MAGNUM ENERGY INC.

FINANCIAL STATEMENTS

For the Year Ended August 31, 2011

Collins Barrow

Chartered Accountants & Consultants

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Independent Auditors' Report

To the Shareholders
Magnum Energy Inc.

We have audited the accompanying financial statements of Magnum Energy Inc., which comprise the balance sheets as at August 31, 2011 and August 31, 2010, and the statements of operations, comprehensive loss and deficit and cash flows for the years ending August 31, 2011 and August 31, 2010, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose 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 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 financial statements present fairly, in all material respects, the financial position of Magnum Energy Inc. as at August 31, 2011 and August 31, 2010, and the results of its operations and its cash flows for the years ended August 31, 2011 and August 31, 2010 in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

We draw attention to note 2 to the financial statements which which describes conditions that indicate the existence of an uncertainty that may cast doubt upon the Company's ability to continue operating as a going concern. Our opinion is not qualified in respect of this matter.

(Signed) "Collins Barrow Calgary LLP

CHARTERED ACCOUNTANTS

Calgary, Canada
December 28, 2011

MAGNUM ENERGY INC.
BALANCE SHEETS

		August 31 2011		August 31 2010
ASSETS				
Current assets:				
Accounts receivable	$	328,260	$	376,878
Prepaid expenses and deposits		80,360		85,709
		408,620		462,587
Property and equipment (notes 4 and 5)		12,996,761		11,288,043
	$	13,405,381	$	11,750,630
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable and accrued liabilities	$	637,702	$	1,172,267
Loan due to joint venture partner (notes 5 and 16)		1,254,075		-
Bank debt (note 6)		3,138,427		4,248,301
		5,030,204		5,420,568
Future income tax liability (note 7)		-		82,300
Asset retirement obligations (note 8)		625,054		481,200
		5,655,258		5,984,068
Shareholders' equity:				
Share capital (note 9)		11,074,853		8,099,711
Warrants (note 9)		281,826		9,400
Contributed surplus (note 10)		1,286,770		1,144,870
Deficit		(4,893,326)		(3,487,419)
		7,750,123		5,766,562
	$	13,405,381	$	11,750,630

Basis of presentation (note 2)
Commitments (notes 9 and 12)
Subsequent events (notes 11 and 16)

See accompanying notes to financial statements

Approved by the Directors:

"Richard A. Nemeth"	*"Gordon J. Dolph"*
Richard A. Nemeth	Gordon J. Dolph

MAGNUM ENERGY INC.
STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

	Year ended August 31 2011	2010
Revenue		
Oil and natural gas sales	$ 2,022,992	$ 2,448,282
Royalties	(103,327)	(269,285)
	1,919,665	2,178,997
Expenses		
Operating	819,888	574,310
General and administrative	894,911	920,447
Bank interest and charges	285,562	218,616
Stock-based compensation	185,000	193,350
Depletion, depreciation and accretion	1,208,828	1,128,425
Imputed interest on joint venture loan	42,193	-
	3,436,382	3,035,148
Loss from operations	(1,516,717)	(856,151)
Settlement of account payable (note 9)	-	19,264
Loss before income taxes	(1,516,717)	(836,887)
Future income tax recovery (note 7)	110,810	179,490
Net and comprehensive loss	(1,405,907)	(657,397)
Deficit, beginning of year	(3,487,419)	(2,830,022)
Deficit, end of year	$ (4,893,326)	$ (3,487,419)
Loss per share:		
-basic and diluted (note 9)	$ (0.04)	$ (0.02)

See accompanying notes to financial statements

MAGNUM ENERGY INC.
STATEMENTS OF CASH FLOWS

	Year ended August 31	
	2011	**2010**
CASH PROVIDED BY (USED IN):		
OPERATING ACTIVITIES		
Net loss	$ (1,405,907)	$ (657,397)
Adjustments for items not involving cash:		
Depletion, depreciation and accretion	1,208,828	1,128,425
Stock-based compensation	185,000	193,350
Imputed interest on joint venture loan	42,193	-
Settlement of account payable	-	(19,264)
Future income tax recovery	(110,810)	(179,490)
	(80,696)	465,624
Changes in non-cash working capital items related to operating:		
Accounts receivable	(73,609)	(122,712)
Prepaid expenses and deposits	8,049	(39,773)
Accounts payable and accrued liabilities	(19,029)	(43,929)
	(165,285)	259,210
INVESTING ACTIVITIES		
Property and equipment expenditures	(2,869,509)	(6,926,175)
Changes in non-cash working capital items related to investing:		
Accounts receivable	122,227	(158,211)
Prepaid expenses and deposits	(2,700)	300
Accounts payable and accrued liabilities	(515,536)	621,172
	(3,265,518)	(6,462,914)
FINANCING ACTIVITIES		
Loan from joint venture partner, net of repayments	1,307,700	-
Proceeds from share issuance (net of issuance costs)	3,232,977	3,343,162
Bank debt proceeds (repayments), net	(1,109,874)	2,860,542
	3,430,803	6,203,704
Decrease in cash and cash equivalents	-	-
Cash and cash equivalents, beginning of year	-	-
Cash and cash equivalents, end of year	$ -	$ -
Supplementary cash flow information:		
Interest paid	$ 218,187	$ 176,234
Income taxes paid	$ -	$ -

Non-cash transactions (note 13)

See accompanying notes to financial statements

1. Nature of Operations

Magnum Energy Inc. (the "Company") was incorporated on June 27, 2003 under the laws of British Columbia, Canada and was continued under the Alberta Business Corporations Act on February 18, 2010. The Company is a public company whose Class A common shares trade on the TSX Venture Exchange. The Company is in the business of the acquisition, exploration, development and production of oil and natural gas properties in Alberta.

