

**CanBaikal Resources Inc.**  
**Financial Statements**  
For the year ended December 31, 2003

**Contents**

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<b>Auditors' Report</b>	<b>2</b>
<b>Financial Statements</b>	
<b>Balance Sheet</b>	<b>3</b>
<b>Statement of Income and Deficit</b>	<b>4</b>
<b>Statement of Cash Flows</b>	<b>5</b>
<b>Notes to Financial Statements</b>	<b>6 - 16</b>



Driving growth

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## Auditors' Report

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**To the Directors of  
CanBaikal Resources Inc.**

We have audited the balance sheet of CanBaikal Resources Inc. as at December 31, 2003 and the statements of income and deficit and cash flows for the year 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*BDO Dunwoody LLP*  
**Chartered Accountants**

Calgary, Alberta  
May 24, 2004

**CanBaikal Resources Inc.**  
**Balance Sheet**  
(In Canadian Dollars)

As at December 31 2003 2002

**Assets**

**Current**

Cash	\$ 994,415	\$ 276,686
Accounts receivable	787,963	3,084
Inventory	139,694	-
Prepays and deposits	<u>709,034</u>	<u>412,108</u>
	<b>2,631,106</b>	<b>691,878</b>

Taxes recoverable (Note 6(g)) 1,465,184 405,262

Property and equipment (Note 4) 42,576 90,819

Petroleum properties and equipment (Note 5) 13,058,645 6,838,596

Future tax asset (Note 6(a)) 2,619,233 3,042,142

**\$ 19,816,744 \$ 11,068,697**

**Liabilities and Shareholder's Equity**

**Current**

Accounts payable and accrued liabilities	\$ 2,500,150	\$ 730,629
Short-term loans (Note 9)	1,081,897	444,961
Income taxes payable	155,621	-
Current portion of long term debt (Note 8)	<u>3,877,200</u>	<u>-</u>
	<b>7,614,868</b>	<b>1,175,590</b>

Long-term debt (Note 8) 3,152,678 -

Provision for future site restoration costs (Note 2 (h)) 16,061 10,144

Due to affiliated company (Note 12) 2,970,361 3,927,953

**13,753,968 5,113,687**

**Shareholders' Equity**

Share capital (Note 7)	10,645,903	10,645,903
Deficit	<u>(4,583,127)</u>	<u>(4,690,893)</u>
	<b>6,062,776</b>	<b>5,955,010</b>

**\$ 19,816,744 \$ 11,068,697**

Approved on behalf of the Board:

 Director

\_\_\_\_\_  
Director

**CanBaikal Resources Inc.**  
**Statement of Income and Deficit**  
**(In Canadian Dollars)**

For the year ended December 31	2003	2002
<b>Production revenue net of mineral taxes and duties</b>	<b>\$ 5,881,803</b>	<b>\$ 2,445,834</b>
<b>Expenses</b>		
Operating	2,686,921	827,584
General and administrative	1,238,614	1,445,803
Interest	526,080	88,738
Amortization, depletion and site restoration	1,554,793	733,963
	<u>6,006,408</u>	<u>3,096,088</u>
<b>Income (loss) from operations</b>	<b>(124,605)</b>	<b>(650,254)</b>
<b>Other items</b>		
Other income	41,711	-
Gain from foreign exchange	769,190	13,754
	<u>810,901</u>	<u>13,754</u>
<b>Income (loss) before income taxes</b>	<b>686,296</b>	<b>(636,500)</b>
<b>Income taxes (Note 6(b))</b>		
Foreign taxes	155,621	54,886
Future taxes (recovery)	422,909	(220,400)
	<u>578,530</u>	<u>(165,514)</u>
<b>Net income (loss) for the year</b>	<b>107,766</b>	<b>(470,986)</b>
Deficit, beginning of year	<u>(4,690,893)</u>	<u>(4,219,907)</u>
<b>Deficit, end of year</b>	<b>\$ (4,583,127)</b>	<b>\$ (4,690,893)</b>

