

PALLISER OIL AND GAS CORPORATION
FINANCIAL STATEMENTS
DECEMBER 31, 2007

AUDITORS' REPORT

To: The Shareholders of
Palliser Oil and Gas Corporation

We have audited the balance sheet of **Palliser Oil and Gas Corporation** (the "Company") as at December 31, 2007 and the statements of operations and deficit and cash flows for the year 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 audit.

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

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

The financial statements as at December 31, 2006 and for the year then ended were audited by other auditors who expressed an opinion without reservation on these statements in their report dated June 27, 2007, except for note 10 which was dated as of August 31, 2007.

Calgary, Alberta
July 11, 2008

HUDSON LLP
Chartered Accountants

Palliser Oil & Gas Corporation

Balance Sheets

As at December 31,

2007

2006

Assets

Current assets

Cash	\$ 554,727	\$ 1,757,949
Accounts receivable	668,107	200,453
Deposits and prepaid expenses	28,266	8,206
	<u>1,251,100</u>	<u>1,966,608</u>

Property, plant and equipment (note 5)

6,329,763 4,195,056

\$ 7,580,863 \$ 6,161,664

Liabilities and Shareholders' Equity

Current liabilities

Accounts payable and accrued liabilities \$ 1,624,002 \$ 1,162,364

Asset retirement obligations (note 6)

294,433 178,533

Future income taxes (note 7)

708,840 199,296

Shareholders' equity:

Share capital (note 8b)	5,636,580	4,817,180
Contributed surplus (note 8d)	106,102	27,605
Deficit	(789,094)	(223,314)
	<u>4,953,588</u>	<u>4,621,471</u>

\$ 7,580,863 \$ 6,161,664

Subsequent events (note 12)

Approved on behalf of the Board:

_____ Director

_____ Director

Palliser Oil & Gas Corporation

Statements of Operations and Deficit

For the years ended December 31,

2007

2006

Revenue

Petroleum and natural gas	\$ 545,448	\$ 161,850
Royalties	(85,102)	(25,504)
	<u>460,346</u>	<u>136,346</u>

Gas processing and other	80,128	65,192
Interest income	17,601	52,593
	<u>97,729</u>	<u>117,785</u>

558,075 254,131

Expenses

Operating	357,634	130,072
General and administrative	346,129	207,783
Stock-based compensation	36,620	18,680
Depletion, depreciation and accretion	242,580	85,868
Part XII.6 tax	5,648	34,954
	<u>988,611</u>	<u>477,357</u>

Loss before income taxes (430,536) (223,226)

Future income tax (recovery) 135,244 (43,190)

Net loss (565,780) (180,036)

Deficit, beginning of year (223,314) (43,278)

Deficit, end of year \$ (789,094) \$ (223,314)

Net loss per share basic and diluted (note 8e) \$ (0.06) \$ (0.02)

Palliser Oil & Gas Corporation

Statements of Cash Flows

For the years ended December 31,

2007

2006

Operating

Net loss \$ (565,780) \$ (180,036)

Items not affecting cash

Depletion, depreciation and accretion 242,580 85,868

Future income taxes 135,244 (43,190)

Stock-based compensation 36,620 18,680

(151,336) (118,678)

Changes in non-cash working capital (note 9)

(155,769) (58,834)

(307,105) (177,512)

Financing

Issue of share capital, net of issue costs 1,173,900 871,955

Investing

Expenditures on property, plant and equipment (2,199,710) (2,096,148)

Payment of shareholder loans acquired - (175,787)

Purchase of 947380 Alberta Ltd. common shares - (549,597)

Changes in non-cash working capital (note 9) 129,693 934,791

(2,070,017) (1,886,741)

Decrease in cash

(1,203,222) (1,192,298)

Cash, beginning of year

1,757,949 2,950,247

Cash, end of year

\$ 554,727 \$ 1,757,949

Supplemental cash flow information:

Interest received \$ 17,601 \$ 52,593

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

1. Incorporation and nature of operations

Palliser Oil & Gas Corporation (“Palliser”) was incorporated under the Business Corporations Act (Alberta) on November 2, 2005. On July 18, 2006 Palliser amalgamated with 947380 Alberta Ltd. (“947380”), a private company (see note 4). The amalgamated entity continued under the name Palliser Oil & Gas Corporation (the “Company”). The Company’s principal business activity is the exploration, exploitation, development and production of petroleum and natural gas reserves in the Provinces of Alberta and Saskatchewan.

