



## **Financial Statements Unaudited**

For the Nine Months Ended  
September 30, 2008 and 2007

### **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The accompanying unaudited interim financial statements of Solara Exploration Ltd. (the "Company") have been prepared by and are the responsibility of the management of the Company. The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.



## Balance Sheets

(Unaudited)

	As at September 30, 2008 \$	As at December 31, 2007 \$
<b>Assets</b>		
<b>Current Assets</b>		
Accounts receivable	1,193,019	841,256
Due from shareholder (Note 4)	85,000	85,000
Advances and prepaids	99,516	116,802
	1,377,535	1,043,058
<b>Property, plant and equipment (Notes 3 and 5)</b>	25,679,913	23,960,126
	27,057,448	25,003,184
<b>Liabilities and Shareholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	1,462,557	1,952,982
Bank debt (Note 6)	7,020,930	5,033,884
	8,483,487	6,986,866
<b>Asset retirement obligations (Note 7)</b>	1,805,992	1,379,141
<b>Convertible debenture (Note 8)</b>	2,483,261	2,408,876
<b>Future income taxes (Note 9)</b>	3,439,433	2,088,420
	16,212,173	12,863,303
<b>Shareholders' Equity</b>		
<b>Capital stock (Note 10)</b>	16,246,057	17,952,113
<b>Equity portion of convertible debenture (Note 8)</b>	404,808	404,808
<b>Contributed surplus (Note 11)</b>	679,067	323,016
<b>Deficit</b>	(6,484,657)	(6,540,056)
	10,845,275	12,139,881
	27,057,448	25,003,184

Basis of presentation and future operations  
Commitments (Note 13)

See accompanying notes to the financial statements.



## Statements of Operations , Comprehensive Income and Deficit

(Unaudited)

	Three months ended September 30, 2008 \$	Three months ended September 30, 2007 \$	Nine months ended September 30, 2008 \$	Nine months ended September 30, 2007 \$
<b>Revenue</b>				
Oil and gas	1,782,447	1,465,477	5,964,630	4,072,856
Royalties	(170,215)	(194,789)	(440,938)	(533,285)
	1,612,232	1,270,688	5,523,692	3,539,571
Interest and other income	8,496	2,807	13,439	8,357
	1,620,728	1,273,495	5,537,131	3,547,928
<b>Expenses</b>				
Operations	495,628	440,686	1,410,244	1,067,683
General and administrative	213,462	101,990	647,138	458,925
Depletion, depreciation and accretion	859,513	739,298	2,750,128	2,310,599
Stock based compensation (Note 11)	-	14,401	80,508	43,203
Interest	172,793	155,340	533,916	343,204
	1,741,396	1,451,715	5,421,934	4,223,614
<b>Income (Loss) before income taxes</b>	(120,668)	(178,220)	115,197	(675,686)
<b>Future income tax reduction (expense) (Note 9)</b>	33,325	53,100	(59,798)	201,700
<b>Net income (loss) and comprehensive income (loss)</b>	(87,343)	(125,120)	55,399	(473,986)
<b>Deficit - beginning of period</b>	(6,397,314)	(1,307,375)	(6,540,056)	(941,642)
<b>Share redemption (Note 10)</b>	-	(25,393)	-	(42,260)
<b>Deficit - end of period</b>	(6,484,657)	(1,457,888)	(6,484,657)	(1,457,888)
<b>Net income (loss) per share</b>				
Basic and diluted (Note 10 (d))	-	-	-	(0.02)

See accompanying notes to the financial statements.



