



Financial Statements
Audited

For the Years Ended
December 31, 2008 and 2007

Management's Report

The accompanying financial statements of Solara Exploration Ltd. have been approved by the Board of Directors and have been prepared in accordance with Canadian generally accepted accounting principles. The financial information contained elsewhere in this report has been reviewed to ensure consistency with these financial statements. In preparing this report, the Corporation undertakes steps to ensure the information presented is accurate and conforms to applicable laws standards, including:

- The Board of Directors and management have established corporate government practices that are consistent with guidelines set out in the report issued by the Toronto Stock Exchange Committee on Corporate Governance in Canada.
- Management maintained accounting control systems designed to provide reasonable assurance that assets are safeguarded, transactions are properly authorized, financial records are accurately maintained and statements are generated in a timely manner.
- The Board of Directors oversees the management of the business and affairs for the Corporation including ensuring management fulfills its responsibility for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board of Directors carries out this responsibility principally through its Audit Committee.
- The Audit Committee of the Board of Directors, comprised of three members considered to be “outside and unrelated” directors, has reviewed the financial statements with management and the external auditors.
- An independent firm of chartered accountants appointed as external auditors by the shareholders, has audited the financial statements and its report is attached.

Signed "*Donald R. Holding*"
Donald R. Holding
President and Chief Executive Officer

Signed "*James E. Lawson*"
James E. Lawson
Chief Financial Officer

April 30, 2009

Auditors' Report

To the Shareholders of Solara Exploration Ltd.

We have audited the balance sheets of Solara Exploration Ltd., as December 31, 2008 and 2007 and the statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada

April 24, 2009



Balance Sheets

	December 31, 2008 \$	December 31, 2007 \$
Assets		
Current Assets		
Accounts receivable	809,752	841,256
Due from shareholder (Note 2)	85,000	85,000
Deposits and prepaids	81,566	116,802
	<u>976,318</u>	<u>1,043,058</u>
Property, plant and equipment (Note 3)	26,219,859	23,960,126
	<u>27,196,177</u>	<u>25,003,184</u>
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable and accrued liabilities	1,923,833	1,952,982
Bank debt (Note 4)	7,523,469	5,033,884
	<u>9,447,302</u>	<u>6,986,866</u>
Asset retirement obligations (Note 5)	1,918,014	1,379,141
Convertible debenture (Note 6)	2,508,056	2,408,876
Future income taxes (Note 7)	2,938,516	2,088,420
	<u>16,811,888</u>	<u>12,863,303</u>
Shareholders' Equity		
Capital stock (Note 8)	15,665,049	17,952,113
Equity portion of convertible debenture (Note 6)	404,808	404,808
Contributed surplus (Note 9)	1,487,968	323,016
Deficit	<u>(7,173,536)</u>	<u>(6,540,056)</u>
	<u>10,384,289</u>	<u>12,139,881</u>
	<u>27,196,177</u>	<u>25,003,184</u>

Basis of presentation and future operations
 Commitments (Note 12)
 Subsequent events (Note 14)
 See accompanying notes to the financial statements.

Approved by the Board of Directors:

Signed "Stanley M. Davison"
 Stanley M. Davison, Director

Signed "Alfred F. Fischer"
 Alfred F. Fischer, Director



Statements of Operations, Comprehensive Loss and Deficit

	Year ended December 31, 2008 \$	Year ended December 31, 2007 \$
Revenue		
Oil and gas income	6,951,840	5,391,075
Royalty income	86,650	116,469
Royalties, Crown and other	(548,386)	(683,532)
	6,490,104	4,824,012
Interest and other income	20,916	13,044
	6,511,020	4,837,056
Expenses		
Operations	1,978,129	1,648,278
General and administrative	951,391	753,115
Depletion, depreciation and accretion	3,679,831	10,679,057
Stock based compensation (Note 9)	98,722	134,402
Interest and accretion on convertible debentures	713,594	505,685
	7,421,667	13,720,537
Loss before income taxes	(910,647)	(8,883,481)
Future income tax reduction (Note 7)	277,167	3,285,067
Net loss and comprehensive loss	(633,480)	(5,598,414)
Deficit - beginning of year	(6,540,056)	(941,642)
Deficit - end of year	(7,173,536)	(6,540,056)
Loss per share		
Basic and diluted (Note 8)	(0.02)	(0.16)
Weighted average shares outstanding		
Basic and diluted	33,825,256	34,392,095

See accompanying notes to the financial statements.



