

Wavefront Energy and Environmental Services Inc.

Consolidated Financial Statements
August 31, 2006

December 14, 2006

Auditors' Report

**To the Shareholders of
Wavefront Energy and Environmental Services Inc.**

We have audited the consolidated balance sheet of **Wavefront Energy and Environmental Services Inc.** as at August 31, 2006 and the consolidated statements of operations and deficit and cash flow for the year 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 audit.

We conducted our audit 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 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 August 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at August 31, 2005 and for the year then ended were examined by other auditors who expressed an opinion without reservation on those financial statements in their report dated December 16, 2005 (except for note 22, which was as of December 22, 2005).

(Signed) "PricewaterhouseCoopers"

Chartered Accountants

Wavefront Energy and Environmental Services Inc.

Consolidated Balance Sheet

As at August 31, 2006

	2006 \$	2005 \$
Assets		
Current assets		
Cash	14,411,315	144,634
Accounts receivable	297,329	69,284
Prepaid expenses	32,219	11,026
Inventory (note 3)	38,002	53,149
	<hr/>	<hr/>
	14,778,865	278,093
Non-participation amounts due (note 5)	1,214,002	-
Property, plant and equipment (notes 4 and 5)	2,485,671	580,568
Intangible assets (note 6)	83,046	73,906
Deposits (note 21)	142,812	-
	<hr/>	<hr/>
	18,704,396	932,567
Liabilities		
Current liabilities		
Bank indebtedness	-	246,380
Accounts payable and accrued liabilities	1,570,319	718,886
Unearned revenue	309	12,611
Notes payable (note 8)	-	75,686
Advances on share subscription	-	450,607
Current portion of obligation under capital leases (note 10)	1,878	11,183
	<hr/>	<hr/>
	1,572,506	1,515,353
Obligation under capital leases (note 10)	-	1,878
Due to shareholders (note 9)	-	34,189
Asset retirement obligation (note 11)	62,668	29,483
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	1,635,174	1,580,903
Shareholders' Equity		
Share capital (note 14)	26,279,824	6,373,647
Contributed surplus (note 14)	1,006,832	165,554
Deficit	(10,217,434)	(7,187,537)
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	17,069,222	(648,336)
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	18,704,396	932,567

Approved by the Board of Directors

(Signed) "Brett Davidson"

Director

(Signed) "D. Brad Paterson"

Director

Wavefront Energy and Environmental Services Inc.

Consolidated Statement of Operations and Deficit

For the year ended August 31, 2006

	2006 \$	2005 \$
Revenue		
Sales	541,012	1,318,360
Other	222,525	15,924
	<u>763,537</u>	<u>1,334,284</u>
Cost of goods sold	<u>107,875</u>	<u>860,427</u>
Gross profit	<u>655,662</u>	<u>473,857</u>
Operating expenses		
Wages, employee benefits and contract employees	1,675,646	723,971
Professional fees (note 18)	802,187	111,599
Office	374,688	259,427
Travel and promotion	210,703	101,352
Depreciation and amortization	128,385	115,388
Consultants	108,388	185,344
Listing and public company fees	106,888	68,821
Research and development	71,567	301,440
Vehicle	84,670	83,433
Repairs and maintenance	40,869	23,793
Accretion of asset retirement obligation (note 11)	18,187	943
Miscellaneous	4,379	5,362
Interest expenses	476	50,903
Bad debt	-	692
Research and development tax (recovery)	-	(11,657)
	<u>3,627,033</u>	<u>2,020,811</u>
Loss from operations	<u>(2,971,371)</u>	<u>(1,546,954)</u>
Other income (expenses)		
Write down of mineral rights (note 5)	(12,626)	-
Foreign exchange loss	(45,900)	5,991
Write down of inventory	-	(59,125)
Loss on disposal of property, plant and equipment	-	(7,643)
	<u>(58,526)</u>	<u>(60,777)</u>
Net loss for the year	<u>(3,029,897)</u>	<u>(1,607,731)</u>
Deficit – Beginning of year	<u>(7,187,537)</u>	<u>(5,579,806)</u>
Deficit – End of year	<u>(10,217,434)</u>	<u>(7,187,537)</u>
Loss per common share (note 15)		
Basic and diluted	<u>(0.09)</u>	<u>(0.06)</u>

Wavefront Energy and Environmental Services Inc.

Consolidated Statement of Cash Flows

For the year ended August 31, 2006

	2006 \$	2005 \$
Cash provided for (used in)		
Operating activities		
Net loss for the year	(3,029,897)	(1,607,731)
Items not affecting cash		
Depreciation and amortization	128,385	115,388
Write down of inventory	-	59,125
Write down of property, plant and equipment	-	97,681
Loss on disposal of property, plant and equipment	-	7,643
Write down of mineral rights	12,626	-
Stock-based compensation (note 14)	873,357	101,904
Accretion of asset retirement obligation	18,187	943
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	(1,997,342)	(1,225,047)
Net change in non-cash working capital items	584,984	401,962
	<hr/>	<hr/>
	(1,412,358)	(823,085)
Financing activities		
(Repayment of) proceeds from bank indebtedness	(246,380)	63,789
Proceeds from private placement – net of share issuance costs (note 14)	17,325,772	535,771
Advances (to) from private placement (note 14)	(450,607)	450,607
Share issuance costs related to shares-for-debt settlement (note 14)	-	(4,200)
Proceeds from notes payable	-	207,876
Repayment of notes payable	(35,686)	(132,190)
Repayment of amounts due to shareholder	(34,189)	-
Proceeds from options exercised	183,027	-
Proceeds from warrants exercised	2,324,882	-
Repayment of obligation under capital leases	(11,183)	(15,399)
	<hr/>	<hr/>
	19,055,636	1,106,254
Investing activities		
Non-participation amounts due (note 5)	(1,334,015)	-
Purchase of property, plant and equipment	(2,023,074)	(148,679)
Proceeds on disposal of property, plant and equipment	-	6,100
Intangible costs	(19,508)	(41,929)
	<hr/>	<hr/>
	(3,376,597)	(184,508)
Increase in cash	14,266,681	98,661
Cash – Beginning of year	144,634	45,973
	<hr/>	<hr/>
Cash – End of year	14,411,315	144,634
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Supplementary information		
Interest paid	13,127	25,488
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1 Description of business

