



Consolidated Financial Statements
Audited

For the Years Ended
December 31, 2009 and 2008

Management's Report

The accompanying consolidated 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 consolidated financial statements. In preparing this report, the Corporation undertakes steps to ensure the information presented is accurate and conforms to applicable standards, including:

- The Board of Directors and management have established corporate governance practice that are consistent with guidelines set out in the report issued by the Toronto Stock Exchange Committee on the 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 consolidated financial statements. The Board 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 consolidated 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, 2010

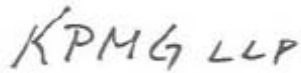
Auditors' Report

To the Shareholders of Solara Exploration Ltd.

We have audited the consolidated balance sheets of Solara Exploration Ltd. as December 31, 2009 and 2008 and the consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in blue ink that reads "KPMG LLP". The letters are slightly slanted and connected, with a stylized 'K' and 'P'.

Chartered Accountants
Calgary, Canada

April 26, 2010



Consolidated Balance Sheets

	December 31, 2009	December 31, 2008
	\$	\$
Assets		
Current assets		
Cash	5,405	-
Accounts receivable	1,731,094	809,752
Due from shareholder (note 2)	85,000	85,000
Deposits and prepaids	82,064	81,566
	1,903,563	976,318
Investment (note 13)	42,065	-
Property, plant and equipment (note 3)	24,049,125	26,219,859
	25,994,753	27,196,177
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	2,135,837	1,923,833
Commodity derivatives (note 10)	57,939	-
Bank debt (note 4)	7,678,614	7,523,469
	9,872,390	9,447,302
Commodity derivatives (note 10)	14,485	-
Asset retirement obligations (note 5)	2,042,465	1,918,014
Convertible debentures (note 6)	2,607,236	2,508,056
Future income taxes (note 7)	2,247,035	2,938,516
	16,783,611	16,811,888
Shareholders' equity		
Capital stock (note 8)	16,499,763	15,665,049
Share purchase warrants (note 8)	145,587	-
Equity portion of convertible debentures (note 6)	404,808	404,808
Contributed surplus (note 9)	1,628,102	1,487,968
Deficit	(9,467,118)	(7,173,536)
	9,211,142	10,384,289
	25,994,753	27,196,177
Basis of presentation and future operations	Approved on Behalf of the Board	
Commitments (note 12)		
Subsequent events (note 15)	(Signed) "Stanley M. Davison"	
See accompanying notes to the consolidated financial statements	(Signed) "Donald R. Holding"	



Consolidated Statements of Operations, Comprehensive Loss and Deficit

	Year Ended December 31, 2009 \$	Year Ended December 31, 2008 \$
Revenue		
Petroleum and natural gas	3,896,940	7,038,490
Royalties	(152,709)	(548,386)
Commodity derivatives (note 10b)		
Realized gains	255,103	-
Unrealized loss	(72,424)	-
Interest and other income	25,347	20,916
	3,952,257	6,511,020
Expenses		
Operations	2,113,340	1,978,129
General and administrative	764,515	951,391
Depletion, depreciation and accretion	3,371,835	3,679,831
Stock based compensation (note 9)	50,675	98,722
Interest and accretion on convertible debentures	633,871	713,594
	6,934,236	7,421,667
Loss before income taxes	(2,981,979)	(910,647)
Future income tax reduction (note 7)	688,397	277,167
Net loss and comprehensive loss	(2,293,582)	(633,480)
Deficit - beginning of year	(7,173,536)	(6,540,056)
Deficit - end of year	(9,467,118)	(7,173,536)
Loss per share		
Basic and diluted (note 8)	(0.06)	(0.02)
Weighted average shares outstanding		
Basic and diluted	38,911,104	33,825,256