**Statements of Cash Flows**  
(Unaudited)

	Three months ended September 30, 2008 \$	Three months ended September 30, 2007 \$	Nine months ended September 30, 2008 \$	Nine months ended September 30, 2007 \$
<b>Operating Activities</b>				
Net (loss) income	(87,343)	(125,120)	55,399	(473,986)
Items not affecting cash				
Depletion, depreciation and accretion	859,513	739,298	2,750,128	2,310,599
Stock based compensation	-	14,401	80,508	43,203
Accretion on convertible debentures	24,795	24,795	74,385	74,385
Future income tax (reduction) expense	(33,325)	(53,100)	59,798	(201,700)
	763,640	600,274	3,020,218	1,752,501
Changes in non-cash working capital	269,048	845,676	(445,105)	(1,788,289)
	1,032,688	1,445,950	2,575,113	(35,788)
<b>Financing Activities</b>				
Issue of common shares	-	-	-	4,090,000
Bank debt	611,857	339,049	1,987,046	4,153,669
Repurchase of shares	(37,493)	(51,830)	(112,155)	(163,783)
Issue costs and commissions	(7,000)	(53,360)	(27,143)	(425,575)
	567,364	233,859	1,847,748	7,654,311
<b>Investing Activities</b>				
Property acquisitions (Note 3)	(1,181,821)	-	(2,364,858)	-
Additions to property, plant and equipment	(799,543)	(1,957,059)	(1,678,208)	(5,922,943)
Changes in non-cash working capital	381,312	277,250	(379,795)	(2,542,000)
	(1,600,052)	(1,679,809)	(4,422,861)	(8,464,943)
<b>Decrease in cash and cash equivalents during the period</b>	-	-	-	(846,420)
<b>Cash and cash equivalents beginning of period</b>	-	-	-	846,420
<b>Cash and cash equivalents end of period</b>	-	-	-	-
<b>Supplemental information</b>				
<b>Cash interest paid</b>	85,919	262,693	380,564	343,205
<b>Cash taxes interest paid</b>	-	-	-	88,131

See accompanying notes to the financial statements.

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**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 the basis that the Corporation will be able to discharge its obligations and realize its assets in the normal course of business. As at September 30, 2008, the Corporation had a working capital deficiency of \$7,105,952 of which \$7,020,930 was bank debt. The Corporation had net income of \$55,399 and funds from operations of \$3,020,218 for the nine months ended September 30, 2008.

As at September 30, 2008, the Corporation is compliant with its lenders covenants. Management believes that they have the continued financial support of the Corporation's lender as described in note 6, 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. If this assumption was not appropriate, adjustments to the carrying amounts of the assets and liabilities, revenues and expenses and the balance sheet classifications used may have been necessary.

**1. Significant Accounting Policies**

The unaudited interim financial statements have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") using the same accounting policies as those set out in note 1 to the audited financial statements for the year ended December 31, 2007, except as described in note 2 below. The unaudited interim financial statements contain disclosures that are supplemental to the Corporation's December 31, 2007 audited financial statements. Certain disclosures, which are normally required to be included in the notes to the audited annual financial statements, have been condensed or omitted. In the opinion of management, these unaudited interim financial statements present fairly the Corporation's financial position as at September 30, 2008 and the results of its operations for the nine months ended September 30, 2008. The unaudited interim financial statements should be read in conjunction with the Corporation's audited financial statements and notes for the year ended December 31, 2007.

**2. Changes in Accounting Policies**

Financial Instruments - Disclosures and Presentation

In December 2006, new standards for "Financial Instruments – Disclosure and Presentation" were introduced which outline the disclosure requirements for financial instruments and non-financial derivatives. This guidance prescribes an increased importance on risk disclosures associated with recognized and unrecognized financial instruments and how such risks are managed. Specifically, it requires disclosure of the significance of financial instruments for a company's financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments (see note 12).

Capital Disclosures

In December 2006, new standards were issued on "Capital Disclosures" requiring disclosures regarding an entity's objectives, policies and processes for managing capital. These disclosures

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include a description of what the Corporation manages as capital, the nature of externally imposed capital requirements, how the requirements are incorporated into the Corporation's management of capital, whether the requirements have been complied with, or consequences of non-compliance and an explanation of how the Corporation is meeting its objective for managing capital. In addition, quantitative data about capital and whether the Corporation has complied with all capital requirements are also required (see note 12).

International Financial Reporting Standards ("IFRS")

The Accounting Standards Board (AcSB) will require public companies in Canada to adopt International Financial Reporting Standards ("IFRS") in 2011. Specific requirements of the transition continue to be under review by the AcSB and the International Accounting Standards Board. The Corporation continues to monitor developments and has not yet assessed the impact of these prospective changes on the financial statements of the Corporation, but will begin to evaluate these proposed changes prior to year end 2008.

**3. Property Acquisitions**

For the nine months ended September 30, 2008, Solara purchased producing and non producing oil and natural gas assets in Alberta for \$2,364,858.

