



***Emerald Bay Energy***

**Emerald Bay Energy Inc.  
Financial Statements  
For the three months ended  
March 31, 2004  
(unaudited)**

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## **UNAUDITED INTERIM FINANCIAL STATEMENTS**

In Accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company Disclosed that its auditors have not reviewed the unaudited financial statements for the period ended March 31, 2004

**Emerald Bay Energy Inc.  
Balance Sheets**

	<b>March 31 2004</b>	December 31 2003
<b>Assets</b>		
<b>Current</b>		
Cash and short term investments	\$ 528,919	\$ 964,995
Accounts receivable	248,824	192,197
Prepaid expenses and deposits	55,321	57,280
Due from related parties (Note 7)	13,565	12,282
	846,629	1,226,754
<b>Due from related parties (Note 7)</b>	<b>219,339</b>	<b>215,735</b>
<b>Property and equipment (Note 4)</b>	<b>780,732</b>	<b>618,390</b>
<b>License</b>	<b>64,853</b>	<b>65,882</b>
<b>Future income taxes (Note 9)</b>	<b>-</b>	<b>-</b>
	\$ 1,911,553	\$ 2,126,761
<b>Liabilities and Shareholders' Equity</b>		
<b>Current</b>		
Bank loan (Note 6)	\$ -	\$ -
Accounts payable and accrued liabilities	420,387	532,771
	420,387	532,771
<b>Future taxes (Note 9)</b>	<b>112,016</b>	<b>146,000</b>
<b>Asset retirement obligation (Note 5)</b>	<b>63,839</b>	<b>61,204</b>
	<b>596,242</b>	<b>739,975</b>
<b>Contingencies (Note 10)</b>		
<b>Shareholders' equity</b>		
Share capital (Note 8(b))	1,942,260	1,949,425
Warrants	42,400	42,400
Deficit	(669,349)	(605,039)
	1,315,311	1,386,786
	\$ 1,911,553	\$ 2,126,761

"Shelby D. Beattie" Director  
Shelby D. Beattie

"Leonard D. Rice" Director  
Leonard D. Rice

The accompanying notes are an integral part of these financial statements.

**Emerald Bay Energy Inc.**  
**Statements of Operations and Deficit**

	<b>March 31 2004</b>	<b>March 31 2003</b>
<b>Revenue</b>		
Petroleum and natural gas sales	\$ 279,604	\$ 456,672
Royalties	(57,242)	( 104,291)
Alberta Royalty Tax Credits	4,695	26,073
Gain (loss) on futures contracts	-	-
	<b>227,057</b>	<b>378,454</b>
<b>Expenses</b>		
Operating	40,029	68,124
General and administrative	219,640	136,511
Research and development	39,121	-
Depletion and amortization	29,531	13,415
Interest	90	6,262
Accretion	2,635	1,013
	<b>331,046</b>	<b>225,325</b>
<b>Income (loss) from operations</b>	<b>(103,989)</b>	<b>153,129</b>
<b>Other income</b>		
Gain on sale of property and equipment	-	-
Interest	5,680	-
	<b>5,680</b>	<b>-</b>
<b>Income (loss) before income taxes</b>	<b>(98,309)</b>	<b>153,129</b>
<b>Income taxes (recovery) (Note 9)</b>		
Current	-	47,010
Future	(34,000)	-
	<b>(34,000)</b>	<b>47,010</b>
<b>Income (loss) for the year</b>	<b>(64,309)</b>	<b>106,129</b>
Deficit, beginning of year	(605,040)	(310,391)
Adjustment to reflect change in accounting policy (Note 5)	-	(19,517)
<b>Deficit, end of year</b>	<b>\$ (669,349)</b>	<b>\$ (223,779)</b>
<b>Loss per common share (Note 8(d))</b>		
	<b>\$ (0.005)</b>	<b>\$ 0.017</b>
<b>Weighted average number of shares</b>		
	<b>11,708,304</b>	<b>6,356,228</b>

The accompanying notes are an integral part of these financial statements.

