Financial Statements of

MADALENA VENTURES INC.

Years ended December 31, 2007 and 2006

KPMG LLP
Chartered Accountants
2700-205 5 Avenue SW
Calgary AB T2P 4B9

Telephone (403) 691-8000
Fax (403) 691-8008
Internet www.kpmg.ca

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Madalena Ventures Inc. as at December 31, 2007 and December 31, 2006 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
April 21, 2008

MADALENA VENTURES INC.

Balance Sheets

As at December 31,	2007	2006
Assets		
Current assets:		
Cash and cash equivalents	$ 13,082,472	$ 19,059,715
Accounts receivable	306,281	279,063
Prepaid expenses	58,189	23,157
	13,446,942	19,361,935
Property and equipment (note 4)	8,099,113	7,064,158
	$ 21,546,055	$ 26,426,093
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 210,703	$ 1,052,499
Asset retirement obligations (note 5)	114,913	80,262
Shareholders' equity:		
Share capital & warrants (note 6)	31,941,768	31,190,593
Contributed surplus (note 6)	3,071,925	1,392,406
Deficit	(13,793,254)	(7,289,667)
	21,220,439	25,293,332
Commitments (note 11)		
	$ 21,546,055	$ 26,426,093

See accompanying notes to the financial statements

On behalf of the Board:

[signed] “Ray Smith”

Ray Smith
Chairman

[signed] “James K. Wilson”

James K. Wilson
Director

MADALENA VENTURES INC.

Statements of Operations and Deficit

For the years ended December 31,		2007		2006
Revenue:				
Petroleum and natural gas	$	932,964	$	290,348
Royalties		(145,798)		(45,180)
		787,166		245,168
Foreign exchange gain		158,613		-
Interest income		661,293		286,533
		1,607,072		531,701
Expenses:				
Operating		233,488		59,712
General and administrative		1,382,596		1,013,873
Stock-based compensation		1,601,591		1,312,249
Depletion, depreciation and accretion		4,422,984		2,793,717
		7,640,659		5,179,551
Loss before the undernoted		(6,033,587)		(4,647,850)
Gain on sale of marketable securities (note 3)		-		45,016
Loss from continuing operations		(6,033,587)		(4,602,834)
Loss from discontinued operations (note 3)		-		(58,662)
Loss for the year		(6,033,587)		(4,661,496)
Deficit - beginning of the year		(7,289,667)		(1,923,069)
Extension of warrants (note 6)		(470,000)		-
Distribution of assets (note 3)		-		(653,386)
Dividend paid in-kind (note 3)		-		(51,716)
Deficit - end of the year	$	(13,793,254)	$	(7,289,667)
Loss per common share - basic and diluted				
Continuing operations	$	(0.06)	$	(0.07)
Discontinued operations (note 3)	$	-	$	-
	$	(0.06)	$	(0.07)
Weighted Average number of shares:				
Basic and Diluted		107,163,771		67,165,574

See accompanying notes to the financial statements

MADALENA VENTURES INC.
Statements of Cash Flows

For the years ended December 31,	2007	2006
Cash provided by (used in):		
Operations:		
Net loss for the year	$ (6,033,587)	$ (4,602,834)
Add (deduct) Items not involving cash:		
Gain on sale of marketable securities	-	(45,016)
Stock-based compensation expense	1,601,591	1,312,249
Depletion, depreciation and accretion	4,422,984	2,793,717
Foreign exchange gain	(158,613)	-
Abandonment costs	(2,214)	-
	(169,839)	(541,884)
Change in non-cash working capital items (note 10)	(129,169)	(50,018)
	(299,008)	(591,902)
Discontinued operations:		
Net loss from discontinued operations	-	(58,662)
Change in non-cash working capital items (note 10)	-	(97,755)
	-	(156,417)
Financing:		
Issue of common shares	298,625	26,959,261
Withholding tax on dividends paid in kind	-	(3,443)
	298,625	26,955,818
Investing:		
Mineral resource properties	-	(20,432)
Property and equipment	(5,360,596)	(9,748,830)
Change in non-cash working capital items (note 10)	(774,876)	869,802
	(6,135,472)	(8,899,460)
Change in cash and cash equivalents	(6,135,856)	17,308,039
Cash and cash equivalents, beginning of the year	19,059,715	1,751,676
Impact of foreign exchange on foreign currency denominated cash balances	158,613	-
Cash and cash equivalents, end of the year	$ 13,082,472	$ 19,059,715