Statements of Cash Flows

	Year Ended December 31, 2008	Year Ended December 31, 2007
	\$	\$
Operating Activities		
Net loss and comprehensive loss	(633,480)	(5,598,414)
Items not affecting cash		
Depletion, depreciation and accretion	3,679,831	10,679,057
Stock based compensation	98,722	134,402
Accretion on convertible debentures	99,180	99,180
Future income tax reduction	(277,167)	(3,285,067)
	2,967,086	2,029,158
Changes in non-cash working capital (Note 11)	(41,589)	1,560,606
	2,925,497	3,589,764
Financing Activities		
Issue of common shares	120,000	4,377,000
Bank debt	2,489,585	5,033,884
Repurchase of shares	(256,495)	(193,173)
Share purchase financing	(15,556)	(55,237)
Issue costs and commissions	(36,463)	(477,619)
	2,301,071	8,684,855
Investing Activities		
Acquisitions of property and equipment	(2,371,475)	-
Additions to property, plant and equipment	(2,934,274)	(8,066,416)
Changes in non-cash working capital (Note 11)	79,181	(5,054,623)
	(5,226,568)	(13,121,039)
Decrease in cash and cash equivalents during the year	-	(846,420)
Cash and cash equivalents beginning of year	-	846,420
Cash and cash equivalents end of year	-	-
Supplemental information		
Cash interest paid	588,749	419,069
Cash interest received	-	13,044
Cash taxes paid	-	88,131

See accompanying notes to the financial statements.

Solara Exploration Ltd.

Notes to the Financial Statements

For the Years ended December 31, 2008 and 2007

Basis of Presentation and Future Operations

Solara Exploration Ltd., (the “Corporation” or “Solara”), is involved in the exploration, development and production of petroleum and natural gas in Canada.

These financial statements have been prepared on a going concern basis which presumes that the Corporation will be able to discharge its obligations and realize its assets in the normal course of business. As at December 31, 2008, the Corporation had a working capital deficiency of \$8,470,984, of which \$7,523,469 was demand bank debt. The Corporation had a net loss and comprehensive loss of \$633,480 and cash flow from operating activities of \$2,925,497 for the year ended December 31, 2008.

As at December 31, 2008, the Corporation was compliant with its lenders covenants. Management believes that they have the continued financial support of the Corporation’s lender as described in note 4 and will have sufficient cash flow from operations in subsequent periods to satisfy its ongoing financial obligations. Consequently, management believes that the going concern assumption is appropriate for these financial statements. Should the going concern assumptions be inappropriate, adjustments to the carrying amounts of the assets and liabilities, revenues and expenses and the balance sheet classifications used would be necessary.

1. Summary of Significant Accounting Policies

The financial statements of the Corporation have been prepared in accordance with generally accepted accounting principles in Canada.

a) Use of Estimates

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 these estimates.

The amounts recorded for depletion and depreciation of petroleum and natural gas interests, and for asset retirement obligations, are based on estimates of petroleum and natural gas reserves and future costs. Proved reserves also provide the basis for determining whether the carrying value of petroleum and natural gas interests is impaired. The determination of stock-based compensation involves estimates of the volatility of the Corporation’s common shares for future rates and expected life. Future income tax expense is calculated using tax rates based on the estimated timing of reversal of temporary differences between accounting and tax values of assets and liabilities and involves forecasting the amount of the future income tax asset that may be realized. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future periods may be material.

b) Property, Plant and Equipment

The Corporation follows the full cost method of accounting for its petroleum and natural gas reserves, whereby all costs incurred in connection with the acquisition, exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition, geological and geophysical activities, rentals on non-producing leases, drilling, completing and equipping of oil and gas wells and administrative costs directly attributed to those activities. Disposition of its petroleum and natural gas reserves are accounted for as a reduction of capitalized costs, with no gain or loss recognized unless the disposition would adjust the depletion rate by 20% or greater.

Depletion and depreciation of proved oil and gas properties is calculated on the unit-of-production method based upon estimates of gross proved reserves as determined by independent reservoir engineers. Petroleum and natural gas reserves are converted to a common unit of measure based on their relative energy content of six thousand cubic feet of gas to one barrel of oil equivalent. Costs of undeveloped properties are not included in the costs subject to depletion. These costs are assessed periodically for impairment.

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In applying the full cost method, the Corporation performs an impairment test (“ceiling test”) whereby the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows based on third party quoted forward prices, adjusted for transportation and quality. Should it be determined that impairment has occurred, the amount of the impairment is measured and recorded as the amount by which the carrying amount of the property and equipment exceeds the estimated net present value of future cash flows of the proved plus probable reserves discounted at a risk free interest rate and the sale of unproved properties.