**Emerald Bay Energy Inc.  
Statements of Cash Flows**

	March 31 2004		March 31 2003
<b>Cash flows from operating activities</b>			
Loss for the year	64,309	\$	106,129
Adjustments for:			
Depletion, amortization and accretion	32,166		14,428
Future income taxes	(34,000)		22,000
Stock option expense	-		-
<b>Cash flow from operations</b>	<b>(66,143)</b>		142,557
Changes in non-cash operating balances			
Accounts receivable	(56,627)		(183,926)
Prepaid expenses and deposits	1,959		5,833
Accounts payable and accrued liabilities	(112,384)		113,036
	<b>(233,195)</b>		77,500
<b>Cash flows from investing activities</b>			
Purchases of property and equipment	(190,829)		(16,774)
	<b>(190,829)</b>		(16,774)
<b>Cash flows from financing activities</b>			
Bank loan advances (repayment)	-		(85,000)
Advances (repayments) from (to) related parties	(4,887)		(5,833)
Issuance of share capital, net of issue costs	(7,165)		-
	<b>(12,052)</b>		(90,833)
<b>Increase (decrease) in cash and short term investments</b>	<b>(436,076)</b>		(30,107)
Cash and short term investments, beginning of period	964,995		37,089
<b>Cash and short term investments, end of year</b>	<b>528,919</b>	<b>\$</b>	<b>6,982</b>

The accompanying notes are an integral part of these financial statements.

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**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**

**March 31, 2004 and 2003**

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**1. Nature of Operations**

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Emerald Bay Energy Inc. (the "Company") was incorporated under the Business Corporations Act of Alberta on May 9, 1997. The Company is engaged in the exploration for and development of petroleum and natural gas properties principally in Alberta and is developing a lateral drainhole drilling technology.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. While the Company has approximately \$426,242 of working capital, the Company is committed to spending \$1.2 million in flow through share obligations for oil and gas exploration in 2004, therefore they will need to be able to generate cash flow, use available bank lines or obtain additional financing. These statements also assume the collection of the \$215,735 long term portion of the amounts due from related parties (Note 7). As discussed in Note 10(b), the Company is defending certain Alberta Royalty tax re-assessments which, if unsuccessful, could have a serious impact on the Company's cash flows.

Management are committed to raising additional capital to meet exploration and operating obligations. While management has been successful in the past surrounding financing, there is no assurance that sufficient funds will be raised in the future.

The Company's ability to continue as a going concern is dependent upon the Company continuing to achieve profitable results, the ability to continue to raise capital for oil and gas exploration and a successful resolution of the tax appeals. Future lateral drainhole drilling operations are dependent on successful testing results and access to additional funding.

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**2. Summary of Significant Accounting Policies**

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The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgement with reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

a) Property and equipment

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are initially capitalized. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling and overhead charges directly related to acquisition and exploration activities.

Costs capitalized, together with the costs of production equipment, are depleted on the unit-of-production method based on the estimated gross proved reserves. Petroleum products and reserves are converted to equivalent units of natural gas at approximately 6,000 cubic feet to 1 barrel of oil.

**March 31, 2004 and 2003**

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**2. Summary of Significant Accounting Policies - continued**

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b) Property and equipment - continued

Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

Proceeds from the sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion.

In applying the full cost method, the Company calculates a ceiling test whereby the carrying value of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. The Company's risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying would be recorded as a permanent impairment.

Furniture and equipment are carried at cost and amortized over the estimated useful lives of the asset on a straight-line basis over three to five years.

c) Joint venture operations

The majority of the Company's petroleum and natural gas exploration activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

d) Asset retirement obligations

In March 2003, the Canadian Institute of Chartered Accountants ("CICA") introduced new recommendations for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Effective fiscal 2003 the Company adopted this standard with retroactive restatement of prior periods. This standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or normal use for the assets and requires that a liability for an asset retirement obligation be recognized when incurred, recorded at fair value and classified as a liability in the balance sheet. When the liability is initially recorded, the entity will capitalize the net present value of the cost and increase the carrying value of the related long-lived asset. Asset retirement obligations represent future liabilities, and, as a result, accretion expense will be accrued on this liability until the obligation is satisfied. At the same time, the capitalized cost will be depleted over the estimated useful life of the related asset. At settlement date, the entity will settle the obligation for its recorded amount or recognize a gain or loss upon settlement.