Wavefront Energy and Environmental Services Inc. (the “Corporation”) is incorporated under the Canada Business Corporations Act. The Corporation’s principal business activities are the enhancement and improvement of oil recovery, oil well stimulation (Powerwave™) and optimization of groundwater remediation (Primawave™) using the Corporation’s patented technology. The Corporation’s strategy is to license the technology to service providers, provide site licenses to oil producers and to acquire or earn working interests in mature oilfields.

2 Accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries and its proportionate share of assets, liabilities, revenues, expenses and cash flows of the mineral property working interests in which it participates (notes 5 and 13). All inter-company balances and transactions have been eliminated. These consolidated financial statements include the following significant accounting policies:

a) Measurement uncertainty

The preparation of financial statements, in conformity with Canadian GAAP, requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Significant estimates include: valuation of non-participation amounts due and impairment amounts related to the oil property plant and equipment; no meaningful production; the allowance for doubtful accounts; provision for warranty expense; determination of percentage of completion for the purposes of revenue recognition; useful lives of property, plant and equipment and stock option valuation. Actual results could differ from those estimates.

b) Cash and cash equivalents

Cash and cash equivalents are comprised of cash on deposit, net of cheques issued in excess of cash on deposit balances held in short-term, highly liquid, government investment certificates, with interest rates ranging from 2.955% to 3.55%. The operating revolving lines of credit are not included in cash and cash equivalents, as they have not fluctuated regularly between being overdrawn and positive (note 7).

c) Translation of foreign currencies

Transactions in foreign currencies are translated into Canadian dollars at rates of exchange at the time of such transactions. Monetary assets and liabilities are translated at current rates of exchange. Foreign operations are considered financially and operationally integrated and are translated into Canadian dollars using the temporal method of translation. Gains and losses resulting from the translation adjustments are included in income.

d) Revenue recognition and unearned revenue

Revenue is recognized when persuasive evidence of an arrangement exists, products or services have been delivered to and accepted by third party customers, the price to the buyer is fixed or determinable and collection is reasonably assured. Amounts received from customers in advance of products or services being provided are recorded as unearned revenue when received. Specific revenue recognition policies are as follows:

- i) Revenue from the sale of monitoring systems is recognized at the completion of a monitoring installation. In addition, under certain sales and service contracts a provision for potential warranty expense is provided for at the time of sale, based on warranty terms and prior claims experience.
- ii) Licensing royalties or technology fees are recognized on a percentage of completion basis as the underlying contracts are for a set time period. Percentage of completion is determined by relating the amount of time a system has been operating to the total contracted amount of time the system will be operating. Any project loss is recognized immediately.
- iii) Revenue associated with the production and sale of crude oil owned by the Corporation is recognized in the same period as when the title passes to the external party.

e) Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation is provided over the useful lives of the assets. Depreciation has been calculated using the following annual rates and methods:

Office furniture and fixtures	20% declining balance
Equipment	20% declining balance
Computer hardware	30% declining balance
Computer software	100% declining balance
Automotive equipment	30% declining balance
Oilfield property, plant and equipment	Units of production
Asset retirement obligations	Units of production

The Corporation evaluates the carrying value of property, plant and equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable, and recognizes an impairment charge when it is probable that estimated future non-discounted cash flows of the underlying assets will be less than the carrying value of the assets. Where there is impairment, the Corporation measures the charge based on the fair value of the assets using the various valuation techniques.

f) Oilfield property, plant and equipment

The Corporation follows the full-cost method of accounting for its oil and gas property operations as determined by the Canadian Institute of Chartered Accountants (“CICA”), Accounting Guideline 16 (“AcG-16”). Under this method, all costs associated with the acquisition of, the exploration for and the development of oil and gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both producing and non-producing wells, production facilities and asset retirement costs. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion or depreciation by more than 20%.

Depletion of oil and gas properties, plant and production equipment is provided using the unit-of-production method based upon estimated proved oil and gas reserves as determined by management and independent engineers. The cost of significant undeveloped properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment has occurred. Estimated future costs to be incurred in developing proved reserves are included in costs subject to depletion. No depletion or depreciation of oilfield property, plant and equipment has been recorded as at August 31, 2006 and 2005, as no meaningful production has occurred and no reasonable estimate of proved reserves could be determined.

Substantially all of the development and production activities of the Corporation are conducted jointly with others (note 5), and accordingly, the financial statements reflect only the Corporation’s proportionate interest in such activities.

