

Condensed Interim Financial Statements of

ARCAN RESOURCES LTD.

Three months ended March 31, 2011 and 2010

(unaudited)

ARCAN RESOURCES LTD.

Condensed Statements of Financial Position

(000's of Canadian dollars)
(unaudited)

	Note	March 31, 2011	December 31, 2010 (note 16)	January 1, 2010 (note 16)
Assets				
Cash and cash equivalents		\$ 33,364	\$ -	\$ -
Trade and other receivables		17,037	15,610	10,012
Prepays and deposits		1,223	1,528	935
Total current assets		51,624	17,138	10,947
Property, plant and equipment	8	288,701	250,155	130,472
Exploration and evaluation assets	9	24,428	23,935	9,832
Total non-current assets		313,129	274,090	140,304
Total assets		\$ 364,753	\$ 291,228	\$ 151,251
Liabilities				
Trade and other payables		\$ 50,773	\$ 43,267	\$ 17,140
Bank loan		-	-	28,586
Fair value of commodity contracts	5	5,248	2,233	-
Total current liabilities		56,021	45,500	45,726
Bank loan	12	-	20,823	-
Convertible debentures	13	71,982	-	-
Fair value of commodity contracts	5	807	-	-
Decommissioning obligations	15	15,590	15,476	7,647
Deferred tax liabilities		4,701	2,204	4,118
Deferred flow-through share premium		-	-	107
Total non-current liabilities		93,080	38,503	11,872
Total liabilities		149,101	84,003	57,598
Equity				
Share capital	10	213,645	212,721	95,677
Share purchase loan		-	-	(100)
Contributed surplus		9,912	7,820	4,274
Equity component of convertible debentures	13	7,971	-	-
Deficit		(15,876)	(13,316)	(6,198)
Total equity		215,652	207,225	93,653
Total equity and liabilities		\$ 364,753	\$ 291,228	\$ 151,251

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

ARCAN RESOURCES LTD.

Condensed Statements of Income (Loss) and Comprehensive Income (Loss)

For the three months ended March 31,
(000's of Canadian dollars, except per share amounts)
(unaudited)

	Note	2011	2010
			(note 16)
Revenue:			
Petroleum and natural gas		\$ 18,306	\$ 8,992
Royalties		(3,822)	(2,352)
Unrealized loss on commodity contracts	5	(3,822)	-
Realized loss on commodity contracts	5	(29)	-
Other revenue		57	3
		10,690	6,643
Expenses:			
Production and operating expenses		4,468	2,387
Exploration and evaluation impairments		3	2,258
Depletion and depreciation		5,072	2,551
General and administrative expenses		2,648	1,360
Finance expenses	6	1,216	458
		13,407	9,014
Loss before income tax			
		(2,717)	(2,371)
Deferred tax reduction			
		157	244
Loss and comprehensive loss for the period			
		\$ (2,560)	\$ (2,127)
Loss per share:			
Basic	11	\$ (0.03)	\$ (0.04)
Diluted	11	\$ (0.03)	\$ (0.04)

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ARCAN RESOURCES LTD.

Condensed Statements of Changes in Equity
(000's of Canadian dollars, except share amounts)
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	Number of Common shares	Share capital	Contributed surplus	Share Purchase Loan	Equity Component of Convertible Debentures	Deficit	Total equity
Balance at January 1, 2010	47,940,060	\$ 95,677	\$ 4,274	\$ (100)	\$ –	\$ (6,198)	\$ 93,653
Issue of common shares	26,000,000	65,000					65,000
Share issue costs, net of tax of \$1,109		(3,171)					(3,171)
Warrants exercised	128,000	256					256
Options exercised	110,000	154					154
Performance options exercised	750,000	750					750
Stock-based compensation			325				325
Transfer of stock-based compensation on exercises		295	(295)				–
Net loss						(2,127)	(2,127)
Balance at March 31, 2010	74,928,060	\$ 158,961	\$ 4,304	\$ (100)	\$ –	(8,325)	\$ 154,840
Balance at January 1, 2010	47,940,060	\$ 95,677	\$ 4,274	\$ (100)	\$ –	\$ (6,198)	\$ 93,653
Issue of common shares	36,421,875	115,025					115,025
Share issue costs, net of tax of \$1,869		(5,347)					(5,347)
Warrants exercised	515,511	993					993
Options exercised	2,043,000	3,773					3,773
Performance options exercised	750,000	750					750
Stock-based compensation			5,396				5,396
Transfer of stock-based compensation on exercises		1,850	(1,850)				–
Share purchase loan repaid				100			100
Net loss						(7,118)	(7,118)
Balance at December 31, 2010	87,670,446	\$ 212,721	\$ 7,820	\$ –	\$ –	\$ (13,316)	207,225
Share issue costs, net of tax of \$3		(9)					(9)
Options exercised	430,000	705					705
Stock-based compensation			2,320				2,320
Transfer of stock-based compensation on exercises		228	(228)				–
Equity component on issuance of convertible debentures					7,971		7,971
Net loss						(2,560)	(2,560)
Balance at March 31, 2011	88,100,446	\$ 213,645	\$ 9,912	\$ –	\$ 7,971	\$ (15,876)	\$ 215,652

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ARCAN RESOURCES LTD.