**4. 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 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 note is due for repayment on or before December 31, 2008 (see note 14).

**5. Property, Plant and Equipment**

	<b>September 30, 2008</b>	December 31, 2007
	\$	\$
Petroleum and natural gas properties - at cost	<b>40,656,086</b>	36,292,132
Office equipment and other assets – at cost	<b>140,790</b>	137,012
Accumulated depletion and depreciation	<b>(15,116,963)</b>	(12,469,018)
	<b>25,679,913</b>	23,960,126

As at September 30, 2008, costs of unproved properties of \$400,000 (September 30, 2007 - \$3,200,000) and salvage values of \$1,554,310 (September 30, 2007 - \$1,260,000) have been excluded from the depletion calculation. Future development costs of \$847,000 (September 30, 2007 - \$175,000) have been included in costs subject to depletion.

General and administrative expenses totalling \$431,425 (September 30, 2007 - \$458,925) directly related to exploration and development projects were capitalized.

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**6. Bank Debt**

The Corporation has a demand revolving credit facility of up to \$10,000,000. The interest rate charged on the revolving credit facility is payable monthly at the bank prime rate plus three quarters of one percent as at September 30, 2008. The effective interest rate was 5.2 %. The credit facility is secured by a \$10,000,000 fixed and floating charge debenture on the assets of the Corporation.

**7. Asset Retirement Obligations**

	Nine months ended September 30, 2008 \$	Year ended December 31, 2007 \$
Balance – beginning of period	1,379,141	935,434
Increase in obligations		
From acquisitions	525,913	335,919
From operations	(201,245)	-
Accretion expense	102,183	107,788
Balance – end of period	1,805,992	1,379,141

The total future asset retirement obligation was estimated by management based on the Corporation's net ownership interest in its 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 Corporations management using the Alberta Energy Utilities Board guidelines for certain areas and actual well abandonment costs.

At September 30, 2008, the undiscounted cash flow of the asset retirement obligation was \$2,443,331 (December 31, 2007 – \$1,379,141). The Corporation expects the obligation to occur over 5 years beginning in 2009 and will be funded from general corporate resources at the time of abandonment. The Corporation does not anticipate any abandonment obligations in 2008. The present value of the obligation has been calculated using a discounted credit adjusted risk free rate of 8.5%, and an inflation rate of 2%.

**8. Convertible Debentures**

In July, 2006, the Corporation raised \$2,756,000 through the issue of an 8.5% fixed rate subordinated convertible debenture which matures on July 7, 2011. The fair value of the conversion feature, calculated using the effective interest method, which is 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 debenture is subordinated to the fixed and floating debenture in favour of the Corporation's lender (see note 6).

The carrying amount of the debentures is accreted to the original face value of the instruments over their life. Accretion expense of \$74,385 (September 30, 2007 - \$74,385) has been recorded during the nine months ended September 30, 2008 and is included in interest expense.

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**9. Income Taxes**

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

	Nine months ended September 30, 2008	Nine months ended September 30, 2007
	\$	\$
Corporate income tax rate	29.5%	32.1%
Income (loss) before income taxes	115,197	(675,686)
Expected income tax (reduction)	33,983	(216,895)
Add (deduct)		
Stock based compensation	23,750	13,868
Other	2,065	1,327
Future income tax expense (reduction)	59,798	(201,700)

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

	September 30, 2008	December 31, 2007
	\$	\$
Property, plant and equipment	(4,424,763)	(3,378,662)
Non-capital losses	219,207	485,325
Share issue costs	296,565	444,703
Asset retirement obligations	469,558	358,577
Other	-	1,637
Future income tax liability	(3,439,433)	(2,088,420)

**10. 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

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not converted by December 31, 2010 will automatically be converted pursuant to the same conversion formula.