See accompanying notes to the financial statements

1. Nature of business and basis of presentation

Madalena Ventures Inc. ("Madalena" or the "Company") was formed under the laws of the Province of British Columbia on September 30, 2004 and was continued under the laws of the Province of Alberta on September 26, 2006. Madalena is in the business of acquiring, exploring for, and developing petroleum and natural gas properties in western Canada and in International market places including Tunisia, and South America. The company has operations in western Canada, Argentina, and Tunisia. Madalena is listed on the TSX Venture exchange under the symbol "MVN".

These financial statements have been prepared on the basis of accounting principals applicable to a going concern, which assume that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. Madalena is an exploration company with limited production and limited cash flow from operations. The Company currently relies on funds from equity financing to pay for exploration activities and overhead expenses. Continuing operations and the recovery of property and equipment costs is dependent on Madalena's ability to identify commercial oil and gas reserves, generate profitable operations and obtain sufficient funds to complete development activities.

The financial statements of the Company are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), within the framework of the significant accounting policies summarized below.

2. Significant accounting policies

<u>Measurement uncertainty</u>

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. These financial statements include amounts recorded for depletion, depreciation, accretion, and asset retirement obligations, and the ceiling test calculation, which are based on estimates of proven reserves, production rates, oil and natural gas prices, future costs, and other relevant assumptions. Accruals for revenues and expenses are based on estimates if actual results are not available, and stock-based compensation amounts are calculated using certain assumptions as more fully described in Note 6. Actual results could differ from the assumptions and estimates used in determining these amounts.

<u>Joint interests</u>

Substantially all of the Company's operations are conducted jointly with others, and accordingly, the financial statements reflect only the Company's interest in such activities.

<u>Cash and cash equivalents</u>

Cash and cash equivalents consist of cash deposits and short-term money market instruments with a maturity of less than three months.

<u>Property and equipment</u>

The Company follows the full cost method of accounting for petroleum and natural gas properties and related expenses. All costs associated with the exploration for and the development of oil and gas reserves in cost centers are capitalized. Such costs include land and lease acquisition, geological and geophysical, drilling costs, lease rentals on non-producing properties, tangible production equipment, retirement costs, and general and administrative expenses directly attributable to exploration and development activities.

Proceeds on sale or disposition of oil and gas properties are credited to the full cost pool unless this results in a change in the depletion and depreciation rate by 20 percent or more, in which case a gain or loss is recognized.

Capitalized costs, including estimated future costs to develop proved reserves, accumulated within a cost center are depleted and depreciated using the unit of production method, based on estimated gross proved reserves of petroleum and natural gas as determined by independent engineers. For purposes of this calculation, reserves and production are converted to equivalent units of petroleum based on relative energy content of six thousand cubic feet of natural gas to one barrel of petroleum. Costs of acquiring and evaluating significant unproved petroleum and natural gas interests are excluded from the depletion calculation until it is determined that proved reserves are attributable to such interests, or until impairment occurs.

All costs directly attributable to cost centers which are in the pre-production stage of development have been capitalized. Costs accumulated in these country-by-country cost centers are evaluated in each reporting period to determine if the costs recorded are recoverable. Costs not likely to be recovered are expensed.

Petroleum and natural gas properties, in cost centers where there are proven reserves, are subject to a ceiling test, to determine if the costs accumulated, are recoverable from the estimated future value of the properties. The costs are considered to be recoverable if the sum of the undiscounted cash flows expected from proved reserves plus the cost of unproved interests net of impairments, exceeds the carrying amount of the cost centre. When the carrying amount is assessed not to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows from the production of proved and probable reserves. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Office furniture, equipment and other assets are recorded at cost less accumulated depreciation. Depreciation is provided over the estimated useful lives of the assets using a 20% declining balance basis for office furniture and equipment, and a straight line basis over the term of the lease for leasehold improvements.

Asset retirement obligations

The Company recognizes an asset retirement obligation (“ARO”) in the period in which a well is drilled and a reasonable estimate of the fair value of the future costs associated with removal, site restoration and asset retirement, can be made. The fair value of the estimated ARO is recorded as a long-term liability with a corresponding increase in the carrying amount of property and equipment. Asset retirement costs recorded in property plant and equipment are amortized using the unit of production method and included in depletion, depreciation, and accretion. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized in the Company’s earnings in the period in which the settlement occurs.