The Corporation’s policy is to apply an impairment test (ceiling test”) to determine if capitalized costs are not recoverable and are greater than the fair value. Capitalized costs are not recoverable if they exceed estimated undiscounted cash flows from future production of proved reserves plus the cost (net of impairment) of unproved properties. Cash inflows and costs are estimated using reserves data determined by independent engineers. Costs are based on expected future production and other costs and include abandonment and site restoration costs. An impairment loss is measured as the amount by which capitalized costs are greater than their recoverable costs. An impairment loss is measured as the amount by which capitalized costs exceed fair value of proved and probable reserves, plus the costs (net of impairment) of unproved properties (see measurement uncertainty discusses above).

g) Asset retirement obligations

The Corporation recognizes the fair value of estimated asset retirement obligations on the consolidated balance sheet when a reasonable estimate of fair value can be made. Asset retirement obligations include those for which a company faces a legal obligation to retire tangible long-lived assets such as well sites, pipeline and facilities. Increases in the asset retirement obligations resulting from the passage of time are recorded as accretion to the asset retirement obligations in the consolidated statement of loss and deficit. Actual expenditures incurred are charged against the accumulated obligations.

The asset retirement cost, equal to the estimated fair value of the retirement obligations, is capitalized as part of the cost of the related long-lived assets. Asset retirement costs are amortized using the same methods as the underlying asset.

h) Intangible assets

Definite life intangible assets are stated at cost less accumulated amortization. Amortization of patents is provided on a straight-line basis over 10 years commencing from the date the patent is granted. The costs of maintaining patents are expensed as incurred. Amortization of the incorporation costs are provided on a straight-line basis over 10 years. The Corporation regularly evaluates the net carrying value of definite intangible assets whenever events or changes in circumstance indicating that the carrying value may not be recoverable. Any impairment in the carrying value is charged to expense in the year that the impairment has been determined.

i) Inventory

Inventories, which consist of pressure sensors and uphole data collection and transmitters, are valued at the lower of cost and net realizable value. Cost is recorded as laid-down cost.

j) Research and development costs

Research costs are expensed as incurred, and significant development costs are capitalized once the Corporation has determined that commercialization criteria concerning the product or process have been met. Amortization of these costs is over their estimated useful lives commencing with the successful commercial production or use of the product or process. On an ongoing basis, management reviews the unamortized balance to ensure that the deferred development costs continue to satisfy the criteria for deferral and amortization.

As at August 31, 2006 and 2005, no development costs have been capitalized.

k) Government assistance

Government assistance related to property, plant and equipment used for research and development is credited against the cost of the related capital asset. All other assistance is credited against the related expenses as incurred.

l) Income taxes

Income taxes are accounted for using the liability method of income tax allocation. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values.

Income tax assets are also recognized for the benefits from tax losses, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on the tax laws and rates that are anticipated to apply in the period of realization.

m) Investment tax credits

Investment tax credits are earned on scientific research and development expenditures. Investment tax credits related to current expenses are included in the determination of net income. Investment tax credits related to the acquisition of assets are deducted from the related assets with any amortization calculated on the net amount. Investment tax credits are accrued when the Corporation has made the qualifying expenditures provided there is reasonable assurance that the credits will be realized.

n) Stock-based compensation plan

The Corporation has a stock-based compensation plan, which is described in note 14. The fair value of the common share purchase option is calculated at the date of grant and is expensed over the vesting period of those options. The Corporation uses the Black-Sholes model to calculate the fair value of stock options issued, which requires certain assumptions be made at the time the options are awarded, including the expected life of the option, the expected number of granted options that will vest and the expected future volatility of the stock.

Any consideration paid by option or warrant holders for the purchase of stock together with any amount previously recognized in contributed surplus are credited to share capital. If plan entitlements are repurchased from the holder, the consideration paid is charged to retained earnings.

o) Loss per share

Basic loss per share are calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated on the basis of the weighted average number of common shares outstanding during the period plus the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the treasury stock method.

3 Inventory

	2006	2005
	\$	\$
Work-in-progress	35,274	35,274
Finished goods	2,728	17,875
	<hr/>	<hr/>
	38,002	53,149
	<hr/>	<hr/>

4 Property, plant and equipment

	2006		
	Cost	Accumulated	Net
	\$	depreciation	\$
		\$	\$
Oilfield property, plant and equipment	1,348,742	-	1,348,742
Equipment	1,442,506	408,022	1,034,484
Computer equipment	133,980	79,310	54,670
Computer software	39,235	36,393	2,842
Vehicles and trailer	16,455	9,221	7,234
Office furniture	68,359	30,660	37,699
	3,049,277	563,606	2,485,671
	2005		
	Cost	Accumulated	Net
	\$	depreciation	\$
		\$	\$
Oilfield property, plant and equipment	71,944	-	71,944
Equipment	43,518	25,893	17,625
Computer equipment	767,926	310,978	456,948
Computer software	91,666	66,889	24,777
Vehicles and trailer	34,695	34,463	232
Office furniture	16,455	7,413	9,042
	1,026,204	445,636	580,568

Property, plant and equipment include equipment under construction of \$514,661 (2005 – \$51,765), which is not being depreciated. Property, plant and equipment also include assets under capital leases with a net book value of \$18,551 (2005 – \$28,411) (note 10).

Depreciation expense for the year ended August 31, 2006 was \$ 122,900 (2005 – \$107,436), including depreciation relating to equipment under capital leases of \$4,638 (2005 – \$7,172). No depletion or depreciation of oilfield property plant and equipment has been recorded as at August 31, 2006 and 2005 as no meaningful production occurred prior to August 31, 2006 and no recoverable estimate of proved reserves could be determined.

In the prior year ended August 31, 2005, property, plant and equipment of \$97,681 were written off as the capital projects were terminated. This amount was charged to research and development on the consolidated statement of loss and deficit.