	For the nine months ended September 30, 2008		For the year ended December 31, 2007	
	Number of Shares	Amount \$	Number of Shares	Amount \$
<b>Class A Shares</b>				
Balance – opening	25,324,192	13,935,414	20,795,181	9,827,989
Issued for cash – flow through	-	-	4,090,000	4,090,000
Issued for cash – flow through	-	-	820,000	287,000
Share purchase financing	-	-	-	(55,237)
Repurchase of shares	(322,755)	(178,792)	(380,989)	(214,338)
Balance – closing	25,001,437	13,756,622	25,324,192	13,935,414
<b>Class B Shares</b>				
Balance - opening	1,044,000	10,440,000	1,044,000	10,440,000
Repurchase of Shares	(21,200)	(208,907)	-	-
Balance – closing	1,022,800	10,231,093	1,044,000	10,440,000
Tax effect adjustment				
Flow-through shares	-	(5,690,876)	-	(4,359,438)
Share issue costs	-	(2,090,876)	-	(2,063,863)
	-	(7,741,658)	-	(6,423,301)
Balance - closing	26,024,237	16,246,057	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 and consultants. 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.

As at September 30, 2008, there were outstanding options to acquire 1,141,661 Class A Shares at \$0.35 per share, net of 175,000 Class A Shares forfeited, 170,000 Class A Shares at \$0.95 per share and 800,000 Class A Shares at \$0.30 per share, net of a 150,000 Class A Shares forfeited, 185,000 Class A Shares at \$0.30 per share and 55,000 Class A Shares at \$0.30 per share.

The following table summarizes the status of the stock option plan as of September 30, 2008, and December 31, 2007.

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<b>September 30, 2008</b>		<b>Options outstanding</b>			<b>Options exercisable</b>	
<b>Exercise Price \$ Per Class A Share</b>	<b>Number Outstanding</b>	<b>Weighted Average Remaining Contractual Life (years)</b>	<b>Weighted Average Exercise Price (\$/share)</b>	<b>Number Exercisable</b>	<b>Weighted Average Exercise Price (\$/share)</b>	
0.35	1,141,661	2.25	0.35	1,141,661	0.35	
0.95	170,000	3.00	0.95	170,000	0.95	
0.30	800,000	4.25	0.30	266,667	0.30	
0.30	185,000	4.75	0.30	66,667	0.30	
0.30	55,000	5.00	0.30	18,333	0.30	
	2,351,661	4.17	0.37	1,663,328	0.40	

<b>December 31, 2007</b>		<b>Options outstanding</b>			<b>Options exercisable</b>	
<b>Exercise Price \$ Per Class A Share</b>	<b>Number Outstanding</b>	<b>Weighted - Average Remaining Contractual Life (years)</b>	<b>Weighted - Average Exercise Price (\$/share)</b>	<b>Number Exercisable</b>	<b>Weighted - Average Exercise Price (\$/share)</b>	
0.35	1,316,661	3.00	0.35	1,316,661	0.35	
0.95	170,000	3.75	0.95	113,333	0.95	
	1,486,661	3.40	0.42	1,429,994	0.40	

**c) Normal Course Issuer Bid**

Under the normal course issuer bid, the Corporation received regulatory approval commencing April 15, 2008 to purchase up to 5% of its outstanding Class A Shares and Class B Shares until April 15, 2009. During the nine months ended September 30, 2008, 322,755 Class A Shares (September 30, 2007-281,489) at a deemed cost of \$178,792, which includes the actual cost plus the adjustment to contributed surplus (September 30, 2007-\$163,783) were purchased and cancelled by the Corporation. The Corporation during the nine months ended September 30, 2008 purchased 21,200 Class B Shares at a deemed cost of \$ 208,907, which includes the actual cost plus the adjustment to contributed surplus (September 30, 2007 – \$NIL).

**d) Per Share Information**

Weighted average number of shares outstanding as at September 30, 2008, for basic and diluted was 34,137,864 Class A Shares on the basis that the 1,022,800 Class B Shares are convertible into 10,228,000 Class A Shares as at September 30, 2008 (September 30, 2007 – 34,879,964 basic and 35,411,446 diluted).

The inclusion of options was anti-dilutive at September 30, 2008.

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**11. Contributed Surplus**

Stock based compensation expense was calculated using the Black-Scholes option pricing model, using a risk free interest rate of 3.88% (2007-3.88%) expected life of five years, expected average volatility factor of 87% (2007-55%) and no dividends. The convertible debentures are convertible into Class A Shares of the Corporation at a price of \$1.50 (2007-\$1.50).