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**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**

**March 31, 2004 and 2003**

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**2. Summary of Significant Accounting Policies - continued**

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e) Revenue recognition

Revenue associated with the sale of crude oil, natural gas and natural gas liquids is recognized when title passes to the purchaser, normally at the pipeline delivery point for natural gas, and at the wellhead for crude oil. Revenue recorded is net of transportation costs.

f) Flow-through equity instruments

Expenditure deductions for income tax purposes related to exploratory activities funded by flow-through share/warrants arrangements are renounced to investors in accordance with income tax legislation. A future tax liability is recognized upon the renunciation of tax pools and share capital is reduced by the estimated costs of the renounced tax deductions. The Company has early adopted the new accounting standard, EIC 146, in tax affecting the flow through shares before renunciations are effected.

g) Financial instruments

The Company carries a number of financial instruments. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

The Company periodically utilizes custom financial instruments to reduce its exposure to fluctuations in commodity prices. Such instruments are not used for trading purposes. Gains and losses on commodity price instruments are included in oil and gas sales on settlement.

h) Measurement uncertainty

The amounts recorded for depletion and amortization of petroleum and natural gas properties and equipment and the provision for asset retirement obligations are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes and estimates in future periods could be significant.

The financial statements include accruals based on the terms of existing joint venture agreements. Due to varying interpretations of the definition of terms in these agreements the accruals made by management in this regard may be significantly different from those determined by the Company's joint venture partners. The effect on the financial statements resulting from such adjustments, if any, will be reflected prospectively.

i) Future income taxes

The liability method is used in accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and measured using substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

j) Cash and short-term investments

Cash and short-term investments include bank balances and all highly liquid instruments purchased with an original maturity of three month or less.

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**March 31, 2004 and 2003**

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**2. Summary of Significant Accounting Policies – continued**

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k) Stock based compensation plan

Effective January 1, 2003, the Company prospectively adopted the new Canadian accounting standard with respect to stock based compensation. The standard requires that the fair value method of accounting be applied for stock options awarded to directors, officers and employees after January 1, 2003. Compensation expense is recorded over the vesting period using the estimated fair value of the option on the grant date. Consideration paid on the exercise of stock options is recorded as share capital.

l) Per share amounts

Basic earnings (loss) per common share per common share are computed by dividing earnings (loss) by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments, in accordance with new standards approved by the Canadian Institute of Chartered Accountants.

m) License fee

License fee relates to patent rights of certain lateral drainhole drilling technology. Commencing in 2003 this license fee will be amortized over the remaining life of the patent (17 years). If the license fee is determined not to have value, it will be written off in the period the determination is made.

n) Research and development

The Company is involved in the research, development and ultimate production of oil field tools. To date, all direct and indirect costs associated with the development of these tools have been expensed as incurred. The Company will commence capitalization and deferral of these costs once technological feasibility is established and criteria for deferral are met.

Investment tax credits are accrued when qualifying expenditures are made and there is reasonable assurance that the credits will be realized. The Company accounts for the investment tax credits using the cost reduction method.

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**3. Change in Accounting Policy**

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Effective December 31, 2003, the Company adopted Accounting Guideline 16 Oil and Gas Accounting – Full Cost. This Guideline deals with the application of the full cost method of accounting for oil and gas exploration and development activities. Had the Company not adopted the Guideline, upon application of the ceiling test the Company's carrying value would not have been in excess of the ceiling value.

