

ARAPAHOE ENERGY CORPORATION

Financial Statements

For the years ended December 31, 2006 and 2005

March 29, 2007

Auditors' Report

To the Shareholders of
Arapahoe Energy Corporation

We have audited the balance sheets of Arapahoe Energy Corporation as at December 31, 2006 and 2005 and the statements of operations and deficit 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 December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

ARAPAHOE ENERGY CORPORATION
Balance Sheet

	Dec 31 2006 \$	Dec 31 2005 \$
Assets		
Current assets		
Cash	8,238	1,069,021
Accounts receivable and accruals	2,559,906	1,467,528
Prepaid expenses	367,752	272,818
	<u>2,935,896</u>	<u>2,809,367</u>
Property, plant and equipment (note 3)	36,294,996	23,787,119
	<u>39,230,892</u>	<u>26,596,486</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 12)	8,731,639	4,910,034
Notes payable (note 5)	525,000	-
Operating loan payable (note 6)	4,905,000	-
Current income tax payable	120,000	-
	<u>14,281,639</u>	<u>4,910,034</u>
Future income tax liability (note 8)	3,645,749	1,890,546
Asset retirement obligation (note 4)	556,300	359,384
	<u>18,483,688</u>	<u>7,159,964</u>
Shareholders' Equity		
Share capital (note 7)	21,892,645	20,661,024
Deficit	(2,846,860)	(2,472,353)
Contributed surplus	1,701,419	1,247,851
	<u>20,747,204</u>	<u>19,436,522</u>
	<u>39,230,892</u>	<u>26,596,486</u>
Commitments & contingencies (note 10)		
Going concern (note 1)		

Approved by the Board of Directors

Jeffrey L. Standen

Robert Chenery

See accompanying notes to financial statements

ARAPAHOE ENERGY CORPORATION
Statement of Operations and Deficit

	Year ended Dec 31	
	2006	2005
	\$	\$
Revenue		
Oil and gas	5,451,865	722,832
Royalties (net of ARTC)	(1,273,172)	(216,775)
	4,178,693	506,057
Expenses		
Operating costs	1,447,909	307,235
Depletion, depreciation and accretion	1,816,940	291,003
Stock based compensation	443,868	450,593
General and administrative	1,549,347	1,174,881
Interest expense	283,185	153,351
Financing costs amortization	-	401,577
Loss on disposal of subsidiary	87,067	
	5,628,316	2,778,640
Other income		
Other income	29,935	41,010
Loss for the year before taxes	(1,419,688)	(2,231,573)
Current income tax expense	(120,000)	-
Future income tax recovery	1,165,181	-
Loss for the year	(374,507)	(2,231,573)
Deficit, beginning of year	(2,472,353)	(240,780)
Deficit, end of year	(2,846,860)	(2,472,353)
Net loss per share		
Basic and Diluted	(0.01)	(0.11)
Going concern (note 1)		

See accompanying notes to financial statements

ARAPAHOE ENERGY CORPORATION

Statement of Cash Flows

For the Year Ended December 31

	2006	2005
Cash provided by (used in)	\$	\$
Operating activities		
Loss for the year	(374,507)	(2,231,573)
Items not affecting cash		
Depletion, depreciation & accretion	1,816,940	291,003
Stock-based compensation	443,868	450,593
Financing cost amortization	-	389,720
Loss on disposal of subsidiary	87,067	-
Future tax recovery	(1,165,181)	-
	808,187	(1,100,257)
Change in non-cash working capital	241,820	(581,028)
	1,050,007	(1,681,285)
Financing activities		
Increase in bank loan	4,905,000	-
Issuance of capital stock for cash	4,222,421	10,877,759
Net change in non-cash financing activities working capital	(63,883)	35,102
	9,063,538	10,912,861
Investing activities		
Acquisition of petroleum and natural gas properties	(18,286,417)	(8,565,615)
Acquisition of Banks Energy Corp	-	(252,696)
Cash received on acquisition of Banks	-	478,610
Proceeds from disposal of petroleum and natural gas properties	4,010,734	-
Financing costs paid in advance	-	-
Net change in non-cash investing activities	3,101,355	165,111
	(11,174,328)	(8,174,590)
Increase (decrease) in Cash	(1,060,783)	1,056,986
Cash, beginning of year	1,069,021	12,035
Cash, end of year	8,238	1,069,021
Taxes paid	-	-
Interest paid	283,185	153,351