2. Significant Accounting Policies

Basis of Presentation and Going Concern

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

These financial statements have been prepared using GAAP applicable to a going concern that contemplate the realization of assets and settlement of liabilities in the normal course of business as they come due.

The Company has a history of operating losses and of negative cash flows from operations. For the year ended August 31, 2011, the Company incurred a loss of $1,405,907 and cash outflows from operating activities of $165,285. The Company's working capital deficit and accumulated deficit at August 31, 2011 totalled $4,621,584 and $4,893,326 respectively. As described in note 9, the Company is committed to spend approximately $47,583 by December 31, 2011 in order to meet its flow-through share obligations to certain shareholders. These factors cast doubt about the Company's ability to continue as a going concern.

Notwithstanding the continued losses, working capital deficiency and financial commitments, these financial statements have been prepared by management on a going concern basis in accordance with GAAP. The acquisition of the Provost area Viking oil producing property in March, 2011 (note 5), the subsequent elimination of the loan due to the joint venture partner in October, 2011 (note 16), the successful public financing which closed on May 18, 2011 (note 9) and the closing of the first tranche of a private placement on December 21, 2011 (note 16) lead management to believe that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and obligations in the normal course of business.

The ability of the Company to continue as a going concern and to realize its assets and discharge its liabilities in the normal course of business is dependent upon its ability to generate future profitable operations and/or to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they become due. While the Company has been successful in obtaining additional sources of funding in the past, there can be no assurance that it will be able to do so in the future. These financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Cash and cash equivalents

Cash and cash equivalents are comprised of amounts on deposit with banks and short term, highly liquid investments with maturities of ninety days or less.

Oil and Gas Properties

Capitalized Costs

The Company follows the full cost method of accounting for oil and natural gas operations whereby all costs of acquiring, exploring for and developing oil and natural gas reserves are initially capitalized on a country-by-country basis. Such costs include land acquisition costs, lease rentals, geological and geophysical activities, carrying charges on non-producing properties, costs of drilling productive and non-productive wells, tangible production equipment, asset retirement costs and overhead charges directly related to acquisition and exploration activities.

2. Significant Accounting Policies (continued)

Proceeds from a sale of oil and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would change the depletion and depreciation rate by 20% or more.

Depletion and Depreciation

Depletion and depreciation of oil and natural gas properties is calculated using the unit-of-production method based on production volumes, before royalties, in relation to total proved reserves as estimated by independent engineers. Natural gas volumes are converted to equivalent oil volumes based on a relative energy content of six thousand cubic feet of natural gas to one barrel of oil. In determining costs subject to depletion, the Company includes estimated future costs to be incurred in developing proved reserves and removes estimated salvage values. Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

Ceiling Test

In applying the full cost method, the Company calculates a ceiling test whereby the carrying value of oil and natural gas properties is compared to the sum of the undiscounted cash flows expected to result from the proved reserves and the lower of cost or market of unproved properties. Cash flows used in the ceiling test are based on independent third party quoted forward prices, adjusted for contracted prices and quality differentials. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of oil and natural gas properties to an amount equal to the estimated net present value of proved and probable reserves and the lower of cost and market of unproved properties. A risk-free interest rate is used to arrive at the net present value of future cash flows. Carrying values in excess of the estimated discounted future cash flows would be recorded as an impairment.

Asset Retirement Obligations

Asset retirement obligations include the abandonment of oil and natural gas wells, the dismantling and removal of tangible equipment such as oil batteries and natural gas facilities and returning the land to its original condition. The Company recognizes the fair value of the obligations in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. Fair value is estimated based on the present value of the estimated future cash outflows to abandon the asset, discounted at the Company's credit-adjusted risk-free interest rate. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset. Revisions to the original estimated cost or the timing of the cash outflows may result in a change to the liability. Actual costs incurred to settle an obligation reduce the liability.

Joint Ventures

A portion of the Company's oil and natural gas operations are conducted jointly with others and accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

Equipment

Equipment is recorded at cost less accumulated depreciation which is provided on a straight-line basis over the life of the related assets.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the recovery or settlement of assets and liabilities at carrying values. Income tax assets are also recognized for the benefits from tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are

2. Significant Accounting Policies (continued)

determined based on substantively enacted tax laws and rates that are anticipated to apply in the period of realization.