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**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**

**March 31, 2004 and 2003**

**4. Property and Equipment**

	<u>March 31, 2004</u>			<u>December 31, 2003</u>		
	<u>Cost</u>	<u>Accumulated Depletion and Amortization</u>	<u>Net Book Value</u>	<u>Cost</u>	<u>Accumulated Depletion and Amortization</u>	<u>Net Book Value</u>
Petroleum and natural gas properties	\$ 1,381,567	\$ 627,096	\$ 754,471	\$ 1,191,970	\$ 600,350	\$ 591,350
Furniture and equipment	<u>63,616</u>	<u>37,355</u>	<u>26,261</u>	<u>62,370</u>	<u>35,600</u>	<u>26,770</u>
	<u>\$ 1,445,183</u>	<u>\$ 664,451</u>	<u>\$ 780,732</u>	<u>\$ 1,254,340</u>	<u>\$ 635,950</u>	<u>\$ 618,390</u>

**5. Asset Retirement Obligation**

The Company adopted the CICA's new recommendation on asset retirement obligations ("ARO") for fiscal 2003, with retroactive restatement of prior periods. At the date of drilling/acquisition the Company identified obligations related to oil and gas properties and recorded a liability equal to the present value of expected future assets retirement obligations. The total future ARO was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of its total ARO to be \$63,839 as at March 31, 2004 based on a total future liability of \$160,031 and incorporated the Company's credit-adjusted risk-free interest rate of 7.5%. These payments are expected to be made over the next 10 years.

The following table reconciles the company's asset retirement obligations for the three months ended March 31, 2003 and 2004:

	<u>2004</u>	<u>2003</u>
Asset retirement obligation, beginning of period	\$ 61,204	\$ 19,517
New liabilities incurred	-	37,634
Liabilities settled	-	-
Accretion expense	<u>2,635</u>	<u>1,013</u>
Asset retirement obligation, end of period	\$ 63,839	\$ 57,164

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**

**March 31, 2004 and 2003**

**6. Bank Loan**

The Company has a \$525,000 (2003 - \$525,000) revolving production loan facility, of which \$nil (2003 - \$nil) plus accrued interest, has been drawn at March 31, 2004. Interest is calculated at the bank's prime rate plus 1.5% (2003 – prime rate plus 1.5%).

Security for the loan consists of a revolving line of credit agreement, a general security agreement over all present after acquired property, a \$2 million debenture at the bank prime rate plus 2% over all oil and gas properties and an assignment of any long-term contracts.

**7. Due From Related Parties and Related Party Transactions**

a) The following amounts are due by related parties:

	<u>Mar 31,2004</u>	<u>Dec 31,2003</u>
<b>Current assets – due from related parties</b>		
Loan due from president (i)	<u>\$ 13,565</u>	<u>\$ 12,282</u>
<b>Due from related parties</b>		
Loan due from officer (ii)	\$ 14,135	\$ 13,523
Note receivable from officer (iii)	<u>205,261</u>	<u>202,212</u>
	<u>\$ 219,396</u>	<u>\$ 215,735</u>

(i) Loan due from president

During 2001, the Company's president who before 2002, had never drawn a salary from the Company, received loan advances of \$70,490 to assist him in his relocation from the United States. This loan is repayable by December 2004 and is secured by shares of the Company owned by the president and a working capital interest in certain oil and gas properties. The value of the security provided to the Company under the terms of the loan agreement at both March 31, 2004 and December 31, 2003 exceeds the book value of the Loan. The loan accrues interest at the bank prime plus 0.5% per annum and is repayable in equal annual instalments. Subsequent to the period-end, this loan has been paid in full.

(ii) Loan due from officer

This loan is unsecured, non interest bearing, and has no specified terms of repayment. The amount due is for expenses paid by the Company on the officer's behalf. As the amount of the loan is equal to the cost of the expenses; the carrying value approximates the fair value of the loan.

(iii) Note receivable from officer

Promissory note bearing interest at 3% per annum and repayable by December 31, 2007. The note is secured by 393,000 common shares of the Company and a personal guarantee from another related officer of the Company. The value of the security provided to the Company at both March 31, 2004 and December 31, 2003 exceeds the book value of the promissory note.