See accompanying notes to the consolidated financial statements



Consolidated Statements of Cash Flows

	Year Ended December 31, 2009	Year Ended December 31, 2008
	\$	\$
Operating Activities		
Net loss	(2,293,582)	(633,480)
Items not affecting cash		
Depletion, depreciation and accretion	3,371,835	3,679,831
Stock based compensation	50,675	98,722
Accretion on convertible debentures	99,180	99,180
Unrealized loss on commodity derivatives	72,424	-
Future income tax reduction	(688,397)	(277,167)
	612,135	2,967,086
Changes in non-cash working capital (Note 11)	491,173	(41,589)
	1,103,308	2,925,497
Financing Activities		
Proceeds on shares issued	1,145,000	120,000
Bank debt	155,145	2,489,585
Repurchase of shares	(8,150)	(256,495)
Share purchase financing	-	(15,556)
Share issue costs	(108,121)	(36,463)
	1,183,874	2,301,071
Investing Activities		
Disposition of property and equipment	490,000	-
Additions to property, plant and equipment	(1,528,704)	(2,934,274)
Acquisitions of property and equipment	-	(2,371,475)
Investment in partnership	(42,065)	-
Changes in non-cash working capital (Note 11)	(1,201,008)	79,181
	(2,281,777)	(5,226,568)
Changes in cash	5,405	-
Cash, beginning of year	-	-
Cash, end of year	5,405	-
Supplemental information		
Cash interest paid	533,093	588,749

See accompanying notes to the consolidated financial statements

Solara Exploration Ltd.

Notes to the Consolidated Financial Statements

For the Years ended December 31, 2009 and 2008

Basis of Presentation and Future Operations

Solara Exploration Ltd., (“Solara” or the “Corporation”), is involved in the exploration, development and production of petroleum and natural gas in Canada. The accounts of Solara Exploration Ltd. include the accounts of its wholly owned subsidiary Marwayne Resources Inc. which was incorporated on June 16, 2009 (see note 13).

These consolidated 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, 2009, the Corporation had a working capital deficiency of \$7,968,827 of which \$7,678,614 is bank debt. The Corporation had a net loss and comprehensive loss of \$2,293,582 and cash flow from operating activities of \$1,103,308 for the year ended December 31, 2009.

As at December 31, 2009, the Corporation was compliant with its lender’s covenants. Management requires and 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 consolidated 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 consolidated 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 change 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 natural gas properties are 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 measurement based on their relative energy content of six

Solara Exploration Ltd.

Notes to the Consolidated Financial Statements

For the Years ended December 31, 2009 and 2008

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.

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 is determined through a review of engineering studies, industry guidelines and management’s estimate on a site-by-site basis. 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. The capitalized amount is depleted on a unit-of-production basis over the life of the total proved reserves. The liability amount is increased each reporting period to reflect the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of future 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.

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 legislation. 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

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

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 one third portion of stock options that vests immediately is expensed at that time. The stock 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 other companies and accordingly, these consolidated financial statements reflect only the Corporation's interest in such activities.

i) 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.

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.

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

m) Financial Derivative and Physical Delivery Sales Contracts

The Corporation may enter into certain financial derivative and physical delivery sales contracts for its oil and natural gas 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 the income statement. Settlements on financial derivative contracts are recognized in petroleum and natural gas revenue as realized gains or losses in commodity derivatives at the time each transaction under a contract is settled. Any physical delivery sales contracts entered into by the Corporation will be 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

Comprehensive income establishes standards for reporting and presenting comprehensive income and other comprehensive income. This standard 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) New Accounting Standards

Goodwill and Intangible assets

On January 1, 2009 the Corporation adopted a new accounting standard for Goodwill and Intangible Assets, which defines the criteria for the recognition of intangible assets. The implementation of this standard did not impact the Company's financial results.