See accompanying notes to financial statements

ARAPAHOE ENERGY CORPORATION

Notes to Financial Statements

For the year ended December 31, 2006

1. BASIS OF PRESENTATION & GOING CONCERN

Arapahoe Energy Corporation (the "Corporation") is engaged in the exploration, development and production of oil and natural gas in Canada.

The financial statements of the Corporation have been prepared following the same accounting policies and methods of computation as the financial statements of the Corporation for the year ended December 31, 2005.

These financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates.

Going concern

These financial statements have been prepared in accordance with GAAP on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Corporation be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The Corporation reported a loss of \$374,507 and funds generated from operations of \$808,187 for year ended December 31, 2006. The Corporation had a working capital deficit of \$11,345,743 at December 31, 2006. As at year end the Corporation was in violation of their covenants with the National Bank of Canada ("National Bank"). As a result, in January 2007, the Corporation entered into a forbearance agreement with the National Bank (note 13). The Corporation's ability to continue as a going concern is dependent upon the Corporation's ability to raise capital and the success of the drilling and exploration program. In addition the Corporation has proposed to conduct a private placement of Debenture Units for minimum proceeds of \$8.5 million and maximum proceeds of \$10.5 million in 2007. The proceeds from this private placement, should it occur, will be used to rectify the working capital deficit as well as meet its capital requirements for 2007 (note 12). There can be no assurance that the Corporation will be successful with those initiatives.

As a result, these circumstances lend substantial doubt as to the ability of the Corporation to meet its obligations as they come due and accordingly, the appropriateness of the use of accounting principles applicable to a going concern. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Corporation be unable to continue in existence. Such adjustments could be material.

2. ACCOUNTING POLICIES

Measurement uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and equipment and the provision for asset retirement obligation costs are based on estimates. In addition, the ceiling test calculation is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. In addition the amounts recorded in stock based compensation and the provision for income taxes are also based on estimates. 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 material.

Joint interests

A portion of the Corporation's exploration, development and production activities is conducted jointly with others. These financial statements reflect only the Corporation's proportionate interest in such activities.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand deposits and investments in highly liquid money market instruments, which are convertible to known amounts of cash in less than three months.

Financial instruments

The fair market value of cash and cash equivalents, accounts receivable, other current assets, accounts payables, notes payable and bank debt approximate their carrying value. From time to time, the Corporation may use derivative financial instruments to manage exposure to fluctuations in commodity prices and foreign currency exchange rates. All transactions of this nature entered into by the Corporation are related to an underlying financial position or to future petroleum and natural gas production. The Corporation does not use derivative financial instruments for speculative trading purposes.

Property, plant and equipment

The Corporation follows the full cost method of accounting whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition, geological and geophysical, drilling of productive and non-productive wells, production equipment and facilities, carrying costs directly related to unproved properties and costs related to acquisition of petroleum and natural gas assets directly or by means of a business combination. These capitalized costs along with estimated future capital expenditures to be incurred in order to develop proved reserves, are depleted and depreciated on a unit of production basis using estimated proved petroleum and natural gas reserves as evaluated by independent engineers. For the purposes of this calculation, petroleum and natural gas reserves are converted to a common unit of measurement on the basis of their relative energy content where six thousand cubic feet of gas equates to one barrel of oil. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion and depreciation until it is determined whether proved reserves are attributable to the properties or impairment occurs.