**CanBaikal Resources Inc.**  
**Statement of Cash Flows**  
**(In Canadian Dollars)**

<b>For the year ended December 31</b>	<u><b>2003</b></u>	<u><b>2002</b></u>
<b>Cash flows from operating activities</b>		
Net income (loss) for the year	\$ 107,766	\$ (470,986)
Items not involving cash:		
Amortization, depletion and site restoration	1,554,793	733,963
Future taxes	422,909	(220,400)
Foreign exchange loss on cash held in a foreign currency	<u>62,289</u>	<u>-</u>
	<b>2,147,757</b>	<b>42,577</b>
Changes in non-cash working capital		
Accounts receivable	(784,879)	(99,145)
Inventory	(139,694)	-
Prepaid and deposits	(296,926)	(373,562)
Taxes recoverable	(1,059,922)	(11,748)
Accounts payable and accrued liabilities	1,769,521	204,556
Short-term loans	636,936	187,751
Income taxes payable	<u>155,621</u>	<u>-</u>
	<b>2,428,414</b>	<b>(49,571)</b>
<b>Cash flows from financing activities</b>		
Advances on long-term debt	7,029,878	-
Repayments to (advances from) affiliated companies	<u>(957,592)</u>	<u>4,100,403</u>
	<b>6,072,286</b>	<b>4,100,403</b>
<b>Cash flows from investing activities</b>		
Additions to petroleum, natural gas properties and equipment	(7,708,168)	(3,870,356)
Property and equipment additions	(21,975)	(7,050)
Proceeds from sale of property and equipment	<u>9,461</u>	<u>11,621</u>
	<b>(7,720,682)</b>	<b>(3,865,785)</b>
<b>Foreign exchange loss on cash held in a foreign currency</b>	<u><b>(62,289)</b></u>	<u><b>-</b></u>
<b>Increase (decrease) in cash for the year</b>	<b>717,729</b>	<b>185,047</b>
Cash, beginning of year	<u>276,686</u>	<u>91,639</u>
<b>Cash, end of year</b>	<b>\$ 994,415</b>	<b>\$ 276,686</b>

December 31, 2003

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## 1. Nature of Operations and Business Risks

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The Company is incorporated under the laws of Alberta and is engaged primarily in the exploration for and development of petroleum and natural gas in Russia. Since inception, the efforts of the Company have been devoted to the acquisition of exploration and production licenses and the development thereof. On January 28, 2002, the Company was acquired by a private company incorporated under the laws of Alberta. Effective January 1, 2004, the Company amalgamated with its parent company, C.B. Acquisition Ltd. The amalgamated company will be continued under the name CanBaikal Resources Inc. The ultimate parent company is a Cyprus company whose principal business is the trading of oil and oil products from the Russian Federation.

All of the Company's petroleum and natural gas operations are based in Russia as a result of the sale of the Canadian properties in the prior year. The political situation, income tax legislation, banking regulations and the general operating environment are changing continuously as Russia makes the transition from a command to a market oriented economy. The Company's operations and financial position will continue to be affected by Russian political developments including the application and interpretation of existing and future legislation and regulations pertaining to petroleum and natural gas exploration and production, imports, exports and income tax. It is possible that these developments may have a significant impact on the Company's ability to continue operations. The likelihood of such developments is not determinable. Management is continuously monitoring potential developments and changes as they occur.

Continuation of the Company as a going concern is dependent upon obtaining additional capital and/or achieving profitable operations. The financial statements do not include any adjustments relating to the realization of assets and liquidation of liabilities that might be necessary should the Company be unable to continue as a going concern.

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## 2. 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

Amortization of property and equipment is computed using the declining balance method using the following annual rates:

Computer hardware	30%
Office equipment and leaseholds	20%
Vehicles	30%

In the year of acquisition one-half of the normal amortization is recorded.

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December 31, 2003

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**2. Significant Accounting Policies - continued**

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(b) Petroleum properties 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 and amortized on the unit-of-production method based on the estimated gross proved reserves as determined by independent petroleum engineers. Petroleum products and reserves are converted to a common unit of measure, using 6 MCF of natural gas to 1 barrel of oil.

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 a 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 by more than 20%.

The Company applies an impairment test ("ceiling test") to determine if capitalized costs are not recoverable and exceed their fair value. Capitalized costs are not recoverable if they are greater than estimated undiscounted cash flows from future production of proven reserves plus the cost (net of impairment) of unproved properties. Commodity prices used in calculating estimated cash inflows are based on quoted benchmark prices in the futures market. Costs used in estimating cash outflows are based on expected future production and other costs and include abandonment and site restoration costs. An impairment loss is recognized if capitalized costs are greater than their recoverable amount. The impairment loss is measured as the amount by which capitalized costs exceed the fair value of proved and probable reserves plus the cost (net of impairment) of unproved properties. Fair value is determined based on the present value of future cash flows, after deducting abandonment and site restoration costs, discounted at a risk-free interest rate. Any impairment loss is charged to earnings.