5 Oilfield property, plant and equipment

In the prior year, the Corporation entered into an Option Agreement (the “Option Agreement”) to acquire ninety percent (90%) of the working interest in the production, equipment and mineral leases of Phoenix Oil, LLC (“Phoenix”) of Claremore, Oklahoma, for total consideration of US\$180,000. The leases, known as the Chelsea-Alluwe Waterflood Leases, are comprised of 780-acres and are situated in Rogers County, Oklahoma. For the Option Agreement, the Corporation paid a US\$15,000 deposit that was applied to the total purchase price. A related limited liability company, Boulder Oil, LLC (“Boulder”) executed the Option Agreement on behalf of the Corporation by paying the remaining US\$165,000 of the purchase price for a sixty percent (60%) working interest in the leases. A director and a related party to a director of the Corporation control fifty-five percent (55%) of the voting membership units of Boulder. In consideration of the US\$15,000 deposit paid by the Corporation retained a thirty percent (30%) working interest in the leases. Each working interest party is responsible for operating and field development costs in proportions relative to their working interest percentage.

The Corporation has capitalized and included in property, plant and equipment its proportionate share of the oil well development costs totalling \$1,254,293 (2005 – \$12,340) related to the Rogers County venture. During the fiscal year ending August 31, 2006, the Corporation became the operator of record, and Boulder, as a non-operating partner, exercised its non-participation right in the Joint Operating Agreement. As at August 31, 2006, amounts due to the Corporation by Boulder totalled \$1,214,002, and are included in non-participation amounts due. Under the Joint Operating Agreement, the Corporation will receive all production revenues from production wells associated with the costs incurred until such time that the Corporation is repaid 200% of the costs incurred, after which, production revenues will revert back to the working interest proportions.

During the year ended August 31, 2006, the Corporation acquired the ten percent (10%) working interest in the Rogers County venture from Phoenix, in exchange for \$214,352 owed. This acquisition of the ten percent interest in the Rogers County venture has been treated as a non-cash transaction for the purposes of the consolidated statement of cash flows.

The Corporation has recognized production revenue of \$16,386 (2005 – \$nil) related to the Rogers County venture.

During the year ended August 31, 2006, the Corporation acquired 100% of the working interest in certain mineral leases adjacent to the Rogers County leases for total consideration of US\$219,000. No costs were incurred on these leases for the year ended August 31, 2006.

During the year ended August 31, 2006, the Corporation decided not to proceed with development of the Milam County mineral rights, and wrote-down mineral rights totalling \$12,626.

No depletion or amortization expense of any oilfield property, plant and equipment has been recorded to date as no meaningful production has occurred and no proved reserves could be determined.

6 Intangible assets

	2006		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Patents	122,409	40,819	81,590
Incorporation costs	3,445	1,989	1,456
	<u>125,854</u>	<u>42,808</u>	<u>83,046</u>
	2005		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Patents	102,901	30,795	72,106
Incorporation costs	3,445	1,645	1,800
	<u>106,346</u>	<u>32,440</u>	<u>73,906</u>

Amortization expense for the year ended August 31, 2006 totalled \$10,368 (2005 – \$7,953).

7 Bank indebtedness

	2006	2005
	\$	\$
The Corporation had a \$150,000 revolving line of credit that bore interest at prime plus 2.0%, was repayable on demand and jointly and severally secured by primary shareholders and certain employees of the Corporation. Subsequent to the year the line of credit was closed	-	147,072
The Corporation has a \$100,000 revolving line of credit that bears interest at prime plus 0.25%, is repayable on demand and is secured by a limited personal guarantee of a primary shareholder of the Corporation totalling \$100,000	-	99,308
	<u>-</u>	<u>246,380</u>

Interest expense on these lines of credit during the year ended August 31, 2006 totalled \$3,592 (2005 – \$8,130).

8 Notes payable

Notes payable represents amounts due to directors of the Corporation. The notes payable were unsecured, bore an interest rate of 14% per annum, had no fixed repayment terms and were repayable 30 days after demand. During the year ended August 31, 2006, the outstanding balance of \$75,686 was repaid. In the prior year ended August 31, 2005, \$100,333 was settled in accordance with the Shares-for-Debt Agreement (the "Debt Settlement") (note 14). The Debt Settlement has been treated as a non-cash transaction for purposes of the consolidated statement of cash flows.

Interest expense for the year ended August 31, 2006, owing to directors of the Corporation, totaled \$5,052 (2005 – \$7,755). Accrued interest payable at August 31, 2006, is \$5,126 (2005 – \$12,631) and is included in accounts payable and accrued liabilities.

9 Due to shareholders

In connection with a reverse take-over that occurred in 2003, certain directors and shareholders of the Corporation entered into a Debt Repayment Agreement. Under the terms of the Debt Repayment Agreement, the creditors agreed to postpone their ability to demand repayment until September 30, 2004 after which, principal repayment was restricted to twenty percent (20%) of consolidated cash flows from operations. As such, the entire balance was classified as long-term debt.

In the prior year ended August 31, 2005, the Corporation settled \$495,515 of amounts due to shareholders in accordance with the Debt Settlement agreement. As a result, the balance outstanding at August 31, 2005 was \$34,189. This balance was repaid during the current year ended August 31, 2006 to a company controlled by a director and a related party of the Corporation.

The amounts due to shareholders were unsecured, bore an interest rate of 8.5% per annum, had no fixed repayment terms and had terms in accordance with the Debt Settlement Agreement discussed above. Interest expense for the year ended August 31, 2006 totalled \$2,181 (2005 – \$11,033). Accrued interest payable at August 31, 2006 is \$41,796 (2005 – \$39,623) and is included in accounts payable and accrued liabilities.