Gains or losses on the disposition of properties are not recognized unless the proceeds on disposition result in a change of 20 percent or more in the depletion rate.

ARAPAHOE ENERGY CORPORATION

Notes to Financial Statements

For the year ended December 31, 2006

Depreciation of furniture and office equipment is provided using the declining balance method at a rate of 20 percent.

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the "ceiling test"). Under this test, an estimate is made of the ultimate recoverable amount from undiscounted future net cash flows based on proved reserves, which are determined by using forecasted future prices, plus the cost of unproved properties. If the carrying amount exceeds the ultimate recoverable amount, an impairment loss is recognized in net earnings. The impairment loss is limited to the amount by which the carrying amount exceeds: (i) the sum of the fair value of proved and probable reserves; and (ii) the costs of unproved properties that have been subject to a separate impairment test.

Asset retirement obligations

Estimated future costs relating to retirement obligations associated with oil and gas well sites and facilities are recognized as a liability, at fair value. The asset retirement cost, equal to the fair value of the retirement obligation, is capitalized as part of the cost of the related asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation. The liability is adjusted at each reporting period to reflect the passage of time, with the accretion charged to earnings. Actual costs incurred upon settlement of the obligations are charged against the liability.

Future income taxes

The Corporation follows the 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 on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

Flow-through shares

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share issues are renounced to investors in accordance with income tax legislation. The estimated tax benefits transferred to shareholders are recorded as a future income tax liability at the time of filing of the renouncement documents with the tax authorities with a corresponding reduction in share capital.

Revenue recognition

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

Stock-based compensation

The Corporation has a stock-based compensation plan. The Corporation follows the fair-value method to record compensation expense with respect to stock options and warrants granted. The fair value of each option or warrant granted is estimated on the date of grant and a provision for the costs is provided for as contributed surplus over the term of the option agreement. Compensation expense associated with options issued to employees, consultants, officers and directors of the Corporation are expensed while compensation expense related to broker warrants issued are recorded as share issue costs and deducted from share capital. The consideration received by the Corporation on the exercise of share options is recorded as an increase to share capital together with corresponding amounts previously recognized in contributed surplus. Forfeitures are accounted for as they occur which could result in recoveries of the compensation

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Notes to Financial Statements
For the year ended December 31, 2006

expense.

Per share amounts

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Weighted average number of shares is determined by relating the portion of time within the year that common shares have been outstanding to the total time in that year.

Diluted per share amounts are calculated using the treasury stock method, which assumes that any proceeds obtained on exercise of share options or other dilutive instruments would be used to purchase common shares at the average market price during the year. The weighted average number of shares outstanding is then adjusted by the net change.

Consolidation

These financial statements for 2005 include the accounts of the Corporation and its wholly owned subsidiary, Torrence Resources Inc. On June 30, 2006 Torrence Resources Inc. was sold to a third party.

Related party transactions

Related party transactions are conducted in the normal course of operations and are measured at exchange value.

3. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated Depreciation Depletion Accretion	Dec 31, 2006 Net Book Value	Dec 31, 2005 Net Book Value
P&NG Properties	38,016,088	1,966,626	36,049,462	23,505,792
Field vehicle	25,000	10,125	14,875	21,250
Office assets	303,837	73,178	230,659	260,077
TOTAL	38,344,925	2,049,929	36,294,996	23,787,119

The depletion calculation excluded unproved property of costs of \$18,653,361 (December 31, 2005 \$16,875,407). The Corporation has not capitalized any general and administrative expenses for the year ended December 31, 2006 or 2005.