Other capital assets such as leasehold improvements, office furniture, computer and other equipment are recorded at cost and depreciated based on rates ranging from 20% to 30% on a declining balance basis.

c) Asset Retirement Obligation

The Corporation recognizes the estimated fair value of an Asset Retirement Obligation (“ARO”) in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability with a corresponding increase in the carrying amount of the related asset. ARO obligations are initially measured at fair value and subsequently adjusted for the accretion of discount and any changes to the underlying cash flows. The capitalized amount is depleted on a unit-of-production basis over the life of the proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the ARO. Actual costs incurred are charged against the ARO to the extent of the recorded liability. Any difference between the actual costs incurred and the recorded liability is recognized as a gain or loss in the period in which the costs are incurred.

d) Income Taxes

The Corporation follows the asset and liability method of accounting for income taxes. Under this method, future income taxes are recorded for the effect of any difference between the accounting and income tax basis of an asset or liability, using the substantively enacted income tax rates expected to apply when the timing difference are expected to reverse. Accumulated future income tax balances are adjusted to reflect changes in income tax rates that are substantively enacted with the adjustment being recognized in earnings in the period that the change occurs. Future income tax assets are subjected to the test of whether the accumulated balance is more likely than not to be realized and any excess income tax asset is offset by a valuation allowance.

e) Flow Through Shares

Flow-through shares are issued and the proceeds are used to fund qualifying exploration and development expenditures within a defined period. The qualifying deductions funded by the flow through arrangements are renounced to investors in accordance with Canadian tax legislations. To recognize the foregone tax benefits of flow through shares, share capital is reduced and a future income tax liability is recorded for the estimated future tax cost of the renounced expenditures, when the expenditures are renounced.

f) Stock Option Plan

The Corporation has a stock option plan for the benefit of directors, officers, employees, consultants and certain service providers. Stock option exercise prices approximate the market price for the common shares on the date the options are issued. Stock options granted under the plan vest as of one third at the date of grant and the balance over the following two years on the anniversary dates.

g) Stock Based Compensation

The Corporation follows the fair value method of accounting for stock options and performance stock options granted to directors, officers, employees, consultants and certain service providers. Stock based compensation expense is recorded for all options granted with the corresponding amount recorded as contributed surplus. Stock based compensation expense for employees is based on the estimated fair value of the related stock option at the time of the grant and is expensed on a straight line basis over the vesting period of the stock option. The stock

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based compensation expense for certain service providers is based on the estimated fair value of the related stock option at the end of each reporting period and the appropriate amount expensed in that period. In determining fair value of the stock options granted, the Black-Scholes Option Pricing Model is used and assumptions regarding interest rates, underlying volatility of the Corporation's shares and the expected life of the stock options are made. When stock options are exercised, the amounts previously accumulated as contributed surplus and the consideration received are recorded as an increase to share capital.

h) Joint Operations

In some cases exploration and production activities of the Corporation are conducted jointly with others and accordingly, these financial statements reflect only the Corporation's interest in such activities.

i) Revenue Recognition

Revenue from the sale of oil and gas is recognized based on volumes delivered to customers at contractual delivery points and rates.

j) Cash and Cash Equivalents

Cash and cash equivalents include cash and term deposits with original maturities of 90 days or less.

k) Per Share Information

Basic per share amounts are calculated using the weighted-average number of Class A Shares outstanding during the period. For purpose of this calculation, Class B Shares are deemed to be converted to Class A Shares on the basis of \$10.00 for each Class B Share divided by the greater of \$1.00 or the market price of Class A Shares at year end. Diluted per share amounts reflect the potential dilution if stock options were exercised and converted to Class A Shares. The treasury stock method of calculating diluted per share amounts is used, which assumes that any proceeds received on exercise of stock options are used to purchase Class A Shares at the average market price during the period.

l) Financial Instruments

Financial instruments must be initially recognized at their fair value on the balance sheet date. Each financial instrument must be included in one of five categories set out in the standard: financial assets and liabilities held for trading, financial assets held to maturity, loans and receivables, financial assets available for sale or other financial liabilities. All financial instruments, with the exception of loans and receivables, held to maturity investments and other financial liabilities measured at amortized cost, are reported on the balance sheet at fair value. Subsequent measurement and changes in fair value will depend on their initial classification. Unrealized gains and losses on financial instruments classified as held for trading are recognized in earnings in the period incurred. Gains and losses on assets available for sale are recognized in other comprehensive income and are charged to earnings when the asset ceases to be recognized or impaired. All derivative instruments, including embedded derivatives, are recorded on the balance sheet at fair value unless they qualify for the normal sale and purchase exception. All changes in fair value are included in earnings unless cash flow hedges are 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.

