

**Wavefront Energy and  
Environmental Services Inc.**

Consolidated Financial Statements  
**August 31, 2007 and 2006**

December 28, 2007

**Auditors' Report**

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

We have audited the consolidated balance sheets of **Wavefront Energy and Environmental Services Inc.** as at August 31, 2007 and 2006 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company'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 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 company as at August 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Accountants**

# Wavefront Energy and Environmental Services Inc.

Consolidated Balance Sheets

As at August 31, 2007 and 2006

|   | 2007<br>\$        | 2006<br>\$        |
|---|-------------------|-------------------|
| <b>Assets</b>   |                   |                   |
| <b>Current assets</b>   |                   |                   |
| Cash and cash equivalents                                     | 5,430,949         | 14,411,315        |
| Accounts receivable   | 902,294           | 297,329           |
| Prepaid expenses  | 24,971            | 32,219            |
| Inventory (note 5)  | 80,946            | 38,002            |
|   | <u>6,439,160</u>  | <u>14,778,865</u> |
| <b>Deposits</b>   | 61,806            | 142,812           |
| <b>Non-participation amounts due</b> (notes 7 and 22)         | 2,040,896         | 1,214,002         |
| <b>Property, plant and equipment</b> (notes 6 and 7)          | 4,343,682         | 2,360,371         |
| <b>Intangible assets</b> (note 8)                             | 2,213,209         | 208,346           |
| <b>Goodwill</b> (note 4)                                      | 1,421,001         | -                 |
|   | <u>16,519,754</u> | <u>18,704,396</u> |
| <b>Liabilities</b>  |                   |                   |
| <b>Current liabilities</b>                                    |                   |                   |
| Accounts payable and accrued liabilities                      | 1,275,854         | 1,570,628         |
| Current portion of amounts due to shareholders (note 9)       | 151,637           | -                 |
| Current portion of obligations under capital leases (note 10) | 30,081            | 1,878             |
|   | <u>1,457,572</u>  | <u>1,572,506</u>  |
| <b>Due to shareholders</b> (note 9)                           | 227,456           | -                 |
| <b>Obligations under capital leases</b> (note 10)             | 73,831            | -                 |
| <b>Asset retirement obligation</b> (note 11)                  | 74,890            | 62,668            |
|   | <u>1,833,749</u>  | <u>1,635,174</u>  |
| <b>Shareholders' Equity</b>                                   |                   |                   |
| <b>Share capital</b> (note 14)                                | 26,911,271        | 26,279,824        |
| <b>Contributed surplus</b> (note 14)                          | 2,342,069         | 1,006,832         |
| <b>Deficit</b>  | (14,567,335)      | (10,217,434)      |
|   | <u>14,686,005</u> | <u>17,069,222</u> |
|   | <u>16,519,754</u> | <u>18,704,396</u> |

Approved by the Board of Directors

(Signed) "Brett Davidson"

Director

(Signed) "D. Brad Paterson"

Director

# Wavefront Energy and Environmental Services Inc.

Consolidated Statements of Operations and Deficit

For the years ended August 31, 2007 and 2006

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|  | 2007         | 2006         |
|--|--------------|--------------|
|  | \$           | \$           |
| <b>Revenue</b>   |              |              |
| Service revenue and royalties                                    | 993,080      | 390,860      |
| Production revenue and operator fees, net of taxes and royalties | 192,395      | 150,152      |
| Interest and other   | 351,803      | 222,525      |
|  | <hr/>        | <hr/>        |
|  | 1,537,278    | 763,537      |
| <b>Expenses</b>  |              |              |
| Direct costs   | 337,862      | 107,875      |
| General and administrative expenses                              | 2,908,009    | 2,217,470    |
| Selling, marketing and travel                                    | 427,565      | 210,703      |
| Amortization, depreciation, depletion and accretion expenses     | 216,162      | 146,572      |
| Listing and public company fees                                  | 195,466      | 106,888      |
| Research and development   | 72,672       | 71,567       |
|  | <hr/>        | <hr/>        |
|  | 4,157,736    | 2,861,075    |
| <b>Loss before the under noted items</b>                         | (2,620,458)  | (2,097,538)  |
| Stock-based compensation   | (1,340,358)  | (873,357)    |
| Foreign exchange loss  | (195,693)    | (45,900)     |
| Write down of property, plant and equipment                      | (160,641)    | (12,626)     |
| Write down of inventory  | (38,002)     | -            |
| Interest expense   | (9,402)      | (476)        |
| Gain on disposal of property, plant and equipment                | 14,653       | -            |
|  | <hr/>        | <hr/>        |
| <b>Net loss for the year</b>                                     | (4,349,901)  | (3,029,897)  |
| <b>Deficit – Beginning of year</b>                               | (10,217,434) | (7,187,537)  |
|  | <hr/>        | <hr/>        |
| <b>Deficit – End of year</b>                                     | (14,567,335) | (10,217,434) |
| <b>Loss per common share</b> (note 15)                           |              |              |
| Basic and diluted  | (0.09)       | (0.09)       |
|  | <hr/>        | <hr/>        |