Flow-through Shares

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. To recognize the foregone tax benefits of flow-through shares, the tax effect related to renounced expenditures is recorded as a reduction to share capital and the recognition of a future income tax liability for the amount of the tax reduction when the expenditures are renounced to the shareholders.

Stock-based Compensation

The Company has a stock-based compensation plan (note 9), whereby stock options are granted in accordance with the policies of regulatory authorities. The fair value of all stock options granted is expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of stock options and warrants, the consideration paid, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital. Stock option forfeitures are accounted for as they occur.

The Company uses the Black-Scholes valuation model to determine the fair value of stock options and warrants at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected life of the option and warrant, the expected price volatility of the underlying security and the risk-free interest rate.

Per Share Amounts

Basic income (loss) per share information is computed by dividing the income (loss) for the year by the weighted average number of Class A common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if potentially dilutive securities were exercised or converted to common stock. The dilutive effect of options and warrants and their equivalent is computed by application of the treasury stock method and the effect of convertible securities by the “if converted” method. The treasury stock method assumes that any proceeds received by the Company upon the exercise of in-the-money options and warrants plus the unamortized portion of stock-based compensation would be used to buy back Class A common shares at the average market price for the period. The weighted average number of shares outstanding is then adjusted by the net change.

Revenue Recognition

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

Interest revenue is recognized as earned.

Measurement Uncertainty

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingencies. Such estimates primarily relate to unsettled transactions and events at the balance sheet date. Actual results could differ from those estimated.

Accounts receivable are stated after evaluation as to their collectability and an appropriate allowance for doubtful accounts is provided.

The amounts recorded for depletion, depreciation, asset retirement obligations and the ceiling test are based on estimated proved reserves, production rates, future oil and natural gas prices and future costs.

2. Significant Accounting Policies (continued)

The amounts recorded to calculate the fair value of the loan due to joint venture partner are based on estimates of the effective interest rate applicable to debt the Company could obtain with an arm's length party on similar terms and estimates of monthly net revenues generated by the property to calculate repayments of principal of the loan which are based on estimated proved reserves, production rates, future oil and natural gas prices and future costs.

The amounts recorded to estimate fair values of stock options and warrants are based on estimates of future volatility of the Company's share price, expected lives of the options and warrants, expected dividends to be paid by the Company and other relevant assumptions.

The amounts recorded and disclosed related to future income tax asset, liability and recovery are based on estimates of the probability of the Company utilizing certain tax pools and assets which in turn, is dependent on estimates of proved and probable reserves production rates and future oil and natural gas prices.

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

Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets and financial liabilities are recognized on the balance sheet at the time the Company becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument. These instruments are classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale or other financial liabilities.

Held-for-trading instruments are financial assets and liabilities typically acquired with the intention of generating revenues in the short-term. However, an entity is allowed to designate any financial instrument as held-for-trading on initial recognition even if it would otherwise not satisfy the definition. Financial assets and financial liabilities required to be classified or designated as held-for-trading are measured at fair value, with gains and losses recorded in net earnings for the period in which the change occurs.

Held-to-maturity investments are non-derivative financial assets, with fixed or determinable payments and with a fixed maturity and an entity has the intention ad ability to hold to maturity. These financial assets are measured at amortized cost using the effective interest method. As at August 31, 2011, the Company did not have any financial assets classified as held-to-maturity.

Available-for-sale financial assets are non-derivative assets that are designated as available-for-sale or that are not classified as loans and receivables, held-to-maturity investments or held-for-trading. Available-for-sale financial assets are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in earnings. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources and other comprehensive income comprises revenue, expenses, gains and losses that are recognized in comprehensive income but excluded from net income. Available-for-sale assets are measured at fair value, except for assets that do not have a readily determinable fair value which are recorded at cost. As at August 31, 2011, the Company does not have any financial assets classified as available-for-sale and the Company does not have any comprehensive income items requiring separate disclosure.

Financial assets classified as loans and receivables are measured at amortized cost using the effective-interest method.

Other financial liabilities are measured at amortized cost using the effective interest method and include all financial liabilities other than derivatives or financial liabilities that have been identified as held-for-trading.

Derivatives are to be measured at fair value and unrealized gains and losses reported in the statement of operations unless the "normal sale and purchase" exemption is utilized or the derivatives are designated as cash flow or net investment hedges. All changes in fair value are included in earnings unless cash flow hedge

2. Significant Accounting Policies (continued)

or net investment accounting is used, in which case changes in fair value are recorded in other comprehensive income to the extent the hedge is effective and in earnings to the extent it is ineffective. The Company has not identified any material imbedded derivatives in any of its financial instruments. The Company has not designated any of its derivatives as hedges.

The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

The Company will assess at each reporting period whether there is any objective evidence that a financial asset, other than those classified as held-for-trading, is impaired.

Accounts receivable are designated as loans and receivables. Accounts payable and accrued liabilities, loan to joint venture partner and bank debt are designated as other financial liabilities.

