

CANADIAN PHOENIX RESOURCES CORP.

Consolidated Financial Statements

For the years ended December 31, 2010 and 2009

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Canadian Phoenix Resources Corp.

We have audited the accompanying consolidated financial statements of Canadian Phoenix Resources Corp. (the "Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of income (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and the notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

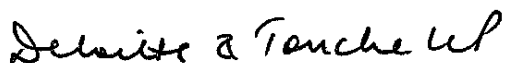
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Calgary, Alberta
April 27, 2011

CANADIAN PHOENIX RESOURCES CORP.
Consolidated Balance Sheets
As at December 31, 2010 and 2009, in Canadian dollars

	2010	2009
Assets		
Current assets		
Cash and cash equivalents (note 3)	75,018,593	459,207
Accounts receivable	118,247	4,467,988
Prepaid expenses and deposits	28,437	203,576
	75,165,277	5,130,771
Restricted cash (note 3)	-	234,751
Property, plant and equipment (note 4)	1,587,695	61,224,188
Equity investment (note 5)	-	32,875,493
	76,752,972	99,465,203
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	715,932	6,277,269
Bank loan (note 6)	-	9,979,259
Loan payable (note 6)	-	2,100,000
	715,932	18,356,528
Asset retirement obligation (note 7)	741,785	4,850,525
Future income tax liability (note 8)	-	3,363,475
	1,457,717	26,570,528
Non-controlling interest (note 9)	-	18,229,659
Shareholders' equity		
Share capital (note 10a)	139,252,062	119,397,580
Warrants (note 10c)	20,896,695	31,054,963
Contributed surplus (note 10b)	6,557,844	4,922,715
Deficit	(91,411,346)	(100,710,242)
	75,295,255	54,665,016
	76,752,972	99,465,203
Commitments & contingencies (note 11)		
Subsequent events (note 15)		

See accompanying notes to the consolidated financial statements

On behalf of the Board of Directors:

"Harry Knutson"

Director

"Daryl Clark"

Director

CANADIAN PHOENIX RESOURCES CORP.
Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)
For the years ended December 31, 2010 and 2009, in Canadian dollars

	2010	2009
Revenue		
Oil and natural gas sales	8,437,953	18,413,984
Royalties	(2,087,222)	(4,266,511)
	6,350,731	14,147,473
Expenses		
Operating costs	3,825,218	6,811,574
Depletion, depreciation and accretion (note 4)	4,499,004	15,750,277
Impairment of property, plant, & equipment (note 4)	5,900,002	7,663,921
Impairment of goodwill	-	213,939
Bad debts expense	43,333	95,046
Stock based compensation (notes 9, 10b)	3,151,331	1,791,873
General and administrative	6,698,392	6,374,058
Financing fees (notes 10a, 10c)	-	1,918,238
Interest expense	270,625	814,270
	24,387,905	41,433,196
Net loss before other items	(18,037,174)	(27,285,723)
Other items		
Interest income	277,198	-
Other income	124,147	299,162
Net loss - equity investment (note 5)	(1,026,088)	(10,254,124)
Gain on disposal of equity investment (note 5)	12,841,958	-
Gain on disposal of subsidiary (note 9)	13,161,409	-
Loss attributable to non-controlling interest (note 9)	456,709	3,725,723
Net income (loss) before taxes	7,798,159	(33,514,962)
Current income tax expense (note 8)	-	(44,908)
Future income tax recovery (note 8)	1,500,737	3,107,763
	1,500,737	3,062,855
Net income (loss) and comprehensive income (loss) for the year	9,298,896	(30,452,107)
Basic and diluted earnings (loss) per share (note 10d)	0.20	(0.66)

See accompanying notes to the consolidated financial statements

CANADIAN PHOENIX RESOURCES CORP.
Consolidated Statements of Changes in Shareholders' Equity
For the years ended December 31, 2010 and 2009, in Canadian dollars

	2010	2009
Share capital (note 10a)		
Balance, beginning of year	119,397,580	118,977,580
Issued on exercise of warrants, net of transaction costs	19,856,637	-
Cancelled	(2,155)	-
Issued as financing fee	-	420,000
Balance, end of year	139,252,062	119,397,580
Warrants (note 10c)		
Balance, beginning of year	31,054,963	32,087,679
Exercised	(10,158,268)	-
Expired	-	(1,416,295)
Modified	-	383,579
Balance, end of year	20,896,695	31,054,963
Contributed surplus (note 10b)		
Balance, beginning of year	4,922,295	3,456,588
Stock-based compensation (stock options)	1,635,549	49,832
Expiry of warrants	-	1,416,295
Balance, end of year	6,557,844	4,922,715
Deficit		
Balance, beginning of year	(100,710,242)	(70,258,135)
Net income (loss)	9,298,896	(30,452,107)
Balance, end of year	(91,411,346)	(100,710,242)
Ending shareholders' equity	75,295,255	54,665,016

See accompanying notes to the consolidated financial statements

CANADIAN PHOENIX RESOURCES CORP.
Consolidated Statements of Cash Flows
For the years ended December 31, 2010 and 2009, in Canadian dollars

	2010	2009
Cash provided by (used in)		
Operating activities		
Net income (loss) for the year	9,298,896	(30,452,107)
Items not affecting cash		
Gain on sale of subsidiary	(13,161,409)	-
Gain on sale of equity investment	(12,841,983)	-
Impairment of property, plant and equipment	5,900,002	7,663,921
Depletion, depreciation and accretion	4,499,004	15,750,277
Equity settled stock-based compensation	1,958,151	1,791,873
Future income tax recovery	(1,500,737)	(3,107,763)
Net loss - equity investment	1,026,088	10,254,124
Non-controlling interest	(456,709)	(3,725,723)
Expense recorded as an increase to ARO	200,000	-
Bad debts expense	43,333	95,046
Impairment of goodwill	-	213,939
Financing fees and payables settled with shares	-	1,333,111
Non-cash financing - warrant modifications (note 10c)	-	383,579
Non-cash interest expense	-	70,000
	(5,035,364)	270,277
Change in non-cash working capital - operating activities	(1,503,229)	(3,868,310)
	(6,538,593)	(3,598,033)
Financing activities		
Increase (decrease) in loans payable	(12,079,259)	12,079,259
Issuance of common shares, net of transaction costs	9,698,368	-
Change in non-cash working capital - financing activities	223,179	-
	(2,157,712)	12,079,259
Investing activities		
Proceeds from disposal of equity investment, net of transaction costs	44,691,364	-
Proceeds from disposal of petroleum and natural gas assets	20,748,791	750,000
Proceeds from disposal of subsidiary, net of \$5,628,342 cash disposed and transaction costs	19,069,284	-
Acquisition of petroleum and natural gas assets	(610,667)	(9,855,846)
Change in non-cash working capital - investing activities	(643,081)	(11,091,651)
Movement in restricted cash	-	1,772,808
	83,255,691	(18,424,689)
Increase (decrease) in cash	74,559,386	(9,943,463)
Cash and cash equivalents, beginning of year	459,207	10,402,670
Cash and cash equivalents, end of year	75,018,593	459,207
Taxes Paid	-	44,908
Interest paid	222,018	843,052