Condensed Statements of Cash Flows

For the three months ended March 31,
(000's of Canadian dollars)
(unaudited)

	Note	2011	2010
Cash flows from operating activities:			
Net loss for the period		\$ (2,560)	\$ (2,127)
Adjustments for:			
Depletion and depreciation		5,072	2,551
Unrealized loss on commodity contracts		3,822	-
Net finance expenses (including accretion)		501	371
Stock-based compensation		2,320	325
Exploration and evaluation expenditures		3	2,258
Deferred tax reduction		(157)	(244)
Reclamation costs		18	(12)
Change in non-cash working capital	7	9	(278)
Interest paid		(139)	(295)
Net cash from operating activities		8,889	2,549
Cash flows from investing activities:			
Property, plant and equipment expenditures		(43,664)	(5,166)
Property acquisition		-	(52,802)
Additions to exploration and evaluation assets		(496)	(12,867)
Change in non-cash working capital	7	6,375	8,233
Net cash used in investing activities		(37,785)	(62,602)
Cash flows from financing activities:			
Proceeds from issue of convertible debentures		86,250	-
Proceeds from issue of share capital		-	65,000
Bank loan repayment		(20,823)	(1,827)
Proceeds from exercise of share options and warrants		705	1,160
Convertible debenture issuance costs		(3,860)	-
Share issuance costs		(12)	(4,280)
Net cash from financing activities		62,260	60,053
Change in cash and cash equivalents		33,364	-
Cash and cash equivalents beginning of period		-	-
Cash and cash equivalents end of period		\$ 33,364	\$ -

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

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Condensed Notes to Interim Financial Statements, page 1

For the three months ended March 31, 2011 and 2010
(000's of Canadian dollars, except share amounts)
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1. Reporting entity:

Arcan Resources Ltd. ("Arcan" or the "Company") is a publicly listed company with a registered head office in Calgary, Alberta. The Company is engaged in the exploration for and development and production of oil and natural gas and conducts many of its activities jointly with others; these interim financial statements reflect only the Company's proportionate interest in such activities.

2. Basis of preparation:

(a) Statement of compliance:

The interim financial statements have been prepared in accordance with IAS 34 – Interim Financial Reporting of the International Financial Reporting Standards ("IFRS"). These financial statements are the Company's first IFRS interim financial statements after its transition to reporting in accordance with IFRS and before the issuance of its first publicly issued annual IFRS financial statements. IFRS 1 – First-time adoption of International Financial Reporting Standards ("IFRS 1") has been applied to these interim financial statements. These interim financial statements use the accounting policies which the Company expects to adopt in its annual financial statements for the year ended December 31, 2011, with the exception of certain disclosures that are normally required to be included in annual financial statements which have been condensed or omitted.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in note 16. The note includes reconciliations of equity and net loss for comparative periods from former Canadian GAAP to IFRS.

The interim financial statements were authorized for issue by the Board of Directors on May 31, 2011.

(b) Basis of measurement:

The financial statements have been prepared on the historical cost basis except that derivative financial instruments are measured at fair value.

The methods used to measure fair values are discussed in note 4.

(c) Functional and presentation currency:

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

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Condensed Notes to Interim Financial Statements, page 2

For the three months ended March 31, 2011 and 2010
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2. Basis of preparation (continued):

(d) Use of estimates and judgements:

The preparation of interim financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

Reserve estimates including production profiles, future development costs, and discount rates are a critical part of many of the estimated amounts and calculations contained in the financial statements. These estimates are verified by third party professional engineers, who work with information provided by the Company to establish reserve determinations. These determinations are updated at least on an annual basis, and more frequently as significant asset or business combinations take place.

Significant areas of estimation, uncertainty and critical judgments in applying accounting policies that impact the amounts recognized in the interim consolidated financial statements include:

- Impairment testing – estimates of reserves, future commodity prices, future costs, production profiles, discount rates, market value of land.
- Depletion and depreciation – oil and natural gas reserves, including future prices, costs and reserve base to use on the calculation of depletion.
- Decommissioning obligations – estimates relating to amounts, likelihood, timing, inflation and discount rates.
- Share-based compensation – forfeiture rates and volatility.
- Derivatives – expected future oil and natural gas prices and expected volatility in these prices.
- Deferred tax – estimates of reversal of temporary differences, tax rates substantively enacted, and likelihood of assets being realized.
- Provisions and contingencies – estimates relating to onerous contracts, including discount rates associated with long term contracts.

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Condensed Notes to Interim Financial Statements, page 3

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

Certain comparative amounts have been reclassified to conform with the current period's presentation.

(a) Jointly controlled operations and jointly controlled assets:

Many of the Company's oil and natural gas activities involve jointly controlled assets. The financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

(b) Financial instruments:

(i) Non-derivative financial instruments:

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, bank loans, convertible debentures, and trade and other payables. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

The Company's non-derivative financial instruments, such as trade and other receivables, bank loans, and trade and other payables, are measured at amortized cost using the effective interest method, less any impairment losses. Cash is comprised of cash on hand.

Convertible debentures can be converted to share capital at the option of the holder and the number of shares to be issued does not vary with changes in the fair value. The liability component of the convertible debentures is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially as the difference between the fair value of the convertible debenture as a whole and the fair value of the liability component. Any transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts. Subsequent to initial recognition, the liability component of the convertible debenture is measured at amortized cost using the effective interest method. The equity component is not re-measured subsequent to initial recognition.

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Condensed Notes to Interim Financial Statements, page 4

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(b) Financial instruments (continued):

(ii) Derivative financial instruments:

The Company has entered into certain financial derivative contracts in order to manage the exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the balance sheet at fair value. Transaction costs are recognized in profit or loss when incurred.

The Company has accounted for its forward physical delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts. As such, these contracts are not considered to be derivative financial instruments and have not been recorded at fair value on the balance sheet. Settlements on these physical sales contracts are recognized in oil and natural gas revenue.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

(iii) Share capital:

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

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Condensed Notes to Interim Financial Statements, page 5

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(c) Property, plant and equipment and exploration and evaluation assets:

(i) Recognition and measurement:

Exploration and evaluation expenditures:

Pre-licence costs are recognized in profit or loss as incurred.