10 Obligation under capital leases

Principal lease payments for the year ended August 31, 2006 totalled \$11,183 (2005 – \$15,399). Future obligations under capital leases are as follows:

	\$
Total future minimum lease payments during 2007	1,920
Less: Interest at rates ranging from 9.2% to 16.3%	<u>42</u>
Balance of obligation under capital lease	1,878
Less: Current portion	<u>1,878</u>
Long-term obligation under capital leases	<u>-</u>

Interest expense for the year ended August 31, 2006 totalled \$1,086 (2005 – \$3,073).

11 Asset retirement obligation

The Corporation has asset retirement obligations associated with its oilfield property plant and equipment (note 5). These asset retirement obligations primarily relate to the plugging of wells and abandonment costs.

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligations associated with the retirement of the Corporation's proportion of oilfield property, plant and equipment assets:

	2006 \$	2005 \$
Asset retirement obligations – Beginning of year	29,483	-
Liabilities incurred	16,517	28,540
Liabilities settled	(1,519)	-
Accretion expense	<u>18,187</u>	<u>943</u>
Asset retirement obligations -- End of year	<u>62,668</u>	<u>29,483</u>

The total undiscounted amount of estimated cash flows required to settle the obligation is US\$301,450 (2005 – \$185,850), which has been discounted using credit-adjusted risk free rates ranging from 6.72% to 13.61%. The majority of these obligations are not expected to be settled for six to thirty years in the future and will be funded from general corporate resources at the time of the retirement and removal.

12 Income taxes

The Corporation and its subsidiaries have non-capital losses in the amount of \$8,742,626 that can be carried forward and used to reduce future income tax liabilities. The potential income tax benefits associated with these losses and expenditures have not been reflected in the consolidated financial statements as they have been fully offset by a valuation allowance. These losses expire as follows:

	\$
2007	934,625
2008	834,919
2009	1,504,905
2010	579,411
2014	1,823,383
2015	1,112,562
2016	1,952,821
	<hr/>
	8,742,626
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The Corporation's substantially enacted statutory tax rate is approximately 32% (2005 – 33%); however, the recorded income tax provision for both fiscal 2006 and 2005 is \$nil due to the full valuation allowance recorded against the Corporation's future tax assets. The difference between the Corporation's net loss for the year and its net loss for tax purposes is primarily the result of stock based compensation and certain other expenses not being deductible for income tax purposes. The Corporation's future tax assets consist primarily of the non-capital losses and SR&ED expenditures carried forward.

13 Contingences and commitments

a) Operating leases

The Corporation is committed under various operating leases for premises, vehicles and contracts. The minimum amounts payable over the next three years are as follows:

	\$
2007	227,271
2008	105,106
2009	57,363
	<hr/>
	389,740
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b) Warranties

At August 31, 2006, the Corporation has recorded a liability of \$4,606 (2005 – \$60,147) for future potential warranty claims related to downhole monitoring.

c) Green Tree Gas and Oil Inc. Farm-in Agreement

At August 31, 2006, the Corporation entered into a “Farm-in” Agreement with Green Tree Oil and Gas Ltd. (“Green Tree”) to develop Green Tree’s Rodney South oil field lease. Under the Farm-in Agreement the Corporation will supply its Powerwave™ technology and fund up to \$2.25 million for initial capital expenditures and working capital requirements. Additional development costs are expected to be financed from cash from operations. Green Tree will act as the Operator of the lease and will contribute the petroleum leases, existing seismic and geological data, and the use of its existing field facilities. Green Tree will also provide its field maintenance staff, administrative, and office support staff. In consideration for each party’s contributions, cash flows from operating activities will be allocated 70% and 30% to the Corporation and Green Tree, respectively, until payout of the Corporation’s initial \$2.25 million capital investment. Subsequent to payout, cash flow from operating activities will be allotted 50% to the Corporation and Green Tree respectively. As at August 31, 2006, the Corporation has paid Green Tree \$74,663 and accrued \$50,637 under the Farm-in Agreement, which has been recorded as property, plant and equipment on the consolidated balance sheet. The Corporation is obligated to the remaining balance of up to \$2,124,700 under the Farm-in Agreement.

14 Share capital

The Corporation’s authorized and issued share capital for the year ended August 31, 2006 and 2005 are as follows:

Authorized

Unlimited common shares without par value

Issued

	2006		2005	
	Number #	Stated capital \$	Number #	Stated capital \$
Balance – Beginning of year	27,998,341	6,306,799	23,562,422	5,201,515
Shares-for-debt- settlement ⁽¹⁾	-	-	2,090,694	591,648
Shares issued in private placement ⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾	13,610,979	17,252,343	2,345,225	513,636
Stock options exercised ⁽⁶⁾	414,366	215,219	-	-
Warrants exercised ⁽⁷⁾	5,890,110	2,505,463	-	-
Balance – End of year	47,913,796	26,279,824	27,998,341	6,306,799

Warrants

	<u>2006</u>		<u>2005</u>	
	Number #	Stated capital \$	Number #	Stated capital \$
Balance – Beginning of year	4,873,314	66,848	2,528,089	44,713
Warrants granted in private placement ⁽²⁾⁽³⁾	1,959,160	73,840	2,345,225	22,135
Exercised ⁽⁷⁾	(5,890,110)	(140,500)	-	-
Warrants exercised ⁽⁷⁾	(942,364)	(188)	-	-
Balance – End of year	-	-	4,873,314	66,848
		<u>26,279,824</u>		<u>6,373,647</u>

⁽¹⁾Effective November 29, 2004, the Corporation settled \$595,848 of notes payable and amounts due to shareholders by way of a Shares-for-Debt Settlement Agreement that resulted in the issuance of 2,090,694 common shares at a deemed price of \$0.285 per common share. This one-time transaction was subject to regulatory approval. The Corporation does not anticipate further shares-for-debt transactions in the foreseeable future. The Corporation paid filing fees of \$4,200 resulting in a net increase to share capital of \$591,648. This Debt Settlement has been treated as a non-cash transaction for the purposes of the consolidated statement of cash flows.