2. Significant accounting policies

The financial statements of Palliser Oil & Gas Corporation (“The Company”) have been prepared by management in accordance with Canadian generally accepted accounting principles. Since the determination of certain assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these financial statements requires the use of estimates and assumptions, which have been made with careful judgement.

Specifically, the amounts recorded for depletion and depreciation of property, plant and equipment and the provision for asset retirement obligations and abandonment costs are based on estimates. The ceiling test is based on estimates of reserves, future production rates, future petroleum and natural gas prices, future costs and other relevant assumptions.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company’s employee stock options have characteristics significantly different from those traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management’s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

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. In the opinion of management, these financial statements have been properly prepared in accordance with generally accepted accounting principles within reasonable limits of materiality and within the framework of the significant policies summarized below.

(a) Property, plant and equipment

Capitalized costs

The Company follows the full cost method of accounting for its petroleum and natural gas properties. Under this method, all costs related to the acquisition of, exploration for, and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, overhead directly related to exploration and development activities and costs of drilling both productive and non-productive wells.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

2. Significant accounting policies – continued

(a) Property, plant and equipment, continued

Proceeds from the sales of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion and depreciation by 20% or more.

Impairment

The impairment calculation, or “ceiling test”, is performed by comparing the carrying value of property, plant and equipment to the sum of undiscounted cash flows expected to result from the future production of proved reserves and the carrying value of unproved properties, net of any impairments. Estimates of future net revenues are based on expected future commodity prices and costs rather than those existing at the measurement date.

Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying value of property, plant and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the carrying value of unproved properties, net of any impairments. A risk-free interest rate is applied to arrive at the net present value of the future cash flows. Any excess is recorded as a permanent impairment and charged as additional depletion and depreciation.

Unproved properties are assessed periodically to determine whether impairment has occurred.

Depletion

Depletion of petroleum and natural gas properties and depreciation of production equipment is calculated using the unit-of-production method based upon estimated proven petroleum and natural gas reserves, before royalties, as determined by management. In determining its depletion base, the Company includes estimated future costs to be incurred in developing proven reserves and excludes the costs of the unproved properties.

Relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Depreciation

Office furniture and computer equipment are amortized using the declining method over its estimated useful life at rates varying from 20% to 45% per annum. Amortization is calculated using the half-year rule in the year of acquisition.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

2. Significant accounting policies, continued

(b) Asset retirement obligations

The fair value of the liability for the Company's asset retirement obligations is recorded in the period it is incurred with a corresponding increase in the carrying value of the related long-lived asset. Fair value is estimated using the present value of the estimated future cash outflows to reclaim and abandon wells and facilities, using the Company's credit-adjusted risk-free interest rate. The liability is subsequently adjusted due to the passage of time and the increase is recorded as an accretion expense. The liability is also adjusted for revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Actual asset retirement obligations paid are deducted from the liability in the year incurred.

(c) Income taxes

The Company uses the asset and liability method of accounting for future income taxes. The future income tax asset or liability is calculated assuming the financial assets and liabilities will be settled at their carrying amount. This amount is compared to the income tax assets and the difference is multiplied by the substantively enacted income tax rate when the temporary differences are expected to reverse.

(d) Interest in joint operations

Substantially all of the exploration, development and production activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

(e) Comparative amounts

Certain comparative amounts have been reclassified to conform with presentation adopted in the current year.

(f) Cash and cash equivalents

Cash and cash equivalents include cash on hand, balances with banks and short-term deposits with original maturities of less than three months.

(g) Flow-through shares

Resource expenditure deductions funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. To recognize the foregone tax benefits to the Company, the future income tax liability and the carrying value of the shares issued are adjusted by the effect of the tax benefits renounced to subscribers when the corresponding exploration and development expenditures are renounced.

