

## AUDITORS' REPORT

### To the Shareholders of Petro-Reef Resources Ltd.

We have audited the consolidated balance sheets of Petro-Reef Resources Ltd. as at December 31, 2006 and 2005, the consolidated statements of operations 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 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 consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and 2005, the results of its operations and its cash flows for years than ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Calgary, Alberta  
April 24, 2007

**PETRO-REEF RESOURCES LTD.**  
**Balance Sheet**  
**As at December 31, 2006 and 2005**

	2006	2005
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ -	\$ 397,904
Accounts receivable	1,864,015	2,142,072
Prepaid expenses and deposits	21,267	11,192
	<u>1,885,282</u>	<u>2,551,168</u>
<b>Property, plant and equipment</b> (note 3)	<u>13,171,164</u>	<u>7,911,121</u>
	<u>\$ 15,056,446</u>	<u>\$ 10,462,289</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Cheques drawn in excess of bank	\$ 1,613	\$ -
Bank line of credit (note 4)	375,000	-
Amounts due to directors and affiliated companies	208,679	177,822
Accounts payable and accrued charges	5,525,800	3,609,757
	<u>6,111,092</u>	<u>3,787,579</u>
<b>Future income taxes</b> (note 8)	634,512	426,827
<b>Asset retirement obligation</b> (note 5)	<u>391,648</u>	<u>217,915</u>
	<u>7,137,252</u>	<u>4,432,321</u>
<b>SHAREHOLDERS' EQUITY</b>		
<b>Share capital</b> (note 6)	7,559,760	5,558,614
<b>Warrants</b> (note 6)	606,719	820,000
<b>Contributed surplus</b> (note 6)	570,609	534,308
<b>Deficit</b>	<u>(817,894)</u>	<u>(882,954)</u>
	<u>7,919,194</u>	<u>6,029,968</u>
	<u>\$ 15,056,446</u>	<u>\$ 10,462,289</u>

SIGNED ON BEHALF OF THE BOARD

"Joseph Werner"  
 Director

"Robert N. Maertens-Poole"  
 Chief Financial Officer

**PETRO-REEF RESOURCES LTD.**  
**Statements of Operations and Deficit**  
**For the years ended December 31, 2006 and 2005**

	2006	2005
<b>Revenue</b>		
Oil and gas sales, net of royalties and ARTC	\$ 5,749,891	\$ 3,224,567
Interest income	9,723	3,427
	<u>5,759,614</u>	<u>3,227,994</u>
<b>Expenses</b>		
Production	1,502,968	757,703
Depletion and depreciation	2,770,624	1,380,232
General and administrative	1,158,160	593,896
Accretion expense	31,786	13,265
Loss on settlement of asset retirement obligation	568	4,291
Interest expense	22,763	44,990
	<u>5,486,869</u>	<u>2,794,377</u>
<b>Income before income tax</b>	272,745	433,617
<b>Future income taxes</b> (note 8)	<u>207,685</u>	<u>184,903</u>
<b>Net income for the year</b>	65,060	248,714
<b>Deficit - Beginning of year</b>	<u>(882,954)</u>	<u>(1,131,668)</u>
<b>Deficit - End of year</b>	<u>\$ (817,894)</u>	<u>\$ (882,954)</u>
<b>Basic and diluted income per common share</b>	<u>\$ 0.00</u>	<u>\$ 0.01</u>