⁽²⁾Effective February 28, 2005, the Corporation issued 2,345,225 units of the Corporation at a price of \$0.23 per unit for gross proceeds of \$539,416. The 2,345,225 units were issued by way of a non-brokered private placement. Each unit consisted of one common share and one-half common share purchase warrant, with each full share purchase warrant entitling the holder to acquire a common share at a price of \$0.40 for a period of 12 months ended February 28, 2006. The common share purchase warrants were valued at \$22,135. Of the 2,345,225 units issued, directors of the Corporation subscribed for 637,104 units. In connection with this non-brokered private placement, the Corporation paid filing fees of \$3,645, resulting in net cash proceeds of \$535,771.

⁽³⁾Effective September 1, 2005, the Corporation issued 1,950,069 units of the Corporation at a price of \$0.23 per unit for gross proceeds of \$450,607. The 1,959,160 units were issued by way of a non-brokered private placement. Each unit consisted of one common share and one common share purchase warrant, with each full share purchase warrant entitling the holder to acquire a common share at a price of \$0.40 for a period of 12 months ending September 1, 2006. The common share purchase warrants were valued at \$73,841. Of the 1,959,160 units issued, a director of the Corporation subscribed for 276,767 units. In connection with this non-brokered private placement, the Corporation issued 128,696 common shares at a deemed price of \$0.23 as a finder's fee to two arm's length parties. In addition, the Corporation paid filing and legal fees of \$3,225 resulting in net cash proceeds of \$447,382.

⁽⁴⁾Effective January 5, 2006, the Corporation issued 7,038,008 common shares at a price of \$1.35 per common share for gross proceeds of \$9,501,311. The 7,038,000 common shares were issued by way of a non-brokered private placement. The Corporation paid a finders fee in the amount of \$450,079 to an arms length party. In addition, the Corporation paid filing and legal fees of \$48,181 resulting in net cash proceeds of \$9,003,051.

⁽⁵⁾Effective May 26, 2006, the Corporation issued 4,485,115 common shares at a price of \$1.80 per common shares for gross proceeds of \$8,073,207. The 4,485,115 common shares were issued by way of a non-brokered private placement. The Corporation paid finder's fees in the amount of \$153,700 to two arm's length parties. In addition, the Corporation paid filing and legal fees of \$43,756 resulting in net cash proceeds of \$7,875,751.

⁽⁶⁾Of the 414,366 stock options exercised during the year ended August 31, 2006, 340,200 stock options were exercised by directors of the Corporation at a prices ranging from \$0.40 to \$0.50.

⁽⁷⁾Of the 5,890,110 common share purchase warrants that were exercised during the year ended August 31, 2006, 1,183,251 common share purchases warrants were exercised by directors of the Corporation at prices ranging from \$0.35 to \$0.55.

Common share purchase warrants

Common share purchase warrants	2006		2005	
	Number #	Weighted average exercise price \$	Number #	Weighted average exercise price \$
Outstanding – Beginning of year	4,873,314	0.48	2,473,501	0.54
Granted	1,959,160	0.40	2,565,449	0.40
Exercised	(5,890,110)	0.40	(165,636)	0.55
Expired	(942,364)	0.56	-	-
Outstanding – End of year	-	-	4,873,314	0.48

Stock-based compensation Plan

The Corporation maintains an Employee, Director, Officer and Consultant Stock Option Plan under which the Corporation may grant options for up to 5,130,623 shares of the Corporation at an exercise price equal to or greater than the market price of the Corporation's stock at the date of grant. All options awarded are exercisable for a period of five years and vest in equal tranches at three (3) month intervals over a period of eighteen (18) months.

A summary of the status of the Corporation's stock option plan as at August 31, 2006 and 2005, and the changes during the years ended on those dates are presented below:

	2006		2005	
Stock options	Number #	Weighted average exercise price \$	Number #	Weighted average exercise price \$
Outstanding – Beginning of year	2,050,455	0.46	1,547,955	0.48
Granted	1,340,000	2.28	702,500	0.43
Exercised	(414,366)	0.44	-	-
Cancelled	(35,000)	0.43	(200,000)	0.52
Outstanding – End of year	2,941,089	1.29	2,050,455	0.46
	Options outstanding		Options exercisable	
Exercise price \$	Number outstanding #	Weighted average remaining contractual life	Number outstanding #	Weighted average remaining contractual life
2.95	725,000	4.4	241,667	4.4
2.57	200,000	4.7	33,333	4.7
1.76	175,000	4.9	-	4.9
0.55	125,000	2.3	125,000	2.3
0.50	690,000	2.1	690,000	2.1
0.45	407,755	3.1	407,755	3.1
0.44	210,000	2.7	210,000	2.7
0.40	408,334	3.9	298,333	3.9
	2,941,089	3.4	2,006,088	3.0

- a) Effective September 1, 2005, the Corporation issued 240,000 stock options to directors of the Corporation with an exercise price of \$0.40. These stock options are subject to the stock option plan and expire on September 1, 2010.
- b) Effective January 11, 2006, the Corporation issued 725,000 stock options to directors and employees of the Corporation with an exercise price of \$2.95. These stock options are subject to the stock option plan and expire on January 11, 2011. Of the 725,000 stock options issued, 525,000 were issued to directors of the Corporation.
- c) Effective May 15, 2006, the Corporation issued 200,000 stock options to an employee of the Corporation with an exercise price of \$2.57. These stock options are subject to the stock option plan and expire on May 15, 2011.
- d) Effective August 1, 2006, the Corporation issued 175,000 stock options to a director and investment relations consultant of the Corporation with an exercise price of \$1.76 and expire on August 1, 2011. Of the 175,000 stock options issued, 100,000 were issued to directors of the Corporation.
- e) Subsequent to the year ended August 31, 2006, 50,000 employee incentive stock options, with an exercise price of \$0.40 were cancelled.