(c) Financial instruments

The Company carries a number of financial instruments as detailed on the balance sheet. 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.

(d) Foreign currency translation

Accounts denominated in foreign currency are translated into Canadian dollars using the year end rate of exchange for monetary assets and liabilities and the rate of exchange in place on the transaction date for non-monetary assets and liabilities and revenues and expenses. Foreign currency gains and losses are charged to operations.

(e) Inventories

Inventories of petroleum products, operating supplies and raw materials are valued at the lower of cost and net realizable value.

December 31, 2003

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**2. Significant Accounting Policies - continued**

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(f) Income taxes

The Company uses the liability method of tax allocation 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.

(g) Measurement uncertainty

The amounts recorded for depletion and amortization of petroleum and natural gas properties and equipment and the provision for site restoration 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 consolidated financial statements of changes and estimates in future periods could be significant.

The financial statements include amounts based on the terms of the interpretation of existing tax legislation in Russia (Note 1). 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 taxation authorities. The effect on the financial statements resulting from such adjustments, if any, will be reflected prospectively.

(h) Site restoration costs

A provision for site restoration costs is made when restoration requirements are established and costs can be reasonably estimated. The site restoration costs are accrued on the basis of actual production. The accrual is based on management's best estimate of these future costs on the ratio of actual production to proved producing reserves. Costs attributable to these commitments and contingencies are expected to be incurred over an extended period of time and are to be funded mainly from the Company's cash provided by operating activities. Although the ultimate impact of these matters on net earnings cannot be determined at this time, it could be material for any one-quarter or year.

(i) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, bank balances and short-term investments with maturities of three months or less.

(j) Revenue recognition

Revenue is recognized on the sale of production and is net of transportation costs when title passes from the Company to its customer.

(k) Stock-based compensation plan

Stock Based Compensation and Other Stock Based Payments - In September 2003, the CICA issued an amendment to section 3870 "Stock based compensation and other stock based payments". The amended section is effective for fiscal years beginning on or after January 1, 2004. The amendment requires that companies measure all stock based payments using the fair value method of accounting and recognize the compensation expense in their financial statements. The Company implemented this amended standard in 2003 in accordance with the early adoption provisions of the standard. Per the transitional provisions, early adoption requires that compensation expense be calculated and recorded in the income statement for options and warrants issued on or after January 1, 2003. There has been no impact of adopting the new accounting for stock based compensation on the consolidated balance sheets and statements of earnings.

**CanBaikal Resources Inc.**  
**Notes to Financial Statements**  
(In Canadian Dollars)

December 31, 2003

**3. Reporting Change in Accounting Policy**

The Company has early adopted the new CICA Accounting Guideline AcG - 16, "Oil and Gas Accounting - Full Cost". The new guideline modifies how the ceiling test is performed, and requires cost centres be tested for recoverability using undiscounted future cash flows from proved reserves which are determined by using forward indexed prices. When the carrying amount of a cost centre is not recoverable, the cost centre would be written down to its fair value. Fair value is estimated using accepted present value techniques which incorporate risks and other uncertainties when determining expected cash flows. Additional disclosures are also required as provided in Note 5. There is no impact on the Company's reported financial results as a result of applying the new Accounting Guideline AcG - 16.

**4. Property and Equipment**

	<u>2003</u>		<u>2002</u>	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Computer hardware	\$ 101,959	\$ 88,842	\$ 91,780	\$ 69,525
Office equipment and leaseholds	116,568	116,568	121,566	86,182
Vehicles	123,976	94,517	116,643	83,463
	<b>\$ 342,503</b>	<b>\$ 299,927</b>	<b>\$ 329,989</b>	<b>\$ 239,170</b>
Net book value	<b>\$ <u>42,576</u></b>		<b>\$ <u>90,819</u></b>	

During the year the Company wrote-off \$36,067 of property and equipment, which has been included in amortization expense.

**5. Petroleum Properties and Equipment**

	<u>2003</u>		<u>2002</u>	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Capitalized costs	\$ 15,852,452	\$ 2,793,807	\$ 8,144,296	\$ 1,305,700
	<b>\$ <u>13,058,645</u></b>		<b>\$ <u>6,838,596</u></b>	

During 2003, \$Nil (2002 - \$822,652) of overhead expenses directly related to exploration and development activities were capitalized.