3. Future Accounting Pronouncements

International Financial Reporting Standards (“IFRS”)

In February, 2008, the CICA Accounting Standards Board confirmed that the changeover to IFRS from GAAP will be required for publicly accountable enterprises effective for the interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition from current GAAP to IFRS is a significant undertaking that may materially affect the Company’s reported financial position and results of operations.

Although IFRS is principles based and uses a conceptual framework similar to GAAP, there are significant differences and choices in accounting policies, as well as increased disclosure requirements under IFRS. The International Accounting Standards Board has issued certain amendments and exemptions to IFRS 1 relating to full cost oil and gas accounting. The amendments permit the Company to apply IFRS prospectively to their full cost pool of capitalized exploration and development expenses, with an initial impairment test, at the transition date. The Company will then be required to adopt a form similar to “successful efforts” method of accounting for oil and gas on a prospective basis.

The Company is in the process of completing its IFRS changeover plan, which includes project structure governance, resourcing and training, analysis of key GAAP differences and a phase plan to assess accounting policies under IFRS as well as potential first time adoption of IFRS exemptions.

4. Property and Equipment

As at August 31, 2011, $1,511,000 (2010- $1,110,000) of oil and natural gas property costs are undeveloped and have not been subject to depletion. The calculation of depletion included future development costs of $625,000 (2010 - $1,800,000). During the year ended August 31, 2011, the Company capitalized approximately $38,900 (2010 - $67,000) of general and administrative expenses.

	August 31, 2011		
	Cost	**Accumulated Depletion and Depreciation**	**Net Book Value**
Oil and natural gas properties	$18,138,281	$ 5,144,643	$12,993,638
Equipment	38,201	35,078	3,123
	$18,176,482	$ 5,179,721	$12,996,761

4. Property and Equipment (continued)

	August 31, 2010		
	Cost	**Accumulated Depletion and Depreciation**	**Net Book Value**
Oil and natural gas properties	$15,239,618	$ 3,960,033	$11,279,585
Equipment	38,201	29,743	8,458
	$15,277,819	$ 3,989,776	$11,288,043

The Company performed a ceiling test calculation at August 31, 2011, to assess the recoverable value of the oil and natural gas properties. The oil and natural gas future prices are based on the August 31, 2011 commodity price forecast of the Company's independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to the Company. Benchmark price and exchange assumptions used are as follows:

	Crude Oil Edmonton	**Natural Gas AECO**
Year	**(Cdn$/bbl)**	**($/mcf)**
2011	88.96	3.24
2012	92.42	3.92
2013	96.75	4.37
2014	97.62	4.83
2015	99.35	5.06
2016	101.09	5.28
2017	101.95	5.74
Escalated at 2% thereafter		

5. Acquisition

On March 15, 2011, the Company acquired a 50% working interest in a Viking oil producing property with a joint venture partner (JV Partner) for a cash consideration of $1,400,000 before adjustments. The acquisition was accounted for using the acquisition method of accounting whereby the assets acquired and the liabilities assumed are recorded at fair value. The purchase price allocation is as follows:

	Total
Net assets acquired:	
Oil and natural gas properties	$ 1,458,798
Asset retirement obligation	(168,708)
	$ 1,290,090
Consideration:	
Loan payable to joint venture partner	$ 1,304,182
Cash adjustments to acquisition	(14,092)
	$ 1,290,090

5. Acquisition (continued)

The acquisition was financed entirely by the JV partner in exchange for the ability to participate in the acquisition, along with other provisions. The Company's portion of the consideration is payable as a non-interest bearing loan to the JV partner in amounts equal to the monthly net revenues generated by the property. Additional repayments of any portion of the loan may be made without interest or penalty.

The fair value of the loan has been discounted using an imputed interest rate of 10%. At acquisition, an imputed interest benefit of $95,818 has been recorded as a reduction of the acquisition of the property with an offsetting reduction in the value of the loan due. Unwinding of the imputed interest benefit will occur over the repayment of the loan using the effective interest rate method. For the period from the date of the acquisition to August, 2011, the Company recognized an imputed interest expense of $42,193 relating to the loan. The continuity of the loan due to the JV partner is as follows:

	August 31 2011	August 31 2010
Original loan due to joint venture partner	$ 1,400,000	$ -
Repayments made during period	(92,300)	-
Imputed interest benefit	(95,818)	-
Recognition of imputed interest expense	42,193	-
Balance, end of year	$ 1,254,075	$ -

Subsequent to the August 31, 2011, the Company entered into an agreement whereby the Company released the JV partner of certain obligations to earn its interest in certain lands in exchange for approximately $1,200,000, which proceeds were used to repay the loan in full (note 16).

6. Bank Debt

As at August 31, 2011, the Company has available a demand revolving operating loan facility with a Canadian financial institution with a borrowing base of $4,250,000. Interest is payable at the lender's prime lending rate plus 2% per annum. As collateral security for the loan facility, there is a general security agreement required from the Company providing a security interest over all present and future acquired property and a floating charge on all lands owned by the Company. The facility may be repaid in whole or in part at any time without penalty and is payable in full on demand by the Lender who may terminate the availability of the facility at any time without notice.