Future income taxes

The Company uses the asset and liability method of accounting for future income taxes. Under this method, future income tax assets and liabilities are recorded based on the difference between the financial accounting and tax basis of the Companies assets and liabilities, and measured using the substantively enacted tax rates and laws anticipated to apply to the years in which the differences will reverse. The effect of a change in income tax rates on future tax liabilities and assets is recognized in income in the period that the change is substantively enacted. The Company records a valuation allowance against any future tax assets where it is unlikely that the asset will be realized during the carry-forward period.

Stock-based compensation

The Company follows the fair value method of accounting for stock options. Under this method, an estimate of the fair value of the cost of all stock options granted to employees, directors and consultants, is calculated using the Black-Scholes option pricing model, and charged to income over the vesting period of the option, with a corresponding increase recorded in contributed surplus. Upon exercise of the stock option, the consideration received by the company, and the amount previously recorded in contributed surplus is recorded as an increase to the share capital of the Company.

Stock-based compensation for non-employees is periodically re-measured until the non-employees performance is complete, or the amortization period is complete. Changes to the re-measured compensation are recognized in the period of change and amortized over the remaining life of the vesting period in the same manner as the original option.

Revenue recognition

Petroleum and natural gas revenues are recognized when the title and risks pass to the purchaser.

Per share amounts

Basic per share amounts are computed by dividing the earnings or loss by the weighted average shares outstanding during the reporting period. Diluted amounts are computed using the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of options and warrants where market price exceeds exercise price are used to repurchase shares at the average market price for the period. The difference between the number of shares that could have been purchased at market prices in the period and the number of options and warrants is added to the weighted average shares outstanding.

Foreign currency transactions

The Company is in the process of developing its business operations in Tunisia and Argentina. During 2007 all transactions and activities of all foreign operations was undertaken by Madalena. All transactions denominated in a foreign currency were translated to Canadian dollars at the exchange rate in affect at the date the transactions occurred. In anticipation of spending future amounts in foreign currencies, the Company purchased US dollars and US dollar investments which it held at year end. These holdings have been translated to Canadian dollars at the exchange rate in affect at year end and the foreign exchange gain on this conversion has been included in computing income from operations.

Impact of new and proposed accounting pronouncements

Accounting changes

On January 1, 2007 the Company adopted the new Canadian accounting standard for "Accounting Changes". The standard provides expanded disclosures for changes in accounting policies, accounting estimates and correction of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or when the change results in more relevant and reliable information. The application of the new standard did not have any impact on the Company's December 31, 2007 financial statements.

Comprehensive income and equity

On January 1, 2007, the Company adopted the new accounting standards for "Comprehensive Income" and "Equity". The new standards require a separate statement of comprehensive income to be recorded separate from the income statement, and a separate category of accumulated comprehensive income in shareholder's equity on the balance sheet. The new statements of comprehensive income and accumulated comprehensive income include gains and losses arising from changes in the fair value of certain financial instruments. The application of this standard did not result in any comprehensive income or loss that is different from the Company's net income or loss for the period ended December 31, 2007.

Financial instruments and hedges

On January 1, 2007, the Company adopted the new accounting standards for "Financial Instruments – Recognition and Measurement", "Financial Instruments – Disclosure and Presentation", and "Hedges". The new standards for Financial Instruments require all financial instruments, including derivatives, to be included in the Company's balance sheet and measured, in most cases, at fair value upon initial recognition. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans or receivables, or other financial liabilities. Financial assets and financial liabilities held-for-trading are measured at fair value with changes in the fair values recognized in net earnings. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost. Financial assets that are available-for-sale are measured at fair value with changes in the fair values recognized in other comprehensive income.

The Company's accounts receivable are classified as loans or receivables and are measured at amortized cost. Accounts payable are classified as other liabilities and are measured at amortized cost. Cash and cash equivalents on the Company's balance sheet includes cash deposited with recognized financial institutions which is classified as held-for-trading and measured at fair value.