Future capital expenditures of \$31,779,000 (2002 - \$14,700,000), as estimated by independent engineers, relating to the development of proved non-producing reserves have been included in costs subject to depletion. As at December 31, 2003, costs of acquiring unproved properties in the amount of approximately \$905,000 (2002 - \$24,000) were excluded from depletable costs.

An impairment test calculation was performed on the Company's property, plant and equipment at December 31, 2003 in which the estimated undiscounted future net cash flows associated with the gross proved reserves exceeded the carrying amount of the Company's property, plant and equipment.

**CanBaikal Resources Inc.**  
**Notes to Financial Statements**  
**(In Canadian Dollars)**

December 31, 2003

**5. Petroleum Properties and Equipment - continued**

The following table outlines benchmark prices used in the impairment test at December 31, 2003:

Year	Siberian Blend US\$/BBL	Pipeline Transportation Fee US\$/BBL	Export Wellhead Oil Price US\$/BBL	Domestic Wellhead Oil Price US\$/BB Including VAT	Domestic to Export Wellhead Price Ratio
2004	30.25	2.00	28.25	19.78	70%
2005	24.96	2.03	22.93	17.20	75%
2006	22.92	2.06	20.86	16.69	80%
2007	20.89	2.09	18.79	15.04	80%
2008	20.85	2.12	18.72	14.98	80%
Thereafter (inflation %)	1.5%/yr	1.5%/yr	1.5%/yr	1.5%/yr	N/A

**6. Income Taxes**

(a) Future income tax asset consists of the following temporary differences:

	<u>2003</u>	<u>2002</u>
Petroleum and natural gas properties	\$ 2,018,189	\$ 2,065,582
Non-capital loss carry-forwards	361,318	865,267
Share issue and finance costs	106,626	44,097
Foreign tax credits	75,775	-
Eligible capital expenditures	57,325	67,196
	<u>\$ 2,619,233</u>	<u>\$ 3,042,142</u>

(b) The actual income tax provision differs from the expected amount calculated by applying the Canadian combined federal and provincial corporate income tax rate to loss before income taxes. The major components of these differences are explained as follows:

Income (loss) before taxes	\$ 686,296	\$ (636,500)
Corporate income tax rate	39%	41%
Expected tax provision (recovery)	267,655	(260,965)
Increase (decrease) in future income taxes resulting from:		
Financing fees	(86,400)	-
Non-deductible professional fees	-	82,642
Other	9,104	123
Rate adjustment	232,550	120,900
Valuation allowance	-	(163,100)
Foreign taxes	155,621	54,886
	<u>\$ 578,530</u>	<u>\$ (165,514)</u>

(c) For income tax purposes, subject to approval by taxation authorities, the Company has losses in the approximate amount of \$1,003,000 (2002 - \$2,205,000) available to be carried forward to reduce taxable income for future years. These losses expire as follows:

2006	\$ 663,500
2007	293,100
2009	46,400
	<u>\$ 1,003,000</u>

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**CanBaikal Resources Inc.**  
**Notes to Financial Statements**  
**(In Canadian Dollars)**

December 31, 2003

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**6. Income Taxes (continued)**

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- (d) The Company has available the following amounts which may be deducted, at the annual rates indicated, in determining taxable income for Canadian income tax purposes of future years:

		<u>2003</u>	<u>2002</u>
Undepreciated capital costs	30% - 100%	\$ 2,850,000	\$ 2,093,000
Foreign exploration and development expenses	10%	\$ 14,935,000	\$ 10,065,000
Cumulative eligible capital	7%	\$ 159,000	\$ 171,000
Financing and share issue costs	20%	\$ 296,000	\$ 112,000

The Company is required to file tax returns in each of the jurisdictions in which it operates. The prime operating jurisdictions are Canada and Russia.

- (e) The Company has approximately \$210,000 of foreign tax credits available to reduce taxable income from taxable income generated as a result of its operations in Russia. The tax credits begin to expire in 2008.
- (f) During 2002, the Russian taxation authority reassessed the Company's 2000 income tax return and adjusted income taxes by \$54,886.
- (g) The amount of taxes recoverable represents VAT recoverable, which is a Russian Value Added Tax. The balance in the account with the Government can only be offset against future liabilities, and never refunded in cash. The amount recorded as an long term asset is based on the interpretation of existing tax legislation in Russia. The accrual made by management may be significantly different from that determined by the taxation authorities and as a result is subject to measurement uncertainty. The effect on the financial statements resulting from such adjustments, if any, will be reflected prospectively.
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**CanBaikal Resources Inc.**  
**Notes to Financial Statements**  
(In Canadian Dollars)