On October 20, 2005, pursuant to the Amalgamation Agreement dated August 9, 2005, the Corporation completed the amalgamation with Banks Energy Inc. The acquisition has been accounted for by the purchase method with oil and gas operating results included in the financial statements commencing October 20, 2005. The value of the transaction was \$8,525,079 with fair values as detailed below:

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Net assets acquired:

Petroleum and natural gas assets	\$13,037,346
Cash	478,610
Non-cash working capital	(2,792,077)
Asset retirement obligation	(308,254)
Future income tax liability	(2,913,867)
Recognition of Arapahoe tax assets	1,023,321
Total net assets acquired	\$ 8,525,079

Consideration:

Common Shares 15,121,206 @ \$0.54	\$8,165,383
Transaction costs paid in common shares 178,336 @ \$0.60	107,000
Transaction costs paid in cash	252,696
Total consideration	\$8,525,079

Based on the ceiling test performed as at December 31, 2006, no impairment of the petroleum and natural gas assets was deemed necessary. The prices used in the ceiling test evaluation of the Corporation's natural gas, crude oil and natural gas liquid reserves at December 31, 2006 were:

	2007	2008	2009	2010	2011	% increase to 2017
Natural Gas (\$/mcf)	7.41	8.06	7.90	7.70	7.95	12
Crude Oil - Light (\$/Bbl)	75.12	75.71	74.26	71.30	68.20	10
Crude Oil – Heavy (\$/Bbl)	53.34	54.51	54.21	52.76	51.15	10
Natural Gas Liquids (\$/Bbl)	52.02	52.43	51.42	49.38	47.23	10

4. ASSET RETIREMENT OBLIGATION

The future asset retirement obligations were estimated by management based on the Corporation's working interest in its wells, estimated costs to remediate, reclaim and abandon the wells and estimated timing of the costs to be incurred in future periods. The Corporation has estimated the net present value of its total asset retirement obligation to be \$556,300 at December 31, 2006 based on a total future liability of \$921,498 as at December 31, 2006. These costs are expected to be incurred over the next three to thirty-four years. The Corporation's risk free interest rate of 10% and an inflation rate of 2.2% were used to calculate the net present value of asset retirement obligation.

The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties:

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	Dec 31 2006	Dec 31 2005
Asset retirement obligation, beginning of year	359,384	14,224
Liabilities acquired from Banks Energy Inc.	-	308,254
Liabilities incurred	141,286	968
Accretion expense	55,630	35,938
Asset retirement obligation, end of year	556,300	359,384

5. NOTES PAYABLE

In March 2006, the Corporation repurchased an interest in CBM lands in the Sarcee area of Alberta from Tower Energy Ltd. This resulted in two promissory notes issued to Tower each in the amount of \$250,000. The first was due on September 3, 2006 and the second is due on March 3, 2007. These carried an interest rate of 6% per annum. As at December 31, 2006, both of the notes were still outstanding and accrued interest in the amount of \$25,000 was recorded.

6. BANK LOAN

At December 31, 2006, the Corporation has access to a revolving line of credit with the National Bank in the amount of \$5,900,000. At December 31, 2006 the Corporation has drawn \$4,905,000. The limit on this facility was extended from \$2,500,000 at December 31, 2005 to facilitate the company's purchase of an additional 52.5% interest in the Campbell prospect. The Corporation increased its interest in the Campbell well which is included in property plant and equipment (note 3). The full facility bears interest at the lenders' prime rate plus 1%. This facility is secured with a general security agreement over the property and assets of the Corporation. This credit facility is dated November 27, 2006 and, pursuant to the terms therein, is subject to an annual review. During the year ended December 31, 2006, the Corporation incurred interest on this facility totaling \$254,560. As at December 31, 2006, the Corporation was in breach of the working capital covenant of this credit agreement. This covenant stated that the working capital ratio should be no less 1:1. At year end our ratio was .28:1

7. SHARE CAPITAL

a) Authorized

Unlimited number of common voting shares of no par value

Unlimited number of preferred shares of no par value

b) Issued and outstanding

	Number of Shares #	Amount \$
Arapahoe share capital prior to acquisition	3,958,691	10,918,692
Elimination of Arapahoe share capital	(3,958,691)	(10,918,692)
Shares issued to shareholders of Old Arapahoe – based on exchange ratio	1,319,563	-