At January 1, 2007 the Company owned investments in bank supported asset backed securities, which were included in cash and cash equivalents. During 2007 the Company realized all of its investments in asset backed securities and re-invested in discount notes and bankers acceptances issued by Canadian banks. The Company designated these financial assets as held-for-trading at January 1, 2007 and upon acquisition during the year, on the basis that the fair value of these instruments is readily measured by reference to traded market values published by chartered financial institutions, and the assets were not transferred to the Company in a related party transaction. These investments were measured at fair value at each reporting date by reference to quoted market prices. Changes in the fair value of these securities were reflected in interest income in the Company's income statement. The Company accounted for these financial assets using the settlement date method of accounting which recognizes the asset on the date it is received by the Company, and recognizes any gain or loss (net of any fair value adjustments already recorded) on the day the security matures.

The Company had no transaction costs related to any of its financial instruments, other than the asset backed securities designated as held-for trading. Transaction costs, which are inherent in the yield on the discount notes, are recorded as part of the interest income adjustments.

The Company is exposed to market risks resulting from fluctuations in commodity prices in the normal course of its business. The Company has reviewed the new Canadian accounting standard for "Hedges" and has determined that the Company has no derivative instruments to which the new standard would apply.

As of January 1, 2008 the Company will be required to adopt two new accounting standards for "Financial Instruments – Disclosures" and "Financial Instruments – Presentation" which will replace the current standard for "Financial Instruments – Disclosure and Presentation". The new standards require disclosure of the significance of financial instruments to an entity's financial statements, the risks associated with the financial instruments and how those risks are being managed. The Company is currently assessing the impact of these two new standards on its financial reporting.

As of January 1, 2008 the Company will be required to adopt a new accounting standard for "Capital Disclosures" which requires entities to disclose their objectives, policies and processes for managing capital, and whether the entity has complied with any externally imposed capital requirements. Currently the Company has no externally imposed capital requirements, and does not expect the new standard to have any material impact on its financial reporting.

In February of 2008 a new accounting standard for "Goodwill and Intangible Assets" was introduced which will require implementation on January 1, 2009. The Company currently has no Goodwill or Intangible Assets, and will evaluate the impact of the new standard if these assets are acquired.

Over the next three years Canadian Generally Accepted Accounting Principals ("GAAP") will be modified to converge with International Financial Reporting Standards ("IFRS"). Madalena plans to monitor and assess the impact of the convergence of Canadian GAAP with IFRS.

Comparative financial information

Certain prior year's comparative figures have been restated to conform to the current year's presentation.

3. Plan of arrangement and discontinued operations

In March 2006, the Company distributed its mineral exploration business, and certain marketable securities associated with the business, to a related company under a plan of arrangement ("the Plan"). The Company accounted for the disposition of the assets under the Plan using the continuity of interest method of accounting. Under this method, the accounting basis of the assets distributed under the plan of arrangement was removed from Madalena's balance sheet in 2006 and charged to retained earnings. The accounting basis of the assets was removed from the balance sheet and charged to retained earnings during 2006 was $653,386, which consisted of mineral resource assets with a carrying value of $610,888, and marketable securities with a carrying value of $42,498.

The Company has calculated a loss from discontinued operations in the amount of $58,662 for the year ended December 31, 2006.

4. Property and equipment

As at December 31,	2007	2006
Canadian petroleum and natural gas properties	$ 10,348,904	$ 9,223,341
Argentina pre-production costs	2,453,162	490,149
Tunisia pre-production costs	2,387,886	41,286
Furniture, equipment and leaseholds	114,072	97,153
	15,304,024	9,851,929
Accumulated depletion and depreciation	(7,204,911)	(2,787,771)
Net book value	$ 8,099,113	$ 7,064,158

At December 31, 2007 the above noted cost centers for Argentina and Tunisia were considered to be in the pre-production stage and all costs directly attributable to these centers were capitalized and excluded from costs subject to depletion and depreciation. There have been no revenues to date from these cost centers.

General and administrative expenses of $263,000 and stock-based compensation of $60,000 ($502,000 and $29,000 for December 31, 2006) directly related to exploration and development activities have been capitalized for the year ended December 31, 2007.

At December 31, 2007, management performed a ceiling test calculation in order to determine if there was impairment in the Canadian cost center. In undertaking the ceiling test calculation the Company relied on the net present value of expected future cash flows from proved plus probable reserves discounted at a risk free interest rate of 5% and calculated using forecast prices as determined by independent petroleum consultants. As a result of the ceiling test calculations, the Company reduced the carrying value of the Canadian cost center to it’s expected present value of $3,181,000, and has recorded a charge of $3,630,000 in depletion for the year.