December 31, 2003

**7. Share Capital**

Authorized:

- Unlimited common shares, without par value
- Unlimited preferred shares, issuable in series

Issued and outstanding common shares:

	2003		2002	
	Number of Shares	Amount	Number of Shares	Amount
Balance, beginning of year	\$ 28,573,616	\$ 10,645,903	27,351,116	\$ 10,248,453
Convertible debentures exercised, net	-	-	62,500	25,000
Options exercised	-	-	1,160,000	372,450
Balance, end of year	<u>28,573,616</u>	<u>\$ 10,645,903</u>	<u>28,573,616</u>	<u>\$ 10,645,903</u>

2002

On January 28, 2002, all the shares of the Company were acquired by a private company incorporated under the laws of Alberta. The ultimate parent company is a Cyprus company whose principal business is the trading of oil and oil products from the Russian Federation.

On January 14, 2002 the holder of a convertible debenture in the amount of \$25,000 elected to convert the debenture to 62,500 common shares.

On January 28, 2002 1,160,000 options were exercised and converted to common shares.

Stock options

The following is the distribution of stock options:

	2003		2002	
	Number of Options	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Stock options outstanding, beginning of year	-	\$ -	1,830,000	\$ 0.61
Exercised	-	-	(1,160,000)	0.33
Cancelled	-	-	(670,000)	1.11
Stock options outstanding, end of year	<u>-</u>	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>

Pursuant to the Offer to Purchase agreement ("the Agreement") dated December 21, 2001, 1,160,000 stock options were exercised and converted into common shares and 670,000 options were cancelled on January 28, 2002. As a result, no options were outstanding at December 31, 2003 or 2002. The proceeds on the exercise of options were non-cash transactions and excluded from the statement of cash flows, as the Company never received cash proceeds on the exercise of the options due to the company who acquired the Company making a payment of the market price as determined in the Agreement over the strike price of the option directly to the option holder.

**CanBaikal Resources Inc.**  
**Notes to Financial Statements**  
(In Canadian Dollars)

December 31, 2003

**8. Long Term Debt** 2003 2002

US dollar loan from Select Energy Trading GmbH for the purposes of financing of working capital, with the interest rate of 1-month LIBOR plus a margin of 6.25%, with an effective interest rate of 7.6%, due on February 28, 2005, with monthly payments of US\$250,000 plus interest. As a condition of the loan the Company has committed to sell 5,000 mtons per month of its oil production eligible for export to the lender at the prevailing market price until February 2005.

\$ 4,523,400 \$ -

Loan from TD Petrotek, a company controlled by the ultimate shareholders, for the purposes of financing of working capital, non-interest bearing, repayable in rubles and due in January 2008 (Note 13(b)).

525,587 -

Loan from Petrotek Pererabotka, a company controlled by the ultimate shareholders for the purposes of financing of working capital and development of new wells, non-interest bearing, repayable in rubles and due in July 2008 (Note 13(b)).

1,980,891 -  
7,029,878 -

Less: current portion

(3,877,200) -

Long-term debt

\$ 3,152,678 \$ -

Based on the exchange rates as of December 31, 2003, estimated principal repayments (Note 13(a)) are due in the next five years as follows:

2004	\$ 3,877,200
2005	646,200
2008	<u>2,506,478</u>
	<u>\$ 7,029,878</u>

**9. Short-Term Loans** 2003 2002

Loan from TD Petrotek, a company controlled by the ultimate shareholders is unsecured, non-interest bearing and is due in December 2004 (Note 13(b)).

\$ 684,097 \$ -

Loan from Petrotek Pererabotchik, a company controlled by the ultimate shareholders, due in December 2004. Pursuant to the agreement dated February 11, 2002 and subsequently amended on December 31, 2002, the amount is unsecured and due on December 31, 2003, bore interest at 21% per annum until March 31, 2003 and thereafter bears interest at 1% per annum (Note 13(b)).