Financial Instruments

In May 2009, the CICA amended Section 3862, Financial Instrument – Disclosures to improve disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. 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 amendments to Section 3862 apply for annual financial statements relating to fiscal years ending after September 30, 2009.

p) New Accounting Standards Not Yet Adopted

Business Combinations

In January 2009, the CICA Accounting Standards Board (AcSB) issued Section 1582, Business Combinations, which establishes principles and requirements of the acquisition method for business combinations and related disclosures. Section 1582 replaces Section 1581, Business Combinations. On January 1, 2011, the Corporation will be required to adopt this 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.

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

Consolidated Statements and Non-controlling interests

In January 2009, the AcSB issued Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling Interests, which together replace Section 1600, Consolidated Financial Statements and harmonizes the Canadian Standards with IFRS. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These sections are effective on or after the beginning of the first reporting period beginning on or after January 1, 2011. Early adoption is permitted.

International Financial Reporting Standards (“IFRS”)

In February 2008, the CICA confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010. The Corporation’s consolidated financial statements up to and including the December 31, 2010 financial statements will continue to be reported in accordance with Canadian GAAP as it exists for each reporting date. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared on an IFRS basis.

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, 2010 (see note 14).

3. Property, Plant and Equipment

	December 31, 2009	December 31, 2008
	\$	\$
Petroleum and natural gas properties	43,101,550	42,071,984
Office equipment and other assets	144,401	141,510
Accumulated depletion and depreciation	(19,196,826)	(15,993,635)
	24,049,125	26,219,859

As at December 31, 2009, costs of unproved properties of \$935,958 (December 31, 2008 - \$1,207,000) and salvage values of \$1,060,187 (December 31, 2008 - \$1,255,000) have been excluded from the depletion calculation. Future development costs of \$928,000 related to proved non-producing properties (December 31, 2008 - \$2,071,000) have been included in costs subject to depletion.

General and administrative expenses of \$455,962 (December 31, 2008 - \$541,968) and stock based compensation expense of \$37,946 (December 31, 2008 – \$94,944) 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 performed a ceiling test calculation at December 31, 2009 and determined there was no impairment of its petroleum and natural gas properties (2008 - \$NIL).

The price forecast used in the reserve evaluation prepared by the independent engineering firm retained by the Corporation is outlined in the table below and is adjusted for quality differential and location specific to the Corporation’s production and reserves.

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

Price Forecast

	Oil CDN\$/Bbl	Natural Gas AECO C CDN\$/mmbtu
2010	71.92	5.76
2011	72.67	6.58
2012	73.28	6.70
2013	74.25	6.73
2014	77.41	6.81
2015	79.43	6.90
2016	82.32	7.15
2017	84.59	7.66
2018	87.34	8.22
2019	89.69	8.40
2020	90.48	8.54
2021	92.15	8.70

Future prices incorporate a US/CDN exchange rate of 2010 - 0.95, 2011 – 0.95, 2012 – 0.95, 2013 - 0.95 thereafter, escalated at 2% per year .

4. Bank Debt

The Corporation has a demand revolving credit facility of up to \$8,000,000. The interest rate charged on advances under the credit facility is payable monthly at the bank prime rate plus 1.5% as at December 31, 2009. The effective interest rate was 3.75% for 2009. The credit facility is secured by a \$10,000,000 fixed and floating charge debenture on the assets of the Corporation. On November 27, 2009, the Corporation’s lender reviewed its credit facility and renewed the facility for \$8,000,000 at a rate equal to the bank prime rate plus 1.50% per annum. The next scheduled review is in April, 2010. The lender’s review is currently in progress. 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.

5. Asset Retirement Obligations

	December 31, 2009	December 31, 2008
	\$	\$
Balance – beginning of year	1,918,014	1,379,141
Acquired	-	702,557
Revisions	(61,364)	(413,353)
Incurred	17,171	56,003
Accretion expense	168,644	193,666
Balance – end of year	2,042,465	1,918,014

The total future asset retirement obligation 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

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

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.

As at December 31, 2009, the undiscounted asset retirement obligation was \$2,574,047 (December 31, 2008 – \$2,561,211). 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%, 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 and 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, 2008 - \$99,180) has been recorded during the year ended December 31, 2009.