The fair value for the compensation costs of stock options issued to both employees and non-employees were calculated using the Black-Scholes option pricing model resulting in an additional charge to wage and to consultant expense with a corresponding increase in contributed surplus, assuming the following:

	2006		2005	
	%	Ranging from %	%	Ranging from %
Dividend yield	-	-	-	-
Risk-free rate	3.17	4.29	3.17	3.17
Average life	5 years	5 years	5 years	5 years
Volatility rate	58.70	115.06	58.70	58.70
Marketability discount	Nil	60	Nil	60
	\$	\$	\$	\$
Weighted fair value of options granted	0.07	2.42	0.07	0.11

During the year ended August 31, 2006, the Corporation incurred \$873,732 (2005 – \$101,904) in compensation expense relating to outstanding employee stock options.

The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of the options by the holders.

Contributed surplus

	2006 \$	2005 \$
Balance – Beginning of year	165,554	63,650
Stock option issuance	873,732	101,904
Stock options exercised	(32,454)	-
	<hr/>	<hr/>
Balance – End of year	<u>1,006,832</u>	<u>165,554</u>

Escrow shares

In connection with the reverse take-over that occurred in 2003, 499,380 escrow shares were cancelled for nominal value. Included in the 14,140,432 common shares issued in conjunction with the acquisition were 8,351,486 escrow shares. These common shares held in escrow are being released from escrow over a period of three years from the date of issue. The balance of common shares held in escrow as at August 31, 2006, was 1,435,733 (2005 – 4,355,199).

15 Loss per share

The Corporation uses the treasury stock method to calculate diluted loss per share. Under the treasury stock method, the numerator remains unchanged from the basic loss per share calculation, as the assumed exercise of the Corporation's share purchase warrants and stock options do not result in an adjustment to income. The weighted average number of common shares outstanding was 34,940,952 (2005 – 25,250,710).

Diluted loss per share is computed by giving effect to the potential dilution that would occur if stock options and common share purchase warrants were exercised. The treasury stock method assumes that the proceeds received from the exercise of the "in-the-money" stock options and common share purchase warrants are used to repurchase common shares at the average market price for the year ended August 31, 2006.

16 Economic dependence and segmented information

During the year ended August 31, 2006, the Corporation recorded revenue from seventeen (2005 – ten) customers. Sales from the top three customers amount to \$137,751, \$120,016, and \$86,001, which represent 18.1%, 15.8%, and 11.3% of total revenue respectively. In 2005, the Corporation recorded revenue from the top three customers of \$883,862, \$169,450 and \$81,931, which represents 66%, 13% and 6% of total revenue respectively.

The Corporation has one reportable operating segment being the enhancement of oil recovery, oil well stimulation and optimization of groundwater remediation using the Corporation's patented technology. During 2006, the Corporation acquired certain oilfield property and equipment and incurred certain development costs (notes 4 and 5) as part of its strategy to employ and further develop the market for its technology. To the extent that operations associated with oil and gas development activity become significant as an operating segment separate from the Corporation's primary business, segmented information may be required in the future.

The Corporation has generated revenue from products sold and services provided within Canada of \$413,210 (2005 – \$1,230,408). The remaining revenue was generated from the United States of \$395,708 (2005 – \$81,931) and Venezuela of \$nil (2005 – \$21,945).

17 Seasonality of operations

Integrated monitoring services offered by the Corporation are seasonable and related to the product offering and geographical extent to which products were offered for sale. The Corporation's main product offering, in relation to integrated monitoring services, is pressure measuring systems suitable for two distinct well types: steam injection wells and independent pressure monitoring wells. The target geographical area of the product offering is Alberta and more specifically the heavy oil belt in the area north of Cold Lake. Due to temperature influences on ground conditions, the majority of work is completed in the months between November and March when the ground is in a "frozen" state passable by vehicles as well as drilling and services rigs.

The Corporation however, is focusing its resources on Powerwave™ technology, where it can showcase its technology in oilfields where it has mineral rights. There are no known seasonal fluctuations in regards to oil production, where the Corporation has mineral rights. As such management believes that this seasonality of operations will have less of an affect moving forward. In regards to the licensing and applications of Primawave™ there are no known seasonal fluctuations.

18 Litigation

During the year ended August 31, 2006, the Corporation initiated a lawsuit against Applied Seismic Corporation ("ASR") of Plano, Texas asserting tortious interference with a pending contract for the implementation of Primawave™ with Occidental Petroleum of Elk Hills in California. ASR had made a counterclaim against the Corporation asserting patent infringement. By way of judgment of non-infringement, it has been determined that the Corporation's tool, either alone or in combination with any other component or process or manner of use, does not infringe any claim of the ASR patents and ASR dismissed with prejudice its counterclaims against the Corporation. Legal and patent attorney costs totalled US\$476,693 and are recorded within the professional fees.

19 Financial instruments

Financial instruments consist of recorded amounts of accounts receivable and other like amounts that will result in future cash receipts, as well as accounts payable and accrued liabilities, borrowings, and other amounts that will result in future cash outlays.

Risk management

The financial risk is the risk to the Corporation's earnings that arises from fluctuations in foreign currency exchange rates the degree of volatility of this rate. The Corporation does not use derivative instruments to reduce its exposure foreign currency risk.