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Crazy Horse share capital	3,766,667	3,767
Elimination of Crazy Horse share capital	(3,766,667)	-
Shares issued to shareholders of Crazy Horse	3,766,667	(228,843)
Debt settlement	80,619	48,371
Private placement	450,000	247,500
Common Share issued as part of offering units	839,373	461,655
Flow Through share issued as part of offering units	3,357,492	1,846,621
Share issue costs	-	(286,048)
Tax effect	-	(620,834)
Balance – December 31, 2004	9,813,714	1,472,189
Issued during 2005		
Quest Capital Corp. – financing costs	1,181,000	300,000
Common shares issued for cash	2,500,000	1,000,000
Flow Through shares issued for cash*	8,823,225	3,970,451
Quest Capital Corp. – loan guarantee	113,000	49,720
Shares issued for debt	289,910	86,973
Woodstone Capital – consulting fee	100,000	40,000
Exercise of stock options	20,000	8,600
Shares issued for acquisition of Arapahoe Energy Holding Ltd. (Banks Energy)	15,299,542	8,272,383
Common shares issued for cash	3,619,317	2,352,556
Flow Through shares issued for cash*	4,041,337	3,031,003
Flow Through shares issued for cash*	1,986,665	1,490,000
Share issue costs	-	(1,412,851)
Balance – December 31, 2005	47,787,710	20,661,024
Issued during 2006		
Exercise of warrants	1,132,322	452,929
Flow Through shares issued for cash*	5,615,400	3,650,010
Flow Through shares issued for cash*	770,000	500,500
Share issue costs		(381,019)
Share issue costs – tax effect		118,299
Stock-based compensation - Warrants		(9,700)
Tax effect flow through renoucement		(3,099,398)
Balance – Dec 31, 2006	55,305,432	21,892,645

* Flow through obligation for all shares issued has been met as of December 31, 2006.

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Notes to Financial Statements
For the year ended December 31, 2006

c) **Stock Option Plan**

The Corporation has a stock option plan, under which the Corporation may grant options to its employees, directors and consultants for up to 10% of the total shares of common stock issued and outstanding at time of option grant. The number of options and the exercise price thereof is set by the Board of Directors at the time of grant, provided that the exercise price shall not be less than the market price of the common shares on the stock exchange on which such shares are then traded. The options granted may be exercisable for a period and may vest at such times as the Board of Directors may determine at the time of grant.

A summary of the status of the Corporation's stock option plan as at December 31, 2006 and changes during the year ended on that date:

	Year ended December 31, 2006	Year ended December 31, 2006 Weighted average exercise price \$
	# Shares	
Outstanding – beginning of year	3,498,181	0.58
Granted during year	1,415,000	0.55
Expired during year	(410,000)	0.63
Outstanding – end of year	4,503,181	0.57

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

Exercise price	Options outstanding # Outstanding Dec 31, 2006	Options outstanding Weighted average remaining contractual life in years	Options outstanding Weighted average exercise price at Dec 31, 2006	Options exercisable Number exercisable	Options exercisable Weighted average exercise price
\$0.40 - \$0.76	4,503,181	2.87	\$0.57	4,199,848	\$0.57
	4,503,181			4,199,848	

Compensation cost of \$443,868 has been recognized in 2006, (\$450,593 – 2005), for stock options granted. These costs are recorded as stock based compensation expense with the offsetting amount being credited to contributed surplus. The fair value for options granted to employees and directors was estimated at the date of grant using a Black-Scholes Option Pricing Model with the following assumptions:

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For the year ended December 31, 2006

Volatility factor of expected market price	98%
Weighted average risk-free interest rate	4.01%
Weighted average expected life in years	3.0
Weighted average expected annual dividends per share	Nil

d) Warrants

During the year ended December 31, 2006, there were 638,540 warrants issued by the Corporation.