(h) Revenue recognition

Revenue from petroleum and natural gas is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating, transportation, and production based royalties are recognized in the same period in which the related revenue is earned.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

2. Significant accounting policies, continued

(i) Per share amounts

Basic per share amounts are calculated using the weighted average number of shares outstanding during the period. Diluted per share amounts are calculated using the treasury-stock method, which assumes that any proceeds obtained on exercise of options, warrants and performance shares would be used to purchase common shares at the estimated market price. The weighted average number of shares outstanding is then adjusted by the net change.

(j) Stock-based compensation

The Company follows the fair value method of accounting for stock options or performance warrants granted to directors, officers, employees and consultants. Fair value is determined at the grant date using the Black-Scholes option-pricing model. As a private company, the Company uses the minimum value method which uses zero volatility in the calculation of fair value for stock options or performance warrants. The value attributed to options is recognized over the vesting period as stock-based compensation expense with a corresponding credit to contributed surplus. The contributed surplus balance is reduced as the options or performance warrants are exercised with the amount initially recorded being credited to share capital. The Company has not incorporated an estimated forfeiture rate, rather the Company accounts for actual forfeitures as they occur.

3. Recent accounting pronouncements

Recently the Accounting Standards Board (“AcSB”) approved new accounting recommendations which have not yet come into effect. The following is a summary of the new recommendations:

(a) Financial Instruments Disclosure and Presentation

In January 2005, the AcSB issued new recommendations for the recognition and measurement of financial instruments, and amendments to the existing presentation and disclosure standards, effective for annual financial statements with fiscal years beginning on or after October 1, 2006 for publicly accountable entities and on or after October 1, 2007 for non-publicly accountable entities. Section 3855 Financial Instruments – Recognition and Measurement establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. Section 3862 Financial Instruments – Disclosure and Section 3863 Financial Instruments - Presentation discuss the presentation and disclosure of these items. The optional application of hedge accounting is covered in Section 3865 Hedges. Section 1530 Comprehensive Income establishes standards for reporting and displaying certain gains and losses, such as unrealized gains and losses related to hedges or other instruments, outside of net income, in a statement of comprehensive income. Section 3251 Equity establishes standards for the presentation of equity and changes in equity, including changes arising from those items recorded in comprehensive income. There have also been numerous consequential amendments made to other Sections including those listed below. The Company will be applying these new recommendations for its financial statement dated 2008. Transitional provisions are complex and vary based on the type of financial instruments under consideration, therefore, the Company has not yet determined the effect of these new standards on its financial statements.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

3. Recent accounting pronouncements, continued

(b) Going concern

For fiscal years beginning on or after January 1, 2008 the AcSB issued recommendations for assessing and disclosing an entity's ability to continue as a going concern. Section 1400 was amended in June 2007 requiring management to assess their ability to continue as a going concern and to disclose the results of this assessment.

(c) Capital disclosures

The AcSB have issued Section 1535 with an effective date for periods commencing on or after October 1, 2007. This standard will require the Company to make disclosures regarding:

- the Company's objectives, policies and processes for managing capital;
- quantitative data about what the Company regards as capital;
- whether the Company had complied with any capital requirements; and
- if it has not complied, the consequences of such non-compliance.

Management is currently reviewing the impact that this standard will have on the Company's financial statements.

(d) Intangible assets

The AcSB has issued new Section 3064, "Goodwill and Intangible Assets" which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. In particular, this section restricts the ability of a company to recognize internal costs as deferred assets. This new standard has an effective date of October 1, 2008. Management is currently considering whether this new standard will have any effect on the Company's financial statements.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

4. Acquisitions

On June 20, 2006, Palliser completed the acquisition of certain petroleum and natural gas properties from Silver Strand Energy Corporation ("Silver Strand") as follows:

Petroleum and natural gas properties	\$ 1,413,850
Asset retirement obligations	(71,352)
Future income tax liability	<u>(165,459)</u>
Net assets acquired	<u>\$ 1,177,039</u>
Consideration	
Cash	\$ 177,039
2,000,000 common shares at \$0.50 per share	<u>1,000,000</u>
	<u>\$ 1,177,039</u>

Silver Strand is a related party by virtue of its outstanding shares being controlled by an officer and director of Palliser. The acquisition was not in the normal course of operations and was recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

The results of operations of Silver Strand are included in the accounts of the Company from June 20, 2006.

