)**	(2,581,106)
	(128,013)	(154,106)
	120,882	117,991

Approved on behalf of the Board:

(Signed) Ernest W. Harrison, Director

(Signed) Marty Martinello, Director

Statement of Income

Year ended March 31, 2004	2004 $	2003 $
Revenue		
Sales of natural gas	**185,118**	274,487
Expenses		
Production royalties *(note 4(a))*	**52,450**	96,762
Field supplies and maintenance	**38,903**	50,058
Rent	**15,600**	14,250
Professional fees	**5,000**	11,630
Management fees *(note 4(b))*	**-**	47,451
General and administrative	**19,439**	18,086
Interest *(note 5)*	**7,806**	6,941
Amortization	**19,827**	16,996
	159,025	262,174
Income before income taxes	**26,093**	12,313
Income taxes	**9,654**	4,694
Recovery on application of prior year's losses	**(9,654)**	(4,694)
	-	-
Net income for year	**26,093**	12,313
Earnings per share	**.00330**	.00156

Statement of Retained Earnings

Year ended March 31, 2004	2004 $	2003 $
Deficit, beginning of year	**(2,581,106)**	(2,593,419)
Net income for year	**26,093**	12,313
Deficit, end of year	**(2,555,013)**	(2,581,106)

Statement of Cash Flows

Year ended March 31, 2004	**2004** **$**	**2003** **$**
Cash flows from operating activities		
Net income for year	**26,093**	12,313
Item not requiring a current cash payment		
Amortization	**19,827**	16,996
	45,920	29,309
Changes in non-cash working capital		
Decrease (increase) in accounts receivable	**29,059**	(36,714)
Increase in prepaid expenses	**(2,789)**	-
Increase (decrease) in accounts payable	**(23,202)**	11,192
	48,988	3,787
Cash flows from investing activities		
Purchase of equipment	**(51,075)**	-
Increase in cash during year	**(2,087)**	3,787
Cash, beginning of year	**11,350**	7,563
Cash, end of year	**9,263**	11,350

	2004 **$**	**2003** **$**
Supplementary Disclosure of Cash Flow Information		
Interest paid	7,806	6,941
Income taxes paid	-	-

Notes to Financial Statements

March 31, 2004

1. **Basis of Presentation**

These financial statements have been prepared on a going concern basis, which contemplates that the company will be able to discharge its liabilities in the normal course of operations.

In order to continue in operation, the company requires extended payment terms on the amount due to a corporation, which is a member of the controlling group.

2. **Significant Accounting Policies and General**

a) **Amortization**

Amortization of equipment has been provided for on the declining balance method as follows:

Pipeline	- 20% per annum
Compressor	- 30% per annum
Equipment	- 20% per annum

b) **Financial instruments**

The company's financial instruments consist of cash, accounts receivable, deposits, accounts payable and accrued liabilities and note payable. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

c) **Measurement uncertainty**

Financial statements are based on representations that often require estimates to be made in anticipation of future transactions and events and include measurements that may, by their nature, be approximations.

3. **Equipment**

	Cost $	Accumulated Amortization $	2004 Net $	2003 Net $
Pipeline	76,045	74,199	1,846	2,306
Compressor	183,445	113,272	70,173	38,453
Equipment	4,807	4,764	43	55
	264,297	192,235	72,062	40,814

March 31, 2004

4. Related Party Transactions

a) Production royalty expense includes $23,140 (2003 - $68,622) charged by a corporation for which a director of the company is an officer. The corporation has been assigned a 12½% (2003 - 25%) royalty on natural gas sales as an inducement with respect to financial assistance provided to Kenartha Oil and Gas Company Limited *(note 5)*.

b) A corporation, which is a member of the controlling group, provides management services to this company and makes certain payments on its behalf. Management fees of $nil (2003 - $47,451) and field expenses of $nil (2003 - $10,457) have been charged in this respect. Included in accounts payable are amounts due to the corporation totalling $nil (2003 - $7,795).

5. Note Payable

The promissory note is due on demand and bears interest at the Bank of Nova Scotia's prime lending rate, compounded monthly.

6. Capital Stock

a) **Authorized**

2,000,000	voting, redeemable (at 1/10th of 1 cent each) non-participating preference shares
Unlimited	common shares

b) **Issued**

500,000	preference shares	$ 500
7,895,790	common shares	2,426,500
		$2,427,000

The company issued 6,579,825 common shares pursuant to a stock dividend declared on May 10, 2002, whereby the holder of each common share received five common shares for each share held. There was no value ascribed to the stock dividend.

c) **Stock option plan**

The company has a designated stock option plan ("DSOP") permitting the granting of options to officers, employees and consultants. On April 6, 2000, the directors reserved 131,496 common shares to the DSOP, at an option price of $0.20 per share, which must be allotted within five years. Pursuant to the stock dividend declared on May 10, 2002 *(see note 6(b))*, the DSOP reserved common shares were increased to 788,976 shares. The option price of the additional 657,480 reserved common shares has yet to be fixed by the directors, but shall not be less than the fair market value of the outstanding common shares at the time the stock dividend was declared. The limit for the DSOP is 10% of the issued common shares and for a single participant, 5% of the issued common shares. No options have been allocated and granted under the DSOP. In 2003 the company passed a resolution to cancel the reservation of common shares under the DSOP.

Notes to Financial Statements (continued)

March 31, 2004

7. **Commitments and Contingencies**

a) In common with other corporations in the gas industry, the company self-insures for any costs related to environmental matters. No events have occurred which might give rise to liability for site cleanup costs and no estimate can be made of future costs, if any, related to environmental matters.

b) The company is committed to make lease payments of $1,000 annually until 2004 for its revenue producing property. As at the financial statement reporting date, the company was in the process of renegotiating a renewal of this lease.

c) On June 1, 2001, the company entered into a three-year premises lease requiring monthly payments of $1,300. As at the financial statement reporting date, the company was in the process of renegotiating a renewal of this lease.

d) Deposits in the amount of $11,150 (2003 - $11,150) are held by the Ontario Ministry of Natural Resources for the company's three gas well leases. Under current legislation, an increase in deposits, to a maximum of $22,000, will be phased in over the next several years.

8. **Tax Losses Carried Forward**

a) The company has accumulated non-capital losses for income tax purposes of $75,951, which can be carried forward to be applied against taxable income. The right to use these losses expires as follows:

2007	$28,442
2008	47,509

In addition, the company has approximately $122,000 in amounts that have been deducted for accounting purposes that have not, as yet, been deducted for income tax purposes, relating to its equipment. The future income tax benefit related to this difference has not been recognized in the accounts.

b) The company has net capital losses of $250,607, which can be carried forward indefinitely to be applied against future taxable capital gains.