The amount of the facility is subject to a borrowing base test performed on a periodic basis by the Lender, based primarily on reserves and using commodity prices estimated by the Lender as well as other factors. Under the terms of the facility, the Company is required to meet certain reporting requirements and financial covenants. As at August 31, 20011, the Company was in compliance with all reporting requirements and covenants. The next review of the facility is scheduled for December 31, 2011. As at August 31, 2011, $3,138,427 was outstanding on this facility.

7. Income Taxes

The provision for future income taxes differs from that which would be expected by applying the effective combined Canadian federal and provincial income tax rates of approximately 27% (2010 – 28.3%) to loss before income taxes. The principal reasons for this difference are as follows:

	2011	2010
Expected income tax recovery on loss before taxes	$ 409,514	$ 236,839
Increase (decrease) resulting from:		
Stock-based compensation	(49,950)	(54,718)
Other	4,364	
Change in tax rates	(23,818)	(2,631)
Future income tax asset not recognized	(229,300)	-
	$ 110,810	$ 179,490

7. Income Taxes (continued)

The components of the Company's future tax asset (liability) are as follows:

		August 31 2011		August 31 2010
Carrying value of property and equipment and asset retirement obligations in excess of available tax deductions	$	(827,000)	$	(784,500)
Non-capital losses carried forward		929,900		650,700
Share issue costs		126,400		51,500
		229,300		(82,300)
Valuation allowance		(229,300)		-
	$	-	$	(82,300)

The Company has available approximately $3,647,000 of non-capital loss carry forwards expiring between 2014 and 2031 and approximately $496,000 of share issuance costs for which a partial benefit has been recognized in the financial statements.

8. Asset Retirement Obligations

The Company has estimated the total future asset retirement obligation based on the Company's net ownership interest in all wells and facilities. This includes all estimated costs to dismantle, remove, reclaim and abandon the wells and facilities and the estimated time period during which these costs will be incurred in the future. The Company has estimated the total undiscounted cash flows required to settle the asset retirement obligations to be approximately $919,000 (2010: $697,000). These payments are expected to be made over the next five to fifteen years. A credit-adjusted risk free rate of 6% (2010 – 6%) was used to calculate the fair value of the asset retirement obligations.

The following table reconciles the asset retirement obligations associated with the retirement of oil and natural gas properties:

		Year ended August 31 2011		Year ended August 31 2010
Balance, beginning of year	$	481,200	$	293,230
Liabilities incurred		11,030		295,890
Liabilities acquired		168,708		-
Liabilities sold		-		(135,839)
Revisions to estimates		(54,767)		-
Accretion expense		18,883		27,919
Balance, end of year	$	625,054	$	481,200

9. Share Capital

Authorized:

Unlimited	Class A voting common shares without par value
10,000,000	Class B voting common shares without par value
10,000,000	Class C non-voting common shares without par value
10,000,000	Class A preferred shares with a par value of $10 each
10,000,000	Class B preferred shares with a par value of $0.01 each

9. Share Capital (continued)

Issued and Outstanding:

Class A voting common shares	**Number of Shares**	**Stated Value**
Balance, August 31, 2009	25,143,572	$ 5,212,749
Private placements	9,128,249	3,468,860
Exercise of options	240,579	106,770
Share issuance costs (net of income tax effect of $57,910)		(165,968)
Future income tax effect related to flow-through shares		(522,700)
Balance, August 31, 2010	34,512,400	$ 8,099,711
Private placements	2,054,001	595,660
Public offering	10,219,000	2,861,864
Exercise of options	150,000	79,500
Share issuance costs (net of income tax effect of $122,013)		(404,032)
Future income tax effect related to flow-through shares		(157,850)
Balance, August 31, 2011	46,935,401	$ 11,074,853

Settlement of Account Payable

On March 22, 2009, the Company issued 214,058 Class A common shares to a certain creditor of the Company in exchange for an outstanding debt owed to them of $64,218. The shares were subject to a four month hold period. The shares have been ascribed a value of $0.153 per share based on the trading price of the shares at the time of the issuance with the share price differential of $12,138 recognized as income attributable to the settlement of the accounts payable as of August 31, 2009. The remaining $19,264 of the debt was included in accounts payable at August 31, 2009 and was recognized as income during the three months ended November 30, 2009, when certain conditions regarding the trading price of the shares of the Company were met.

Issuance of Class A common shares

Under the terms of a Short Form Prospectus closed by the Company on May 18, 2011, 10,219,000 units (each a "Unit") of Magnum at a price of $0.30 per Unit, were issued for total gross proceeds of $3,065,700. Each Unit consists of one Class A Voting common share of the Company and one-half of a non-transferable Class A Common Share purchase warrant (each whole warrant a "Warrant"). Each whole Warrant will entitle the holder thereof to purchase one Class A Common Share (a "Warrant Share") at an exercise price of $0.45 per Warrant Share at any time on or before the earlier of the date that is:
(a) one year from the completion of the offering; and (b) 30 days after the giving of notice of early termination by the Company, which may be given by the Company, in its sole discretion, if the closing price of the Class A Common Shares on the TSX Venture Exchange is at least $0.60 for a minimum of 20 consecutive trading days (whether or not trading of Class A Common Shares occurs on such days) . The value of the 10,219,000 Class A common shares issued was calculated at $0.2601 per share for total proceeds of $2,861,864 with the balance of the proceeds of $203,836 allocated to the warrants (see below).