See accompanying notes to the consolidated financial statements

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Canadian Phoenix Resources Corp. (the “Corporation”) is engaged in the exploration, development and production of petroleum and natural gas in Western Canada. During 2010, the Corporation disposed of the majority of its productive assets, holding the proceeds from disposition in cash and cash equivalents, which the Corporation is seeking to redeploy in new productive assets.

These consolidated 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 revenues and expenses, assets and liabilities, and disclosure of contingent assets and liabilities. Areas requiring significant judgment and estimation are further discussed in note 2n.

On November 16, 2009, the Corporation’s shareholders approved a 25-for-one share consolidation. As a result, the numbers of common shares in the Corporation, common share purchase warrants and stock options were reduced to one twenty-fifth of their then outstanding amounts. Disclosures in these consolidated financial statements relating to common shares, common share purchase warrants and stock options, as well as information presented on a per-share basis, reflect post share consolidation amounts.

2. ACCOUNTING POLICIES

a) Basis of consolidation

The consolidated balance sheet as at December 31, 2010 includes the Corporation’s accounts and 100% of those for the following wholly-owned subsidiaries:

- CPH-Sarcee Corporation
- CPH-Investment Corporation

Neither CPH-Sarcee Corporation nor CPH-Investment Corporation had any assets or liabilities as at December 31, 2010.

Serrano Energy Ltd.

On May 26, 2010, the Corporation disposed its controlling interest in Serrano Energy Ltd. (“Serrano”). See note 9 for further details of the Serrano disposition.

Serrano was accounted for using the purchase method of accounting, whereby the Corporation recorded its acquired interest in Serrano’s net identifiable assets at fair value, with the excess of consideration paid recorded as goodwill. Included in the Corporation’s consolidated statements of income (loss) and comprehensive income (loss) and cash flows for the years ended December 31, 2010 and 2009, are 100% of Serrano’s revenues, expenses and cash flows incurred prior to May 26, 2010. Included in the Corporation’s consolidated balance sheet as at December 31, 2009 are 100% of Serrano’s assets and liabilities. Serrano’s pre-May 26, 2010 net losses attributable to non-controlling interests are shown separately in the Corporation’s consolidated statements of income (loss) and comprehensive income (loss). Serrano’s net assets attributable to non-controlling interests are presented on the Corporation’s consolidated balance sheet as at December 31, 2009 between non-current liabilities and shareholders’ equity.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

Post-acquisition decreases in the Corporation's ownership interest in Serrano from the disposition of shares held by the Corporation or from shares issued by Serrano to outside interests are reflected as increases to the non-controlling interest. Any difference between the proceeds received by the Corporation and the reduction in its interest in Serrano's net assets was recorded as an adjustment to property, plant and equipment. On the full disposition of the Corporation's interest in Serrano in the year ended December 31, 2010, a gain was recorded for the excess of net proceeds over the carrying value of Serrano's net assets on the disposition date.

Post-acquisition increases in the Corporation's ownership interest in Serrano from additional share purchases or the cancellation of Serrano shares held by non-controlling interests are accounted for as reductions to the non-controlling interest. Any excess of the consideration provided over the fair value of the Corporation's incrementally acquired interest is accounted for as goodwill. Any excess of fair value incrementally acquired over the consideration provided is accounted for as a reduction in the fair value of non-current assets acquired, with any remainder accounted for as a gain in the consolidated statements of income (loss) and comprehensive income (loss).

Equity investments

Investments for which the Corporation exerts significant influence over the investee, but does not hold a controlling interest, are accounted for using the equity method of accounting. These investments are initially recorded at cost and are subsequently increased for the Corporation's pro-rata share of post-acquisition earnings of the investee and additional investments. The carrying value of an equity investment is decreased by the Corporation's pro-rata share of post-acquisition losses of the investee and by dividends received.

Joint ventures

A significant portion of the Corporation's activities are conducted within unincorporated joint ventures. The financial statements reflect the Corporation's proportionate interest in such activities.

b) Cash and cash equivalents

Cash and cash equivalents include cash and money market instruments that carry terms of not more than 90 days as at the date of investment. Cash that is restricted under indemnity or other agreements is classified separately in the balance sheet.

c) Financial instruments

All financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading," "available-for-sale," "held-to-maturity," "loans and receivables" or "other financial liabilities."

Cash is designated as "held-for-trading" and is measured at fair value with changes in fair value recognized in earnings. Accounts receivable and cash call advances are designated as "loans and receivables," which are initially measured at fair value and subsequently measured at amortized cost using the effective interest method. Accounts payable, bank loans, and loans payable are designated as "other financial liabilities," which are initially measured at fair value and subsequently measured at amortized cost using the effective interest method.

d) Property, plant and equipment

Petroleum and natural gas (“P&NG”) assets

The Corporation presents P&NG assets at their historical cost, less accumulated depletion and impairments, using the full cost method of accounting. Under this method, all costs directly related to the acquisition, exploration and development of P&NG reserves are capitalized. Such costs include those for land acquisition, geological and geophysical assessments, drilling and developing wells, and overhead costs that are directly related to acquisition, exploration and development activities.

Capitalized costs relating to proved reserves are depleted using the unit-of-production method, based on proved P&NG reserves (before royalties) determined by independent petroleum engineers. Production and reserves of natural gas are converted to equivalent barrels of crude oil on the basis of six thousand cubic feet of gas to one barrel of oil.

Proceeds from the sale of P&NG properties are applied against capitalized costs with no gain or loss recognized unless such a sale would result in a greater than 20% change in the depletion rate.