# Wavefront Energy and Environmental Services Inc.

## Consolidated Statements of Cash Flows

For the years ended August 31, 2007 and 2006

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|   | 2007               | 2006               |
|---|--------------------|--------------------|
|   | \$                 | \$                 |
| <b>Cash provided from (used in)</b>                           |                    |                    |
| <b>Operating activities</b>                                   |                    |                    |
| Net loss for the year   | (4,349,901)        | (3,029,897)        |
| Items not affecting cash                                      |                    |                    |
| Stock-based compensation (note 14)                            | 1,340,358          | 873,357            |
| Amortization, depreciation, depletion and accretion expenses  | 216,162            | 146,572            |
| Write down of property, plant and equipment                   | 160,641            | 12,626             |
| Write down of inventory                                       | 38,002             | -                  |
| Gain on disposal of property, plant and equipment             | (14,653)           | -                  |
|   | <u>(2,609,391)</u> | <u>(1,997,342)</u> |
| Net change in non-cash working capital items (note 16)        | (560,700)          | 584,984            |
|   | <u>(3,170,091)</u> | <u>(1,412,358)</u> |
| <b>Financing activities</b>                                   |                    |                    |
| Repayment of bank indebtedness                                | -                  | (246,380)          |
| Proceeds from private placement (net of share issuance costs) | -                  | 17,325,772         |
| Proceeds from warrants exercised                              | -                  | 2,324,882          |
| Proceeds from options exercised                               | 26,326             | 183,027            |
| Advances on private placement                                 | -                  | (450,607)          |
| Repayment of notes payable                                    | -                  | (35,686)           |
| Repayment of amounts due to shareholder                       | (75,819)           | (34,189)           |
| Repayment of obligation under capital leases                  | (15,737)           | (11,183)           |
|   | <u>(65,230)</u>    | <u>19,055,636</u>  |
| <b>Investing activities</b>                                   |                    |                    |
| Purchase of property, plant and equipment                     | (1,928,110)        | (1,897,774)        |
| Intangible costs  | (2,413,154)        | (144,808)          |
| Non-participation amounts due                                 | (826,894)          | (1,334,015)        |
| Business acquisition (note 4)                                 | (600,000)          | -                  |
| Proceeds on disposal of property, plant and equipment         | 23,113             | -                  |
|   | <u>(5,745,045)</u> | <u>(3,376,597)</u> |
| <b>(Decrease) increase in cash and cash equivalents</b>       | <b>(8,980,366)</b> | <b>14,266,681</b>  |
| <b>Cash and cash equivalents – Beginning of year</b>          | <b>14,411,315</b>  | <b>144,634</b>     |
| <b>Cash and cash equivalents – End of year</b>                | <b>5,430,949</b>   | <b>14,411,315</b>  |
| <b>Supplementary information</b>                              |                    |                    |
| Interest paid   | 9,190              | 13,127             |

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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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 involve the licensing and utilization of the Corporation's patented process for the enhancement and improvement of oil recovery and oil well stimulation (Powerwave<sup>TM</sup>), and the optimization of groundwater remediation (Primawave<sup>TM</sup>) approaches. In the oil sector the Corporation's strategy is to leverage its intellectual property through licenses of the technology to service providers, provide site licenses to oil producers and to obtain over-riding royalty payments in-kind for site licenses. In the environmental sector the Corporation's strategy is to provide site licenses to service providers, consultants, and stakeholders involved in site specific groundwater clean-up.

## 2 Accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and 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 6 and 7). 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; 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; and, balances held in short-term, highly liquid, government investment certificates or bankers acceptances with interest rates ranging from 3.40% to 4.75%. The Corporation maintains revolving operating lines of credit that are included in cash and cash equivalents, as they fluctuated regularly between being overdrawn and positive.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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c) Translation of foreign currencies

Transactions in foreign currencies are translated into Canadian dollars at rates of exchange at the time of such transactions. Foreign operations are considered financially and operationally integrated and are translated into Canadian dollars using the temporal method of translation. Accordingly, monetary assets and liabilities are translated at current rates of exchange. Non-monetary assets and liabilities are translated at historical exchange rates. Revenue and expenses denominated in a foreign currency are translated at the monthly average exchange rate (except for amortization which is translated at historical exchange rates). Gains and losses resulting from the translation adjustments are included in income.

d) Revenue recognition

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. Specific revenue recognition policies are as follows:

- i) Revenue from oilfield services is recognized when the underlying services are provided. Revenue from the sale of rental tools is recognized when the equipment is delivered and accepted by third party customers.
- ii) Licensing royalties and 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) Warranty expense

Under certain rates and service contracts a provision for potential warranty expenses is provided for at the time of sale, based on warranty terms and prior claims experience.

f) 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:

|  |                        |
|--|------------------------|
| Oilfield property, plant and equipment | Units of production    |
| Equipment                              | 20% declining balance  |
| Computer equipment                     | 30% declining balance  |
| Computer software                      | 100% declining balance |
| Automotive equipment                   | 30% declining balance  |
| Office furniture and fixtures          | 20% declining balance  |

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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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 loss as the amount by which the carrying amount exceeds its fair value.

g) 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. 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, 2007 and 2006, as the oilfield property remains classified as unproven.