Exploration and evaluation costs, including the costs of acquiring licenses, geological and geophysical, drilling, sampling, decommissioning and often directly attributable internal costs, initially are capitalized as exploration and evaluation assets. The costs are accumulated in cost centres by well, field or exploration area and not depreciated pending determination of technical feasibility and commercial viability.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units.

The technical feasibility and commercial viability of extracting a mineral resource is considered to be determinable when proven and/or probable reserves are determined to exist. A review of each exploration licence or field is carried out, at least annually, to ascertain whether proven and/or probable reserves have been discovered. Upon determination of proven and/or probable reserves, exploration and evaluation assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to property, plant and equipment or expensed to exploration and evaluation impairments.

Development and production costs:

Items of property, plant and equipment, which include oil and gas development and production assets, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into cash generating units ("CGU") for impairment testing. When significant parts of an item of property, plant and equipment, including oil and natural gas interests, have different useful lives, they are accounted for as separate items (major components).

Gains and losses on disposal of an item of property, plant and equipment, including oil and natural gas interests, are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized net within profit or loss.

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Condensed Notes to Interim Financial Statements, page 6

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(c) Property, plant and equipment and exploration and evaluation assets (continued):

(ii) Subsequent costs:

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as oil and natural gas interests only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in profit or loss as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

(iii) Depletion and depreciation:

The net carrying value of development or production assets is depleted using the unit of production method by reference to the ratio of production in the year to the related proven and probable reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually.

The estimated useful lives for all production assets are assumed to be equal to the reserve life of the oil and natural gas assets, and therefore are also depreciated using the unit of production method.

For other assets, depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Land is not depreciated.

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Condensed Notes to Interim Financial Statements, page 7

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(c) Property, plant and equipment and exploration and evaluation assets (continued):

(iii) Depletion and depreciation (continued):

The estimated useful lives for other assets for the current and comparative years are as follows:

Office equipment	5 – 10 years
Computer equipment	0 – 3 years
Vehicles	3 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(d) Leased assets:

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases, which are not recognized on the Company's statement of financial position.

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(e) Impairment:

(i) Financial assets:

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

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Condensed Notes to Interim Financial Statements, page 8

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(e) Impairment (continued):

(i) Financial assets (continued):

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

(ii) Non-financial assets:

The carrying amounts of the Company's non-financial assets, other than exploration and evaluation ("E&E") assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

E&E assets are allocated to related CGU's when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to property, plant and equipment.

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Condensed Notes to Interim Financial Statements, page 9

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(e) Impairment (continued):

(ii) Non-financial assets (continued):

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGU's are allocated to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of property, plant and equipment and exploration and evaluation assets, recognized in prior years, is assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

(f) Share based payments:

The grant date fair value of options granted to employees, officers, and directors is recognized as compensation expense, within general and administrative expenses, with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

(g) Provisions:

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

(i) Decommissioning obligations:

The Company's activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

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Condensed Notes to Interim Financial Statements, page 10

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(g) Provisions (continued):

(i) Decommissioning obligations (continued):

Decommissioning obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the statement of financial position date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs in income or loss whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the asset retirement obligations are charged against the provision to the extent the provision was established.

(ii) Onerous contracts:

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognises any impairment loss on associated assets.

(h) Revenue:

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the buyer which is usually when legal title passes to the external party and when collection is reasonably assured. This is generally at the time product enters the pipeline.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

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Condensed Notes to Interim Financial Statements, page 11

For the three months ended March 31, 2011 and 2010
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3. Significant accounting policies (continued):

(i) Finance income and expenses:

Finance expense comprises interest expense on bank loans and convertible debentures, accretion of the discount on the decommissioning obligations and convertible debentures.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in profit or loss using the effective interest method. The capitalization rate used to determine the amount of borrowing costs to be capitalized is the weighted average interest rate applicable to the Company's outstanding borrowings during the period.

Interest income is recognized as it accrues in profit or loss, using the effective interest method.

(j) Income tax:

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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Condensed Notes to Interim Financial Statements, page 12

For the three months ended March 31, 2011 and 2010

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3. Significant accounting policies (continued):

(j) Income tax (continued):

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(k) Earnings per share:

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees, officers, and directors or convertible debentures. The number of additional shares related to the convertible debentures is calculated assuming the debentures are converted into common shares by dividing the face value of the convertible debentures by the conversion price. Profit or loss is adjusted by any interest or accretion related to the convertible debenture. The number of additional shares related to stock options is calculated by assuming proceeds from the exercise of stock options are used to buy back common shares at the average market price. The additional shares are the difference between the exercised options and the assumed number acquired.

(l) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. On issuance the premium recorded on the flow-through share, being the difference in price over a common share with no tax attributes, is recognized on the statement of financial position. As expenditures are incurred the future tax liability associated with the renounced tax deductions is recognized through profit and loss with a pro-rata portion of the deferred premium.

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Condensed Notes to Interim Financial Statements, page 13

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3. Significant accounting policies (continued):

(m) New standards and interpretations not yet adopted:

The following pronouncements from the IASB will become effective for financial reporting periods beginning on or after January 1, 2013 and have not yet been adopted by the Corporation. All of these new or revised standards permit early adoption with transitional arrangements depending upon the date of initial application:

IFRS 9 - Financial Instruments addresses the classification and measurement of financial assets.

IFRS 10 - Consolidated Financial Statements builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.

IFRS 11 - Joint Arrangements establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.