	<b>Nine months ended September 30, 2008</b>	<b>Year ended December 31, 2007</b>
	\$	\$
Balance – beginning of period	<b>323,016</b>	76,363
Stock based compensation expense	<b>80,508</b>	134,402
Adjustment for Share Redemption	<b>275,543</b>	21,165
Expired Warrants	-	91,086
Balance – end of period	<b>679,067</b>	323,016

**12. 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 September 30, 2008, Solara’s accounts receivables consisted of \$659,895 from joint interest partners, and \$533,124 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

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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 September 30, 2008 and did not provide for any doubtful accounts, nor was it required to write-off any receivables during the nine months ended September 30, 2008.

As at September 30, 2008 and December 31, 2007, Solara considers its trade receivables to be aged as follows:

	<b>September 30, 2008</b>	December 31, 2007
	\$	\$
Not passed due (less than 90 days)	<b>1,079,262</b>	699,905
Past due (91 - 120 days)	<b>113,757</b>	141,351
	<b>1,193,019</b>	841,256

**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 6, 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 at September 30, 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

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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 nine months ended September 30, 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 has not participated in any hedging and or counter party transactions.

**(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 nine months ended September 30, 2008, if interest rates had been 1 % lower with all other variables held constant, after tax net earnings for the period would have been \$36,476 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 nine months ended September 30, 2008.

**Current Market Conditions**

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 Company's business and value of its securities.

**Capital Management**

The Corporation's policy is to maintain a strong 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, debt and working capital. In order to maintain or adjust the capital structure, the Corporation may, from time to time, issue shares and adjust its capital spending to manage current and projected debt levels. The Corporation monitors capital based on the ratio of net debt to annualized funds from operations. This ratio is calculated as net debt, defined as outstanding bank debt, divided by funds from operations for the most recent calendar quarter, annualized (multiplied by four). 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 maintain a ratio of net debt to annualized funds from

operations of 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 September 30, 2008, the Corporation's ratio of net debt to annualized cash flow was 2.3 to 1, which is within the range established by the Corporation. Note that the convertible debenture debt under long term liabilities has been excluded from the net debt to cash flow calculation since it is not due and payable until July, 2011. If it had been included, the net debt to

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cash flow ratio would have been 3.1 to 1. The Corporation anticipates that the ratio will remain within or close to the target range through 2008. The Corporation's share capital is not subject to external restrictions; however, the bank debt facility is based on oil and natural gas reserves (see note 6). 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 nine months ended September 30, 2008.

**Fair Value of Financial Instruments**

Solara's financial instruments as at September 30, 2008 and December 31, 2007 include accounts receivable, an amount due from shareholder, accounts payable and accrued liabilities, bank debt and debenture debt. 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.

**Cash Flow Information**

Changes in non-cash working capital were as follows:

	<b>2008</b>	2007
Nine Months Ended September 30,	\$	\$
<b>Changes in non-cash working capital balances</b>		
Accounts receivable	<b>(351,761)</b>	1,233,519
Advances and prepaids	<b>17,286</b>	173,131
Inventory	-	(202,367)
Accounts payable and accrued liabilities	<b>(490,425)</b>	(5,534,572)
	<b>(824,900)</b>	(4,330,289)

**13. Commitments**

- a) The Corporation is committed to office lease payments totalling \$225,908 to March 1, 2011 based on current operating costs. These obligations are as follows:

	\$
<b>2008</b>	<b>23,370</b>
2009	93,479
2010	93,479
2011	15,580

- b) During the nine months ended September 30 of 2008, the Corporation incurred \$924,287 in qualifying expenditures covering the Corporation's flow through obligation from 2007.

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**14. Related Party Transactions**

The President, C.E.O. 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 nine months ended September 30, 2008, the Corporation paid a total of \$47,500 for various fees (September 30, 2007 - \$205,190). The Corporation has provided a loan in the amount of \$85,000 to purchase 340,000 Class A Shares of the Corporation to the President and C.E.O. 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, 2008.

The Corporate Secretary of the Corporation is counsel with a law firm that provides legal services to the Corporation. During the nine months ended September 30, 2008, the Corporation paid a total of \$79,834 (September 30, 2007 - \$57,207) for such services.

For the nine months ended September 30, 2008, consulting services were provided by a private Alberta Corporation controlled by the Vice President, Engineering and Operations for \$45,000 (September 30, 2007 - \$135,000). These consulting services expired on March 31, 2008 upon the resignation of the Vice President.

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