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 exceed fair value of proved and probable reserves, plus the costs (net of impairment) of unproved properties.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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h) 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.

i) Goodwill

Goodwill represents the excess of the purchase price of a business acquisition over the fair value of the underlying net assets at the date of acquisition. Goodwill arising from the acquisition is not amortized and is tested for impairment annually, or more frequently if events or changes in circumstances indicate the net asset might be impaired. Impairment is tested by comparing the carrying amount of the reporting unit, including goodwill, with its fair value. Fair value is determined using the discounted, estimated future operating cash flows of the reporting unit. When the fair value of the reporting unit exceeds its carrying value, goodwill of the reporting unit is not considered to be impaired. When the carrying value of the reporting unit exceeds its fair value, the implied fair value of the reporting unit's goodwill, determined in the same manner as the value of goodwill is determined in a business acquisition, is compared with its carrying amount to measure the amount of the impairment loss, if any.

j) Intangible assets

Intangible assets acquired individually or as part of a group of other assets are initially recognized at and measured at cost. Amortization is provided over the useful lives of the assets. Amortization has been calculated using the following annual rates and methods:

|                                  |                                   |
|----------------------------------|-----------------------------------|
| Gross over-riding royalty rights | Units of production               |
| Net over riding royalty rights   | Units of production               |
| Fully-paid up license            | Straight-line basis over 15 years |
| Patents                          | Straight-line basis over 10 years |
| Incorporation costs              | Straight-line basis over 10 years |

The Corporation regularly evaluates the net carrying value of finite life intangible assets whenever events or changes in circumstances indicate 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.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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k) Inventory

Inventories, which consist primarily of pressure sensors, uphole data collection systems and transmitters, ball valves and sand pumps are valued at the lower of cost, on a first-in, first-out basis, and net realizable value.

l) 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 on-going 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, 2007 and 2006, no development costs have been capitalized with the exception of development costs related to oilfield property, plant and equipment as described in note 2(g).

m) 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.

n) 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.

o) 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.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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p) Stock-based compensation plan

The Corporation has a stock-based compensation plan, which is described in note 15. 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.

q) Loss per share

Basic loss per share is 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 Future accounting changes

In January 2005, the Accounting Standards Board (“AcSB”) of the Canadian Institute of Chartered Accountants (“CICA”) issued CICA Handbook Section 3855 “Financial Instruments – Recognition and Measurement”, Handbook Section 1530, “Comprehensive Income”, and Handbook Section 3865 “Hedges”. The new standards will require presentation of a separate statement of comprehensive income under specific circumstances. Under the new standards, unrealized gains and losses on financial assets that will be held as available for sale, unrealized foreign currency translation amounts arising from self-sustaining foreign operations, and changes in the fair value of cash flow hedging instruments, will be recorded in a Consolidated Statement of Other Comprehensive Income until recognized in the Consolidated Statement of Income. Other Comprehensive Income will form part of shareholders’ equity. Also under the new standards, derivative financial instruments will be recorded in the balance sheet at fair value and the changes in fair value of derivatives designated as cash flow hedges will be reported in comprehensive income. The Corporation is in the process of assessing the impact of adopting these new standards. The Corporation will adopt these new standards effective September 1, 2007.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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Effective September 1, 2007, the Corporation will also be required to adopt CICA Handbook Section 3861, “Financial Instruments–Disclosure and Presentation”, which requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity’s financial position, performance and cash flows. Also this section enables users through disclosure to evaluate the nature and extent of our use of financial instruments, the business purposes they serve and the risks associated with the instruments and management policies for mitigating and managing those risks. The corporation is in the process of assessing the impact of adopting this new standard.

In March 2007, the CICA issued Handbook Section 3862, “Financial Instruments–Disclosures”, which complements CICA 3861 and provides expanded disclosure requirements that provide additional detail by financial assets and liability categories. This standard harmonizes disclosures with International Financial Reporting Standards. The Corporation is in the process of assessing the impact of adopting these new standards. This standard applies to interim and annual financial statements beginning September 1, 2008.

In March 2007, the CICA also issued Handbook Section 3863, “Financial Instruments–Presentation” to enhance financial statement users’ understanding of the significance of financial instruments to an entity’s financial position, performance and cash flows. This Section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, gains and losses, and the circumstances in which financial assets and financial liabilities are offset. This standard harmonizes disclosures with International Financial Reporting Standards. The Corporation is in the process of assessing the impact of adopting this new standard. This standard applies to interim and annual financial statements beginning September 1, 2008.

### **Accounting changes**

In July 2006, the CICA issued the new handbook Section 1506, “Accounting Changes,” effective for annual and interim periods beginning on or after January 1, 2007. This section establishes criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates, and the correction of errors. The disclosure is to include, on an interim and annual basis, a description and the impact on the Company of any new primary source of GAAP that has been issued but is not yet effective. This new standard is not expected to have a material effect on our financial position or results of operations. This standard applies to interim and annual financial statements beginning September 1, 2007.

### **Capital disclosures**

In November 2006, the CICA issued the new handbook Section 1535, “Capital Disclosures,” effective for annual and interim periods beginning on or after October 1, 2007. This section establishes standards for disclosing information about a company’s capital and how it is managed in order that a user of the financial statements may evaluate the company’s objectives, policies, and processes for managing capital. This new standard is not expected to have a material effect on our financial position or results of operations. This standard applies to interim and annual financial statements beginning September 1, 2008.

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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## International financial reporting standards

The CICA plans to converge Canadian GAAP for public companies with International Financial Reporting Standards (IFRS) over a transition period that is expected to end in 2011. The impact of the transition to IFRS on our consolidated financial statements has not yet been determined.