m) Financial derivative and physical delivery sales contracts

The Corporation may enter into certain financial derivative and physical delivery sales contracts in order to reduce its exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. Any financial derivative contracts entered into by the Corporation will be recorded on the balance sheet at fair value, with changes in the fair value recognized in petroleum and natural gas revenue. Settlements on financial derivative contracts are recognized in petroleum and natural gas revenue at the time each transaction under a contract is settled. Any physical delivery sales contracts entered into by the Corporation will be

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recognized in petroleum and natural gas sales at the time of the settlement and there will be no recognition of fair value on the balance sheet.

n) Comprehensive Income

This standard establishes standards for reporting and presenting comprehensive income and other comprehensive income. 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, in accordance with generally accepted accounting principles, are recognized in comprehensive income but excluded from net income.

o) Capital Disclosures

On January 1, 2008, the Corporation adopted a new accounting standard for capital disclosures. This standard specifies disclosures about objectives, policies and processes for managing capital, quantitative data about what an entity regards as capital, whether an entity has complied with all capital requirements and, if it has not complied, the consequences of such non-compliance. The implementation of this standard did not impact the Corporation's financial results (see note 10).

p) Changes in Accounting Policies

Financial instruments

On January 1, 2008, the Corporation adopted new accounting standards for Financial Instruments - Disclosures, and Financial Instruments – Presentation. The new disclosure standards increase the Corporation's disclosures regarding the risks associated with financial instruments and how those risks are managed. The implementation of these standards did not impact the Corporation's financial results; however, it did result in additional disclosures (see note 10).

Capital disclosures

On January 1, 2008, the Corporation adopted a new accounting standard for Capital Disclosures. This standard specifies disclosures about objectives, policies and processes for managing capital, quantitative data about what an entity regards has capital, whether and entity has complied with all capital requirements and, if it has not complied, the consequences of such none – compliance. The implementation of this standard did not impact Corporation's financial results; however, it did result in additional disclosures (see note10).

q) New accounting pronouncements

Goodwill and intangible assets

On January 1, 2009 the Corporation will be required to adopt a new accounting standard for Goodwill and Intangible Assets, which defines the criteria for the recognition of intangible assets.

Business combinations

On January 1, 2011, the Corporation will be required to adopt a new accounting standard for Business Combinations, which harmonizes existing Canadian standards with International Financial Reporting Standards ("IFRS"). Early adoption of the new standard is permitted.

Convergence with IFRS

On January 1, 2011, the Corporation will be required to adopt IFRS. The transition from current GAAP to IFRS is a significant undertaking that may materially affect the Corporation's reported financial position and results of operations amendments and exemptions to IFRS 1. One such exemption relating to full cost oil and gas accounting

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is expected to reduce the administrative burden in the transition from the current Canadian Accounting Guideline 16 to IFRS. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment will potentially permit the Corporation to apply IFRS prospectively to its full cost pool, rather than the retrospective assessment of capitalized exploration and development expenses, with the proviso that an impairment test under IFRS standards be conducted at the transition date.

The Corporation has not completed development of its IFRS changeover plan, which will include project structure and governance, resourcing and training, analysis of key difference between IFRS and GAAP, as well as a phased plan to assess accounting policies under IFRS and any potential IFRS 1 exemptions. The Corporation anticipates the completion of its project scoping, which will include a timetable for assessing the impact on data system, internal controls over financial reporting, and business activities, such as financing and compensation arrangements, by late 2009.

2. Due from Shareholder

The Corporation loaned an officer \$85,000 for the purchase of 340,000 Class A Shares of the Corporation in November, 2005. The demand loan is interest bearing at the bank prime rate plus one quarter percent and is secured by the Class A Shares purchased, and personally guaranteed. The demand loan is due for repayment on or before December 31, 2009 (see note 13).

3. Property, Plant and Equipment

	December 31, 2008	December 31, 2007
	\$	\$
Petroleum and natural gas properties - at cost	42,071,984	36,292,132
Office equipment and other assets – at cost	141,510	137,012
Accumulated depletion and depreciation	(15,993,635)	(12,469,018)
	26,219,859	23,960,126

As at December 31, 2008, costs of unproved properties of \$1,207,000 (December 31, 2007 - \$1,100,000) and salvage values of \$1,255,000 (December 31, 2007 - \$1,260,000) have been excluded from the depletion calculation. Future development costs of \$2,071,000 related to proved non-producing properties (December 31, 2007 - \$560,000) have been included in costs subject to depletion.

General and administrative expenses of \$541,968 and stock based compensation expense of \$94,944 (December 31, 2007 - \$451,500) directly related to exploration and development projects were capitalized.