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**

**March 31, 2004 and 2003**

**8. Equity Instruments**

- a) Authorized  
Unlimited number of common voting shares  
Unlimited number of preferred shares, issuable in series.

b) Issued

	<b>March 31, 2004</b>	
	<b>Number of</b>	<b>Amount</b>
	<b>Shares</b>	<b>Amount</b>
<b>Balance, beginning of period</b>	<b>11,708,304</b>	<b>\$ 1,949,425</b>
Issued pursuant to private placements (Note 7(f))		
Repurchase of common shares	-	-
Flow through shares (Note 7(g))		
Issue costs		7,165
Tax effect		
<b>Balance, end of period</b>	<b>11,708,304</b>	<b>\$ 1,949,425</b>
<b>Weighted average number of shares outstanding</b>	<b>11,708,304</b>	

c) Stock options

The Company has established a stock option plan whereby the Company may grant directors, officers, employees and consultants up to a maximum of 10% of the issued common shares. The exercise price of each option equals the market price of the Company's shares on the date of grant. Stock options vest evenly over a 3-year period from the date of grant and expire 5 years after the date of grant.

	<b>March 31, 2004</b>		<b>December 31, 2003</b>	
	<b>Number of</b>	<b>Weighted</b>	<b>Number of</b>	<b>Weighted</b>
	<b>options</b>	<b>average</b>	<b>options</b>	<b>Average</b>
		<b>exercise</b>		<b>Exercise</b>
		<b>price</b>		<b>price</b>
Stock options, beginning of period	620,000	\$ 0.22	620,000	\$ 0.22
Granted	550,000	0.32		
Stock options outstanding, end of period	1,170,000	\$ 0.27	620,000	\$ 0.22
Exercisable, end of period	541,396	\$ 0.22	541,396	\$ 0.22

**Emerald Bay Energy Inc.  
Notes To Financial Statements**

**March 31, 2004 and 2003**

**8. Equity Instruments – continued**

The stock options outstanding as at March 31, 2004 are as follows:

<b>Exercise prices</b>	<b>Options outstanding</b>			<b>Options exercisable</b>	
	<b>Options outstanding</b>	<b>Weighted average remaining term (years)</b>	<b>Weighted average exercise price</b>	<b>Options exercisable</b>	<b>Weighted average exercise price</b>
\$0.19	117,904	4.0	\$ 0.19	39,300	\$ 0.19
\$0.21	302,096	1.0	0.21	302,096	0.21
\$0.25	200,000	1.2	0.25	200,000	0.25
\$0.32	550,000	5.0	0.32		0.32
	<u>1,170,000</u>	<u>3.2</u>	<u>\$ 0.22</u>	<u>541,396</u>	<u>\$ 0.22</u>

The stock options outstanding as at December 31, 2003 are as follows:

<b>Range of exercise prices</b>	<b>Options outstanding</b>			<b>Options exercisable</b>	
	<b>Options outstanding</b>	<b>Weighted average remaining term (years)</b>	<b>Weighted average exercise price</b>	<b>Options exercisable</b>	<b>Weighted average exercise price</b>
\$0.19	117,904	4.0	\$ 0.19	39,300	\$ 0.19
\$0.21	302,096	1.0	0.21	302,096	0.21
\$0.25	200,000	1.2	0.25	200,000	0.25
	<u>620,000</u>	<u>1.6</u>	<u>\$ 0.22</u>	<u>541,396</u>	<u>\$ 0.22</u>

d) Diluted earnings (loss) per share

No diluted earnings (loss) per share figures have been disclosed as such would be anti-dilutive.

e) Flow through shares

Pursuant to a Prospectus dated November 4, 2003, the Company issued 3,826,076 flow through common shares for gross proceeds of \$1,339,127 (\$0.35 per share). The Company is committed to spend these flow through funds by the end of 2004 on qualifying expenditures.