IFRS 12 - Disclosure of Interest in Other Entities provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.

IFRS 13 - Fair Value Measurement defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.

IAS 27 - Separate Financial Statements revised the existing standard which addresses the presentation of parent company financial statements that are not consolidated financial statements.

IAS 28 - Investments in Associate and Joint Ventures revised the existing standard and prescribes the accounting for investments and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

The Company has not completed its evaluation of the effect of adopting these standards on its financial statements.

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4. Determination of fair values:

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(i) Property, plant and equipment and exploration and evaluation assets:

The fair value of property, plant and equipment and E&E assets recognized in an acquisition, is based on market values. The market value of property, plant and equipment and E&E assets is the estimated amount for which property, plant and equipment could be exchanged on the acquisition date between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value of oil and natural gas interests (included in property, plant and equipment) and intangible exploration assets is estimated with reference to the discounted cash flows expected to be derived from oil and natural gas production based on externally prepared reserve reports. The risk-adjusted discount rate is specific to the asset with reference to general market conditions.

The market value of other items of property, plant and equipment is based on the quoted market prices for similar items.

(ii) Cash and cash equivalents, trade and other receivables, trade and other payables, bank loans and convertible debentures.

The fair value of cash and cash equivalents, trade and other receivables, and trade and other payables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At March 31, 2011 and December 31, 2010, the fair value of these balances approximated their carrying value due to their short term to maturity.

Convertible debentures for disclosure purposes are fair valued based on quoted market prices. Bank loans bear a floating rate of interest and therefore carrying value approximates fair value.

(iii) Derivatives:

The fair value of forward contracts and swaps is determined by discounting the difference between the contracted prices and published forward price curves as at the balance sheet date, using the remaining contracted oil and natural gas volumes and a risk-free interest rate (based on published government rates). The fair value of options and costless collars is based on option models that use published information with respect to volatility, prices and interest rates.

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4. Determination of fair values (continued):

(iv) Stock options:

The fair value of employee stock options is measured using a Black Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds).

5. Financial risk and capital management:

(a) Commodity price risk

The Company utilizes financial derivative contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

During the year ended December 31, 2010 the Company entered into four costless collar financial oil contracts. The contracts are each for 500 barrels per day of oil with floor prices of \$70.00 per barrel Canadian dollar WTI. Two of the contracts have ceiling prices of \$100.00 per barrel Canadian dollar WTI and the other two contracts have ceiling prices of \$100.05 and \$100.30 per barrel Canadian dollar WTI, respectively. All contracts are for the period from January 1, 2011 to December 31, 2011. During the three months ended March 31, 2011 the Company entered into two costless collar financial oil contracts. The contracts are each for 500 barrels per day of oil with floor prices of \$75.00 per barrel Canadian dollar WTI. One of the contracts has a ceiling price of \$126.00 per barrel Canadian dollar WTI and the other contract has a ceiling price of \$127.50 per barrel Canadian dollar WTI. Both contracts are for the period from January 1, 2012 to December 31, 2012. The Company recognized an unrealized loss of \$3.8 million on the contracts for the three months ended March 31, 2011 (2010 – nil). The Company recognized a realized loss of \$30 on the contracts for the three months ended March 31, 2011 (2010 – nil).

The Company has assessed the sensitivity of the fair value of the oil commodity contracts to fluctuations in forward crude oil prices. As at March 31, 2011, if the forward price of crude had been \$1.00 higher, net income for the period would have been approximately \$686 lower, due to a higher unrealized loss on the commodity contracts. An equal and opposite impact would have occurred to net income had the forward price of crude been \$1.00 lower.

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5. Financial risk and capital management (continued):

(b) Capital management:

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business.

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying petroleum and natural gas assets. The Company considers its capital structure to include shareholder's equity of \$215.7 million (December 31, 2010 - \$207.2 million), bank debt and convertible debentures of \$72.0 million (December 31, 2010 - \$20.8 million) and a working capital deficiency of \$4.4 million (December 31, 2010 - \$28.4 million). In order to maintain or adjust the capital structure, the Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

The Company monitors capital based on the ratio of net debt to quarterly annualized funds from operations. In this ratio, net debt is defined as outstanding bank debt plus convertible debentures plus or minus working capital, divided by funds from operations for the most recent calendar quarter, annualized (multiplied by four). Funds from operations is defined as cash flow from operating activities before changes in non-cash working capital. The Company's strategy is to maintain a ratio of less than 2 to 1 although it is anticipated to be higher than that ratio over the next few years due to the long-term nature of the convertible debenture. This ratio may increase at certain times as a result of acquisitions. In order to facilitate the management of this ratio, the Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

As at March 31, 2011 and 2010, the Company's ratio of net debt to quarterly annualized funds from operations was 2.2 to 1 and 3.6 to 1, respectively. The Company's ratio of net debt to quarterly annualized funds from operations at March 31, 2011 was slightly above the 2 to 1 ratio that management targets to maintain. The Company issued \$86.3 million principal amount of convertible debentures during the period (note 13) which was used to reduce bank debt levels through this debt instrument with a five year term.

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5. Financial risk and capital management (continued):

(b) Capital management (continued):

The Company's bank completed its semi-annual borrowing base review on May 25, 2011 and the bank credit facility has been established at \$120 million. The next scheduled renewal is on or before May 29, 2012. The Company continually monitors its financing alternatives, and expects to finance its 2011 cash capital expenditures program from internally generated funds from operations, debt, and equity.