## 4 Business acquisition

Effective March 1, 2007, the Corporation acquired (the "Acquisition") all of the issued and outstanding shares of Top Gun Sand Pumps & Rentals Ltd. ("Top Gun"), a privately-held Saskatchewan company that provides specialized pumping equipment and services for use in heavy oil wells. Total consideration for the Acquisition was \$1,200,000 (the "Purchase Price"). Of the total Purchase Price, the Corporation paid \$542,250 cash, issued 600,000 common shares in the capital of the Corporation valued at \$1.00 per share based on the average quoted market price at the date of the Acquisition and repaid notes payable in the amount of \$57,750.

The Acquisition was accounted for using the purchase method and these financial statements include results of operations of the acquired enterprise from the date of acquisition. The preliminary fair values ascribed to the assets and liabilities are as follows:

|  | \$               |
|--|------------------|
| Current assets   | 413,330          |
| Non-current assets   | <u>132,528</u>   |
| Total assets acquired  | <u>545,858</u>   |
| Current liabilities  | 213,583          |
| Non-current liabilities, amounts due to shareholders and bank indebtedness | <u>553,276</u>   |
| Total liabilities assumed  | <u>766,859</u>   |
| Net liabilities assumed  | (221,001)        |
| Goodwill   | <u>1,421,001</u> |
| Purchase price   | <u>1,200,000</u> |

The above purchase price allocation is based upon a preliminary evaluation of the fair value of the assets and liabilities acquired and is subject to adjustment pending a final purchase price allocation.

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

August 31, 2007 and 2006

## 5 Inventory

|                  | 2007<br>\$    | 2006<br>\$    |
|------------------|---------------|---------------|
| Work-in-progress | -             | 35,274        |
| Finished goods   | 80,946        | 2,728         |
|                  | <u>80,946</u> | <u>38,002</u> |

## 6 Property, plant and equipment

|   | <u>2007</u>      |                                   |                  |
|---|------------------|-----------------------------------|------------------|
|   | Cost<br>\$       | Accumulated<br>depreciation<br>\$ | Net<br>\$        |
| Oilfield property, plant and equipment          | 1,966,213        | -                                 | 1,966,213        |
| Equipment                                       | 2,298,389        | 265,496                           | 2,032,893        |
| Computer equipment                              | 208,126          | 107,436                           | 100,690          |
| Computer software                               | 170,091          | 72,519                            | 97,572           |
| Automotive equipment                            | 184,595          | 68,948                            | 115,647          |
| Office furniture and fixtures                   | 68,821           | 38,154                            | 30,667           |
|   | <u>4,896,235</u> | <u>552,553</u>                    | <u>4,343,682</u> |
|   | <u>2006</u>      |                                   |                  |
|   | Cost<br>\$       | Accumulated<br>depreciation<br>\$ | Net<br>\$        |
| Oilfield property, plant and equipment (note 7) | 1,223,442        | -                                 | 1,223,442        |
| 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            |
| Automotive equipment                            | 16,455           | 9,221                             | 7,234            |
| Office furniture and fixtures                   | 68,359           | 30,660                            | 37,699           |
|   | <u>2,923,977</u> | <u>563,606</u>                    | <u>2,360,371</u> |

Property, plant and equipment includes oilfield property, plant and equipment of \$1,966,213 related to improved properties and therefore not subject to depreciation and depletion and equipment under construction of \$1,710,408 (2006 – \$514,661), which is not being depreciated. Property, plant and equipment also include assets under capital leases with a cost of \$168,140 (2006 – \$52,571) and a net book value of \$109,860 (2006 – \$18,551) (note 10).

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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Depreciation expense for the year ended August 31, 2007 was \$183,548 (2006 – \$122,900), including depreciation relating to equipment under capital leases of \$12,207 (2006 – \$4,638). No depletion or depreciation of oilfield property plant and equipment has been recorded as at August 31, 2007 and 2006 as the oilfield property remains classified as an unproven property.

### 7 Oilfield property, plant and equipment

#### Rogers County

During 2005, 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 for the US\$15,000 deposit paid, 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.

Included in oilfield property, plant and equipment is the Corporation’s proportionate share of oil well development costs totalling \$1,786,345 (2006 – \$1,254,293) related to the Rogers County venture. During the fiscal year ended 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, 2007, amounts due to the Corporation by Boulder totalled \$2,040,896 (2006 – \$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 the settlement of a liability of \$214,352. This acquisition was treated as a non-cash transaction for the purposes of the consolidated statement of cash flows.

The Corporation has recognized production revenue of \$87,683 (2006 – \$16,386) related to the Rogers County venture.

#### Young County

During the year ended August 31, 2007, the Corporation acquired 100% of the working interest in certain mineral leases in Young County, Texas for total consideration of \$179,868. No costs were incurred on these leases for the year ended August 31, 2007.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

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### Milam County

In the prior 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.

### 8 Intangible assets

|                       | <b>2007</b>     |                    |                         |
|-----------------------|-----------------|--------------------|-------------------------|
|                       | <b>Cost</b>     | <b>Accumulated</b> | <b>Net</b>              |
|                       | \$              | amortization       | \$                      |
|                       |                 | \$                 | \$                      |
| Royalty rights        | 2,016,443       | 6,479              | 2,009,964               |
| Fully-paid up license | 106,990         | 8,826              | 98,164                  |
| Patents               | 154,225         | 50,255             | 103,970                 |
| Incorporation costs   | 3,445           | 2,334              | 1,111                   |
|                       | <hr/> 2,281,103 | <hr/> 67,894       | <hr/> 2,213,209         |
|                       |                 |                    | <hr/> <b>2006</b> <hr/> |
|                       | <b>Cost</b>     | <b>Accumulated</b> | <b>Net</b>              |
|                       | \$              | amortization       | \$                      |
|                       |                 | \$                 | \$                      |
| Royalty rights        | 125,300         | -                  | 125,300                 |
| Patents               | 122,409         | 40,819             | 81,590                  |
| Incorporation costs   | 3,445           | 1,989              | 1,456                   |
|                       | <hr/> 251,154   | <hr/> 42,808       | <hr/> 208,346           |

Amortization expense for the year ended August 31, 2007 totalled \$25,579 (2006 – \$10,368).