The forecast benchmark prices for which the ceiling test was based, are as follows:

Year	Light, Sweet Crude Oil (40 API, 0.3%S) at Edmonton Then Current $Cdn/bbl	Alberta Natural Gas Liquids (Then Current Dollars) Edmonton Butane $Cdn/bbl	Alberta Natural Gas AECO/NIT Spot Then Current $Cdn/mmbtu)
2008	91.10	72.88	6.53
2009	87.10	69.68	7.33
2010	83.10	66.48	7.37
2011	81.10	64.88	7.37
2012	81.10	64.88	7.37
2013	81.10	64.88	7.37
2014	81.10	64.88	7.57
2015	81.10	64.88	7.74
2016	81.12	64.89	7.91
2017	82.76	66.21	8.08
2018+	+2.0%/yr	+2.0%/yr	+2.0%/yr

The prices for crude oil, natural gas and natural gas liquids in the above table are based on product price and market forecasts prepared by independent petroleum consultants at January 1, 2008. These prices have been adjusted for transportation and the energy value of gas in determining the net present value of future cash flows.

5. Asset retirement obligations

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. As at December 31, 2007, the Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately $229,000 ($236,000 at December 31, 2006) which are expected to be incurred over the next 15 years. A credit-adjusted risk-free rate of 8% and an inflation rate of 2% were used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

As at December 31,		2007		2006
Balance, beginning of the year	$	80,262	$	-
Accretion expense		5,844		5,945
Costs incurred		(2,214)		-
Adustment to estimate of accrued obligations		31,021		
Obligations accrued		-		74,317
Balance, end of year	$	114,913	$	80,262

6. Share capital

<u>Authorized</u>

The authorized share capital of the Company consists of an unlimited number of common shares without nominal or par value.

<u>Issued and outstanding</u>

Common shares	Number		Amount
Balance, December 31, 2005	51,420,949	$	4,045,562
Issued for cash	38,155,250		24,904,500
Options exercised	1,700,000		262,000
Warrants exercised	15,115,250		1,257,626
Contributed surplus associated with options exercised	-		185,769
Issue costs	-		(2,006,564)
Balance, December 31, 2006	106,391,449	$	28,648,893
Warrants exercised	477,250		290,325
Contributed surplus associated with options exercised	-		42,550
Options exercised	500,000		60,000
Balance, December 31, 2007	107,368,699	$	29,041,768

Warrants			
Balance, December 31, 2006	-		2,541,700
Warrants exercised	-		(51,700)
Warrants expired	-		(70,000)
Warrants extended			480,000
Balance, December 31, 2007	-	$	2,900,000

Total December 31, 2007	107,368,699	$	31,941,768

On March 2, 2006 the Company issued 12,000,000 common shares at a price of $0.50 per share for total proceeds of $6,000,000 pursuant to a private placement. The agent of the private placement received a cash commission of 5% or $300,000 and 600,000 warrants. Each warrant was convertible into a common share of the Company at $0.50 per share until March 2, 2007, at which time 7,500 warrants expired and the remainder were exercised. The estimated fair value of the broker warrants was $64,000 using the Black-Scholes option pricing model. The estimated value was calculated assuming a volatility of 50%, a risk-free interest rate of 4%, and an expected life of one year. The estimated value of the broker warrants and the cash commission was recorded as issue costs.

On May 16, 2006 the Company issued 1,000,000 units at a value of $1.00 per unit for gross proceeds of $1,000,000 pursuant to a private placement. Each unit consisted of one common share and one-half of a warrant. Each whole warrant was convertible into a common share of the Company at $1.25 until May 16, 2007, at which time all the warrants expired. The estimated fair value of the warrants was $134,000 using the Black-Scholes option pricing model. The estimated value was calculated assuming a volatility of 50%, a risk-free interest rate of 4%, and an expected life of one year.