Quarterly, the Corporation performs a two-part test (the “ceiling test”) to determine whether capitalized P&NG assets are impaired:

- i. If the total carrying value of proved P&NG assets exceeds the sum of all estimated undiscounted future net cash flows resulting from the production of proved reserves, then an indicator of impairment is considered to exist, and a discounted cash flow test (ii) is conducted.
- ii. Impairment is recognized if the total carrying value of proved P&NG assets exceeds their fair value, being the estimated future cash flows from proved plus probable reserves, which are adjusted for potential risk factors and are discounted using a risk-free interest rate.

The ceiling test is performed on a consolidated basis and includes only the Corporation’s interest in the carrying value of P&NG assets, estimated P&NG reserves and future cash flows, and excludes all non-controlling and external interests.

The carrying values of unproved P&NG assets and major development projects are excluded from the ceiling test calculation, but are considered impaired when related properties are likely to be abandoned, leases are unlikely to be renewed, or the probability of economically-feasible production is considered remote.

Office equipment and furniture

Office equipment and furniture is carried at historical cost, less accumulated amortization. Amortization is calculated using the declining balance method at rates between 20% and 50%.

e) Goodwill

Goodwill represents the excess of purchase price over the estimated fair value of the net identifiable assets acquired in a business combination. Goodwill is not amortized, but is rather assessed for impairment, annually, or as events occur that indicate impairment exists. Impairment of goodwill is recognized for any excess of its carrying value over its estimated fair value.

The estimated fair value of goodwill is determined by first valuing the Corporation as a whole. This fair value is then allocated to each of the Corporation's identifiable assets and liabilities, with any residual amount being allocated as the estimated fair value of goodwill.

f) Asset retirement obligations

The Corporation recognizes a liability for asset retirement obligations associated with the retirement of its P&NG assets. The liability is initially measured using the estimated future cash flows required to retire existing assets, discounted using a credit and inflation-adjusted risk-free interest rate. An equal amount is recognized as a P&NG asset.

Subsequent to initial recognition, the liability increases for the accretion of the discounted balance, and is also adjusted for changes to the estimated timing and amount of retirement expenditures and for actual expenditures incurred. The related P&NG asset initially recognized is depleted on the same basis as other P&NG assets.

g) Stock-based compensation

Stock options granted by the Corporation to directors, officers, employees and consultants are measured at their fair values. Fair values of stock options issued are determined on their grant date, using the Black-Scholes option pricing model, and are recognized as an expense over the vesting periods of the options; a corresponding increase is recorded to contributed surplus.

When stock options are exercised, the cash proceeds along with the amount previously recorded as contributed surplus are recorded as share capital. When the right to receive options is forfeited before the options have vested, any expense previously recorded is reversed.

The fair value of stock appreciation rights granted by the Corporation is assessed at grant date and each reporting date. Stock appreciation rights are cash-settled instruments, with the cash settlement amount being the difference between the exercise price of the instrument and the Corporation's share price on the date of exercise. The fair value of each stock appreciation right is recorded as a liability, and is determined as the excess, if any, between the Corporation's share price on the assessment date and the exercise price of each right. The movement in value since the prior reporting period is recorded in the statement of income (loss) and comprehensive income (loss), with a corresponding adjustment to the liability on the balance sheet.

h) Share purchase warrants

Warrants with the right to acquire common shares in the Corporation are typically issued through the Corporation's debt or equity financing activities. The fair values of these warrants are determined on their issuance date, using the Black-Scholes option pricing model, and are recorded as both a separate component of shareholders' equity and as a reduction in the values of related debt or share capital.

When share purchase warrants are exercised, the cash proceeds along with the amount previously recorded as a separate component of shareholders' equity are recorded as share capital. When share purchase warrants expire, the amount previously recorded as a separate component of shareholders' equity is reclassified to contributed surplus.

i) Share issue costs

Costs incurred to issue shares, which may include cash or equity-settled payments, are accounted for as a reduction in share capital.

j) Flow-through shares

Historically, the Corporation has issued flow-through shares, and may do so in the future. Flow-through shares entitle the Corporation to renounce – and flow-through share investors to claim – the income tax deductions for certain exploration expenditures in Canada. Proceeds from the issuance of flow-through shares are recorded as an increase to share capital. When the Corporation subsequently renounces its right to deduct these exploration expenditures for income tax purposes, a reduction in share capital and a future income tax liability is recognized for the foregone tax benefit to the Corporation.

k) Revenue recognition

Revenue from the sale of crude oil, natural gas and natural gas liquids is recorded when title passes to a third party, which is typically upon delivery of the product to processing facilities. Operating and transportation costs, and production-based royalties related to the sale of the product are recognized in the same period in which the revenue is recorded. When the full collection of sales proceeds is uncertain, a provision may be recorded for uncollectible amounts.

l) Income taxes

The Corporation follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial statement carrying values and the tax bases of existing assets and liabilities. Future income tax assets and liabilities are measured using the enacted or substantively enacted income tax rates that apply to the years that the temporary differences are expected to be recovered or settled.

The effect on future income tax assets and liabilities of a change in income tax rates is recognized as a future income tax recovery or expense in the period that the change is enacted. A valuation allowance is provided against future income tax assets when it is more likely than not that the tax benefit of the asset will not be realized.

The future income tax impact of transactions affecting equity is also recorded in equity.

m) Per share amounts

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution from common shares issuable through outstanding stock options and common share purchase warrants, using the treasury stock method of accounting, as if these dilutive shares had been issued at the beginning of the period. The treasury stock method assumes that proceeds received from the exercise of “in-the-money” stock options and common share purchase warrants are used to purchase common shares of the Corporation at their average market price for the period. In periods that the Corporation reports a net loss, per share amounts are not presented on a diluted basis as the result would be anti-dilutive.

n) Estimates and measurement uncertainty

The preparation of the financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the values and presentation of assets, liabilities, revenues, expenses and disclosures of contingencies and commitments. Such estimates primarily relate to unsettled transactions and events at the balance sheet date which are based on information available to management at each financial statement date. Actual results could differ from those estimated.

Areas where management is required to make significant estimations or where measurements are uncertain are as follows:

- i. Depletion and impairment of P&NG assets are determined using estimates for resource reserves, and the impairment assessment of P&NG assets requires further assumptions for future commodity prices, royalties, operating costs, development costs, abandonment costs, and the fair value of unproven properties, all of which are inherently uncertain. To mitigate the risk that inappropriate assumptions are used, estimates are evaluated by independent petroleum engineers.
- ii. The provision for asset retirement obligations requires management to estimate the timing and amount of cash flows required to retire its P&NG assets.
- iii. The Corporation uses the Black-Scholes option pricing model to determine the fair value of stock options and share purchase warrants granted. This model requires management to estimate the volatility of the Corporation's future share price, expected lives of stock options and future dividend yields.
- iv. The recognition of future income tax assets requires judgment as to whether future taxable income will be sufficient to realize the benefit of these tax assets.