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

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### Greentree Gas and Oil Ltd. royalty rights

At August 31, 2006, the Corporation entered into a "Farm-in" Agreement with Greentree Gas and Oil Ltd. ("Greentree") 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. Greentree 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. Greentree 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 Greentree, 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 Greentree respectively. As at August 31, 2007, the Corporation has paid Greentree \$1,823,235 (2006 – \$74,663) and accrued \$132,828 (2006 – \$7,464) under the Farm-in Agreement, which has been recorded as an intangible asset on the consolidated balance sheet. The Corporation is obligated to the remaining balance of up to \$293,937 under the Farm-in Agreement. The resulting asset is classified as finite life intangible asset.

No amortization expense of Gross over-riding royalty rights has been recorded to date as the underlying oilfield property remains under development.

During the year ended August 31, 2006, the Corporation entered into a net over-riding royalty agreement on a single gas well with Greentree. As at August 31, 2007, the Corporation has recorded an intangible asset of \$60,379 (2006 – \$43,173) on its balance sheet. The resulting asset is classified as a finite life intangible asset and amortized based on the underlying asset. Amortization expense for August 31, 2007 is \$6,479, (2006 – \$nil).

### 9 Due to shareholders

In connection with the business acquisition described in note 4, the shareholders of Top Gun agreed to enter into debt repayment agreements. Under the terms of the debt repayment agreements, the amounts due to shareholders are unsecured, bear no interest, and are repayable in equal quarterly installments over three years.

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

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## 10 Obligations under capital leases

The obligations under capital leases bear interest at rates ranging from 1.9% to 4.0% and mature in 2009. Assets with a net book value of \$109,860 (2006 – \$18,551) have been pledged as collateral.

|   | 2007<br>\$ | 2006<br>\$ |
|---|------------|------------|
| Total obligations under capital leases      | 105,600    | 1,920      |
| Less: Interest                              | 1,688      | 42         |
| Balance of obligations under capital leases | 103,912    | 1,878      |
| Less: Current portion                       | 30,081     | 1,878      |
| Long-term obligations under capital leases  | 73,831     | -          |

Interest expense for the year ended August 31, 2007 totalled \$1,688 (2006 – \$1,086).

Aggregate annual principal payments due on the obligations under capital leases required in the next two years are as follows:

|      | \$      |
|------|---------|
| 2008 | 30,081  |
| 2009 | 73,831  |
|      | 103,912 |

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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## 11 Asset retirement obligation

The Corporation has asset retirement obligations associated with its oilfield property, plant and equipment (note 7). 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:

|  | 2007   | 2006    |
|--|--------|---------|
|  | \$     | \$      |
| Asset retirement obligations – Beginning of year | 62,668 | 29,483  |
| Liabilities incurred                             | 5,187  | 16,517  |
| Liabilities settled                              | -      | (1,519) |
| Accretion expense                                | 7,035  | 18,187  |
|  | <hr/>  | <hr/>   |
| Asset retirement obligations – End of year       | 74,890 | 62,668  |

The total undiscounted amount of estimated cash flows required to settle the obligation is US\$322,528 (2006 – US\$301,450), 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 one to twenty-nine years in the future and will be funded from general corporate resources at the time of the retirement and removal.

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

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## 12 Income taxes

Future income taxes reflect the net tax affects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Corporation has recognized a valuation allowance for those future tax assets for which it is more likely than not that realization will not occur. Significant components of the Corporation's future tax assets and liabilities as of August 31, 2007 are as follows:

|  | 2007<br>\$        | 2006<br>\$        |
|--|-------------------|-------------------|
| Future income tax assets                               |                   |                   |
| Non-capital losses carried forward                     | 2,558,422         | 2,504,349         |
| Net operating losses carried forward                   | 756,101           | 214,528           |
| Interest expense not tax-deductible until future years | 109,591           | 28,345            |
| Research and development expenditures                  | 127,805           | 129,829           |
| Property, plant and equipment and intangible assets    | -                 | 3,466             |
| Financing costs  | 125,827           | 174,821           |
| Unrealized foreign exchange capital losses             | 58,058            | -                 |
|  | <hr/> 3,735,804   | <hr/> 3,055,338   |
| Future income tax liabilities                          |                   |                   |
| Property, plant and equipment and intangible assets    | <hr/> (105,892)   | <hr/> -           |
|  | 3,629,912         | 3,055,338         |
| Less: Valuation allowance                              | <hr/> (3,629,912) | <hr/> (3,055,338) |
| Net future income tax asset                            | <hr/> -           | <hr/> -           |

As at August 31, 2007, the Corporation has scientific research and experimental development expenditures in the amount of \$444,926 (2006 – \$444,926) available for carry-forward to reduce future taxable income.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