In two separate closings on November 2, 2006 and November 16, 2006, the Company issued 25,061,500 and 93,750 units respectively at a value of $0.80 per unit for gross proceeds of $20,049,200 and $75,000 respectively, pursuant to a private placement. Each unit consisted of one common share and one-half of a warrant. Each whole warrant was convertible into a common share of the Company at $0.90 until November 2, 2007 and November 16, 2007 respectively. The estimated fair value of the warrants was $2,420,000 using the Black-Scholes option pricing model. The estimated value was calculated assuming a volatility of 50%, a risk-free interest rate of 4%, and an expected life of one year. On October 16, 2007 the TSX Venture Exchange consented to extend the expiry date of the 12,577,625 outstanding warrants until May 2, 2008. The Company re-calculated the estimated fair value of the extension using the Black-Scholes option pricing model, assuming a volatility of 50%, a risk-free interest rate of 4% and an extended life of six months. The estimated value of $480,000 from extension of the warrants has been recorded as additional stock-based compensation of $10,000 for the amount that relates to insiders, and as a charge against retained earnings of $470,000 for non-insiders. The broker of the private placement received a cash commission of 6% or $1,207,452 and 1,509,315 warrants on November 16, 2006. Each broker warrant was convertible into common shares of the Company at $0.80 per share until November 16, 2007. All broker warrants expired on November 16, 2007. The estimated fair value of the broker warrants was $258,000 using the Black-Scholes option pricing model. The estimated value was calculated assuming a volatility of 50%, a risk-free interest rate of 4%, and an expected life of one year. The estimated value of the broker warrants and the cash commission was recorded as issue costs.

Stock options

Under the Companies stock option plan, directors, officers, employees and consultants are eligible to receive options to acquire common stock, with terms not to exceed five years. The exercise price of each stock option is the average market price of the Company’s stock for the five trading days prior to the grant date. The Company may only grant options equal to a total of 10% of the issued and outstanding common share of the Company.

Options granted to directors of the Company have a term of five years to expiry and vest immediately upon grant of the option. Options granted to officers, employees, and consultants of the Company have a term of five years to expiry, and vest equally over three years, on each anniversary of the grant date.

The following table provides information with respect to stock option transactions for the years ended December 31, 2007 and 2006:

As at December 31,	2007		2006	
	Number of Options	Weighted Average Exercise Price ($)	Number of Options	Weighted Average Exercise Price ($)
Outstanding, beginning of the year	8,400,000	0.59	6,800,000	0.20
Granted	2,250,000	0.60	6,600,000	0.71
Exercised	(500,000)	(0.12)	(1,700,000)	(0.15)
Re-distributed	1,000,000	0.12	-	-
Relinquished	(1,000,000)	(0.12)	-	-
Cancelled	-	-	(3,300,000)	(0.23)
Outstanding, end of the year	10,150,000	0.62	8,400,000	0.30
Exercisable, end of the year	5,200,000	0.55	2,400,000	0.30

The following table provides information on the unexercised stock options:

	Outstanding		Exercisable	
Exercise Price	Number	Weighted Average Remaining Life (years)	Number	Weighted Average Remaining Life (years)
$0.12	1,000,000	2.76	1,000,000	2.76
$0.41	300,000	3.00	300,000	3.00
$0.60	2,150,000	4.47	1,300,000	4.47
$0.66	4,300,000	3.16	1,633,333	3.16
$0.73	1,100,000	3.22	566,667	3.22
$0.70	100,000	4.80	-	-
$0.85	1,200,000	3.79	400,000	3.79
	10,150,000	3.49	5,200,000	3.46

The fair value of each option has been estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions.

As at December 31,	2007	2006
Expected life (in years)	4.4	4.8
Risk-free interest rate (%)	4.2	4.1
Volatility (%)	50	50
Fair value of options	0.33	0.33

Warrants

During 2006 the Company issued the following warrants to shareholders and listing agents to purchase common shares

Date Issued	Expiry Date	Number of Warrants	Price ($)
2-Mar-06	2-Mar-07	600,000	0.50
16-May-06	16-May-07	500,000	1.25
2-Nov-06	2-May-08	12,530,750	0.90
2-Nov-06	2-Nov-07	1,503,690	0.80
16-Nov-06	2-May-08	46,875	0.90
16-Nov-06	16-Nov-07	5,625	0.80
		15,186,940	

The following table summarizes the warrant activity during for the years ended December 31, 2007 and 2006.