For the year ended December 31, 2008 the Corporation purchased producing and non-producing oil and natural gas assets in Alberta in two separate transactions for \$2,371,475. The Corporation preformed a ceiling test calculation at December 31, 2008 and determined there was no impairment of its petroleum and natural gas properties (2007 - \$6,866,081). The price forecast used in the reserve evaluation prepared by the independent engineering firm retained by the Corporation is outlined in the following table and is adjusted for quality differential and location.

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Price Forecast

	Oil CDN\$/Bbl	Gas AECO C CDN\$/mmbtu
2009	68.61	7.58
2010	78.94	7.94
2011	83.54	8.34
2012	90.92	8.70
2013	95.91	8.95
2014	97.84	9.14
2015	99.82	9.34
2016	101.83	9.54
2017	103.89	9.75
2018	105.99	9.95

Future prices incorporate a US/CDN exchange rate of 2009 – 0.825, 2010 – 0.85, 2011 – 0.875, 2012 – 0.925 thereafter, escalated at 2% per year thereafter.

4. Bank Debt

The Corporation has a demand revolving credit facility of up to \$10,000,000. The interest rate charged on advances under the credit facility is payable monthly at the bank prime rate plus three quarters of one percent as at December 31, 2008. The effective interest rate was 3.38 % for 2008. The credit facility is secured by a \$10,000,000 fixed and floating charge debenture on the assets of the Corporation. On February 17, 2009, the Corporation's major lender reviewed its credit facility and renewed the facility for \$9,000,000 at a rate equal to the bank prime rate plus 1.25% per annum. The next scheduled review is in May, 2009.

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. A decrease in the borrowing base could result in a reduction to the credit facility. The next such review scheduled for May, 2009.

5. Asset Retirement Obligation

	2008 \$	2007 \$
Balance – beginning of year	1,379,141	935,434
Acquired	702,557	-
Revisions	(374,901)	-
Incurred	56,003	335,919
Accretion expense	155,214	107,788
Balance – end of year	1,918,014	1,379,141

The total future ARO was estimated by management based on the Corporation's net ownership interest in the wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The expected cost of site reclamations was estimated by the Corporation's management using the Alberta Energy Utilities Board guidelines for certain areas and actual well abandonment costs for Alberta. Note that all of the Corporation's assets are located in Alberta.

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As at December 31, 2008, the undiscounted cash flow of the asset retirement obligation was \$2,561,211 (December 31, 2007 – \$1,716,990). The Corporation expects the obligation to occur on average over 6 years and will be funded from general corporate resources at the time of abandonment. The present value of the obligation has been calculated using a discounted credit adjusted risk free rate of 9.00 %, and an annual inflation rate of 2.5%.

6. Convertible Debentures

In July, 2006, the Corporation raised \$2,756,000 through the issue of 8.5% fixed rate unsecured subordinated convertible debentures which mature on July 7, 2011. Each \$1,000 debenture is convertible at any time prior to July 7, 2011 (debenture expiry date) into 667 Class A Shares at a price of a \$1.50 per share. The debentures are redeemable at the option of the Corporation at any time after July 6, 2007 at \$1,050 per debenture provided that the average trading price of the Class A Shares exceed a \$1.80 for 20 consecutive trading days prior to the notice date.

The fair value of the conversion feature, calculated using the effective interest method, was estimated to be \$404,808, has been classified as equity. The debt component is classified as a liability and recorded as the present value of the obligation to make future interest payments in cash. The convertible debentures are subordinated to the fixed and floating debenture in favor of the Corporation's lender (see note 4).

The carrying value of the convertible debenture debt component is accreted to the original face value of the instruments over their useful life. Accretion expense of \$ 99,180 (December 31, 2007 - \$99,180) has been recorded during the year ended December 31, 2008.

7. Income Taxes

The provision for income taxes is different from the amount computed by applying the combined Canadian Federal and Provincial tax rates to the loss before income taxes. The principal reasons for the difference are as follows:

	December 31, 2008	December 31, 2007
	\$	\$
Corporate income tax rate	29.5%	32.1%
Loss before income taxes	(910,647)	(8,883,481)
Expected income tax (reduction)	(268,640)	(2,851,597)
Add (deduct)		
Stock based compensation	29,123	43,143
Rate change effect	(84,993)	(335,293)
Change in prior year estimate	12,090	(62,688)
Valuation allowance	-	(82,487)
Other	35,253	3,855
Income tax reduction	(277,167)	(3,285,067)

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The net future income tax liability is composed of temporary differences and the following table shows the tax-effected amounts of those items.