Foreign currency risk

The Corporation is exposed to currency risks as a result of its export to foreign jurisdictions of goods produced in Canada or services provided from Canada. These risks are partially covered by purchases of goods and services in the foreign currency.

Credit risk

Credit risk arises from the potential that a counterparty will fail to perform its obligations. The Corporation's financial instruments that are exposed to concentrations of credit risk consist primarily of accounts receivable and non-participation amounts due. Concentrations of credit risk with respect to accounts receivable are limited as the majority of transactions are with large publicly traded corporations or government organizations and the dispersion of these customers across geographic areas. Concentrations of credit risk with respect to non-participation amounts due are related to the Rogers County Venture (note 5) and are based on production of that venture.

Fair value of financial instruments

The carrying value of the Corporation's interest in financial instruments approximates their fair value. The estimated fair value approximates the amount for which the financial instruments could currently be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Certain financial instruments lack an available trading market; therefore, fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instrument.

20 Guarantees

In the normal course of operations, the Corporation may provide indemnification to counterparties that would require the Corporation to compensate them for costs incurred as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The terms of these indemnification agreements will vary based upon the contract. Management does not expect the potential amount of these counterparty payments to have a material effect on the Corporation's financial position or operating results.

21 Contingent commitments

During the year ended August 31, 2006, the Corporation entered into a Letter of Intent to acquire a 100% undivided interest (the “Top Gun Acquisition”) in Top Gun Sand Pumps and Rentals (“Top Gun”), an arms-length privately held Saskatchewan company. Total consideration for the Top Gun Acquisition will not exceed \$1.2 million (the “Top Gun Purchase Price”). Of the total Purchase Price, the Corporation will issue common shares in its capital, such value equal to fifty percent (50%) of the Top Gun Purchase Price (i.e., up to \$600,000), based on the closing share price of the Corporation’s listed common shares on the TSX Venture Exchange (the “TSX”) on the trading day prior to the execution date of the purchase agreement(s). In addition, Top Gun’s principals have agreed to have all shareholder advances, loans, debts and interest to be restructured as unsecured and non-interest bearing, to be repaid over three (3) years.

In addition, and during the year ended August 31, 2006, the Corporation also entered into a purchase agreement to acquire fifty (50%) percent of the outstanding membership units of Oil Enhancement Tools LLC (“OET”), a privately held Wyoming company, from an arms length individual (the “OET Acquisition”). Total consideration for the OET Acquisition will not exceed US\$250,000 (the “Purchase Price”). In connection with entering into the Letter of Intent, the Corporation advanced a US\$100,000 refundable deposit (the “OET Deposit”). The OET Deposit is secured by a demand promissory note, with the membership units or shares in OET placed in trust with the Corporation’s lawyers. Upon closing of the OET Acquisition, the Corporation will issue common shares in its capital; such value equal to US\$100,000 of the purchase price, based on the closing share price of Corporation’s listed common shares on the TSX on the trading day prior to the execution date of the Purchase Agreement(s) and the balance of US\$50,000 in cash.

Completion of the Top Gun and OET acquisitions is subject to a number of conditions, including but not limited to, TSX acceptance, further due diligence by the Corporation, definitive purchase agreements and the Corporation’s board approval. There can be no assurances that the transaction will be completed as proposed or at all.

22 Related party transactions

During the year ended August 31, 2006, the Corporation had the following related party transactions:

- a) The Corporation incurred charges for wages, employee benefits, and consultants totaling \$416,646 (2005 – \$284,688) that were paid to significant shareholders or a company controlled a party related to a director of the Corporation. At the end of the year, no amounts (2005 – \$nil) were included in the accounts payable and accrued liabilities.
- b) In connection with the September 1, 2005 non-brokered private placement, whereby the Corporation issued 1,595,069 units at a price of \$0.23 per unit for gross proceeds of \$450,586. Each unit consisting of one common share and one share purchase warrant expiring on September 1, 2007. A director of the Corporation subscribed for 276,676 units for total subscription proceeds of \$63,635.

- c) During the year, directors of the Corporation exercised 1,183,251 common share purchase warrants at a prices ranging from \$0.44 to \$0.45 for aggregate consideration of \$493,150.
- d) During the year, directors and a related party to a director of the Corporation exercised 340,200 incentive stock options at prices ranging from \$0.40 to \$0.50 for aggregate consideration \$155,310.
- e) In the prior year, the Corporation entered into the Option Agreement to acquire ninety percent (90%) of the working interest in the production, equipment and mineral leases of known as the Chelsea-Alluwe Waterflood Leases in Rogers County, Oklahoma (“Leases”). Boulder Oil, LLC, a related limited liability company executed the Option Agreement on behalf of the Corporation by paying US\$165,000 of the purchase price in exchange for a sixty percent (60%) working interest in the Leases. Each working interest party is responsible for operating and field development costs in proportions relative to their working interest percentage.

During the fiscal year ending August 31, 2006, the Corporation became the Operator of Record. As the Operator, the Corporation is initially responsible for all operating expenses and development costs, which are then charged back to each non-operating partner relative to their working interest percentage. Boulder however, as a non-operating partner, exercised its non-participation right under the Joint Operating Agreement. Under the Joint Operating Agreement, the Corporation will receive all production revenues from production wells until such time that the Corporation is repaid 200% of the costs incurred, after which, production revenues will revert back to the working interest proportions. As at August 31, 2006, total amounts owed to the Corporation by Boulder totalled \$1,214,002, and are included in non-participation amounts due as a non-current asset.

23 Comparative figures

Certain comparative figures have been reclassified to conform with the current year presentation.