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

o) Future changes in accounting standards

In February 2008, the Accounting Standards Board announced that, effective for fiscal years beginning on or after January 1, 2011, International Financial Reporting Standards ("IFRS") will replace Canadian GAAP for publicly accountable enterprises. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosure requirements. The Corporation will first report under IFRS for its March 31, 2011 consolidated interim financial statements, and comparative figures previously reported under Canadian GAAP will be converted to IFRS.

3. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH

As at December 31, 2010, the Corporation held \$7.5 million in an operating account and \$67.5 million in term deposits, held with chartered Canadian banks. The term deposits earn at fixed and variable interest rates, effectively bearing between 1.10% and 1.30% as at December 31, 2010, and can be redeemed without penalty within 90 days of the original investment dates, and are not subject to valuation fluctuations. As at December 31, 2009, all cash and cash equivalents were held in operating accounts.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

As at December 31, 2009, the Corporation held \$0.2 million in cash restricted for settling future abandonment costs. As at December 31, 2010, the Corporation had no restrictions on any cash balances.

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment comprises the following:

	December 31, 2010		
	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
P&NG assets	47,446,595	45,984,159	1,462,436
Office equipment and furniture	383,288	258,029	125,259
	47,829,883	46,242,188	1,587,695

	December 31, 2009		
	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$
P&NG assets	120,648,253	59,639,926	61,008,327
Office equipment and furniture	481,862	266,001	215,861
	121,130,115	59,905,927	61,224,188

Property, plant and equipment decreased during 2010 primarily as a result of Serrano's disposal of its 20% interest in the Blackrod SAGD oil sands project in the first quarter of 2010, and the subsequent disposal of the Corporation's interest in Serrano in the second quarter of 2010 (see note 9).

During the year ended December 31, 2010, the Corporation recorded \$4.3 million in depletion of P&NG assets and depreciation of office equipment and furniture, and \$5.9 million in impairments of P&NG assets. During the year ended December 31, 2009, the Corporation recorded \$15.4 million in depletion of P&NG assets and depreciation of office equipment and furniture, and a further \$7.7 million impairment of P&NG assets.

All P&NG assets recorded by the Corporation as at December 31, 2010 were included in the depletion calculation for 2010. P&NG assets with a net book value of \$12.7 million as at December 31, 2009, including a proportionate \$8.9 million in assets related to equity investments, were excluded from the 2009 depletion calculation.

Future development costs of \$1.0 million for undeveloped, proved reserves as at December 31, 2010 were included in the depletion calculation for 2010. As at December 31, 2009, \$13.2 million in future development costs were included in the depreciation calculation for 2009, of which \$9.9 million related to the Corporations holding in equity investees.

The Corporation has not capitalized any general and administrative expenses for the years ended December 31, 2010 or 2009.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

Ceiling test for asset impairment

The December 31, 2010 ceiling test was conducted on a consolidated basis in accordance with GAAP, whereby the carrying value of P&NG assets is compared to the future cash flows these assets are expected to generate. Assessments for the impairment of P&NG assets are based on estimates of P&NG reserves, future operating and capital expenditures based on historical data and management forecasts, and future price estimates received from independent petroleum engineers, adjusted for heat content and basis differential.

Estimates used for the ceiling test as at December 31, 2010 are as follows:

Year	Exchange Rate (USD/CAD)	Nymex (USD/Mcf)	AECO (CAD/Mcf)	Edmonton Light (CAD/Bbl)	Hardisty Heavy (CAD/Bbl)
2011	0.98	4.50	4.16	86.22	68.79
2012	0.98	5.15	4.74	89.29	68.33
2013	0.98	5.75	5.31	90.92	67.03
2014	0.98	6.25	5.77	92.96	67.84
2015	0.98	6.75	6.22	96.19	70.23
>2015	0.98	+2% per year	+2% per year	+2% per year	+2% per year

The carrying value of the Corporation's P&NG assets at December 31, 2010, prior to impairment, exceeded the expected cash flows from proved reserves. This triggered an additional assessment of the assets' carrying value against the expected discounted cash flows from proved and probable reserves. Total impairment charges of \$5.9 million were recorded for the excess of asset carrying value over these cash flows during 2010, compared with \$7.7 million in 2009.

5. EQUITY INVESTMENTS

In September 2008, the Corporation acquired 56.5% of the voting shares in Marble Point Energy Limited ("Marble Point"). This interest increased to 58.1% of voting shares in the fourth quarter of 2009. Although the Corporation held the majority of voting shares, control of Marble Point was jointly held with other parties, so the Corporation accounted for Marble Point using the equity method of accounting.

On May 26, 2010 the Corporation's shareholders approved a plan to vote its shares held in Marble Point in favour of an amalgamation between Marble Point and a third party. The shareholders of Marble Point approved the transaction on June 25, 2010.

Total proceeds on the sale of the Corporation's shares in Marble Point were \$44.7 million, net of \$0.3 million in transaction costs. A gain on sale of \$12.8 million was recorded, being the excess of net proceeds over the carrying value of the equity investment in Marble Point as at June 25, 2010 of \$31.9 million.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

Prior to the disposition of Marble Point, the Corporation recorded its share in Marble Point's net loss as an expense in its financial statements.

The equity method losses recognized by the Corporation for its investment in Marble Point for the years ended December 31, 2010 and 2009 include the following Marble Point activity:

	2010	2009
	\$	\$
Revenue		
Oil and gas	12,482,034	23,250,889
Royalties	(1,265,453)	(2,892,519)
Gains on commodity derivatives	3,150,171	2,424,124
	<u>14,366,752</u>	<u>22,782,494</u>
Expenses		
Depletion, depreciation and accretion	8,618,578	17,807,210
Operating costs	3,322,856	6,271,231
General and administrative	1,730,734	5,950,692
Interest charges	1,183,280	1,901,778
Transportation	619,053	1,303,611
Stock-based compensation	387,623	3,489,725
Interest accretion – financing costs	18,533	30,759
Other income	(233,226)	(2,388,676)
	<u>15,647,431</u>	<u>34,366,330</u>
Net loss	(1,280,679)	(11,583,836)
Proportionate share of net loss	(744,494)	(6,591,992)
Adjustment for depreciation and depletion on equity method consolidation	(281,594)	(3,662,132)
Total equity loss	(1,026,088)	(10,254,124)

6. BANK LOAN AND LOAN PAYABLE

As at December 31, 2009, the Corporation's subsidiary, Serrano, had drawn on \$10.0 million of a \$12.0 million operating line of credit with a financial institution. The effective interest rate on the line was 3.5% as at December 31, 2009, and was repaid in full on March 31, 2010.