397,800 444,961  
\$ 1,081,897 \$ 444,961

**CanBaikal Resources Inc.**  
**Notes to Financial Statements**  
**(In Canadian Dollars)**

**December 31, 2003**

<b>10. Statement of Cash Flows</b>	<u><b>2003</b></u>	<u><b>2002</b></u>
(a) Interest and income taxes		
Interest paid	<u>\$ 316,283</u>	<u>\$ 2,388</u>
Income taxes paid	<u>\$ -</u>	<u>\$ 252,328</u>
(b) During 2003, the Company had the following non-cash transactions:		
(i) Issued Nil (2002 - 62,500) common shares on exercise of convertible debenture in the amount of \$Nil (2002 - \$25,000).		
(ii) Issued Nil (2002 - 1,160,000) common shares pursuant to the exercise of options by employees for \$Nil (2002 - \$372,450). The amount was settled by reduction of outstanding advances from an affiliated company		
(iii) Settled \$Nil (2002 - \$265,160) short-term loan through exchange of its interest in the Canadian oil and gas properties.		
(iv) Redeemed convertible debentures in the amount of \$Nil (2002 - \$200,000). The amount was settled by reduction of advances from an affiliated company.		
(v) Accrued \$526,080 (2002 - \$78,850) interest on short-term financing and \$300,000 (2002 - \$7,500) loan administration fee.		

**11. Related Party Transactions**

Except as noted elsewhere in these financial statements, the Company had the following transactions with related parties:

- (a) During 2003, \$Nil (2002 - \$Nil) in interest was paid to related parties with respect to the convertible debentures.
- (b) During 2003, Novation Trading Limited, the ultimate parent company (Note 1) had loaned the Company a total of \$2,690,202 (2002 - \$3,649,117). The loan is unsecured, bearing interest at 7.5% per annum and is due on December 31, 2007.
- (c) During 2003, the Company paid \$3,000 US per month for general and administrative services to a company controlled by the ultimate shareholders.
- (d) During 2003, the Company advanced \$880,496 (2002 - \$24,720) to a company controlled by the ultimate shareholders to conduct a seismic exploration program.

Except as disclosed, all related party transactions have been measured at the exchange amounts, which is the amount of consideration established and agreed to by the related parties and are similar to those negotiated with third parties.

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**CanBaikal Resources Inc.**  
**Notes to Financial Statements**  
**(In Canadian Dollars)**

**December 31, 2003**

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**12. Due to Affiliated Companies**

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The following represents balances owing to affiliated companies, related by virtue of being the parent company or the ultimate parent company:

	<u>2003</u>	<u>2002</u>
Novation Trading Limited	\$ 36,882	\$ 9,354
C.B. Acquisition Ltd.	<u>2,933,478</u>	<u>3,918,599</u>
	<u>\$ 2,970,360</u>	<u>\$ 3,927,953</u>

The amount due to Novation Trading Limited ("Novation") is unsecured, bearing interest of 10% and is due on December 31, 2007. The amount due to C.B. Acquisition Ltd. ("C.B.") has no set terms of repayment, is unsecured and non-interest bearing. As no repayments are required before December 31, 2004 the amounts have been classified as a long-term liability.

Subsequent to year end, all rights, title and interest under Loan Agreement was transferred from Novation to Cyfield and then to C.B.Acquisition Ltd.

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**13. Financial Instruments**

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As disclosed in Note 2(c), the Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to foreign currency rate risk, fair value risk, and credit risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

(a) Foreign currency rate risk

Substantially all of the Company's transactions are conducted with foreign corporations and accordingly the related financial assets and liabilities are subject to fluctuations in exchange rates. The Company does not have exposure to highly inflationary foreign currencies. It maintains bank accounts and trade accounts in U.S dollar and Russian rubles to offset purchases from the U.S. and Russia.

(b) Fair value risk

The fair value of the Company's current financial assets and liabilities is approximated by their carrying values due to the short-term nature of the items. The fair value of the Company's amounts due to and from affiliated companies have not been disclosed as reliable market information is not readily available.

(c) Credit risk

The Company is exposed to credit risk to the extent of non-performance by third parties in the payment of receivable amounts. Substantially all the Company's accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks.

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**December 31, 2003**

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**14. Commitments and Contingencies**

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- (a) Under the Russian exploration and production license agreement, the taxes and payments required to be paid by the Company include: 1% of estimated exploration, evaluation costs; 3% of the estimated exploration costs for delineation wells; 7% of the value of production; and other taxes stipulated by the authorities.
- (b) The Company is subject to various regulatory and statutory requirements relating to the protection of the environment. Any changes in these estimates will affect future earnings. Costs attributable to these commitments and contingencies are expected to be incurred over an extended period of time and are to be funded mainly from the Company's cash provided by operating activities.

The operations of the Company are complex, related tax interpretations, regulations and legislation affecting the Company are continually changing. Although the ultimate impact of these matters on net earnings cannot be determined at this time, it could be material for any one quarter or year.

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**15. Comparative figures**

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

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