**PETRO-REEF RESOURCES LTD.**  
**Statement of Cash Flows**  
**For the years ended December 31, 2006 and 2005**

	<b>2006</b>	<b>2005</b>
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income for the year	\$ 65,060	\$ 248,714
Items not effecting working capital		
Accretion expense	31,786	13,265
Depletion and depreciation	2,770,624	1,380,232
Loss on settlement of asset retirement obligation	568	4,291
Stock based compensation	481,709	176,308
Future income taxes	207,685	184,903
	<u>3,557,432</u>	<u>2,007,713</u>
Asset retirement expenditures	(1,000)	(19,520)
Net change in non-cash operating working capital items (note 12)	<u>1,585,925</u>	<u>198,837</u>
	<u>5,142,357</u>	<u>2,187,030</u>
<b>Financial activities</b>		
Bank line of credit	375,000	(700,000)
Proceeds from share issue	-	1,575,000
Share issue costs	(1,500)	(166,822)
Proceeds from exercise of stock options and warrants	<u>1,343,957</u>	<u>79,000</u>
	<u>1,717,457</u>	<u>787,178</u>
<b>Investing activities</b>		
Expenditures on property, plant and equipment	(7,888,288)	(2,374,843)
Net change in non-cash investing working capital items (note 12)	<u>628,957</u>	<u>210,310</u>
	<u>(7,259,331)</u>	<u>(2,164,533)</u>
<b>(Decrease) increase in cash</b>	(399,517)	809,675
<b>Bank (cheques drawn in excess of bank)</b>		
- Beginning of year	<u>397,904</u>	<u>(411,771)</u>
<b>Cheques drawn in excess of bank (bank)</b>		
- End of year	<u>\$ (1,613)</u>	<u>\$ 397,904</u>
<b>Supplemental information</b>		
Interest paid	<u>\$ 22,763</u>	<u>\$ 44,990</u>

## **1. Accounting policies**

Petro-Reef Resources Ltd. (the "Company") is engaged in the exploration for and production of oil and natural gas in Canada. The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada.

The Company has a working capital deficit of 4,225,810 as at December 31, 2006 and \$1,236,411 as at December 31, 2005. The Company is subject to certain debt covenants pertaining to demand operating facilities (note 3). At December 31, 2006 the Company was not in compliance with the working capital covenant. The working capital deficiency primarily results from accounts payable and accrued liabilities incurred as part of its drilling program. Management is proposing to repay this working capital deficiency through a combination of cash flows and future equity issues (note 12).

Significant accounting policies are summarized as follows:

### **Oil and gas operations**

The Company follows the full cost method of accounting for crude oil and gas operations whereby all costs related to the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Government incentives are credited to the cost of the oil and gas properties at the time the expenditures are incurred. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent depletion rate.

The Company places a limit on the carrying value of property, plant and equipment and other assets, which may be depleted against revenues of future periods (the "ceiling test"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves using forward pricing, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the fair value of proved and probable reserves, and the cost, less any impairment, of unproved properties that contain no probable reserves.

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the Company includes the net book value of its oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves and excludes the unimpaired cost attributable to unproved properties.

### **Depreciation**

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%. Depreciation of computer equipment is calculated using the declining balance method at an annual rate of 45%. Leasehold improvements are amortized over the useful life of 5 years using the straight-line method.

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### **Asset retirement obligation**

The Company records a liability for the fair value of legal obligations associated with the retirement of long-lived tangible assets in the period in which they are incurred, normally when the asset is purchased or developed. On recognition of the liability there is a corresponding increase in the carrying amount of the related asset known as the asset retirement cost, which is depleted on a unit-of-production basis over the life of the reserves. The liability is adjusted each reporting period to reflect the passage of time, with the accretion charged to earnings, and for revisions to the estimated future cash flows. Actual costs incurred upon settlement of the obligations are charged against the liability.

### **Stock options**

The Company has an incentive stock option plan for employees, officers, directors and consultants as described in note 6. The Company records stock based compensation expense using the fair value method. The fair value of an option is calculated at the grant date, and expensed equally over the vesting term of the option. The Company records the cumulative stock based compensation as a contributed surplus. When options are exercised, contributed surplus is reduced and share capital is increased by the amount of accumulated stock based compensation for the exercised option. Any consideration received on the exercise of stock options is credited to share capital.

### **Revenue recognition**

Revenue associated with the sale of crude oil, natural gas and natural gas liquids owned by the company are recognized when title passes from the company to its customers.

### **Income taxes**

The company follows the liability method of accounting for income taxes. Under this method, the company records future income taxes for the effect of any differences between the accounting and the income tax basis of an asset or liability using income tax rates substantially enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognized in income in the period of the change.

### **Earnings per share**

The company uses the treasury stock method to determine the dilutive effect of stock options and other dilutive instruments. This method assumes that any proceeds from the exercise of in-the-money stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period.

### **Joint ventures**

Substantially all of the company's activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the company's proportionate interest in such activities.