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, 2009	December 31, 2008
	\$	\$
Corporate income tax rate	29.0%	29.5%
Loss before income taxes	(2,981,979)	(910,647)
Expected income tax (reduction)	(864,774)	(268,640)
Add (deduct)		
Stock based compensation	14,696	29,123
Rate change effect	112,432	(84,993)
Change in prior year estimate	21,397	12,090
Accretion on convertible debenture	28,762	29,258
Other	(910)	5,995
Income tax reduction	(688,397)	(277,167)

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

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, 2009	December 31, 2008
	\$	\$
Property, plant and equipment	(3,417,163)	(4,087,607)
Non-capital losses	499,412	411,480
Share issue costs	140,531	258,107
Asset retirement obligations	510,616	479,504
Other	19,569	-
Future income tax liability	(2,247,035)	(2,938,516)

As at December 31, 2009 the Corporation had non-capital losses of approximately \$1,998,000 that will expire in the years 2016 to 2019.

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, 2009, 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 July 29, 2009, the Corporation completed a non-brokered private placement of 5.1 million units for aggregate proceeds of \$510,000. Each Unit was priced at \$0.10 and comprised two flow through Class A Shares priced at \$0.05 per share and one purchase warrant plus \$0.10 to acquire one flow through Class A Share of the Corporation exercisable on or before March 31, 2010.

On December 22, 2009, the Corporation completed a private placement of 5.5 million flow-through Class A Shares for aggregate proceeds of \$550,000. Of the 5.5 million Class A Shares issued, 3,000,000 Class A Shares were placed by a brokerage firm. Under the terms of the agreement the brokerage firm received an 8% commission and broker warrants for 240,000 Class A Shares at \$0.10/share which will expire on December 31, 2010.

In December of 2008, the Corporation completed a private placement of flow through shares issuing 600,000 Class A Shares at \$0.20 per share. On February 28, 2009 the Corporation recorded the renouncement of expenditures relating to the flow-through shares issued in December 2008. The cumulative tax effect adjustment relating to the flow through shares was \$31,200.

In prior years the Corporation had provided a non-interest bearing demand loan to an employee for \$70,794 secured by 188,000 Class A Shares of the Corporation. During the year the shares were returned to the Corporation and the loan was forgiven.

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

	For the year ended December 31, 2009		For the year ended December 31, 2008	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Class A Shares				
Balance – opening	24,620,937	13,385,075	25,324,192	13,935,414
Issued for cash – flow through	16,550,000	1,023,156	600,000	120,000
Share purchase financing	(188,000)	-	-	(15,557)
Repurchase of shares	(110,000)	(59,662)	(1,303,255)	(654,782)
Balance – closing	40,872,937	14,348,569	24,620,937	13,385,075
Class B Shares				
Balance - opening	986,700	9,867,000	1,044,000	10,440,000
Repurchase of Shares	-	-	(57,300)	(573,000)
Balance – closing	986,700	9,867,000	986,700	9,867,000
Future tax effect of flow through renunciations		(5,528,657)		(5,497,457)
Share issue costs, net of future income taxes	-	(2,187,149)	-	(2,089,569)
	-	(7,715,806)	-	(7,587,026)
Balance - closing	41,859,637	16,499,763	25,607,637	15,665,049

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, 2009, and December 31, 2008.

	Number of Stock Options	Weighted Average Exercise Price (\$/share)
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
Granted	1,090,000	0.10
Forfeited	(75,000)	0.49
Outstanding, December 31, 2009	3,366,661	0.28
Exercisable, December 31, 2009	2,301,661	0.33

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

The following table summarizes stock options outstanding at December 31, 2009.