A summary of the status of the Corporation's warrants as at December 31, 2006 and changes during the year ended on that date:

	Year ended Dec 31, 2006	
	# Warrants	Weighted average exercise price \$
Outstanding – beginning of year	6,008,946	1.19
Issued during year	638,540	0.65
Exercised during year	(1,132,322)	0.40
Expired during year	(4,876,624)	1.37
Outstanding – end of year	638,540	0.65

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

Exercise price	Warrants outstanding # Outstanding Dec 31, 2006	Warrants outstanding Weighted average remaining contractual life in years	Warrants outstanding Weighted average exercise price at Dec 31, 2006	Warrants exercisable Number exercisable	Warrants exercisable Weighted average exercise price
\$0.65	638,540	1.18	\$0.65	638,540	\$0.65
	638,540			638,540	

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There were 638,540 warrants issued during the year ended December 31, 2006. Compensation cost of \$9,700 has been recognized in the year ended December 31, 2006 (\$0 – 2005) for warrants issued. These costs are recorded as share issue costs with the offsetting amount being credited to contributed surplus. The fair value for warrants issued was estimated at the date of issue using a Black-Scholes Option Pricing Model with the following assumptions:

Volatility factor of expected market price	98%
Weighted average risk-free interest rate	4.01%
Weighted average expected life in years	1.0
Weighted average expected annual dividends per share	Nil

e) Contributed surplus

	Year ended December 31, 2006
Balance December 31, 2005	1,247,851
Options issued	443,868
Warrants issued	9,700
Balance Dec 31, 2006	1,701,419

f) Per share amounts

For the year ended December 31, 2006 the weighted average number of shares were 52,238,294 (2005- 23,223,660). Diluted earnings per share reflect the exercise of options and warrants as if issued at the later of the date of grant or the beginning of the year. This calculation takes into account only the options and warrants that are considered in the money at December 31, 2006. Given the share price at December 31, 2006, no options or warrants were considered to be dilutive and therefore were not factored into the weighted average number of shares. The diluted weighted average number of shares for the year ended December 31, 2006 was 52,238,294 (2005 – 23,475,941).

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8. INCOME TAX

	2006	2005
Loss before income taxes	(1,419,688)	(2,231,573)
Combined federal and provincial income tax rate	37.06%	40.50%
Tax effect	(526,136)	(903,676)
Crown charges	-	3,699
Stock based compensation costs	164,497	182,468
Resource allowance	(54,435)	(59,033)
Change in valuation allowance and tax estimates	-	913,563
Rate change	(745,113)	(161,294)
Other	(3,994)	24,273
Future income taxes recovery	(1,165,181)	-

The components of the net future income tax asset as at December 31, 2006 were as follows:

	2006	2005
Future income tax assets:		
Asset retirement obligation	172,515	131,157
Share issue costs	420,676	443,378
Non-capital losses carried forward	1,548,013	2,156,654
	2,141,204	2,731,189
Future income tax liabilities:		
Property, plant and equipment	5,786,953	4,621,735
Net future income tax liability	3,645,749	1,890,546

The Corporation's non-capital losses expire between 2007 and 2015 and are as follows;

Year incurred	Net Capital Loss \$	Year of expiry
2005	2,098,897	2015
2004	1,141,791	2014
2003	826,785	2010
2002	409,508	2009
2001	134,791	2008
2000	380,033	2007
Total	4,991,805	

Given the uncertainty of realization, no future tax asset has been recognized in these financial statements. The Corporation's tax pools associated with its property, plant and equipment expenditures consist of approximately \$7.1 million of Canadian Oil and Gas Property Expenditures (COGPE), \$1.0 million of Canadian Development Expenditures (CDE), \$1.3 million of Canadian Exploration Expenditures (CEE), \$4.0 million of

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Undepreciated Capital Costs (UCC) and \$4.7 million of non capital loss (NCL) carry forwards. Flow through obligation of \$4,150,510 was incurred in 2006. All of these funds were spent on exploration expenditures prior to December 31, 2006.