### **Cash and Cash equivalents**

Cash and cash equivalents consist of all cash on hand and balances with banks, as well as all highly liquid short-term investments. The Company considers all highly liquid short-term investments with original terms to maturity of three months or less to be cash equivalents.

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**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

**Measurement uncertainty**

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions and to use judgment regarding assets, liabilities, revenues and expenses. Accordingly, actual results may differ from those estimated amounts.

Recorded amounts for depletion and depreciation, asset retirement obligations and abandonment costs, the impairment of oil and natural gas properties and amounts used for the ceiling test and impairment calculations and based on estimates of oil and natural gas reserves and future costs required to develop those reserves. By their nature, these estimates of reserves and the related future cash flows and costs are subject to measurement uncertainty, and the effect on the consolidated financial statements of future periods could be significant.

**2. Property, plant, and equipment**

	<b>December 31, 2006</b>		
	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net</b>
Petroleum and natural gas	\$ 21,659,267	\$ 8,528,679	\$ 13,130,588
Furniture and fixtures	80,275	39,699	40,576
	<u>\$ 21,739,542</u>	<u>\$ 8,568,378</u>	<u>\$ 13,171,164</u>

	<b>December 31, 2005</b>		
	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net</b>
Petroleum and natural gas	\$ 13,661,763	\$ 5,766,284	\$ 7,895,479
Furniture and fixtures	47,113	31,471	15,642
	<u>\$ 13,708,876</u>	<u>\$ 5,797,755</u>	<u>\$ 7,911,121</u>

No interest or general and administrative expenses were capitalized during the period.

Unproven property costs of \$1,249,477 (2005 – \$390,069) have been excluded from capitalized costs subject to depletion.

The company performed a ceiling test calculation at December 31, 2006 in accordance with the policy described in note 1. The oil and gas future prices used in the calculation were based on the company's January 1, 2007 commodity price forecast which is consistent with the price forecast used by its independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to the company. The following table summarizes the benchmark prices used in the ceiling test calculation.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

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<b>Year</b>	<b>WTI Oil (\$US/bbl)</b>	<b>Foreign Exchange rate</b>	<b>Edmonton Light (crude oil) (\$Cdn/bbl)</b>	<b>AECO Gas (\$Cdn/MMBtu)</b>
2007	65.73	0.86	74.10	7.72
2008	68.82	0.86	77.62	8.59
2009	62.42	0.86	70.25	7.74
2010	58.37	0.86	65.56	7.55
2011	55.20	0.86	61.90	7.72
2012 – 2017	59.20	0.86	66.41	8.19
Escalate thereafter	2.0% per year		2.0% per year	2.0% per year

The ceiling test calculation did not result in any impairment write down at December 31, 2006.

### **3. Demand operating facilities**

Facility A is a revolving operating demand loan with a maximum limit of \$3,750,000. Facility B is a non-revolving acquisition/development demand loan that provides an additional \$1,000,000 of financing. Interest is at prime plus 1.25% per annum for Facility A and 1.5% per annum for the Facility B. At December 31, 2006 the balance owing on the current loan was \$375,000 (2005 - \$ NIL).

The facilities are secured by \$5,000,000 floating charge debenture over all the Company's assets with a negative pledge and undertaking to provide fixed charges on the Company's major producing properties at the request of the bank. The facilities are repayable on demand and are reviewed periodically by the bank, the next review being scheduled for May 2007.

The terms of the Company's bank facility includes certain financial statement covenants. At December 31, 2006, the Company was in violation of the working capital covenant, whereby it must maintain a 1 to 1 working capital ratio (including in working capital the undrawn portion of the facility). The Company's bank has issued a waiver regarding this violation. Management is proposing to repay this working capital deficiency through a combination of cash flows and future equity issues (note 12).