	December 31, 2008	December 31, 2007
	\$	\$
Property, plant and equipment	(4,087,607)	(3,378,662)
Non-capital losses	411,480	485,325
Share issue costs	258,107	444,703
Asset retirement obligations	479,504	358,577
Other	-	1,637
Future income tax liability	(2,938,516)	(2,088,420)

As at December 31, 2008 the Corporation had non-capital losses of approximately \$1,646,000 that will expire in the years 2015 to 2018.

8. Capital Stock

a) Authorized and issued

Unlimited number of Class A Shares with no par value.
 Unlimited number of Class B Shares with no par value.
 Unlimited number of preferred shares with no par value, of which none have been issued.

The Corporation may issue an unlimited number of Class A Shares and Class B Shares both of which are voting shares. The Class B Shares are convertible at the option of the Corporation, at any time after December 31, 2008, into Class A Shares on the basis of \$10.00 for each Class B Share, divided by the greater of \$1.00 or the market price of Class A Shares at the time of conversion. Any Class B Shares not converted by December 31, 2010 will automatically be converted pursuant to the same conversion formula.

On December 31, 2008, the Corporation completed a private placement of flow through shares issuing 600,000 Class A Shares at \$0.20 per share. (4,090,000 Class A Shares at \$1.00 per share and 820,000 Class A Shares at \$0.35 per share for 2007).

The Corporation provided a non-interest bearing demand loan to an employee for \$15,557 (2007 - \$55,237) to acquire Class A Shares of the Corporation. The loan is non-interest bearing and secured by 99,000 (2007 - 96,960) Class A Shares of the Corporation purchased with the loan.

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	For the year ended December 31, 2008		For the year ended December 31, 2007	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Class A Shares				
Balance – opening	25,324,192	13,935,414	20,795,181	9,827,989
Issued for cash – flow through	600,000	120,000	4,090,000	4,090,000
Issued for cash – flow through	-	-	820,000	287,000
Share purchase financing	-	(15,557)	-	(55,237)
Repurchase of shares	(1,303,255)	(654,782)	(380,989)	(214,338)
Balance – closing	24,620,937	13,385,075	25,324,192	13,935,414
Class B Shares				
Balance - opening	1,044,000	10,440,000	1,044,000	10,440,000
Repurchase of Shares	(57,300)	(573,000)	-	-
Balance – closing	986,700	9,867,000	1,044,000	10,440,000
Cumulative tax effect adjustment relating to the following				
Flow-through shares	-	(5,497,457)	-	(4,359,438)
Share issue costs	-	(2,089,569)	-	(2,063,863)
	-	(7,587,026)	-	(6,423,301)
Balance - closing	25,607,637	15,665,049	26,368,192	17,952,113

b) Stock options

The Corporation has a stock option plan under which it may grant options to directors, officers, employees, consultant and certain service providers. Stock options are granted at the discretion of the Board of Directors and subject to the applicable regulations, vest over two years and expire five years after the date of grant.

The following table summarizes the status of the stock option plan as at December 31, 2008, and December 31, 2007.

	Number of Stock Options	Weighted Average
		Exercise Price (\$/share)
Outstanding, December 31, 2006	1,316,661	0.35
Granted	170,000	0.95
Outstanding, December 31, 2007	1,486,661	0.42
Granted	1,190,000	0.30
Forfeited	(325,000)	0.33
Outstanding, December 31, 2008	2,351,661	0.37
Exercisable, December 31, 2008	1,658,328	0.40

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The following table summarizes stock options outstanding at December 31, 2008.

Weighted Average Exercise Price (\$/Share)	Number of Stock Options Outstanding	Weighted Average Remaining Contractual Life (years)	Number of Stock Options Excisable
0.35	1,141,661	2.00	1,141,661
0.95	170,000	2.75	170,000
0.30	800,000	4.00	266,667
0.30	185,000	4.50	61,667
0.30	55,000	4.75	18,333
0.37	2,351,661	3.16	1,658,328

c) Normal course issuer bid

Under the normal course issuer bid, the Corporation received approval commencing April 15, 2008 to purchase up to 5% of its outstanding Class A Shares until April 15, 2009. During the year ended December 31, 2008 the Corporation repurchased and cancelled 1,303,255 Class A Shares (2007 – 380,989) at a net cost of \$189,153. The average carrying value of the Class A Shares repurchased of \$654,782 (2007 - \$214,338) was charged to share capital with the difference of \$465,629 (2007 - \$21,165) included in contributed surplus.

Under the normal course issuer bid, the Corporation received approval commencing April 15, 2008 to purchase up to 5% of its outstanding Class B Shares until April 15, 2009. During the year ended December 31, 2008 the Corporation repurchased and cancelled 57,300 Class B Shares (2007 – NIL) at a net cost of \$67,343. The average carrying value of the Class B Shares repurchased of \$573,000 was charged to share capital with the difference of \$505,657 included in contributed surplus.

d) Per share information

The weighted average number of Class A Shares outstanding as at December 31, 2008, for basic and diluted was 33,825,256 Class A Shares (December 31, 2007 – 34,392,095 basic and diluted). Due to net losses realized for the years ended December 31, 2008 and 2007, the inclusion of stock options is anti-dilutive.