9. FINANCIAL INSTRUMENTS

The fair market value of cash, receivables, other current assets, payables and bank debt approximate their carrying value due to their short term nature.

Risk management activities

Substantially all of the Corporation's accounts receivable are due from companies in the oil and gas industry and are subject to the normal industry credit risks. The carrying value of accounts receivable reflects management assessment of the associated risks.

10. COMMITMENTS & CONTINGENCIES

The Corporation has an obligation under an office lease agreement, through 2010, requiring annual payments of a fixed amount of \$156,000 per year plus operating expenses. Operating expenses are estimated to be \$84,000 in 2006 and increasing each year with inflation. The Corporation intends to sublet approximately 3,500 sq ft of the 7,800 sq ft until such time as additional space is required to satisfy the corporate growth.

As at December 31, 2006 the Corporation had over \$4.9 million in payables to vendors that had been outstanding for over 90 days. At the time of this report this amount has increased to \$6.8 million. At the present time the Corporation is negotiating a settlement with these parties that will see all amounts settled upon the closing of the proposed financing in early April of 2007 (note 12). As at the date of this report the Corporation has outstanding claims and liens filed against it in the amount of \$1.87 million.

11. RELATED PARTY TRANSACTIONS

In October 2005, the Corporation entered into an agreement with Kinghorn Resources Ltd (Kinghorn) to lease approximately 7,800 sq ft of office space in the beltline area of Calgary. Kinghorn is a private corporation controlled by Jeffrey Standen, President and CEO of Arapahoe. This transaction was measured at fair value. During the year ended December 31, 2006, The Corporation paid to Kinghorn the amount of \$234,276 which represents 12 months rent and operating expenses at \$19,523 per month. As at December 31, 2006 Arapahoe owed Kinghorn \$22,284.

During the year ended December 31, 2006, the Corporation incurred a liability in the amount of \$92,560 to 559046 Alberta Ltd. ("559046"), a company owned by Sharon Standen, wife of Jeffrey Standen, President and CEO of the Corporation. This amount resulted from the forfeiture of office rental fees by 559046 as part of a contract to secure 50% rights to certain Sarcee lands.

ARAPAHOE ENERGY CORPORATION

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12. PROPOSED FINANCING

The Corporation intends to complete a private placement of Convertible Debenture Units (“Debenture Units”) of the Corporation for maximum proceeds of \$10.5 million and minimum proceeds of \$8.5 million. D & D Securities Company has agreed to act as the Corporation’s agent in connection with this Offering. D & D Securities Company has received verbal expressions of interest for \$9 million of this Offering. This Offering is anticipated to be completed in April 2007.

For every \$1.00 invested under this Offering, a subscriber for Debenture Units will be issued (i) a convertible secured debenture (“Debenture”) in the amount of \$1.50 (the “Repayment Amount”) and (ii) four (4) purchase warrants (“Warrants”). The Debentures will be issued under an industry standard trust indenture. Each Warrant will entitle the holder thereof to purchase one common share (“Common Share”) of the Corporation during the period expiring on 24 month anniversary of the date of closing (“Closing”) of the Offering at an exercise price of \$0.125.

The sum of the Repayment Amount and all accrued and unpaid interest (collectively, the “Debt Amount”) shall be due and payable in cash on the second anniversary of the Closing (the “Maturity Date”). The Corporation has the right to pre-pay the Debt Amount, in whole, at any time prior to August 30, 2007. The Corporation shall be deemed to have elected to exercise its pre-payment right if the shareholders of the Corporation do not approve the conversion feature of the Debentures at a meeting of shareholders held on or before July 31, 2007.