### **4. Asset retirement obligation**

The total future asset retirement obligation was estimated based on the Company's net ownership in all wells and facilities, estimated costs to reclaim and abandon the wells and the estimated timing of costs to be incurred in future periods. The Company has estimated the net present value of its asset retirement obligation to be \$391,648 (2005 - \$217,915) as at December 31, 2006 based on a total future liability of \$711,198 (2005 - 389,677) which will be incurred between 2006 and 2021. A credit adjusted risk free rate of 5.36 percent (2005 - 6.08 percent) and an inflation rate of 2 percent were used to calculate the fair value of the asset retirement obligation.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

A reconciliation of the asset retirement obligation is provided below:

	<u>2006</u>	<u>2005</u>
Balance, beginning of year	\$ 217,915	\$ 155,456
Liabilities incurred in year	142,379	64,423
Liabilities settled in year	(432)	(15,229)
Accretion expense	31,786	13,265
	<u>391,648</u>	<u>217,915</u>
Balance, end of year	\$ 391,648	\$ 217,915

**5. Share capital**

**a) Authorized**

Unlimited number of voting Class A common shares

**b) Issued**

**Class A common shares**

	<u>2006</u>		<u>2005</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Balance, beginning of year	21,438,924	\$ 5,558,614	17,738,937	\$ 4,772,876
Exercise of options (ii)	1,180,000	1,042,909	200,000	101,060
Exercise of warrants (iii)	1,066,367	959,737	-	-
Unit private placement (i)	-	-	3,499,987	874,995
Share issue costs, (net of \$96,500 of tax) (i)	-	(1,500)	-	(190,317)
	<u>23,685,291</u>	<u>\$ 7,559,760</u>	<u>21,438,924</u>	<u>\$ 5,558,614</u>
Balance, end of year	23,685,291	\$ 7,559,760	21,438,924	\$ 5,558,614

- (i) During 2005, the Company issued 3,499,987 Units priced at \$0.45. Each unit consisted of one Common Share and one Purchase Warrant. Each Purchase Warrant entitles the holder to purchase on additional Common Share at an exercise price of \$0.70 per Common Share until February 17, 2007. The warrants have been ascribed a fair value of \$700,000 using the Black-Scholes pricing model assuming a risk-free interest of 3%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 121%. Sinalta Investments Ltd. was paid a finder's fee of \$100,000, and granted warrants to 500,000 Common Shares at an exercise price of \$0.70 until February 17, 2007. These warrants have been recorded as share issue costs estimated at \$120,000 using the Black-Scholes pricing model assuming a risk-free interest rate of 3%; weighted average life of 1.5 years; dividend yield of nil; and expected volatility rate of 121%. All shares were subject to a hold period to January 17, 2006.
- (ii) The increase in share capital as a result of the exercise of stock options is comprised of the amount of cash received of \$597,501 and the compensation expensed previously of \$445,408.

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

(iii) The increase in share capital as a result of the exercise of warrants is comprised of the amount of cash received of \$746,456 and the reclassification to share capital of the ascribed value related to the warrants exercised of \$213,281.

**b) Warrants**

**2006**

	<b>Weighted Average Exercise Price</b>	<b>Number</b>	<b>Amount</b>
Balance, beginning of year ((note 5(a)(i)))	\$ 0.70	3,999,987	\$ 820,000
Exercise of warrants	0.70	(1,066,367)	(213,281)
Balance, end of year	<u>\$ 0.70</u>	<u>2,933,620</u>	<u>\$ 606,719</u>

**2005**

	<b>Weighted Average Exercise Price</b>	<b>Number</b>	<b>Amount</b>
Balance, beginning of year	\$ -	-	\$ -
Private placement agent warrants ((note 5 (a)(i)))	0.70	500,000	120,000
Unit private placement ((note 5 (a)(i)))	0.70	3,499,987	700,000
Balance, end of year	<u>\$ 0.70</u>	<u>3,999,987</u>	<u>\$ 820,000</u>

**c) Contributed surplus**

	<b>2006</b>	<b>2005</b>
Balance beginning of period	\$ 534,308	\$ 380,060
Compensation recognized in the year	481,709	176,308
Adjustment for options exercised in the period	(445,408)	(22,060)
Balance, end of period	<u>\$ 570,609</u>	<u>\$ 534,308</u>

**d) Per share amounts**

Earnings (loss) per common share are calculated using the weighted average number of common shares outstanding during the year. A reconciliation of the denominators used in the per share calculation is outlined below:

	<b>2006</b>	<b>2005</b>
Basic weighted average common shares	22,109,165	18,994,641
Effect of dilutive options and warrants	<u>3,304,499</u>	<u>2,752,516</u>
Diluted weighted average common shares	<u>25,413,664</u>	<u>21,747,157</u>

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

**6. Stock based compensation**

The Company has a stock option plan for directors, officers and key employees. The exercise price of each option equals the market price of the Company's stock on the date of grant. Options vest after one year and expire after a maximum period of five years from the date of issue.