Weighted Average Exercise Price (\$/Share)	Number of Stock Options Outstanding	Weighted Average Remaining Contractual Life (years)	Number of Stock Options Exercisable
0.35	1,111,661	1.00	1,111,661
0.95	150,000	1.75	150,000
0.30	775,000	3.00	516,667
0.30	185,000	3.50	123,333
0.30	55,000	3.75	36,667
0.10	1,090,000	4.75	363,333
0.37	3,366,661	2.96	2,301,661

c) Normal Course Issuer Bid

Under the normal course issuer bid, the Corporation received approval commencing May 6, 2009 to purchase up to 5% of its outstanding Class A Shares until May 5, 2010. During the year ended December 31, 2009 the Corporation repurchased and cancelled 110,000 Class A Shares (2008 – 1,303,255) at a net cost of \$8,150 (2008 - \$189,153). The average carrying value of the Class A Shares repurchased of \$59,662 (2008 - \$654,782) was recorded in share capital with the balance of \$51,512 (2008 - \$465,629) recorded in contributed surplus.

Under the normal course issuer bid, the Corporation received approval commencing May 6, 2009 to purchase up to 5% of its outstanding Class B Shares until May 5, 2010. During the year ended December 31, 2009 the Corporation repurchased and cancelled NIL Class B Shares (2008 – 57,300) at a net cost of \$NIL (2008 - \$67,343). The average carrying value of the Class B Shares repurchased of NIL (2008 – \$573,000) was recorded to share capital with the balance of \$NIL (2008 - \$505,657) recorded in contributed surplus.

d) Share Purchase Warrants

Warrants were issued pursuant to the July 29, 2009 non-brokered private placement and are exercisable on the basis of one flow through Class A Share of the Corporation at a price of \$0.10 per share on or before March 31, 2010 (see note 15b). The fair value of the Class A Share purchase warrants was calculated at the grant date using the Black-Scholes Pricing Model and was recorded to share purchase warrants in shareholders' equity. During 2009, 850,000 warrants were exercised at \$0.10 and the Corporation issued 850,000 Class A Shares. The assumptions used in the calculation of the fair value of the warrants are noted below.

Risk – free interest rate	0.56%
Expected life	8 months
Expected volatility	248%
Fair value per warrant	\$0.029

Pursuant to the December 22, 2009 private placement, 240,000 broker warrants were issued and are exercisable on the basis of one warrant plus \$0.10 to acquire one Class A Share on or before December 31, 2010. The assumptions used in the calculation of the fair value of the warrants are noted below.

Risk – free interest rate	0.69%
Expected life	1 year
Expected volatility	257%
Fair value per warrant	\$0.099

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

	Warrants	Amount (\$)
Share Purchase Warrants Issued (Unit Offering)	5,100,000	146,213
Warrants Exercised During the Year	(850,000)	(24,369)
Broker Warrants Issued	240,000	23,743
Balance, December 31, 2009	4,490,000	145,587

e) Per Share Information

The weighted average number of shares outstanding as at December 31, 2009, for basic and diluted was 38,911,104 shares (December 31, 2008 – 33,825,256 basic and diluted). Due to net losses for the years ended December 31, 2009 and 2008, the inclusion of stock options and warrants 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 0.59% (2008 - 3.62%), expected life of five years, expected average volatility factor of 252% (2008 - 117%) and no dividends.

	December 31, 2009	December 31, 2008
	\$	\$
Balance – beginning of year	1,487,968	323,016
Stock based compensation expense	50,675	98,722
Stock based compensation capitalized	37,946	94,944
Shares purchased for cancellation	51,512	971,286
Balance – end of year	1,628,102	1,487,968

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. Solara’s risk management policies are 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.

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

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, 2009, included in Solara's accounts receivables is \$844,986 from joint interest partners, \$523,385 from petroleum and natural gas marketers and the balance of \$362,723 in other accounts receivable. 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, 2009 and did not provide for any doubtful accounts, nor was it required to write-off any receivables during the year ended December 31, 2009.