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The Corporation and its subsidiaries also have, in aggregate, Canadian non-capital losses in the amount of \$8,906,592 and U.S. net operating losses of \$1,890,252 to be carried forward and used to reduce income for tax purposes in future years, subject to confirmation by taxation authorities. 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:

|      | U.S.<br>\$       | Canadian<br>\$   |
|------|------------------|------------------|
| 2008 | -                | 834,919          |
| 2009 | -                | 1,504,905        |
| 2010 | -                | 579,441          |
| 2014 | -                | 1,823,383        |
| 2015 | -                | 1,112,562        |
| 2024 | 669              | -                |
| 2025 | 180,377          | -                |
| 2026 | 327,314          | 1,792,581        |
| 2027 | 1,381,892        | 1,258,801        |
|      | <u>1,890,252</u> | <u>8,906,592</u> |

The Corporation's substantially enacted Canadian statutory tax rate is approximately 32.35% (2006 – 33.18%). The difference between the computed expected income tax recovery and the actual income tax recovery are summarized as follows:

|   | 2007<br>\$         | 2006<br>\$         |
|---|--------------------|--------------------|
| Loss before income tax  | <u>(4,349,901)</u> | <u>(3,029,897)</u> |
| Expected income tax recovery at statutory income tax rate     | (1,407,192)        | (1,005,320)        |
| Adjusted for the following:                                   |                    |                    |
| Difference between U.S. and Canadian tax rates on U.S. losses | (95,130)           | (55,677)           |
| Stock-based compensation                                      | 433,606            | 289,780            |
| Unrealized foreign exchange capital loss                      | 65,385             | -                  |
| Substantively enacted rates                                   | 102,270            | 408,068            |
| Expiry of non-capital losses                                  | 263,877            | 14,228             |
| Financing costs   | -                  | (203,103)          |
| Valuation allowance   | 574,574            | 495,913            |
| Non-deductible and other items                                | 62,610             | 56,111             |
|   | <u>-</u>           | <u>-</u>           |

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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## 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 two years are as follows:

|      |                |
|------|----------------|
|      | \$             |
| 2008 | 139,510        |
| 2009 | <u>55,884</u>  |
|      | <u>195,394</u> |

b) Farm-in Agreement

As described in note 8, the Corporation is obligated to fund \$293,937 as at August 31, 2007 under the Farm-in Agreement with Greentree.

c) Supplier purchase obligations

The Corporation is committed to the purchase of inventory in the amount of \$293,613 as at August 31, 2007 from a third party supplier.

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

### 14 Share capital

The Corporation's authorized and issued share capital for the year ended August 31, 2007 and 2006 are as follows:

Authorized

Unlimited common shares without par value

#### Issued common shares

|   | 2007        |                      | 2006        |                      |
|---|-------------|----------------------|-------------|----------------------|
|   | Number<br># | Stated capital<br>\$ | Number<br># | Stated capital<br>\$ |
| Balance – Beginning of year                             | 47,913,796  | 26,279,824           | 27,998,341  | 6,306,799            |
| Shares issued in private placement <sup>(1)(2)(3)</sup> | -           | -                    | 13,610,979  | 17,252,343           |
| Shares issued in Top Gun acquisition <sup>(4)</sup>     | 600,000     | 600,000              | -           | -                    |
| Stock options exercised <sup>(5)</sup>                  | 58,316      | 31,447               | 414,366     | 215,219              |
| Warrants exercised <sup>(6)</sup>                       | -           | -                    | 5,890,110   | 2,505,463            |
| Balance – End of year                                   | 48,572,112  | 26,911,271           | 47,913,796  | 26,279,824           |

#### Warrants

|  | 2007        |                      | 2006        |                      |
|--|-------------|----------------------|-------------|----------------------|
|  | Number<br># | Stated capital<br>\$ | Number<br># | Stated capital<br>\$ |
| Balance – Beginning of year                          | -           | -                    | 4,873,314   | 66,848               |
| Warrants granted in private placement <sup>(1)</sup> | -           | -                    | 1,959,160   | 73,840               |
| Exercised <sup>(6)</sup>                             | -           | -                    | (5,890,110) | (140,500)            |
| Warrants cancelled                                   | -           | -                    | (942,364)   | (188)                |
| Balance – End of year                                | -           | -                    | -           | -                    |
|  |             | 26,911,271           |             | 26,279,824           |

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

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- <sup>(1)</sup> Effective September 1, 2005, the Corporation issued 1,959,160 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.
- <sup>(2)</sup> 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 7,038,008 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.
- <sup>(3)</sup> 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.
- <sup>(4)</sup> In connection with the Acquisition of Top Gun (note 4), the Corporation issued 600,000 common shares at a deemed value of \$600,000.
- <sup>(5)</sup> The 58,146 stock options exercised during the year ended August 31, 2007, were at a prices ranging from \$0.40 to \$0.50. The 414,366 stock options exercised during the year ended August 31, 2006 were at prices ranging from \$0.40 to \$0.50.
- <sup>(6)</sup> Of the 5,890,110 common share purchase warrants that were exercised during the prior 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         | Number<br># | Weighted<br>average<br>exercise price<br>\$ |
|--|-------------|---|
| Outstanding – August 31, 2005          | 4,873,314   | 0.48  |
| Granted                                | 1,959,160   | 0.40  |
| Exercised                              | (5,890,110) | 0.40  |
| Expired                                | (942,364)   | 0.56  |
|  | <hr/>       |   |
| Outstanding – August 31, 2007 and 2006 | -           | -   |
|  | <hr/>       |   |