The net debt to quarterly annualized funds from operations has been calculated as follows:

Three months ended	March 31, 2011	March 31, 2010
Working capital deficiency (including bank debt and convertible debentures)	\$ 76,379	\$ 40,908
Cash flow from operating activities	8,889	2,549
Change in non-cash operating working capital	(9)	278
Funds from operations	8,880	2,827
Annualizing factor	x4	x4
Annualized funds from operations	\$ 35,520	\$ 11,308
Ratio	2.2 to 1	3.6 to 1

The Company's share capital is not subject to external restrictions, however the bank debt facility is based on petroleum and natural gas reserves and a financial covenant (see note 12). The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future.

There were no changes in the Company's approach to capital management during the period.

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6. Finance expenses:

Three months ended	March 31, 2011	March 31, 2010
Financial expenses:		
Interest on bank loans	\$ 190	\$ 381
Interest on convertible debentures	664	-
Accretion on convertible debentures	220	-
Accretion of decommissioning obligations	142	77
	<u>\$ 1,216</u>	<u>\$ 458</u>

7. Supplemental cash flow information:

Changes in non-cash working capital is comprised of:

Three months ended	March 31, 2011	March 31, 2010
Source/(use) of cash:		
Trade and other receivables	\$ (1,427)	(3,995)
Prepays and deposits	305	15
Trade and other payables	7,506	11,935
	<u>\$ 6,384</u>	<u>\$ 7,955</u>
Related to operating activities	\$ 9	\$ (278)
Related to investing activities	\$ 6,375	\$ 8,233

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8. Property, plant and equipment:

<hr/>	
Cost or deemed cost:	
Balance at January 1, 2010	\$ 130,472
Additions	87,400
Acquisitions	42,821
Decommissioning obligations	7,500
Balance at December 31, 2010	268,193
Additions	43,664
Decommissioning obligations	(46)
Balance at March 31, 2011	\$ 311,811
<hr/>	
Depletion, depreciation and impairment losses:	
Balance at January 1, 2010	\$ -
Depletion and depreciation	16,764
Impairment loss	1,274
Balance at December 31, 2010	18,038
Depletion and depreciation	5,072
Balance at March 31, 2011	\$ 23,110
<hr/>	
Carrying amounts:	
At January 1, 2010	\$ 130,472
At December 31, 2010	\$ 250,155
At March 31, 2011	\$ 288,701

The calculation of depletion includes estimated future development costs of \$182,991 (2010 - \$34,798) associated with the development of the Company's proved plus probable reserves and excludes salvage value of \$1,707 (2010 - \$1,707).

(a) Security:

At March 31, 2011 and December 31, 2010 all of the Company's properties are pledged as security for the bank loans.

(b) Contingencies:

Although the Company believes that it has title to its oil and natural gas properties, it cannot control or completely protect itself against the risk of title disputes or challenges.

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9. Exploration and evaluation assets:

Balance at January 1, 2010	\$	9,832
Acquisitions		9,981
Additions		8,134
Exploration and evaluation impairments		(4,012)
Balance at December 31, 2010		23,935
Additions		496
Exploration and evaluation impairments		(3)
Balance at March 31, 2011	\$	24,428

Exploration and evaluation (E&E) assets consist of the Company's exploration projects which are pending the determination of proven and/or probable reserves. Additions represent the Company's share of costs incurred on E&E assets during the period.

10. Share capital:

The Company is authorized to issue an unlimited number of common shares.

The holders of common shares are entitled to receive dividends as declared by the Company and are entitled to one vote per share.

The Company is also authorized to issue an unlimited number of preferred shares issuable in series.

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11. Earnings per share:

The following table summarizes the basis for the determination of basic and diluted per share amounts:

	2011	2010
Weighted average number of shares – basic and diluted	88,071,919	48,319,960

In computing diluted per share amounts at March 31, 2011, 8,450,000 options (March 31, 2010 – 4,497,000 options), nil warrants (March 31, 2010 – 458,631 warrants) were excluded for the calculation as their effect was anti-dilutive. The Company has also excluded the convertible debentures which would convert into an additional 5,038,095 common shares, as they were also anti-dilutive.

12. Bank loans:

The Company has total available credit facilities of \$120 million (the "Facilities") comprised of a \$110 million syndicated extendible, revolving term credit facility and a \$10 million non-syndicated extendible revolving operating term credit facility. The Facilities are available on a revolving basis until May 29, 2012. On May 29, 2012, at the Company's discretion, the Facilities are available on a non-revolving basis for a period of one year, at which time the Facilities would be due and payable. Alternatively, the Facilities may be extended for a further 364 day period at the request of the Company, subject to approval by the lenders. Interest on the Facilities is calculated at the bank prime rate of interest, plus an applicable facility margin depending upon certain ratios. The \$120 million borrowing base is subject to a semi-annual and annual review by the bank. As the available lending limits of the Facilities are based on the bank's interpretation of the Company's reserves and future commodity prices, there can be no assurance as to the amount of the facilities that will be determined at each scheduled review. The Facilities are secured by a \$500 million first floating charge debenture and a general security agreement over all Company assets. Pursuant to the terms of the credit facilities, the Company has provided the covenant that at all times its working capital ratio shall be not less than 1 to 1. The working capital ratio is defined under the terms of the Facilities as current assets, including the undrawn portion of the Facilities, to current liabilities, excluding any current bank indebtedness under the Facilities. The Company is compliant with this covenant at March 31, 2011 and December 31, 2010. This facility had an effective interest rate of 5.25% at March 31, 2011 (March 31, 2010 – 4.75%).