As at December 31, 2009 and December 31, 2008, Solara considers its trade receivables to be aged as follows:

	December 31, 2009	December 31, 2008
	\$	\$
Not passed due (less than 90 days)	1,522,810	674,878
Past due (91 - 120 days)	208,284	134,874
	1,731,094	809,752

As of April 13, the Corporation had collected \$28,564 of the past due trade receivables. The remaining \$179,720 relates in part to prior period gross overriding royalties which are owed to the Corporation by various joint interest partners. Solara is currently working with these partners to resolve payment of the outstanding royalties.

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

Solara Exploration Ltd.

Notes to the Consolidated Financial Statements

For the Years ended December 31, 2009 and 2008

Corporation may from time to time utilize both financial derivatives and physical delivery sales contracts to manage market risks.

(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, 2009.

(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 entered into a financial commodity price contract with its lender which provided 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. The Corporation entered into a second financial commodity price contract with its lender which provided 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.

The Company uses a non-GAAP measure, funds from operations, as a measure of current operating efficiency. Funds from operations represent cash flow provided by operating activities prior to changes in non-cash working capital. For the year ended December 31, 2009, the sensitivity of changes in the Company's realized petroleum and natural gas prices would have been as follows: A change of \$1.00 per barrel in the realized price for petroleum, including crude oil, condensate and natural gas liquids, would have resulted in an increase to funds from operations for the year of approximately \$39,848. An increase of \$0.10 per thousand cubic feet in the realized price for natural gas would have resulted in an increase to funds from operations for the year of approximately \$37,062. Readers are cautioned that the above sensitivity results should not be extrapolated further without considering the Company's commodity price contract portfolio, royalty parameters, and other potential price-related effects on the results for the periods indicated. The effect of the above sensitivities on the net loss and comprehensive loss would have been approximately the same as on funds from operations.

Realized Commodity Derivative Gain

The realized commodity derivative gain of \$255,103 for the year ended December 31, 2009 (year ended December 31, 2008 – \$NIL) relates to the cash settlement of derivative instruments.

Unrealized Commodity Derivative Loss

The unrealized commodity derivative loss of \$72,424 for the year ended December 31, 2009 (year ended December 31, 2008 – \$NIL) represents the change in fair value of the Corporation's commodity price agreements.

(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, 2009, if interest rates had been 1% lower with all other variables held constant, after tax net loss for the year would have been \$55,906 lower, due to lower interest expense. An equal and opposite impact

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

would have occurred to the net loss 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, 2009.

Capital Management

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, working capital and bank debt. 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 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, 2009, the Corporation's ratio of bank debt to annual funds from operations was approximately 12.5 to 1. The Corporation anticipated that the ratio would 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, 2009.

Fair Value of Financial Instruments

Solara's financial instruments as at December 31, 2009 and December 31, 2008 include accounts receivable, an amount due from shareholder, accounts payable and accrued liabilities, commodity derivatives, bank debt and convertible debentures. The fair value of these amounts, excluding bank debt and convertible debentures 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. The fair value of convertible debentures approximates its carrying value based on current interest rates and related market values and current pricing of financial instruments with comparable terms.

The fair value of commodity derivatives as at December 31, 2009 is comprised of the following commodity price risk management agreements (See note 15). The Corporation's derivative contracts have been assessed on the fair value hierarchy as outlined in note 1. The commodity derivatives are classified as level 2. Assessment of the significance of a particular input to their fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

Term	Contract	Monthly Volume (GJs)	Fixed Price (\$/GJ)	Fair value as at December 31 , 2009 (\$/CDN)
Jan 2010 to Mar 2011	Call	6,200	6.675	(34,160)
Jan 2010 to Mar 2011	Call	10,850	7.50	(38,264)
Total CAN				(72,424)

Solara Exploration Ltd.
Notes to the Consolidated Financial Statements
For the Years ended December 31, 2009 and 2008