Additionally, as at December 31, 2009 the Corporation had a \$2.1 million loan payable to a private, arm's length mezzanine lender. The loan had an interest rate of 15% and was repaid in full following the closing of the Serrano disposition further described in Note 10. Certain transactions regarding this loan were with parties related to the Corporation (see note 9).

7. ASSET RETIREMENT OBLIGATION

The Corporation's asset retirement obligation is determined by discounting its portion of the estimated timing and amount of the future costs required to remediate, reclaim and abandon its P&NG wells. These costs have been estimated using an inflation rate of 2% and have been discounted to their present value using a risk-adjusted rate of 7.5%.

Changes to the Corporation's asset retirement obligation during 2010 and 2009 are as follows:

	\$
Balance, January 1, 2009	4,551,669
Liabilities disposed	(158,135)
Additional liabilities incurred	73,432
Changes to estimates	26,912
Accretion expense	356,647
Balance, December 31, 2009	4,850,525
Liabilities disposed	(3,988,370)
Additional liabilities incurred	200,000
Reclamation expenditures	(10,797)
Changes to estimates	(484,282)
Accretion expense	174,709
Balance, December 31, 2010	741,785

As at December 31, 2010, the undiscounted value of cash flows required to settle the estimated asset retirement obligation is \$0.8 million, with expenditures expected to occur between 2011 and 2029.

8. INCOME TAXES

All current and future income tax recoveries and expenses reported by the Corporation for the years ended December 31, 2010 and 2009 relate to taxable losses or income reported to Canadian tax authorities. Taxable income is determined by adjusting certain GAAP income and expenses to comply with their income tax treatment.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

The income tax expense (recovery) that would be computed by applying combined enacted federal and provincial income tax rates of 28% in 2010 and 29% in 2009 to income or loss before income taxes is reconciled to actual income tax recoveries as follows:

	2010	2009
	\$	\$
Income tax expense (recovery) on net income (loss) before tax at statutory rates	2,183,485	(9,719,339)
Increase (decrease) in income taxes from:		
Non-taxable impacts from Serrano disposal	(2,573,634)	-
Change in valuation allowance	(2,466,388)	3,389,595
Rate adjustments and other	800,492	385,079
Non-deductible stock-based compensation	548,254	519,643
Adjustment for non-controlling interest	(127,879)	(1,080,460)
Prior year adjustments and expiry of non-capital loss carry-forwards	133,845	774,819
Other	1,088	2,494,528
Impairment of goodwill	-	62,042
Finance costs	-	111,238
Total income tax recovery	(1,500,737)	(3,062,855)

Future income tax assets and liabilities arise from temporary differences between the accounting carrying values and tax bases of assets, liabilities and equity. Future income tax assets and liabilities are recorded at the statutory income tax rate for the years these temporary differences are expected to reverse.

The components of net future income tax assets and liabilities as at December 31, 2010, based on a future enacted tax rate of 25%, and December 31, 2009, based on a future enacted tax rate of 26%, are as follows:

	2010	2009
	\$	\$
Future income tax assets:		
Non-capital loss carry-forwards	6,516,603	8,098,672
Capital loss carry-forwards	4,959,553	-
Property, plant and equipment	3,376,408	2,352,358
Share issue costs	440,607	738,057
Asset retirement obligation	185,447	1,261,137
Accounts receivable	-	102,712
Equity investment	-	9,205,768
	15,478,618	21,758,704
Valuation allowance	(15,478,618)	(17,945,006)
Future income tax asset	-	3,813,698
Future income tax liability:		
Property, plant and equipment	-	(7,177,173)
Future income tax liability	-	(7,117,173)
Net future income tax liability	-	(3,363,475)

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

A valuation allowance of \$15.5 million has been recognized by the Corporation, reducing the carrying value of its future income tax asset to \$nil. The valuation allowance will only be reversed, and a future income tax asset recognized, to the extent that these assets are more likely than not to be utilized through future taxable earnings.

As the Corporation has disposed of most of its producing assets, management has determined there is no objective evidence to support recognizing any future income tax asset as at December 31, 2010, so a full valuation allowance has been provided against all future income tax assets. To the extent that the Corporation is able to generate future taxable income, the valuation allowance could be partially or entirely reversed. The measurement of future income tax assets and the related valuation allowance is based on estimates of the timing and amount of future taxable income, as well as future income tax rates, and actual taxable benefits may differ.

As at December 31, 2010, the Corporation had \$26.1 million of non-capital losses available for deduction against future taxable income, compared with \$31.1 million as at December 31, 2009. The expiration schedule of these loss carry forwards is as follows:

Year of expiration	Loss carry-forward
	\$
2013	1,141,791
2014	1,037,564
2015	229,136
2027	2,285,221
2028	9,047,253
2029	7,844,273
2030	4,481,176
Total	26,066,414

9. DISPOSAL OF SERRANO AND NON-CONTROLLING INTEREST

On May 26, 2010, the shareholders of the Corporation and the shareholders of Serrano approved the sale of all of Serrano's shares to an intermediate oil and gas producer. The disposition of the Corporation's controlling interest in Serrano yielded gross proceeds of \$24.8 million and resulted in a \$13.2 million gain on disposal, calculated as follows:

Cash flow or balance	\$
Gross proceeds	24,773,136
Less transaction costs	75,509
Less net asset carrying value as at May 26, 2010	29,676,395
Less non-controlling interest carrying value as at May 26, 2010	(18,140,177)
Gain on disposal of Serrano	13,161,409

Prior to May 26, 2010, the Corporation included 100% of Serrano's financial results and balances in its consolidated financial statements, and recorded an offsetting expense and to reflect pro-rata non-controlling interest in Serrano's net earnings, and a balance sheet amount between liabilities and shareholders' equity to reflect pro-rata non-controlling interests in Serrano's net assets.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

Changes to the non-controlling interest (“NCI”) balance sheet amount reported by the Corporation are as follows:

	\$
Balance, January 1, 2009	26,777,183
Decrease for Serrano net loss during the period	(3,725,723)
Decrease for recognition of future tax liability on flow-through shares	(872,083)
Increase for Serrano stock-based compensation	1,742,041
Decrease for Serrano share cancellation	(7,806,296)
Increase for Serrano shares issued	2,114,537
Balance, December 31, 2009	18,229,659
Decrease for Serrano net loss prior to May 26, 2010	(456,709)
Increase for Serrano’s stock-based compensation prior to May 26, 2010	322,602
Increase for Serrano shares issued prior to May 26, 2010	44,625
Derecognition on sale of investment in Serrano	(18,140,177)
Balance, December 31, 2010	-

Prior to the May 26, 2010 disposal of Serrano, the Corporation’s interest in Serrano fluctuated for the following events:

- a. In January 2009, 4,037,344 of Serrano’s common shares, held by non-controlling interests, were cancelled, reducing the number of Serrano’s common shares outstanding to 19,457,389. As a result, the Corporation’s holding of Serrano’s common shares outstanding increased from 47% to 56.8%. The increase in the Corporation’s interest is reflected in the Corporation’s consolidated financial statements as a \$7.8 million decrease to the non-controlling interest balance, \$7.6 million decrease in property, plant and equipment, and a \$0.2 million impairment of goodwill.
- b. In April 2009, Serrano issued 422,454 common shares as partial settlement to certain trade creditors, reducing the Corporation’s holding of Serrano’s common shares outstanding from 56.8% to 55.6%. The decrease in the Corporation’s interest is reflected in the Corporation’s consolidated financial statements as a \$2.1 million decrease in accounts payable, \$1.3 million increase to the non-controlling interest balance and a \$0.8 million decrease in property, plant and equipment.
- c. In July 2009, Serrano issued 400,000 common shares to an outside party and redeemed 69,000 shares held by the Corporation in Serrano. As a result of the share issuance and redemption, the Corporation’s interest in Serrano decreased from 55.6% to 54.3%. The decrease in the Corporation’s interest in Serrano was reflected in the Corporation’s consolidated financial statements as a \$0.7 million increase in the non-controlling interest balance and a \$0.1 million decrease in property, plant and equipment.

In December 2009, Serrano issued 28,622 shares to non-controlling interests. As a result, the Corporation’s interest in Serrano decreased marginally and in the non-controlling interest balance in the Corporation’s consolidated financial statements increased by \$0.1 million.

10. SHAREHOLDERS' EQUITY

On November 1, 2009, the Corporation's share holders approved a 25-for-one share consolidation, reducing the number of shares, stock options and share purchase warrants to one-twenty-fifth of their then outstanding amounts. All share, stock option and share purchase warrant information is presented on a post consolidation basis.

a) Share capital

Authorized

Unlimited number of common voting shares with no par value
Unlimited number of preferred shares with no par value

Issued and outstanding

	Number of Common Shares	Assigned Value \$
Outstanding, January 1, 2009	45,275,751	118,977,580
Issued as financing fee	976,744	420,000
Outstanding, December 31, 2009	46,252,495	119,397,580
Issued on exercise of warrants, net of transaction costs	7,787,767	19,856,637
Cancelled	(1,022)	(2,155)
Outstanding, December 31, 2010	54,039,240	139,252,062

In December 2009, the Corporation issued 976,744 common shares with an assigned value of \$0.4 million as a financing fee for the \$2.1 million loan (see note 6).

In the third quarter of 2010, 1,317,159 shares were issued as a result of the exercise of common share purchase warrants. In the fourth quarter of 2010, a further 6,470,608 common shares were issued as a result of additional warrant exercises. All warrants exercised during 2010 had an exercise price of \$1.25 per common share. In addition to cash proceeds, net of transaction costs, the assigned value of common shares issued by way of warrant exercise includes the \$10.2 million fair value of warrants exercised, determined at the time the warrants were issued.

During 2010, 1,022 common shares were returned to the Corporation and were cancelled.

Subsequent to December 31, 2010, an additional 4,429,478 common shares were issued by way of warrant exercises (see note 15).

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

b) Stock-based compensation

The expenses recorded for stock-based compensation for the years ended December 31, 2010 and 2009 comprise the following:

	2010	2009
Fair value of stock options recognized	1,635,549	49,832
Payments for stock appreciation rights	1,193,180	-
Stock-based compensation recorded for Serrano	322,602	1,742,041
Total stock-based compensation	3,151,331	1,791,873

Stock options

Pursuant to the Corporation's stock option plan, the aggregate number of shares that may be reserved for issuance under the plan shall not exceed 10% of the Corporation's issued and outstanding common shares. The number of options granted, as well as their vesting terms, contractual lives and exercise prices are at the discretion of the Board of Directors, provided that the exercise price is not less than the market price of the common shares on the grant date.

Changes to stock options outstanding during the years ended December 31, 2010 and 2009 are as follows:

	Number of options	Weighted average exercise price
		\$
Outstanding, January 1, 2009	247,440	4.25
Expired	(2,000)	17.00
Forfeited	(123,040)	4.20
Outstanding, December 31, 2009	122,400	3.13
Forfeited	(97,600)	4.12
Granted	2,460,000	1.29
Outstanding, December 31, 2010	2,484,800	1.31

The Corporation uses the Black-Scholes option pricing model to estimate the fair value of each stock option granted. The Black-Scholes option pricing model requires the Corporation to estimate the expected lives of the options granted, the future volatility of the Corporation's common share price, risk-free interest rates and an expected dividend yields. The Corporation estimates the expected lives of the options granted based on historical option exercises, expirations and forfeitures; share price volatility is estimated with reference to historical volatility; risk-free rates are based on Government of Canada bonds; and the Corporation has used an expected dividend yield of zero, based on historical dividend policy.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

The weighted average values used to determine the Black-Scholes fair value of options granted in the years ended December 31, 2010 and 2009 are as follows:

	2010	2009
Number of options granted	2,460,000	-
Risk-free interest rate	2.68%	-
Expected life of options	4.8 years	-
Expected stock price volatility	60%	-
Expected dividend yield	0%	-
Weighted average Black-Scholes fair value per option	\$0.66	-

The following table summarizes the terms of stock options outstanding and exercisable as at December 31, 2010:

Options Outstanding			Options Exercisable	
Weighted Average Exercise Price	Number of Options Outstanding	Weighted Average Remaining Contractual Life Years	Weighted Average Exercise Price	Number of Options Outstanding
\$			\$	
1.28	2,310,000	4.7	1.28	2,310,000
1.50	150,000	5.0	1.50	150,000
3.13	24,800	2.1	3.13	24,800
1.31	2,484,800	4.7	1.31	2,484,800

Stock appreciation rights

During the year ended December 31, 2009, the Corporation created a Stock Appreciation Rights Plan ("Plan") under which, at the discretion of the Board, stock appreciation rights ("SARs") could be granted to any director, officer, employee or consultant of the Corporation or subsidiary of the Corporation. During the year ended December 31, 2009, the Corporation granted 2,640,000 SARs at a strike price of \$0.75 per SAR. During 2009, 80,000 SARs expired, unexercised.