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13. Convertible debentures:

On February 14, 2011, Arcan issued \$86.3 million principal amount of 6.25% Convertible Unsecured Subordinated Debentures for net proceeds of \$82.4 million. The Debentures pay interest semi-annually on February 28 and August 31, commencing with the initial interest payment on August 31, 2011 and have a maturity date of February 28, 2016. The Debentures are convertible at the option of the holder to common shares at a conversion price of \$8.75 per common share. The Company has the option to redeem the Debentures on and after February 28, 2014 and at any time prior to February 28, 2016 at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest provided that the current market price is at least 125% of the conversion price of \$8.75. On redemption or maturity the Company may elect to repay the principal and satisfy its interest obligations by issuing Arcan common shares.

Upon issuance of the debentures, the liability component of the convertible debentures was recognized initially at the fair value of a similar liability that does not have an equity conversion option. The difference between these two amounts of \$10.6 million has been recorded as equity with the remaining \$71.8 million allocated to long-term debt, net of \$3.9 million of transaction costs. The discount on the debentures is being accreted such that the liability at maturity will equal the face value of \$86.3 million.

Certain officers and directors of the corporation acquired \$1.3 million of the debenture issue.

The directly attributable transaction costs of \$3.9 million were proportionally allocated to the liability and equity components.

	February 14, 2011	
Long-term liability, net of transaction costs	\$	71,762
Equity component, net of transaction costs and deferred tax		7,971
Deferred tax on equity component of convertible debentures		2,657
Transaction costs		3,860
Face value	\$	86,250

The following table indicates the changes in the convertible debentures during the period:

	Face Value	Debt Component	Equity Component
Balance at February 14, 2011	\$ 86,250	\$ 71,762	\$ 7,971
Accretion on convertible debentures	-	220	-
	\$ 86,250	\$ 71,982	\$ 7,971

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14. Share based payments:

The Company's stock option plan provides for granting of options to directors and employees to a maximum of ten percent of the total issued and outstanding common shares of the Company. These options have a term of five years to expiry. Some of the options vest immediately, others vest one-third as of the date of grant, and one-third on each of the first two anniversary dates, and others vest one-third on each of the first three anniversary dates. The Company has reserved common shares for issuance under the stock option plan in the amount of the stock options outstanding from time to time.

The number and weighted average exercise prices of share options are as follows:

	March 31, 2011		December 31, 2010	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
(in thousands of options)				
Outstanding at beginning of period	8,390	\$ 3.82	4,671	\$ 2.01
Granted	500	5.50	5,834	4.57
Exercised	(430)	1.64	(2,043)	1.85
Forfeited	(10)	3.48	(72)	2.87
Outstanding at end of period	8,450	\$ 4.03	8,390	\$ 3.82
Exercisable at end of period	1,970	\$ 2.20	2,342	\$ 2.12

The fair value of the options was estimated using the Black Scholes model with the following weighted average inputs:

	Three months ended, March 31, 2011	Year ended, December 31, 2010
Fair value at grant date	\$ 3.81	\$ 3.25
Share price	5.50	4.57
Exercise price	5.50	4.57
Volatility	88.0%	91.2%
Option life	5 years	5 years
Dividends	0%	0%
Risk-free interest rate	2.5%	2.6%

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14. Share based payments (continued):

A forfeiture rate of 8 % (2010 - 8 %) is used when recording stock-based compensation. This estimate is adjusted to the actual forfeiture rate. Stock-based compensation cost of \$ 2.3 million (March 31, 2010 - \$ 0.3 million) was expensed during the three months ended March 31, 2011.

15. Decommissioning obligations:

	March 31, 2011	December 31, 2010
Balance, beginning of period (January 1)	\$ 15,476	\$ 7,647
Liabilities incurred	234	1,130
Liabilities incurred on acquisition	-	5,692
Accretion expense	142	468
Changes in estimates	(280)	679
Reclamation costs	18	(140)
Balance, end of period	\$ 15,590	\$ 15,476

The Company's decommissioning obligations result from its ownership interest in oil and natural gas assets including well sites and gathering systems. The total decommissioning obligation is estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon these wells and facilities and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning obligations to be \$15.6 million as at March 31, 2011 (December 31, 2010: \$15.5 million) based on an undiscounted total future liability of \$21.3 million (December 31, 2010 - \$21.0 million). These payments are expected to be made over the next 10 years with the majority of costs to be incurred between 2018 and 2019. An inflation rate of 2% (2010 - 2%) was used to inflate the costs, and a long-term risk-free rate of 3.8% (2010 - 3.5%) was used to calculate the carrying value of the decommissioning obligations.

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16. Reconciliation of equity from Canadian GAAP to IFRS:

These interim financial statements are the Company's first prepared under IFRS.

The adoption of IFRS requires the application of IFRS 1. IFRS 1 generally requires that an entity retrospectively apply all IFRS effective at the end of its first IFRS reporting period; however IFRS 1 provides certain mandatory exceptions and permits limited optional exemptions. The IFRS 1 optional exemptions that have been applied include:

- Deemed cost exemption for full cost oil and gas entities as further described in note 16 (a).
- Decommissioning obligation exemption that allows any changes in decommissioning obligations on transition to IFRS to be adjusted through opening retained earnings.
- Stock-based compensation exemption that allows a company to only have to evaluate share based compensation awards that were unvested as of the date of transition and that were issued subsequent to November 7, 2002.
- Business combinations exemption that allows a company to not have to restate any business combinations that occurred prior to the date of transition.

The accounting policies in note 3 have been applied in preparing the interim financial statements for the three months ended March 31, 2011, the comparative information for the three months ended March 31, 2010, the financial statements for the year ended December 31, 2010 and the preparation of the opening IFRS balance sheet at January 1, 2010, the Company's date of transition to IFRS.

In preparing its opening IFRS balance sheet, comparative information for the three months ended March 31, 2010 and financial statements for the year ended December 31, 2010, the Company adjusted amounts previously reported in financial statements prepared in accordance with former Canadian GAAP. An explanation of how the transition from former Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes accompanying the tables.