9. Contributed Surplus

Stock based compensation expense was calculated using the Black-Scholes Option Pricing Model, using a risk free interest rate of 3.62% (2007-3.88%), expected life of five years, expected average volatility factor of 117% (2007-61%) and no dividends. The convertible debentures are convertible into Class A Shares of the Corporation at a price of \$1.50 (2007-\$1.50).

	2008	2007
	\$	\$
Balance – beginning of year	323,016	76,363
Stock based compensation expense	98,722	134,402
Stock based compensation capitalized	94,944	-
Shares purchased for cancellation	971,286	21,165
Expired Warrants	-	91,086
Balance – end of year	1,487,968	323,016

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10. Financial Risk Management

Overview

Solara has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about Solara's exposure to each of the above risks, the Corporation's objectives, policies and processes for measuring and managing risk, and the Corporation's management of capital. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Corporation's risk management framework. The Board is in the process of implementing risk management policies. Solara's risk management policies will be designed to identify and analyze the risks faced by the Corporation, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Corporation's activities.

Credit Risk

Credit risk is the risk of financial loss to the Corporation if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from Solara's accounts receivables from joint interest partners and petroleum and natural gas marketers. As at December 31, 2008, Solara's accounts receivables consisted of \$517,767 from joint interest partners, and \$291,985 of receivables from petroleum and natural gas marketers. Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. Solara's policy to mitigate credit risk associated with these balances is to establish marketing relationships with established purchasers. The Corporation historically has not experienced any collection issues with its petroleum and natural gas marketers, and currently has no such collection issues. Joint interest receivables are typically collected within one to three months of the joint interest bill being issued to the partner. Solara attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances is dependent on industry factors, such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint interest partners as disagreements occasionally arise that increases the potential for non-collection. Solara does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners; however, Solara does have the ability to withhold production from joint interest partners in the event of non-payment, to take its share of production in kind and cash call partners for their share of capital expenditures. The carrying amount of accounts receivable represents the maximum credit exposure. Solara did not have an allowance for doubtful accounts as at December 31, 2008 and did not provide for any doubtful accounts, nor was it required to write-off any receivables during the year ended December 31, 2008.

As at December 31, 2008 and December 31, 2007, Solara considers its trade receivables to be aged as follows:

	December 31, 2008	December 31, 2007
	\$	\$
Not passed due (less than 90 days)	674,878	699,905
Past due (91 - 120 days)	134,874	141,351
	<u>809,752</u>	<u>841,256</u>

As of April 24, 2009, the Corporation had collected \$47,415 of the past due trade receivables. The remaining \$87,459 relates to prior period gross overriding royalties which are owed to the Corporation by various joint venture partners. Solara is currently working with these partners to resolve payment of the outstanding royalties. The Corporation has the right of offset with respect to approximately \$65,000 of royalty revenue from one of the parties.

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Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. Solara's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking harm to the Corporation's reputation. Solara prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Corporation utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, Solara has a revolving reserves based credit facility, as outlined in note 4, which is reviewed at least annually by its lender.

Market Risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices and interest rates, will affect the Corporation's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Corporation may from time to time utilize both financial derivatives and physical delivery sales contracts to manage market risks. The Corporation had no such contracts as at December 31, 2008.

(a) Foreign currency exchange rate risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of Solara's oil and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for oil and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Corporation had no forward exchange rate contracts in place as at or during the year ended December 31, 2008.

(b) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for oil and natural gas are impacted by not only the relationship between the Canadian and United States dollar, as outlined above, but also world economic events that dictate the levels of supply and demand. The Corporation does not have any commodity price contracts outstanding as at December 31, 2008 (see note 14).

(c) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Solara is exposed to interest rate fluctuations on its bank debt, which bears a floating rate of interest. For the year ended December 31, 2008, if interest rates had been 1% lower with all other variables held constant, after tax net earnings for the period would have been \$44,425 higher, due to lower interest expense. An equal and opposite impact would have occurred to net earnings had interest rates been 1% higher. The Corporation had no interest rate swap or financial contracts in place as at or during the year ended December 31, 2008.

Capital Management

General adverse economic conditions globally, including the possibility of a recession in Canada and a worldwide economic slowdown, recent disruptions to the credit and financial markets in Canada and worldwide and local economic turmoil may adversely affect the value of the Corporation's business and value of its securities.