**9. Income Taxes**

The effective rate of income tax varies from the statutory rate as follows:

	<u>2004</u>
Combined tax rate	<u>40.74%</u>
Expected income tax provision at statutory rate	\$ ( 38,800)
Non-deductible crown charges	15,500
Resource allowance	(1,000)
Non-taxable Alberta royalty tax credits	(1,000)
Other	( 9,000)
Actual income tax provision	<u>\$ ( 34,300)</u>

**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**

**March 31, 2004 and 2003**

Subject to confirmation by income tax authorities, the Company has the following approximate undeducted tax pools:

	<b>Mar 31, 2004</b>	Dec 31, 2003
Cumulative Canadian Oil and Gas Property Expenses	<b>\$ 255,000</b>	\$ 250,000
Cumulative Canadian Development Expenses	<b>18,000</b>	18,000
Foreign Exploration and Development Expenses	<b>260,000</b>	260,000
Undepreciated Capital Cost	<b>165,000</b>	162,000
Share issue costs	<b>345,000</b>	360,000
Scientific Research and Experimental Development	<b>180,000</b>	140,000
Attributed Canadian Royalty Income	<b>\$ 760,000</b>	\$ 715,000

These pools are deductible from future income at rates prescribed by the Canadian Income Tax Act.

The components of the Company's future income tax asset (liability) are a result of the origination and reversal of temporary differences and are comprised of the following:

<b>Nature of temporary differences</b>	<b>Mar 31, 2004</b>	Dec 31, 2003
Property and equipment, ARO, License Fee	<b>\$ (27,000)</b>	\$ 24,000
Share issue costs	<b>115,000</b>	120,000
Scientific Research and Experimental Development	<b>60,000</b>	47,000
Investment tax credits	<b>73,000</b>	71,000
Attributed Canadian royalty income	<b>87,000</b>	82,000
Unexpended flow-through funds	<b>(420,000)</b>	(490,000)
<b>Future income tax (liability) asset</b>	<b>\$ (112,000)</b>	<b>\$ (146,000)</b>

**10. Contingencies**

a) In 2000, the Company commenced legal action against a joint venturer claiming underpayment of a net profit royalty. The joint venturer has issued a counterclaim for an unspecified amount, claiming an overpayment of this royalty. In the opinion of management, the outcome of these claims is not determinable at this time.

b) In 2003, Alberta Revenue issued Notices of Reassessment to the Company disallowing claims for Alberta Royalty Tax Credits ("ARTC") made in the Alberta Corporate Income tax returns for the years 1998 – 2001. The Company disagrees with these reassessments and the Company

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**Emerald Bay Energy Inc.**  
**Notes To Financial Statements**

**March 31, 2004 and 2003**

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has filed a Notice of Objection with Alberta Revenue. No provision has been made in these financial statements for the repayment of these ARTC's, if any, which may be determined to be payable. Should the Company be unsuccessful in defending its position, a liability of approximately \$281,000 of previously received ARTC's, including accrued interest, would arise. In addition, the Company would have to repay \$34,419 of the 2002 ARTC installment claim previously received. These transactions would have a material effect on the Company's financial position. The final outcome of this matter is not determinable at this time.

In view of the above matter, management has not accrued any further ARTC's relating to the oil and gas wells in question.

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**11. Stock Compensation**

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On March 29, 2004 the Company granted 550,000 stock options at a price of \$0.32 per share, a three year vesting period and a 5 year term. The Company recorded compensation expense when stock options were issued to employees, as disclosed in Note 2(k).

The fair value of share options was estimated using the Black-Scholes option-pricing model with the following assumptions: Dividend yield (Nil), Expected volatility (0.55), risk-free interest rate (3.4%), and weighted average life of 5 years. The estimated value of \$88,000 is being amortized to income over the 3 year vesting period

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**12. Subsequent Events**

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- (a) In March 2004, the Company entered into a financing agreement with Dominick and Dominick Securities Inc. (the "Agent") to assist the Company raise up to \$2 million consisting of \$1 million of flow through shares at a price of \$0.385 per share and \$1million of common shares at a price of \$0.35 per share. The Company will pay the Agent a commission of 7% of the proceeds and issue the Agent warrants equal to 10% of the number of shares sold. This financing agreement expires on May 31, 2004 and as such, there is no assurance that this financing will be successful.
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**13. Comparative Figures**

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Certain of the prior year's figures have been reclassified to conform with current presentation.

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