During the first and second quarters of 2010, a total of 440,000 SARs were exercised at a value of \$0.2 million, calculated as the market price of common shares less the strike price at the time of exercise. A further 200,000 SARs expired, unexercised.

On August 27, 2010, the SARs Plan was terminated by the Corporation's Board of Directors, resulting in the immediate exercise of 1,920,000 remaining unexercised SARs for a total payment of \$1.0 million.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

c) Warrants

During the course of financing activities, the Corporation may issue common share purchase warrants (“warrants”), entitling the holder to exercise the warrant for a stated number of common shares in the Corporation at a stated price. The value of attributed to warrants is measured using the Black-Scholes pricing model on the grant date, and is recorded as a separate component of shareholders’ equity. When warrants are exercised, the value attributed to the warrants is reclassified to share capital, while the value of warrants expired is reclassified to contributed surplus.

Changes to warrants outstanding during the years ended December 31, 2010 and 2009 are as follows:

	Number of options	Weighted Average Exercise Price	Weighted Average Fair Value per Warrant	Total Value
		\$	\$	\$
Outstanding, January 1, 2009	30,424,602	4.48	1.05	32,087,679
Expired	(2,254,867)	2.90	0.63	(1,416,295)
Modifications	-	-	-	383,579
Outstanding, December 31, 2009	28,169,735	1.25	1.10	31,054,963
Exercised	(7,787,767)	1.25	1.30	(10,158,268)
Outstanding, December 31, 2010	20,381,968	2.50	1.03	20,896,695

On November 12, 2009, shareholders approved several modifications to the terms of all then outstanding warrants. A summary of the modifications is as follows:

- i. To 8,904,712 warrants issued in March 2008
 - Expiry date extended one year to March 17, 2011
 - Exercise price reduced to \$1.25 until January 11, 2011, which increases to \$2.50 until expiration.
- ii. To 17,365,023 warrants issued in August 2008
 - Expiry date extended one year to September 19, 2011
 - Exercise price reduced to \$1.25 until January 11, 2011, which increases to \$2.50 until expiration.
- iii. To 1,900,000 issued in September 2008
 - Expiry date extended one year to September 30, 2011
 - Exercise price reduced to \$1.25 until September 30, 2011, which increases to \$2.50 until expiration.

The fair value impact of the modified terms was determined using the Black-Scholes pricing model, and a \$383,579 increase in the value attributed to the warrants was recorded as a financing fee in the income statement in 2009, with a corresponding increase to the warrant component of shareholders’ equity.

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

The following table summarizes the terms of warrants outstanding and exercisable as at December 31, 2010:

Exercise price	Number of Warrants Outstanding	Weighted Average Remaining Contractual Life	Number of Exercisable Warrants
\$		Years	
1.25	6,377,120	0.2	6,377,120
1.25	13,422,007	0.7	13,422,007
2.50	582,841	0.8	582,841
1.29	20,381,968	0.6	20,381,968

Subsequent to December 31, 2010, 4,429,478 warrants were exercised at a price of \$1.25 and 4,681,042 warrants have expired. After this exercise and expiry, the Corporation has 11,271,448 warrants outstanding expiring in September 2011.

d) Per share amounts

For the year ended December 31, 2010 the weighted average number of shares outstanding was 46.8 million, compared with 45.3 million in 2009. Basic net earnings per share was \$0.20 in 2010 compared with a net loss per share of \$0.66 in 2009.

Diluted per share amounts include the impact from the exercise of stock options and warrants on basic per share amounts using the treasury stock method of accounting. Under this method, the Corporation is assumed to have used the proceeds from the exercise of stock options and warrants to acquire and cancel its common shares at the weighted average market price during the period. Only those stock options and warrants outstanding at the end of the period that would have been in-the-money compared with the weighted average market price are considered dilutive. In years that a net loss is incurred, no dilutive stock options or warrants are included, as their effect would be anti-dilutive.

11. COMMITMENTS & CONTINGENCIES

a) Office and equipment leases

The Corporation's operating lease for office space, reported as a commitment in 2009, expired in 2010 and was not renewed. Currently, the Corporation leases its office premises on a month-to-month basis so no equivalent commitments are reported for 2010.

b) Management services agreement

During 2010, the Corporation entered into a management services agreement for the provision certain executive and administrative functions at a rate of \$10,000 per month. The agreement expires in December 2012 and is renewed on an annual basis thereafter, but can be cancelled on two months' notice. The counter-party to the agreement is related to the Corporation (see note 12).

c) Indemnifications

From time to time, the Corporation may be involved in litigation or have claims sought against it in the normal course of business operations. As at or subsequent to December 31, 2010, the Corporation is unaware of any claims or actions that would materially affect its reported financial position or results from operations.

Under the terms of certain agreements and the by-laws of the Corporation, the Corporation indemnifies individuals who have acted at the request of the Corporation to be a director and/or officer to the extent permitted by law, against any and all damages, liabilities, costs, charges or expenses suffered by or incurred by the individuals as a result of their service.

12. RELATED PARTY TRANSACTIONS

During the years ended December 31, 2010 and 2009, the Corporation paid consulting fees to certain directors or parties related to these directors. The fees were for services provided in the normal course of business and have been measured at an exchange amount also considered to be equivalent to the amount that would have been paid to a third party. Total related fees were \$0.1 million during 2010 and \$0.3 million during 2009.

In December 2010, the Corporation entered into a management services agreement for services provided by an officer of the Corporation and other administrative services. The counterparty to the agreement is related through affiliation with the officer and Michael Atkinson, a director of the Corporation. For the year ended December 31, 2010, the Corporation recorded an expense of \$10,000 with a corresponding amount in accounts payable for such services.