A summary of the status of the company's stock option plan as of December 31, 2006 and 2005 and changes during the year are presented below:

	<u>2006</u>		<u>2005</u>	
	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
Balance beginning of year	2,120,000	\$ 0.50	1,510,000	\$ 0.49
Granted	1,040,000	1.24	810,000	0.50
Exercised	(1,180,000)	(0.50)	(200,000)	(0.40)
Balance end of year	<u>1,980,000</u>	<u>\$ 0.89</u>	<u>2,120,000</u>	<u>\$ 0.50</u>
Exercisable end of year	<u>940,000</u>	<u>\$ 0.50</u>	<u>1,310,000</u>	<u>\$ 0.50</u>

The following table summarizes information about stock options outstanding at December 31, 2006:

	<u>Options outstanding</u>		<u>Options exercisable</u>	
<u>Exercise Price</u>	<u>Number outstanding</u>	<u>Weighted Average Remaining contractual life</u>	<u>Number exercisable</u>	<u>Weighted Average Remaining contractual life</u>
\$ 0.42	350,000	1.52	350,000	1.52
0.50	430,000	3.54	430,000	3.54
0.52	10,000	3.65	10,000	3.65
0.70	100,000	2.46	100,000	2.46
0.71	50,000	2.21	50,000	2.21
0.90	40,000	4.87	-	-
1.05	50,000	4.73	-	-
1.20	390,000	4.82	-	-
1.30	<u>560,000</u>	4.47	<u>-</u>	<u>-</u>
	<u>1,980,000</u>	<u>3.70</u>	<u>940,000</u>	<u>2.68</u>

Compensation cost of \$481,709 (2005 - \$176,308) has been recognized for stock options granted during the year.

The weighted average fair value of each option granted during the year ended December 31, 2006 is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
Stock-based compensation (\$)	\$481,709	\$176,308
Fair value of options granted (\$/share)	0.78	0.33
Risk-free interest rate (%)	4.02	3.40
Expected life (years)	3	3
Expected volatility (%)	103	102
Expected dividend yield (%)	-	-

**7. Income taxes**

The following table summarizes the temporary differences which give rise to the future income tax liability at December 31:

	<u>2006</u>	<u>2005</u>
Future income tax liabilities		
Property, plant and equipment	\$ 801,585	\$ 577,232
Future income tax assets		
Asset retirement obligation	(113,578)	(73,263)
Share issue costs	( 53,495)	(77,142)
Balance, end of year	<u>\$ 634,512</u>	<u>\$ 426,827</u>

At December 31, 2006, the company has successor tax pools of approximately \$365,399 (2005 - \$365,399) available for deduction from future taxable income. These successor pools have not been recognized for purposes of the future tax calculation due to the uncertainty as to whether sufficient revenue will be realized from the related properties to utilize the pools.

The income tax provision differs from the amount computed by applying the expected income tax rate of 34.49% (2005 – 37.62%) to earnings before taxes. The reasons for this difference are as follows:

	<u>2006</u>	<u>2005</u>
Earnings (loss) before taxes	\$ 272,745	\$ 433,617
Expected tax rate	34.49%	37.62%
Expected tax expense at combined federal and provincial rates	\$ 94,070	\$ 163,127
Crown royalties and production taxes	177,259	149,550
Alberta royalty tax credit	(44,314)	( 57,519)
Resource allowance	(119,458)	(128,209)
Stock based compensation	166,141	66,327
Increase (decrease) in future taxes due to tax rate reduction	(69,139)	(3,396)
Other	3,126	(4,977)
Balance, end of year	<u>\$ 207,685</u>	<u>\$ 184,903</u>

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

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**8. Commitments**

The present office lease agreement expires on September 30, 2011. Future lease payments, excluding operating costs, to the end of the lease term are as follows:

2007	\$77,577
2008	80,922
2009	84,258
2010	86,762
2011	65,070

Annual operating costs are estimated at \$33,370

**9. Financial instruments**

Fair value

Financial instruments include bank indebtedness, accounts receivable, and accounts payable and accrued charges. At December 31, 2006, the fair market value of the financial instruments approximated their carrying value due to the short-term maturity of these instruments.