On July 18, 2006 Palliser completed the acquisition of all of the outstanding shares of 947380 Alberta Ltd. ("947380"). A summary of the transaction using the purchase method of accounting is as follows:

Petroleum and natural gas properties	\$ 880,001
Net working capital assumed	10,000
Shareholder loans assumed	(175,788)
Asset retirement obligations	(50,966)
Future income tax liability	<u>(77,027)</u>
Net assets acquired	<u>\$ 586,220</u>
Consideration	
Cash	<u>\$ 586,220</u>

947380 was a related party by virtue of 50% of its outstanding shares being controlled by an officer and director of Palliser. The acquisition was not in the normal course of operations and was recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

The results of operations of 947380 are included in the accounts of the Company from July 18, 2006.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

5. Property, plant and equipment

December 31, 2007	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and natural gas properties and equipment	\$ 6,575,888	\$ (287,485)	\$ 6,288,403
Office furniture and equipment	63,773	(22,413)	41,360
	<u>\$ 6,639,661</u>	<u>\$ (309,898)</u>	<u>\$ 6,329,763</u>

December 31, 2006	Cost	Accumulated Depletion and Depreciation	Net
Petroleum and natural gas properties and equipment	\$ 4,235,481	\$ (77,485)	\$ 4,157,996
Office furniture and equipment	45,443	(8,383)	37,060
	<u>\$ 4,280,924</u>	<u>\$ (85,868)</u>	<u>\$ 4,195,056</u>

The cost of unproved properties at December 31, 2007 of \$594,454 (2006 – \$890,254) was excluded from the depletion calculation. Estimated future development costs associated with the development of the Company's proved reserves of \$509,400 (2006 – nil) have been included in the depletion calculation.

The following corporate expenses related to exploration and development activities were capitalized:

	December 31, 2007	December 31, 2006
General and administrative expense	\$ 332,845	\$ 344,672
Stock-based compensation expense, including future income taxes	61,677	-
	<u>\$ 394,522</u>	<u>\$ 344,672</u>

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

5. Property, plant and equipment, continued

In conducting the ceiling test as at December 31, 2007, the Company's estimated future cash flows exceeded the carrying value of the related petroleum and natural gas properties, after using certain assumptions pertaining to future commodity prices. Assumptions for crude oil refinery postings at Edmonton and for spot natural gas postings at AECO-C storage hub are as follows:

	Oil (\$/barrel)	Gas (\$/mcf)
2008	77.00	7.55
2009	78.35	7.90
2010	79.60	8.05
2011	80.65	8.35
2012	78.60	9.10
Thereafter (% change)	+2%	+2%

The Company's price forecasts at the wellhead reflect quality and transportation adjustments.

6. Asset retirement obligations

The future asset retirement obligations were determined by management and were based on the Company's net ownership interest, the estimated future costs to reclaim and abandon the wells and facilities and the estimated timing of when the costs will be incurred. The Company estimated the net present value of its total asset retirement obligations as at December 31, 2007 to be \$294,433 (2006 - \$178,533) based on a total future liability of \$617,900 (2006 - \$388,300). These obligations are expected to be settled at various times over the next 14 years. An 8% (2006 - 8%) credit adjusted risk free discount rate and 2% (2006 - 2%) inflation rate were used to calculate the present value of the asset retirement obligation.

The following table reconciles the Company's asset retirement obligations:

	December 31, 2007	December 31, 2006
Asset retirement obligations, beginning of period	\$ 178,533	\$ -
Incurred	97,350	56,215
Acquired	-	122,318
Accretion	18,550	-
Asset retirement obligations, end of period	<u>\$ 294,433</u>	<u>\$ 178,533</u>

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

7. Future income taxes

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

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Property, plant and equipment	\$ (1,118,090)	\$ (300,896)
Non-capital losses	314,000	75,300
Asset retirement obligations	94,500	25,000
Share issue costs	750	1,300
	<u>\$ (708,840)</u>	<u>\$ (199,296)</u>

8. Share capital

a. Authorized

Unlimited number of common voting shares.