In 2009, the Corporation obtained a \$2.1 million loan facility from an arm's length mezzanine lender (see note 6). A fee of \$20,000 was paid in cash and a bonus of \$420,000, representing 20% of the principal of the facility, was paid through the issuance of 976,744 Common Shares at a price of \$0.43 per share. Michael Atkinson acted as a consultant to the mezzanine lender and provided strategic advice for this lending transaction. Mr. Atkinson received a fee of \$10,000 from the lender for structuring and performing due diligence on the credit facility. Mr. Atkinson also funded a \$95,000 portion of the loan.

13. FINANCIAL INSTRUMENTS

Fair value of financial instruments

The Corporation's financial instruments as at December 31, 2010 consist of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities. The carrying values of all of the Corporation's financial instruments are equal to their fair values. The fair values of financial instruments are allocated between three levels of a fair value hierarchy, based on the degree of certainty around the fair values. The levels and the valuation techniques used to value financial

Level 1 - Quoted prices in active markets for identical assets

Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Significant other observable inputs

Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 - Significant unobservable inputs

Significant reliance is placed on unobservable prices, supported by little or no market activity.

As at December 31, 2010, all financial instruments held by the Corporation were considered to be Level 1 financial instruments whose fair values approximate their carrying values.

Classification of financial instruments

All financial assets (except for cash and cash equivalents which are classified as held for trading) are classified as either loans or receivables and are accounted for on an amortized cost basis. All financial liabilities are classified as other liabilities. There are no financial assets on the balance sheet that have been designated as available-for-sale. There have been no changes to the aforementioned classifications during the year ended December 31, 2010.

Financial instrument risk management

The nature of these instruments and its operations expose the Corporation to market risks and credit risks. The Corporation manages its exposure to these risks by operating in a manner that minimizes this exposure. While management monitors and administers these risks, the Board of Directors of the Corporation has the overall responsibility for the establishment and oversight of the Corporation's risk management framework.

a) Market risks

Market risks to which the Corporation is exposed include unfavorable movements in commodity prices, interest rates, and foreign exchange rates. As at December 31, 2010, the Corporation has disposed of most of its producing assets and holds a significant cash position. Consequently, its exposure to these risks has been significantly reduced, but as the Corporation redeploys its cash, exposure to these risks may increase. The objective of the Group is to mitigate exposure to these risks while maximizing returns.

Commodity price risk

The Corporation is exposed to adverse consequences such as declining revenue and asset recoverability in the event of declining oil and gas prices. The Corporation manages commodity price risk by updating and monitoring forecast cash flows and profitability and taking appropriate actions as needed. To date, the Corporation has not used hedging strategies, such as forward oil and natural gas sale contracts to lock-in prices with respect to future deliveries, to counter commodity price risk, but it may do so in the future.

Interest rate risk

As at December 31, 2010, the Corporation's exposure to movements in interest rates was limited to potential decreases in interest income from variable rate interest income on its cash and cash

CANADIAN PHOENIX RESOURCES CORP.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

equivalents. The Corporation mitigates its exposure to this risk by holding its cash and cash equivalents in a combination of fixed and variable interest rate accounts, held with three Canadian chartered banks. As at December 31, 2010, \$40.0 million of the Corporation's cash and cash equivalents were held in fixed interest rate accounts, and \$35.1 million was held in variable interest rate accounts, based on Canadian prime rates. Based on these allocations, an immediate and prolonged 1% decrease in market interest rates would result in a \$0.4 decrease in annual pre-tax interest income in 2011, and an immediate and prolonged 1% increase in market interest rates would result in a \$0.4 million increase in annual pre-tax interest income in 2011.

Foreign exchange risk

Although the Corporation's P&NG revenues are denominated in Canadian dollars, the underlying market prices of these commodities are quoted in United States dollars, exposing the Corporation to fluctuations in the exchange rate between the Canadian and the United States dollar. The Corporation does not make any significant foreign currency denominated payments. Management monitors foreign exchange rate movements, but as at December 31, 2010 the Corporation had no currency hedging contracts in place to manage foreign exchange risk and no such contracts were utilized during 2010.

b) Credit risk

Credit risk is the risk of default on payment by counterparties to financial assets held by the Corporation. Virtually all of the Corporation's accounts receivables are concentrated with a limited number of customers and joint venture partners in the oil and gas industry. Management considers this concentration of credit risk to be acceptable, as customers are major industry participants, and receivables from partners are protected by effective industry standard legal remedies. The Corporation requires cash calls from its partners on major field projects in advance of commencement.

Consolidated accounts receivable at December 31, 2010 were \$0.1 million, net of a \$0.2 million provision for bad debts on one account.

The maximum exposure to credit risk is therefore represented by the carrying amount of accounts receivable on the balance sheet. In the immediate future, it is not expected that the Corporation's exposure to credit risk will be significant, until such time as cash is redeployed in new P&NG assets.

c) Concentration risk

Concentration risk is the risk that a significant proportion of the Corporation's cash and cash equivalents is held with one financial institution, exposing the Corporation to the risk that this institution may not have the liquidity to honour withdrawals or redemptions of the Corporation's funds. Concentration risk is managed by placing cash and cash equivalents between several chartered Canadian banks.

As at December 31, 2010, the largest holding of cash and cash equivalents with one financial institution was \$40.0 million.

14. CAPITAL MANAGEMENT

The Corporation's objectives when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. The Corporation defines capital as shareholder equity and working capital. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year-over-year sustainable profitable growth.

As at December 31, 2010, the Corporation's focus is to convert its remaining P&NG assets to cash at values that maximize shareholder value, while preserving the base of its cash and cash equivalents available for redeployment to producing assets. Notwithstanding the aforementioned focus, there have been no changes in the Group's capital management strategies and processes from the previous year.

The Corporation has no externally imposed capital requirements and there are no external financial covenants to which the Corporation must adhere as at December 31, 2010.

15. SUBSEQUENT EVENTS

Warrant exercises and expiry

Between January 1, 2011 and January 11, 2011, the Corporation issued 4,429,478 common shares by way of the exercise of warrants for cash proceeds of \$1.25 per share, and as of January 12, 2011, the exercise price of all outstanding warrants was \$2.50 per warrant. On March 17, 2011, an additional 4,681,042 warrants outstanding as at December 31, 2010 expired. After the exercise and expiration of these warrants, the Corporation has 58,468,718 issued and outstanding common shares and 11,271,448 outstanding warrants which expire in September 2011.