Credit risk

Substantially all of the Company's accounts receivable are due from customers in the oil and gas industry and are subject to normal industry credit risks.

Interest rate risk

The Company is exposed to interest rate cash flow risk to the extent that its bank loans are at a floating rate of interest. The related disclosure regarding these debt instruments is included in note 3 of these financial statements.

**10. Related party transactions**

All related party transactions are in the normal course of operations and have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties. During the year, the Company purchased engineering services in the amount of \$1,051,073 (2005- \$369,663) from a director of the Company. The Company also purchased professional services in the amount of \$78,086 (2005 - \$26,636) from directors of the Company. Included in accounts payable at December 31, 2006 is 208,679 (2005 - \$177,822), payable to related parties.

	<u>2006</u>	<u>2005</u>
Property, plant and equipment	\$ 1,051,073	\$ 369,663
Expenses:		
Professional services included in general and administrative expenses	78,086	26,631
Accounts payable at end of year	<u>\$ 208,679</u>	<u>\$ 177,822</u>

**PETRO-REEF RESOURCES LTD.**  
**Notes to Financial Statements**  
**As at December 31, 2006 and 2005**

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**11. Cash flows – supplemental information**

	<u>2006</u>	<u>2005</u>
Changes in non-cash working capital		
Operating Activities:		
Accounts receivable	\$ 175,127	\$ (470,221)
Prepaid deposits	(10,075)	(5,120)
Accounts payable and accrued charges	<u>1,420,873</u>	<u>674,178</u>
	<u>1,585,925</u>	<u>198,837</u>
Investing Activities:		
Accounts receivable	102,930	161,840
Accounts payable and accrued charges	<u>526,027</u>	<u>48,470</u>
	<u>628,957</u>	<u>210,310</u>
	<u>\$ 2,214,882</u>	<u>\$ 409,147</u>

**12. Subsequent events**

The Company entered into a private placement financing arrangement closed on January 19, 2007. The Company issued 4,782,609 Units priced at \$1.15 and offered an Over – Allotment Option that issued an additional 478,261 Units priced at \$1.15. The Over-Allotment Options were exercised on January 17, 2007.

Each Unit consists of one Common Share and one half of one warrant. Each whole warrant entitles the holder to purchase one additional Common Share at an exercise price of \$1.75 per Common Share until July 25, 2008.

Petro-Reef Resources Ltd. is pleased to announce that it has entered into an engagement letter with Primary Capital Inc. (“Primary”) pursuant to which Primary has agreed, subject to completion of satisfactory due diligence, to sell on a “best efforts” basis, up to a maximum of 1,500,000 common Shares (“Flow Through Shares”) at a price of \$2.00 per share on a flow through basis for an aggregate purchase price of \$3,000,000 (\$2,805,000 net of commissions). The Closing Date is expected to be on or about April 13, 2007, or as otherwise agreed by Petro-Reef and Primary.

Petro-Reef has agreed to pay Primary a commission equal to 6.5% of the gross proceeds raised, and to issue broker warrants (“Broker Warrants”) to it, entitling Primary to purchase up to that number of common shares of Petro-Reef which is equal to 6.5% of the number of Flow Through Shares issued under the Offering, at an exercise price of \$2.00 per share at any time on or before July 25, 2008. These shares will not carry flow through treatment.

The Flow Through Shares will be issued as a private placement to certain investors identified by Primary. The net proceeds received from the sale of the Flow Through Shares will be used to fund the continued exploration and development of Petro-Reef’s properties. Closing is subject to normal regulatory approvals. The Flow Through Shares will be subject to a four month hold period from the Closing Date.

The financing closed as proposed on April 25, 2007.

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