In October 2009, the Company issued 3,000,000 Class A common shares at $0.20 per share for total proceeds of $600,000. In June and July 2010, the Company issued 2,332,250 Class A common shares at $0.40 per share for total proceeds of $932,900.

Flow-through Shares

In December 2010, the Company issued 2,054,001 flow-through Class A common shares at $0.29 per share for total proceeds of $595,660. In February 2011, the Company renounced $595,660 of qualifying expenditures on its flow-through shares issued in 2010. The Company recorded a recovery of future income tax assets with a corresponding reduction in share capital of $157,850 in February, 2011 with respect to the renunciation. Of the expenditures renounced, $581,759 was renounced under the one year look-back rule that allows companies to renounce qualifying expenditures prior to incurring the expenditures. A Part XII.6 tax

9. Share Capital (continued)

was levied commencing March 1, 2011 at a prescribed rate applied to the difference between the amount renounced and the actual expenditures incurred. For the year ended August 31, 2011, $6,000 (2010 – $2,100) of Part XII.6 tax is included with interest expense. As at August 31, 2011, the Company had $47,583 remaining to expend pursuant to the 2011 renouncement.

In December 2009, the Company issued 3,795,999 flow-through Class A common shares at $0.51 per share for total proceeds of $1,935,960. In February 2010, the Company renounced $1,935,960 of qualifying expenditures on its flow-through shares issued in 2009. The Company recorded a recovery of future income tax assets with a corresponding reduction in share capital of $522,700 in February, 2010 with respect to the renunciation. As at August 31, 2010, the Company had fully incurred all of the qualifying expenditures related to the 2010 renouncement.

Per Share Amounts

The table below summarizes the weighted average number of Class A common shares used in calculating loss per share.

	2011	2010
Basic and diluted	38,970,916	30,644,277

The weighted average number of shares outstanding for the years ended August 31, 2011 and 2010 were not increased for outstanding stock options and warrants for purposes of calculating diluted loss per share as the effect would be anti-dilutive.

Warrants

Share purchase warrants transactions for the year are summarized as follows:

	Number of Warrants	Fair Value of Warrants	Weighted Average Exercise Price
Balance as at August 31, 2009	1,585,000	$ 222,000	$0.40
Expired	(1,585,000)	(222,000)	$0.40
Broker's warrants granted	117,583	9,400	$0.40
Balance as at August 31, 2010	117,583	9,400	$0.40
Warrants granted upon issuance of units	5,109,500	203,836	$0.45
Expired	(117,583)	(9,400)	$0.40
Broker's warrants granted	817,250	97,990	$0.30
Warrant issue costs (net of income tax effect of $7,327)		(20,000)	
Balance as at August 31, 2011	5,926,750	$ 281,826	$0.43

On May 18, 2011, the Company issued 5,109,500 warrants to acquire Class A common shares at $0.45 per share for a period of one year. The fair value of each warrant was estimated at $0.0399 using the Black-Scholes option pricing model using a one year expected life, a 0% dividend rate, an expected volatility of 66% and a risk free rate of 1.43%. Broker's warrants to acquire 817,250 Class A common shares at $0.30 per share for a period of two years were also issued in May 2011. The value of the broker's warrants of $0.12 per warrant was estimated using the Black-Scholes method using a two year expected life, a 0% dividend rate, an expected volatility of 74% and a risk free rate of 1.43%.

On June 22, 2010, 117,583 Class A common share broker warrants were granted with an exercise price of $0.40 and a one year expiry date. The fair value of the warrants granted was estimated at $0.08 per warrant using the Black-Scholes option pricing model using a one year expected life, a 0% dividend yield, an expected volatility of 37% and a risk-free interest rate of 2.77%. These warrants expired, unexercised.

9. Share Capital (continued)

The warrants outstanding and their expiry dates are as follows:

Number of Warrants	Exercise Price	Expiry Date
5,109,500	$0.45	May 18, 2012
817,250	$0.30	May 18, 2013

Stock Options

The Company has established a stock option plan in accordance with the policies of the TSX Venture Exchange under which it is authorized to grant share purchase options up to 10% of its outstanding Class A common shares. Options are issued at the market price of the Company's stock on the date of the grant. Unless otherwise stated, the options vest when granted. The options are issued for a maximum term of five years. Stock option transactions for the year and the number of stock options outstanding are summarized below:

	Number of Options	Weighted Average Exercise Price ($)
Balance as at August 31, 2009	2,414,000	0.28
Granted	931,579	0.37
Expired	(275,000)	0.35
Cancelled	(150,000)	0.18
Exercised	(240,579)	0.37
Balance as at August 31, 2010	2,680,000	0.23
Granted	925,000	0.32
Exercised	(150,000)	0.18
Balance as at August 31, 2011	3,455,000	0.25