Should the shareholders of the Corporation approve the conversion feature of the Debentures at a meeting of shareholders held on or before July 31, 2007, the holders of Debentures shall be entitled to convert each \$1.00 invested under this Offering (the “Invested Amount”) into 12 Common Shares at any time prior to the Maturity Date. Should the shareholders of the Corporation approve the conversion feature of the Debentures at a meeting of shareholders held on or before July 31, 2007, the Corporation shall be entitled to convert each \$1.00 of Invested Amount into 12 Common Shares at any time prior to the Maturity Date following the date on which the trading price of the Common Shares has not been less than \$0.65 per share for a period of 20 trading days (days during which the exchange or market on which the Common Shares are listed for trading is open for business).

Holders of Debentures shall be given the opportunity to (i) convert each \$1.00 of Invested Amount into 12 Common Shares in advance of the completion by the Corporation of a “Business Combination Transaction” or (ii) directly exchange their Debentures for consideration offered by the other party to the “Business Combination Transaction”. The approval of holders of not less than two-thirds of the outstanding is required in order for the Corporation to complete a “Business Combination Transaction”.

Commencing on the first anniversary of the Closing, interest (“Interest”) shall accrue on the outstanding Invested Amount at the rate of 20% per annum calculated annually not in advance. Interest shall be due and payable in cash on the Maturity Date and monthly thereafter until all amounts owing under the Debentures are repaid in full. In the event of the conversion of the Debentures into Common Shares, the accrued and unpaid Interest associated with the converted Debentures shall be due and paid, at the option of the Corporation (i) in cash or (ii) by the issue of such number of Common Shares equal to the

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amount of Interest due and payable divided by the greater of (y) the volume weighted average trading price of the Common Shares for the period of 20 trading days (days during which the exchange or market on which the Common Shares are listed for trading is open for business) ending on the fifth business day prior to the date of the conversion and (z) \$0.10.

The payment of the Debt Amount shall be secured by a security interest granted by the Corporation in favour of the holders of the Debentures in respect of (i) all present and after-acquired rights and interest of the Corporation in and to real property and (ii) all present and after acquired personal property of the Corporation. Such security shall be subordinate only the security interest granted by the Corporation to its principal lender.

Among other industry standard events of default, the failure of the Corporation to complete a "Business Combination Transaction" by December 31, 2007 will be considered a default under the Debentures, unless such date is extended or waived by the holders of Debentures. Upon an event of default, the Debt Amount shall be immediately due and payable.

The Corporation intends to expend the net proceeds of the Offering for the following purposes: \$6,000,000 to pay trade payables with the balance to be used to fund capital expenditures and general working capital obligations. There may be circumstances where, for sound business reasons, a reallocation of funds may be necessary for the Corporation to achieve its business objectives.

The Corporation will seek shareholder approval of the conversion feature of the Debentures at a meeting of shareholders which is anticipated to be held prior to June 30, 2007. The Debentures offered under this Offering will not be convertible until such time as shareholder approval is obtained.

It is expected that existing management, officers, directors, insiders and future directors, officers and insiders will participate in this Offering for approximately \$750,000.

The closing of this Offering is subject to receipt of normal course regulatory approvals.

Under the term of this financing the Corporation will have \$6.0 million of these funds to apply to settlement of the accounts payable. This requires that we negotiate a reduction in the debt load with these parties. Efforts are now underway to settle these debts for 70% in cash or 50% cash and 50% in convertible debenture.

13. SUBSEQUENT TRANSACTIONS

As a result of the Corporation being in default of the covenants of the Credit Agreement dated November 27, 2006, the Corporation entered into a Forbearance Agreement dated January 3, 2007 with the National Bank. Under the terms of this agreement, the Corporation paid the bank a forbearance fee of \$59,000 on January 31, 2007 along with a 2% per annum increase in the interest rate, to be in effect until the Corporation can demonstrate that there are no longer any defaults in the terms of the Credit Agreement and the Forbearance Agreement. On February 6, 2007 the Corporation presented a plan to refinance the Corporation which caused the bank to extend the Forbearance period expiry date to April 16, 2007.