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

### 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, 2007 and 2006, and the changes during the years ended on those dates are presented below:

| Stock options                      | 2007        |   | 2006        |   |
|------------------------------------|-------------|---|-------------|---|
|                                    | Number<br># | Weighted<br>average<br>exercise price<br>\$ | Number<br># | Weighted<br>average<br>exercise price<br>\$ |
| Outstanding – Beginning<br>of year | 2,941,089   | 1.29  | 2,050,455   | 0.46  |
| Granted                            | 205,000     | 0.97  | 1,340,000   | 2.28  |
| Exercised                          | (58,316)    | 0.45  | (414,366)   | 0.44  |
| Cancelled                          | (70,000)    | 0.56  | (35,000)    | 0.43  |
| Outstanding – End of year          | 3,017,773   | 1.30  | 2,941,089   | 1.29  |

  

| Exercise<br>price<br>\$ | Options outstanding        |  | Options exercisable        |  |
|-------------------------|----------------------------|--|----------------------------|--|
|                         | Number<br>outstanding<br># | Weighted<br>average<br>remaining<br>contractual<br>life in years | Number<br>outstanding<br># | Weighted<br>average<br>remaining<br>contractual<br>life in years |
| 2.95                    | 725,000                    | 3.6  | 725,000                    | 3.6  |
| 2.57                    | 200,000                    | 4.0  | 166,667                    | 4.0  |
| 1.76                    | 175,000                    | 4.2  | 116,667                    | 4.2  |
| 0.97                    | 185,000                    | 4.3  | 30,833                     | 4.3  |
| 0.55                    | 125,000                    | 1.5  | 125,000                    | 1.5  |
| 0.50                    | 660,000                    | 1.4  | 660,000                    | 1.4  |
| 0.45                    | 407,755                    | 2.4  | 407,755                    | 2.4  |
| 0.44                    | 210,000                    | 1.8  | 210,000                    | 1.8  |
| 0.40                    | 330,018                    | 3.2  | 330,018                    | 3.2  |
|                         | 3,017,773                  | 2.9  | 2,771,940                  | 2.9  |

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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- a) Effective March 6, 2007, the Corporation issued 205,000 stock options to directors and employees of the Corporation with an exercise price of \$0.97. These stock options are subject to the stock option plan and expire on March 6, 2012. Of the 205,000 stock options issued, 90,000 were issued to directors of the Corporation.
- b) Subsequent to the year ended August 31, 2007, 50,000 employee incentive stock options, with an exercise price of \$0.97 were cancelled unexercised.

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:

|  | 2007<br>% | 2006<br>%       |
|--|-----------|-----------------|
| Dividend yield   | -         | -               |
| Risk-free rate   | 3.98      | 3.51 to 4.29    |
| Average life   | 5 years   | 5 years         |
| Volatility rate  | 104.09    | 44.56 to 113.16 |
|  | \$        | \$              |
| Weighted fair value of options granted during the year | 0.76      | 0.07 to 2.10    |

During the year ended August 31, 2007, the Corporation incurred \$1,378,212 (2006 – \$873,357) 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

|                             | 2007<br>\$ | 2006<br>\$ |
|-----------------------------|------------|------------|
| Balance – Beginning of year | 1,006,832  | 165,554    |
| Stock option issuance       | 1,340,358  | 873,357    |
| Stock options exercised     | (5,121)    | (32,079)   |
|                             | <hr/>      | <hr/>      |
| Balance – End of year       | 2,342,069  | 1,006,832  |

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

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### Escrow shares

In connection with the reverse take-over that occurred in 2003, 8,351,486 common shares were subject to a value escrow agreement. In connection with the business acquisition (note 4) that closed on March 1, 2007, 600,000 common shares were issued as part of the consideration. The balance of all common shares held in escrow as at August 31, 2007, was 540,000 (2006 – 1,435,733).

### 15 Loss per share

The Corporation uses the treasury stock method to calculate diluted earnings per share. Under the treasury stock method, the numerator remains unchanged from the basic earnings 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 is 47,937,111 (2006 – 34,940,952).

Diluted loss per share is computed by giving effect to the potential dilution that would occur if stock options were exercised. The treasury stock method assumes that the proceeds received from the exercise of the "in-the-money" stock options are used to repurchase common shares at the average market price for the year ended August 31, 2007.

In determining diluted loss per share, the weighted average number of shares outstanding was increased by \$776,778 (2006 – 514,303) for stock options eligible for exercise where the average market price of the common shares for the year exceeds the exercise price. The diluted weighted average number of shares outstanding was 48,713,889 (2006 – 35,463,815). As the result was anti-dilutive in both fiscal 2007 and 2006, no adjustments were made to net loss to calculated diluted loss per share.