As at August 31, 2011, stock options were outstanding as follows:

Number of Options	Exercise Price ($)	Remaining contractual life in years	Expiry Date	Number of Options Exercisable
650,000	0.18	0.23	November 24, 2011	650,000
500,000	0.18	0.75	June 1, 2012	500,000
200,000	0.18	2.44	February 5, 2014	200,000
225,000	0.18	2.67	May 1, 2014	225,000
244,000	0.18	2.72	May 20, 2014	244,000
100,000	0.255	3.09	October 1, 2014	100,000
561,000	0.37	3.16	October 27, 2014	561,000
50,000	0.45	3.30	December 17, 2014	50,000
300,000	0.295	1.13	October 15, 2013	225,000
50,000	0.25	2.44	February 7, 2014	25,000
575,000	0.34	4.58	March 30, 2016	575,000
3,455,000		2.20		3,355,000

9. Share Capital (continued)

During the year ended August 31, 2009, the Company applied to the TSX Venture Exchange to re-price, to $0.18 per share, 1,575,000 options outstanding at an average exercise price of $0.36 per share. The re-pricing was approved at the Annual General and Special Meeting of the Company held on January 20, 2010.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with assumptions as follows:

	2011	2010
Fair value	$0.13 to $0.24	$0.04 to $0.31
Risk-free interest rate	1.32% - 1.97%	1.04% - 2.77%
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	81% - 90%	37% - 89%
Expected life of options (years)	2 - 5	1 - 5

10. Contributed Surplus

The following summarizes the Company's contributed surplus:

	August 31 2011	August 31 2010
Balance, beginning of year	$ 1,144,870	$ 747,510
Options vested	185,000	193,350
Options exercised	(52,500)	(17,990)
Warrants expired	9,400	222,000
Balance, end of year	$ 1,286,770	$ 1,144,870

11. Related Party Transactions

During the year, the Company incurred consulting fees totaling $70,000 charged by companies controlled by directors or officers of the Company (2010 -$164,300), and legal fees totaling $56,528 charged by a firm where a director is a partner (2010 - $34,300). Directors fees of $28,420 were paid during the year (2010 - $33,780). These transactions were measured at the exchange amount which is the amount agreed upon by the transacting parties.

The Company shares office space with another public company which has certain directors and officers who are also directors and officers of the Company. During the year ended August 31, 2011, the Company paid approximately $12,000 (2010 - $20,800) for office and equipment rentals to that company under a cost sharing agreement. These transactions were measured at the exchange amount which is the amount agreed upon by the transacting parties.

Included in accounts payable and accrued liabilities at August 31, 2011 is approximately $2,000 (2010 - $25,100) with respect to unpaid consulting fees, legal fees and general administration owing to related companies which is due under normal credit terms.

Effective November 1, 2011, the Company entered into a six month consulting agreement with a company controlled by a director whereby the company shall provide business development consulting services at a fee of $8,000 per month.

12. Commitments

The Company has lease commitments for base rental payments for offices and equipment through 2015. The approximate minimum lease commitments including operating costs for the next four years are as follows:

2012	$	88,000
2013		88,000
2014		31,000
2015		2,055
	$	209,055

13. Non-cash Transactions

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows during the years ended August 31 as follows:

- asset retirement obligations of $124,971 (2010 - $295,890) on property and equipment
- $97,990 (2010 - $9,400) in non-cash share issuance expenses related to the grant of Broker warrants
- in 2010 the Company sold its interest in the Cherry area natural gas wells and facilities in exchange for the outstanding net charges payable to the operator of approximately $225,000.

14. Financial Instruments and Risk Management

The nature of the Company's operations exposes the Company to market, liquidity and credit risk. The Company employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Company's business objectives and risk tolerance levels. Risk management is ultimately established by the Board of Directors and is implemented by senior management and monitored by the risk management function within the Company.

Market Risk

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Company's net earnings or the value of financial instruments. The objective of the Company is to manage and mitigate market risk exposures within acceptable limits, while maximizing returns.

Commodity Price Risk

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices to manage its cash flow. Commodity prices for oil and natural gas are impacted by numerous factors, including supply and demand, the relationship between the Canadian and U.S. dollar, the political climate and other market forces. As of August 31, 2011, the Company had entered into no derivative financial instruments for the purpose of managing commodity price risk.

Interest Rate Risk

Interest rate risk is the risk that the fair value of financial instruments and future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facility. The floating rate debt is subject to interest rate cash flow risk, as the cash required to service the debt will fluctuate as a result of changes in market rates. The Company had no interest rate swaps or financial contracts in place as at or during the year ended August 31, 2011. If interest rates had been 1% lower with all other variables held constant, after tax net loss for the year ended August 31, 2011 would have been approximately $20,500 lower, due to lower interest expense. An equal opposite impact would have occurred to net loss had interest rates been 1% higher.