Unlimited number of First and Second preferred shares.

b. Issued and outstanding

	<u>December 31, 2007</u>		<u>December 31, 2006</u>	
	Number	Amount	Number	Amount
Balance, beginning of period	9,405,735	\$ 4,817,180	5,740,435	\$ 2,945,225
Shares issued for cash	1,677,000	1,173,900	1,665,300	876,680
Shares issued on acquisition of oil and gas properties	-	-	2,000,000	1,000,000
Share issuance costs	-	-	-	(4,725)
Future tax effect on flow- through shares	-	(354,500)	-	-
Balance, end of period	<u>11,082,735</u>	<u>\$ 5,636,580</u>	<u>9,405,735</u>	<u>\$ 4,817,180</u>

- i) On June 20, 2006, the Company issued 815,000 Common Shares at \$0.50 per share and 400,300 flow-through Common Shares at \$0.60 per share for gross proceeds of \$647,680.
- ii) On June 20, 2006, the Company issued 2,000,000 common shares as partial consideration for the acquisition of petroleum and natural gas properties from Silver Strand (see note 4).

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

8. Share capital, continued

- iii) On October 17, 2006, the Company issued 50,000 Common Shares at \$0.50 per share for gross proceeds of \$25,000.
- iv) On December 19, 2006, the Company issued 360,000 Common Shares at \$0.50 per share and 40,000 flow-through Common Shares at \$0.60 per share for gross proceeds of \$204,000.
- v) On various dates from July 13, 2007 to October 12, 2007, the Company issued 1,677,000 Common Shares at \$0.70 per share for gross proceeds of \$1,173,900.

c. Stock based compensation

The Company measures compensation costs associated with stock based compensation using the fair market value method and the cost is recognized over the vesting period of the underlying security. The fair value of each stock option or performance warrant is determined at each grant date using the Black-Scholes model with the following weighted average assumptions:

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
Risk free interest rate (%)	4.25	4.25
Expected life (years)	5	5
Expected volatility (%)	0	0
Dividend yield (%)	0	0
Weighted average fair value, per option/warrant (\$)	0.098	0.119

During 2007 the Company recorded \$78,497 (2006 - \$18,680) of stock-based compensation expense related to stock options and performance warrants, of which \$41,877 (2006 - nil) was capitalized in accordance with the Company's full cost accounting policy. As stock-based compensation is non-deductible for tax purposes, a future income tax liability of \$19,800 (2006 - nil) associated with the current year's capitalized stock-based compensation has been recorded.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

8. Share capital, continued

i) Stock Options

The Company has a stock option plan for its directors, officers, employees, and consultants, which permits the granting of options up to 10% of the issued and outstanding shares of the Company at the date of grant. The number of options and the exercise price thereof is set by the Board of Directors at the time of grant provided that such exercise price shall not be less than that from time to time permitted under the rules of any stock exchange on which the Company's shares may be listed. The maximum number of options that may be granted to any one individual shall not exceed 5% of the Company's issued and outstanding common shares. The options granted under the plan may be exercisable for a period not exceeding five years and may vest at such times as the Board of Directors may determine at the time of grant.

	<u>December 31, 2007</u>		<u>December 31, 2006</u>	
	Number of options	Weighted Average Exercise Price	Number of options	Weighted Average Exercise Price
Balance, beginning of period	650,000	\$ 0.50	350,000	\$ 0.50
Granted	280,000	0.50	300,000	0.50
Balance, end of period	<u>930,000</u>	<u>\$ 0.50</u>	<u>650,000</u>	<u>\$ 0.50</u>

Stock options outstanding and exercisable at December 31, 2007

<u>Options Outstanding</u>			<u>Options Exercisable</u>		
Options	Price	Weighted-avg Life Remaining (in years)	Options	Price	Weighted-avg Life Remaining (in years)
930,000	\$ 0.50	3.5	643,333	\$ 0.50	3.3

ii) Performance Warrants

The Company issued 400,000 performance warrants on June 1, 2007 to officers and directors of the Company at an exercise price of \$0.70 ("Base Price"). The performance warrants allow the participant to purchase one-half of the common shares underlying the warrants after the time of issue and one-half after the first anniversary after the date of issue, provided that the Company's common share price has increased above the Base Price to a price per common share representing a compounded annual rate of return of at least 50% per annum with reference to the base price.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

8. Share capital, continued

d. Contributed surplus

	December 31, 2007	December 31, 2006
Balance, beginning of period	\$ 27,605	\$ 8,925
Stock-based compensation	<u>78,497</u>	<u>18,680</u>
Balance, end of period	<u>\$ 106,102</u>	<u>\$ 27,605</u>

e. Per share amounts

Per share amounts have been calculated on the weighted average number of shares outstanding. The weighted average shares outstanding for the year ended December 31, 2007 was 10,044,543 (2006 – 7,472,814). For the year ended December 31, 2007 and 2006 no shares were added for stock options or warrants as the results were anti-dilutive.