11. Cash Flow Information

Changes in non-cash working capital were as follows:

	December 31, 2009	December 31, 2008
	\$	\$
Changes in non-cash working capital balances		
Accounts receivable	(921,342)	31,504
Deposits and prepaids	(498)	35,237
Accounts payable and accrued liabilities	212,005	(29,149)
	(709,835)	37,592
	2009	2008
	\$	\$
Changes in non-cash working capital relates to		
Operating	491,173	(41,589)
Investing	(1,201,008)	79,181
	(709,835)	37,592

12. Commitments

- a) The Corporation is committed to office lease payments to March 1, 2011 including estimated operating costs. These obligations are as follows

	\$
2010	93,479
2011	15,580

- b) The Corporation has an obligation to incur approximately \$562,000 in qualifying expenditures by December 31, 2010 resulting from the private placements of flow through shares completed during 2009.

13. Investment

As part of its ongoing risk and capital management strategy in 2009, Solara entered into a Farmout, Option and Conveyance Agreement on June 30, 2009 (the "Farmout") with the Marwayne Production Limited Partnership (the "LP") which provided for the farmout by the Corporation of certain interests. The Farmout provided for the LP to fund the \$1,300,000 capital program involving the drilling of three wells on or before December 31, 2009 to earn a 60% working interest in the lands, with a further option to fund the drilling of four option wells in 2010 (see note 15). As part of the transaction, the LP paid \$490,000 to Solara to equalize into the project such that its interest would be uniform in the project lands. The equalization funds were based on the LP's proportionate share of the total proved plus probable producing independent engineered value of these assets at December 31, 2008. A wholly owned subsidiary of the Corporation, Marwayne Resources Inc., has been appointed as the General Partner of the LP. The Corporation owns 45 partnership units in the LP representing 0.034% of the total issued and outstanding partnership units. In addition, the officers and directors of the Corporation owned 150 units or 11.00 % of the total partnership units outstanding.

Solara Exploration Ltd.

Notes to the Consolidated Financial Statements

For the Years ended December 31, 2009 and 2008

14. 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, 2009 the Corporation paid the private Company a total of \$204,333 for various fees (2008 - \$131,950). 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, 2010 (see note 2).

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, 2009, the Corporation paid a total of \$84,622 (2008 - \$79,834) for such services.

For the year ended December 31, 2009, consulting services were provided by the Vice President, Engineering and Operations and a company controlled by him for \$150,000 (2008 - \$45,500). These transactions have been recorded at the exchange amount of the consideration which is the amount agreed upon between the parties.

For the year ended December 31, 2009, consulting services were provided by the Vice President, Exploration's company controlled by him for \$29,548 (2008 - \$NIL). These transactions have been recorded at the exchange amount of the consideration which is the amount agreed upon between the parties.

15. Subsequent Events

- a) On January 29, 2010 the Corporation issued 600,000 stock options to employees, directors and consultants at an exercise price of \$0.12 per Class A Share. Under the terms of the agreement one third of the options vest immediately, one third on January 29, 2011 and one third on January 29, 2012. The expiry date on the options granted is January 29, 2015.
- b) The Corporation raised \$415,000 through the exercise of 4,150,000 Share Purchase Warrants on or before March 31, 2010 on the basis of one Warrant plus \$0.10 for one Class A Share. The Share Purchase Warrants had been previously issued in August, 2009 as part of a private placement of Class A Shares and Share Purchase Warrants. The proceeds of the financing will be used to fund a portion of the Corporation capital drilling program 2010.
- c) The Marwayne Production Limited Partnership ("LP") pursuant to the Farmout, Option and Conveyance Agreement dated June 30, 2009, exercised their option prior to December 31, 2009 to drill four wells and earn a working interest in the balance of the Marwayne Project Lands located in eastern Alberta.
- d) On April 15, 2010, Solara settled out the two Natural Gas Contracts with its lender by paying a settlement amount of \$9,145.