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

At the date of IFRS transition – January 1, 2010:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Trade and other receivables	\$ 10,012	\$	\$ 10,012
Prepays and deposits	935		935
Total current assets	10,947		10,947
Property, plant and equipment	140,304	(9,832)	130,472
Exploration and evaluation assets	-	9,832	9,832
Total non-current assets	140,304	-	140,304
Total assets	\$ 151,251	\$ -	\$ 151,251
Liabilities			
Trade and other payables	\$ 17,140	\$	\$ 17,140
Bank loan	28,586		28,586
Total current liabilities	45,726		45,726
Decommissioning obligations	5,371	2,276	7,647
Deferred tax liabilities	4,687	(569)	4,118
Deferred flow-through share premium	-	107	107
Total non-current liabilities	10,058	1,814	11,872
Total liabilities	55,784	1,814	57,598
Equity			
Share capital	93,714	1,963	95,677
Share purchase loan	(100)		(100)
Contributed surplus	4,080	194	4,274
Deficit	(2,227)	(3,971)	(6,198)
Total equity	95,467	(1,814)	93,653
Total equity and liabilities	\$ 151,251	\$ -	\$ 151,251

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

March 31, 2010

	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Trade and other receivables	\$ 14,006	\$	\$ 14,006
Prepays and deposits	921		921
Total current assets	14,927		14,927
Property, plant and equipment	212,140	(22,603)	189,537
Exploration and evaluation assets		22,700	22,700
Total non-current assets	212,140	97	212,237
Total assets	\$ 227,067	\$ 97	\$ 227,164
Liabilities			
Trade and other payables	\$ 29,075	\$	\$ 29,075
Bank loan	26,760		26,760
Decommissioning obligations	9,685	3,931	13,616
Deferred tax liabilities	3,832	(959)	2,873
Total non-current liabilities	40,277	2,972	43,249
Total liabilities	69,352	2,972	72,324
Equity			
Share capital	156,622	2,339	158,961
Share purchase loan	(100)		(100)
Contributed surplus	4,223	81	4,304
Deficit	(3,030)	(5,295)	(8,325)
Total equity	157,715	(2,875)	154,840
Total equity and liabilities	\$ 227,067	\$ 97	\$ 227,164

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

At the end of the last reporting year under Canadian GAAP – December 31, 2010:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets			
Trade and other receivables	\$ 15,610	\$ -	\$ 15,610
Prepays and deposits	1,528	-	1,528
Total current assets	17,138	-	17,138
Property, plant and equipment	272,045	(21,890)	250,155
Exploration and evaluation assets	-	23,935	23,935
Total non-current assets	272,045	2,045	274,090
Total assets	\$ 289,183	\$ 2,045	\$ 291,228
Liabilities			
Trade and other payables	\$ 43,267	\$ -	\$ 43,267
Fair value of commodity contracts	2,233	-	2,233
Total current assets	45,500	-	45,500
Bank loan	20,823	-	20,823
Decommissioning obligations	10,848	4,628	15,476
Deferred tax liabilities	2,839	(635)	2,204
Total non-current assets	34,510	3,993	38,503
Total liabilities	80,010	3,993	84,003
Equity			
Share capital	210,382	2,339	212,721
Contributed surplus	6,086	1,734	7,820
Deficit	(7,295)	(6,021)	(13,316)
Total equity	209,173	(1,948)	207,225
Total equity and liabilities	\$ 289,183	\$ 2,045	\$ 291,228

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

Reconciliation of consolidated statement of loss and comprehensive loss for the three months ended March 31, 2010:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Revenue:			
Petroleum and natural gas	\$ 8,992	\$	\$ 8,992
Royalties	(2,352)		(2,352)
Other revenue	3		3
	6,643	-	6,643
Expenses:			
Production and operating	2,387	-	2,387
Exploration and evaluation impairment	-	2,258	2,258
Depletion and depreciation	3,219	(668)	2,551
General and administrative	1,473	(113)	1,360
Interest	382	(382)	-
Accretion	107	(107)	-
Finance expenses	-	458	458
	7,568	1,446	9,014
Loss before income tax	(925)	(1,446)	(2,371)
Deferred tax reduction	122	122	244
Loss and comprehensive loss for the period	\$ (803)	\$ (1,324)	\$ (2,127)
Loss per share:			
Basic and diluted	\$ (0.02)		\$ (0.04)

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

Reconciliation of consolidated statement of loss and comprehensive loss for the year ended December 31, 2010:

Notes	Canadian GAAP	Effect of transition to IFRS	IFRS
Revenue:			
Petroleum and natural gas	\$ 55,575	\$	\$ 40,871
Royalties	(14,704)		14,704
Unrealized loss on commodity contracts	(2,233)		(2,233)
Realized loss on commodity contracts	-	-	-
Interest and other income	23	-	23
	38,661	-	38,661
Expenses:			
Production and operating expenses	11,110	-	11,110
Exploration and evaluation impairment	-	4,012	4,012
Depletion and depreciation	21,500	(4,736)	16,764
Impairment loss on property, plant and equipment	-	1,274	1,274
General and administrative expenses	8,982	1,540	10,522
Accretion	711	(711)	-
Interest	1,780	(1,780)	-
Finance expenses	-	2,249	2,249
	44,083	1,849	45,931
Loss before income tax	(5,422)	(1,849)	(7,270)
Deferred tax reduction	354	(202)	152
Loss and comprehensive loss for the year	\$ (5,068)	\$ (2,050)	\$ (7,118)
Loss per share:			
Basic and diluted	\$ (0.07)		\$ (0.10)

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

Notes to reconciliations

(a) IFRS 1 election for full cost oil and gas entities

The Company elected an IFRS 1 exemption whereby the Canadian GAAP full cost pool was measured upon transition to IFRS as follows:

- (i) exploration and evaluation assets were reclassified from the full cost pool to exploration and evaluation assets at the amount that was recorded under Canadian GAAP; and
- (ii) the remaining full cost pool was allocated to the respective CGU's and components in property, plant and equipment pro rata using reserve values.