The Corporation's policy is to maintain a sufficient capital base to sustain the future development of the business and to maintain investor, creditor and market confidence. The Corporation manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Corporation considers its capital structure to include shareholders' equity and bank debt. In order to maintain or adjust the capital structure, the Corporation may, from time to time, issue shares and adjust its

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capital spending to manage current and projected debt levels. The Corporation monitors capital based on the ratio of bank debt to annual funds from operations. Funds from operations is calculated based on cash provided by operating activities before changes in non-cash working capital and expenditures on asset retirement obligations. The Corporation's strategy is to endeavor to maintain a ratio of bank debt to annual funds from operations of approximately 2.5 to 1 or lower. This ratio may increase at certain times as a result of acquisitions and/or large capital projects. As at December 31, 2008, the Corporation's ratio of net debt to annual funds from operations was approximately 2.52 to 1. The Corporation anticipates that the ratio will exceed the target range through 2009 due to lower funds from operations affected by lower commodity prices. The Corporation's share capital is not subject to external restrictions; however, the bank debt facility is based on petroleum and natural gas reserves (see note 4), and contains certain financial covenants. The Corporation has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. There were no changes in the Corporation's approach to capital management during the year ended December 31, 2008.

Fair Value of Financial Instruments

Solara's financial instruments as at December 31, 2008 and December 31, 2007 include accounts receivable, an amount due from shareholder, accounts payable and accrued liabilities, bank debt and convertible debenture. The fair value of these amounts, excluding bank debt, approximate their carrying amounts due to their short terms to maturity. Bank debt is payable on demand and bears interest at a floating market rate, and accordingly, the fair market value approximates the carrying amount.

11. Cash Flow Information

Changes in non-cash working capital were as follows:

Year Ended December 31,	2008 \$	2007 \$
Changes in non-cash working capital balances		
Accounts receivable	31,504	1,914,908
Advances and prepaids	35,237	158,145
Accounts payable and accrued liabilities	(29,149)	(5,567,070)
	37,592	(3,494,017)
Year Ended December 31,	2008 \$	2007 \$
Changes in non-cash working capital relates to		
Operating	(41,589)	1,560,606
Investing	79,181	(5,054,623)
	37,592	(3,494,017)

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12. Commitments

- a) The Corporation is committed to office lease payments totalling \$202,538 to March 1, 2011 based on current operating costs. These obligations are as follows:

	\$
2009	93,479
2010	93,479
2011	15,580

- b) The Corporation has an obligation to incur \$120,000 in qualifying expenditures by December 31, 2009 resulting from the private placement of flow through shares completed during 2008.

13. Related Party Transactions

The President, CEO, and a director of the Corporation is a major shareholder of a private Alberta company that provides management consulting services to the Corporation. During the year ended December 31, 2008, the Corporation paid a total of \$131,950 for various fees (December 31, 2007 – \$194,710). The Corporation has provided a demand loan in the amount of \$85,000 to purchase 340,000 Class A Shares of the Corporation to the President and CEO in November, 2005. The loan is secured by the Class A Shares and a demand promissory note bearing interest at bank prime plus one quarter of one percent. The note is due on or before December 31, 2009 (see note 4).

The Corporate Secretary of the Corporation is counsel with a law firm that provides legal services to the Corporation. During the year ended December 31, 2008, the Corporation paid a total of \$84,622 (December 31, 2007 - \$53,360) for such services.

For the year ended December 31, 2008, consulting services were provided by a company controlled by an officer of the Corporation for \$45,000 (December 31, 2007 - \$180,000). These consulting services expired on March 31, 2008 upon the resignation of the officer.

These transactions have been recorded at the exchange amount of the consideration which is the amount agreed upon between the parties.

14. Subsequent Events

- a) On February 17, 2009, the Corporation's major lender reviewed its credit facility and renewed the facility for \$9,000,000 at a rate equal to the prime rate plus 1.25% per annum. The next scheduled review is in May, 2009 (see note 14).
- b) On March 11, 2009, the Corporation entered into a commodity price contract with its lender which provides for a minimum price of \$5.21 per gigajoule (GJ) on 350 GJs per day for the period commencing on April 1, 2009 until December 31, 2009, and a ceiling price of \$7.50 per GJ commencing on January 1, 2010 and ending March 31, 2011.
- c) On March 23, 2009, the Corporation entered into a second commodity price contract with its lender which provides for a minimum price of \$5.00 per GJ on 200 GJs per day for the period commencing on April 1, 2009 until December 31, 2009, and a ceiling price of \$6.675 per GJ commencing on January 1, 2010 and ending March 31, 2011.