9. Supplemental cash flow information

	December 31, 2007	December 31, 2006
Changes in non-cash working capital		
Change in accounts receivable	\$ (467,654)	\$ (142,353)
Change in deposits and prepaid expenses	(20,060)	(8,206)
Change in accounts payable and accrued liabilities	<u>461,638</u>	<u>1,026,516</u>
	<u>\$ (26,076)</u>	<u>\$ 875,957</u>
Relating to:		
Operating activities	\$ (155,769)	\$ (58,834)
Investing activities	<u>129,693</u>	<u>934,791</u>
	<u>\$ (26,076)</u>	<u>\$ 875,957</u>

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

10. Related party transactions

- a. The Company incurred \$2,939 (2006 – \$14,409) for legal services from a firm in which a director of the Company is a partner. Of this amount, \$2,939 (2006 – \$14,409) is included in accounts payable.
- b. The Company has farmed out the purchase of certain production equipment to companies controlled by officers and directors of the Company. The production equipment farm out was not in the normal course of business and therefore has been recorded at the Company's cost. The Company leased these assets back on a monthly basis. Net payments under these arrangements for 2007 were \$5,720.

In addition, the Company paid \$20,000 (2006 - \$NIL) for the rental of certain other production equipment to a Company owned by an officer and Director of the Company

- c. Included in accounts receivable is \$203,623 (2006 – \$41,456) from a Company owned by an officer and director of the Company. Included in the \$203,623 accounts receivable is the accounts receivable for the farm-out of the production equipment (\$166,000) that was collected subsequent to year end.

The related party transactions, other than the farm out of the production equipment, were in the normal course of operations and were recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

11. Financial instruments

a. Fair value

The Company's carrying values of cash, accounts receivable and accounts payable and accrued liabilities approximates their fair values due to the immediate or short-term maturity of these instruments.

b. Credit risk

The majority of the accounts receivable are in respect to oil and natural gas operations. The Company generally extends unsecured credit to these customers, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company has not experienced any credit loss in the collection of receivables to date.

c. Commodity prices and exchange rate risk

The nature of the Company's operations results in exposure to fluctuation in commodity prices and exchange rates. Since inception, the Company has not entered into any derivative contracts to hedge these risks.

Palliser Oil & Gas Corporation

Notes to the Financial Statements

For the Years Ended December 31, 2007 and 2006

12. Subsequent events

a. Credit facility

In February 2008, the Company obtained a revolving operating line of credit (the "Facility") of \$1.6 million that is initially capped at \$0.8 million subject to the Company's ability to tie in the successful gas wells drilled in 2007. The Facility is payable in full on demand of the lender. Advances under the Facility are available by way of prime rate loans with interest rates of one per cent over the bank's prime lending rate. The Facility is secured by a general assignment over the Company's assets.

b. Performance warrants

On April 3, 2008, pursuant to the terms of the agreement all outstanding performance warrants (400,000) were cashlessly exercised resulting in the Company issuing 192,592 common shares.

c. Office lease

On June 6, 2008, the Company entered into an agreement to lease office space effective August 1, 2008. Pursuant to the agreement the Company's commitment will total \$112,550 in 2008, \$270,300 in 2009, \$275,500 in 2010, \$288,300 in 2011, \$295,750 in 2012 and \$172,520 in 2013.

d. Private placement

The Company completed a private placement on July 11, 2008. The Company issued 8,412,135 Common Shares at \$1.35 per share and 1,289,769 flow-through Common Shares at \$1.62 per share for gross proceeds of \$13.5 million. The proceeds for the flow-through Common Shares must be spent on qualifying exploration and development expenditures by December 31, 2009.