For January 1, 2010, this resulted in a \$9.8 million increase in exploration and evaluation assets with a corresponding decrease in property, plant and equipment. For March 31, 2010, this resulted in a \$22.7 million increase in exploration and evaluation assets with a corresponding decrease in property, plant and equipment. For December 31, 2010, this resulted in a \$23.9 million increase in exploration and evaluation assets with a corresponding decrease in property, plant and equipment.

(b) Decommissioning obligations:

Under previous Canadian GAAP asset retirement obligations were discounted at a credit adjusted risk free rate of 8 percent. Under IFRS the estimated cash flow to abandon and remediate the wells and facilities has been risk adjusted therefore the provision is discounted at a risk free rate of 4 percent. Upon transition to IFRS this resulted in a \$2.3 million increase in the decommissioning obligations with a corresponding increase in deficit. As a result of the change in the risk free rate the decommissioning obligations increased by \$1.6 million for the three months ended March 31, 2010 with a corresponding increase in property, plant and equipment. At December 31, 2010 this resulted in a \$2.4 million increase in the decommissioning obligations with a corresponding increase in property, plant and equipment.

As a result of the change in the decommissioning obligation accretion expense decreased by \$31 during the three months ended March 31, 2010 under IFRS compared to Canadian GAAP. For the year ended December 31, 2010, decommissioning obligation accretion expense decreased by \$242 under IFRS compared to Canadian GAAP. In addition, under Canadian GAAP accretion of the discount was included in depletion and depreciation. Under IFRS it is included in finance expenses.

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

(c) Share-based payments:

Under previous Canadian GAAP, the Company recognized an expense related to their share-based payments on a straight-line basis through the date of full vesting and did not incorporate a forfeiture rate. Under IFRS, the Company is required to recognize the expense over the individual vesting periods for the graded vesting awards and estimate a forfeiture rate. For January 1, 2010, this resulted in a \$194 increase to contributed surplus with a corresponding increase to deficit. For March 31, 2010, this resulted in a \$113 decrease to stock-based compensation expense with a corresponding decrease to contributed surplus. For December 31, 2010, this resulted in a \$1.5 million increase to stock-based compensation expense with a corresponding increase to contributed surplus.

(d) Depletion policy:

Upon transition to IFRS, the Company adopted a policy of depleting oil and natural gas interests on a unit of production basis over proved plus probable reserves. The depletion policy under Canadian GAAP was based on units of production over proved reserves. In addition depletion was done on the Canadian cost centre under previous Canadian GAAP. IFRS requires depletion and depreciation to be calculated based on individual components (ie. fields or combinations thereof).

There was no impact of this difference on adoption of IFRS at January 1, 2010 as a result of the IFRS 1 election as discussed above.

For the year ended December 31, 2010 component accounting over proved and probable reserves resulted in a decrease to depletion expense of \$4.7 million with a corresponding change to property, plant and equipment. For the three months ended March 31, 2010 component accounting resulted in a decrease to depletion expense of \$0.7 million with a corresponding change to property, plant and equipment.

(e) Impairments:

Under previous Canadian GAAP, an impairment of oil and gas assets was recognized and measured at a country cost centre level and was not reversed. Under IFRS, impairments of oil and gas assets are recognized and measured at a cash-generating unit level and impairments are reversed. The Company recognized impairment for the year ended December 31, 2010 of \$1.3 million. The impairment relates to the Company's natural gas CGU and arose primarily due to declining forward natural gas prices. The impairment was based on the difference between the property, plant and equipment net book values and their recoverable amounts. The recoverable amounts were determined using fair value less costs to sell based on discounted future cash flows of proved and probable reserves using forecast prices and costs discounted at 15%.

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16. Reconciliation of equity and loss from Canadian GAAP to IFRS (continued):

(e) Impairments (continued):

The Company also expensed \$2.3 million and \$4.0 million of exploration and evaluation costs for the three months ended March 31, 2010 and the year ended December 31, 2010, respectively, related to unsuccessful exploration projects and expiring land leases.

(f) Flow-through shares:

Under previous Canadian GAAP, proceeds received from flow-through shares were included in their entirety in share capital and the estimated tax cost of issuing flow-through shares was reflected in share capital and deferred taxes when the expenditures were renounced. Under IFRS, the premium received on the flow-through shares, being the difference in price over a common share with not tax attributes, is not included in share capital, but rather is included on the balance sheet as a deferred liability. In addition, as the flow-through expenditures are incurred the deferred tax liability associated with the renounced tax deductions are recognized through profit and loss along with a pro-rata portion of the deferred premium.

On transition the Company increased share capital by \$2.0 million reflecting the net impact of eliminating the premiums on previous flow-through share issuances and the associated deferred tax amounts. A deferred premium liability of \$0.1 million was also recognized on transition. During the 2010 year, the deferred premium of \$0.1 million and associated tax effect of the flow-through shares of \$0.4 million was recognized in the deferred tax reduction on the statement of income.

(g) Cash flows:

Upon transition to IFRS, there were no significant changes to operating, investing or financing cash flows for the three months ended March 31, 2010 or the year ended December 31, 2010.