### 16 Net change in non-cash working capital items

|   | 2007      | 2006      |
|---|-----------|-----------|
|   | \$        | \$        |
| Accounts receivable                       | (191,636) | (228,045) |
| Inventories                               | (80,946)  | 15,147    |
| Prepaid expenses and other current assets | 7,248     | (41,249)  |
| Accounts payable and accrued liabilities  | (295,366) | 839,131   |
|   | <hr/>     | <hr/>     |
|   | (560,700) | 584,984   |
|   | <hr/>     | <hr/>     |

# Wavefront Energy and Environmental Services Inc.

Notes to Consolidated Financial Statements

August 31, 2007 and 2006

## 17 Segmented information

The Corporation determines its reportable segments based on the structure of its operations, which are focused in two principal business segments – the deployment of technology and equipment to third parties in return for rental and royalty income and, the development of oil and gas properties utilizing the Corporation's Powerwave technology and equipment. The accounting policies of these segments are the same as those described in note 2.

| <b>Year ended<br/>August 31, 2007</b> | <b>Equipment<br/>and<br/>technology<br/>\$</b> | <b>Oil and gas<br/>properties<br/>\$</b> | <b>Corporate<br/>and other<br/>\$</b> | <b>Year ended<br/>August 31<br/>2007<br/>\$</b> |
|---------------------------------------|--|--|---------------------------------------|---|
| Revenue                               | 993,080  | 192,395                                  | 351,803                               | 1,537,278                                       |
| Net loss for the year                 | (1,204,606)                                    | (1,477,891)                              | (1,667,404)                           | (4,349,901)                                     |
| Segment assets                        | 4,350,004                                      | 6,374,847                                | 5,794,903                             | 16,519,754                                      |
| Capital expenditures                  | 3,349,111                                      | 2,413,154                                | -                                     | 5,762,265                                       |
| <b>Year ended<br/>August 31, 2006</b> | <b>Equipment<br/>and<br/>technology<br/>\$</b> | <b>Oil and gas<br/>properties<br/>\$</b> | <b>Corporate<br/>and other<br/>\$</b> | <b>Year ended<br/>August 31<br/>2006<br/>\$</b> |
| Revenue                               | 390,860  | 150,152                                  | 222,525                               | 763,537   |
| Net loss for the year                 | (930,269)                                      | (694,797)                                | (1,404,831)                           | (3,029,897)                                     |
| Segment assets                        | 1,380,096                                      | 2,790,756                                | 14,533,544                            | 18,704,396                                      |
| Capital expenditures                  | 655,821  | 1,386,761                                | -                                     | 2,042,582                                       |
|                                       |  | <b>2007</b>                              |                                       | <b>2006</b>                                     |
| <b>Geographic Information</b>         | <b>Revenue<br/>\$</b>                          | <b>Total assets<br/>\$</b>               | <b>Revenue<br/>\$</b>                 | <b>Total assets<br/>\$</b>                      |
| Canada                                | 1,318,738                                      | 12,195,833                               | 437,722                               | 15,561,726                                      |
| United States                         | 218,540  | 4,323,921                                | 325,815                               | 3,142,670                                       |
|                                       | 1,537,278                                      | 16,519,754                               | 763,537                               | 18,704,396                                      |

# Wavefront Energy and Environmental Services Inc.

## Notes to Consolidated Financial Statements

August 31, 2007 and 2006

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During the year ended August 31, 2007, the Corporation recorded revenue from thirty-nine (2006 – seventeen customers). Sales in 2007 from the top three customers amounted to \$267,162, \$184,012 and \$153,941, which represented 17.8%, 12.0% and 10.0%, respectively of total revenue. Sales in 2006 from the top three customers amounted to \$137,751, \$120,016 and \$86,001, which represented 18.1%, 15.8% and 11.3%, respectively of total revenue.

### 18 Seasonality of operations

Oilfield 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 oilfield services, are rental and sale of downhole equipment. The target geographical area of the product offering is Alberta and Saskatchewan. Due to temperature influences on ground conditions, the months of December, March and April have lower activities.

The Corporation focuses its resources on Powerwave and Primawave technologies. There no known seasonal fluctuations in regards to oil production, where the Corporation has mineral rights or enters into licensing or usage agreements in either targeted implementation sectors. As such management believes that this seasonality of operations will have minimal affects moving forward.

### 19 Litigation

In the prior year ended August 31, 2006, the Corporation initiated a lawsuit against Applied Seismic Corporation ("ASR") of Plano, Texas asserting tortuous interference with a pending contract for the implementation of Powerwave 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 \$547,243 (US\$476,693) and are recorded within professional fees. Subsequent to the year ended August 31, 2007, the Corporation initiated a lawsuit against ASR seeking damages for the initial lawsuit.

### 20 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, obligations under capital leases, due to shareholders, asset retirement obligations and other amounts that will result in future cash outlays.

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## **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 7) 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.

## **21 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.

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## 22 Related party transactions

The Corporation had the following related party transactions:

- a) 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.
- b) During the ended August 31, 2006, directors of the Corporation exercised 1,183,251 common share purchase warrants at prices ranging from \$0.44 to \$0.45 for aggregate consideration of \$493,150.
- c) During the ended August 31, 2006, 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.
- d) In a 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, 2007, total amounts owed to the Corporation by Boulder totalled \$2,040,896 (2006 – \$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.

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## 24 Subsequent event

On December 24, 2007, the Corporation completed the private placement of 4,985,678 units (“Units”) of the Corporation at a price of \$0.95 per Unit for gross proceeds of \$4,736,394. Each Unit consists of one common share of the Corporation and one-half of one common share purchase warrant (“Warrant”) with each full Warrant entitling the holder to acquire a common share of the Corporation at a price of \$1.25 up to December 24, 2008. All Units issued under the private placement are subject to a four-month hold period. Net proceeds from the private placement are estimated to approximate \$4,259,754.