14. Financial Instruments and Risk Management (continued)

Foreign Exchange Risk

Foreign exchange risk is the risk that the fair value of financial instruments and future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of the Company's oil and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for oil and natural gas are denominated in U.S. dollars, and therefore, are impacted by changes in the exchange rate between the Canadian and U.S. dollar. As at August 31, 2011, the Company had no forward foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Cash and cash equivalents consisted of cash bank balances and term deposits maturing in 30 days. The Company manages the credit exposure related to short-term investments by selecting counterparties based on credit ratings and monitors all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

The majority of the Company's accounts receivables are due from companies in the oil and natural gas industry and are subject to normal industry credit risks including commodity price fluctuations and escalating costs. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued by the partner. The Company has not experienced any credit loss in the collection of accounts receivable to date.

As at August 31, 2011, the Company's receivables consisted of approximately $42,100 from joint venture partners, $230,650 from oil and natural gas marketers, $36,400 from government agencies and $19,110 from miscellaneous sources.

The Company sells the majority of its production to three oil and natural gas marketers and therefore is subject to concentration risk. At August 31, 2011, the Company's largest credit exposure to the oil and natural gas marketers represents approximately 69% of accounts receivable. Management does not believe that this concentration of credit risk will result in any loss to the Company based on past payment experience. Receivables from oil and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large oil and natural gas marketers. The Company does not obtain collateral from oil and natural gas marketers or others in the event of non-payment.

The carrying amount of accounts receivable represents the maximum credit exposure and therefore, the Company reviews its outstanding receivables on an ongoing basis. As of August 31, 2011, there were no significant receivables greater than 90 days.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure it will have sufficient liquidity to meet its liabilites when due. By nature, the oil and natural gas industry is very capital intensive. As a result, the Company prepares annual capital expenditure budgets and utilizes authorizations for expenditures to manage capital expenditures. The Company expects to repay its financial liabilities in the normal course of operations within the next year and to fund future operational and capital requirements through operating cash flows as well as future equity and debt financings. The Company also has a revolving operating credit facility to facilitate the management of its liquidity risk and is required to meet certain financial commitments as described in note 6.

14. Financial Instruments and Risk Management (continued)

Fair Value of Financial Instruments

The estimated fair value of accounts receivable, accounts payable and accrued liabilities, and bank debt approximates their carrying value due to their short terms to maturity and the floating interest rate on the Company's debt. The fair value of the loan due to joint venture partner approximates its carrying value as the fixed rate at which the interest is being imputed approximates the interest rate at which the Company could currently obtain fixed rate financing with similar terms and conditions. At August 31, 2011, the Company does not hold any financial instruments for which it has elected to apply hedge accounting under Section 3865.

15. Capital Management

There was no change to the Company's capital management during the year ended August 31, 2011. The Company actively manages its capital structure which includes shareholders' equity. In order to maintain or adjust the capital structure, the Company considers the following: incremental investment and acquisition opportunities, the current level of credit available from the Company's lender, the level of credit that may be obtainable from the Company's lender as a result of growth in reserve values, the availability of other sources of debt with different characteristics than the existing bank debt, the sale of assets, limiting the size of the investment program, and new share issuances if available on favourable terms. The Company's objective is to maintain a flexible structure that will allow it to execute its investment program, including exploration and development of its oil and natural gas properties and acquisition and disposition transactions that will carry varying amounts of risk. The Company continually strives to balance the proportion of debt and equity in its capital structure to take into account the level of risk being incurred in its investment program. The Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

The Company monitors its capital monthly by forecasting expected cash flows from oil and natural gas based on current price and production information. The Company also monitors compliance with the financial covenants it has under its credit facility whereby certain ratios are required to be maintained between specific reserve value data and financial data is monitored. As of August 31, 2011, the Company was in compliance with all required covenants with its banker.

16. Subsequent Events

On October 26, 2011, the Company entered into an amendment of a joint venture agreement under which terms the Company released its joint venture partner from certain obligations to earn its interest in certain lands in exchange for approximately $1,200,000. The proceeds were used to repay the loan to the joint venture partner (note 5) in full.

On November 18, 2011, the Company announced that it had arranged a non-brokered private placement of up to $1,000,000 through the issuance of up to 5,000,000 flow-through Class A common shares at a price of $0.20 per share. The private placement is subject to the approval of the TSX-Venture Exchange. On December 21, 2011, the Company closed the first tranche of the private placement and issued an aggregate of 2,819,785 flow-through Class A common shares for gross proceeds of $563,957 in connection with the private placement. Finders fees of $15,974 were paid and the Company issued 46,620 finders warrants to acquire Class A common shares at $0.20 per share for a period of one year. Pursuant to the terms of the private placement, the Company is committed to renounce to the subscribers $563,957 of qualifying expenditures and to incur these expenditures prior to December 31, 2012.

On November 24, 2011, 650,000 options at an exercise price of $0.18 per share expired unexercised and the Company granted 1,625,000 stock options expiring in 5 years, at an exercise price of $0.18 per share to various consultants, officers and directors. Concurrently, 400,000 options previously granted to a consultant and outstanding at August 31, 2011, were re-priced from $0.34 to $0.18 per share.