	Number		Weighted Average Exercise Price
Balance, December 31, 2005	15,000,000	$	0.08
Issued	15,186,940		0.89
Converted to common stock	(15,115,250)		0.08
Balance, December 31, 2006	15,071,690		0.89
Converted to common stock	(477,250)		0.50
Expired	(2,016,815)		0.91
Balance, December 31, 2007	12,577,625	$	0.90

Per share amounts

In the calculation of diluted per share amounts, stock options and warrants are assumed to have been converted at the later of the first day of the year and the grant date in the current year. The treasury stock method is used to determine the dilutive effect of the stock options and the warrants and assumes that proceeds received from the exercise of in-the-money options and warrants and the unrecognized stock-based compensation expense are used to repurchase common shares a the average market price.

For the year ended December 31, 2007 all of the 10,150,000 outstanding stock options (8,400,000 for December 31, 2006), and all of the 12,577,625 outstanding warrants (15,071,690 for December 31, 2006) have been excluded in calculating the weighted average number of diluted common shares outstanding, as they have been determined to be anti-dilutive.

7. Contributed surplus

As at December 31,		2007		2006
Balance, beginning of the year	$	1,392,406	$	237,145
Stock-based compensation expensed		1,591,591		1,312,249
Stock-based compensation capitalized		60,478		28,781
Balance transferred on expiration of warrants		70,000		-
Exercise of stock options		(42,550)		(185,769)
Balance, end of the year	$	3,071,925	$	1,392,406

8. Income taxes

Income taxes differ from the amounts that would be obtained by applying the Canadian statutory income tax rates to the net loss before income taxes as follows:

For the years ended December 31,		2007		2006
Net income (loss) before income taxes	$	(6,033,587)	$	(4,661,496)
Combined federal and provincial tax rate		32.12%		34.50%
Computed "expected" income tax recovery	$	(1,937,988)	$	(1,608,216)
Non deductible crown charges		-		5,455
Resource allowance		-		23,365
Stock-based compensation		514,541		452,726
Change in valuation allowance		878,857		949,540
Change in tax rates		537,090		180,085
Other		7,500		(2,954)
	$	-	$	-

At December 31, 2007 the Company had approximately $6,501,000 ($3,568,000 for December 31, 2006) of non capital losses available to offset future years' taxable income, the benefit of which has not been recorded in these financial statements. The $6,501,000 of losses will expire as follows: $70,000 in 2008, $125,000 in 2009, $75,000 in 2014, $3,298,000 in 2026, and 2,933,000 in 2027.

The major components of the Company's net future taxes are as follows:

As at December 31,		2007		2006
Future income tax assets (liabilities):				
Foreign exchange	$	(39,653)	$	-
Non capital loss carryforwards		1,625,187		1,034,715
Share issue costs		261,362		405,917
Asset retirement obligations		28,728		23,276
Property and equipment		626,109		158,967
Valuation allowance		(2,501,733)		(1,622,876)
Net future tax asset	$	-	$	-

9. Segmented information

Management has determined that the Company operates in one dominant industry segment, which involves the exploration and development of petroleum and natural gas products in the following areas:

As at December 31, 2007	Canada	Argentina	Tunisia	Total
Property and equipment expenditures	$ 1,111,461	$ 1,917,543	$ 2,331,593	$ 5,360,596
Total Assets	16,705,006	2,453,162	2,387,886	21,546,055
As at December 31, 2006				
Property and equipment expenditures	9,246,177	470,961	31,692	9,748,830
Total Assets	$ 25,894,658	$ 490,149	$ 41,286	$ 26,426,093

10. Supplemental cash flow information

Changes in non-cash working capital items are comprised of the following:

For the years ended December 31,	2007	2006
Accounts receivable	$ (27,218)	$ (210,427)
Prepaid expenses and deposits	(35,031)	(22,288)
Accounts payable and accrued liabilities	(841,796)	954,744
Change in non-cash working capital	$ (904,045)	$ 722,029
Attributable to:		
Operating activities	$ (129,169)	$ (50,018)
Discontinued operations	-	(97,755)
Investing	(774,876)	869,802
	$ (904,045)	$ 722,029

11. Commitments

The Company entered into a lease agreement for office premises commencing April 15, 2006 to June 15, 2010. The minimum rentals payable including estimated operating costs are summarized in the following table:

2008	$ 119,145
2009	119,145
2010	119,145
2011	59,573
Total	$ 417,009

On October 29, 2007, and November 14, 2007, the Company signed joint venture and operating agreements to explore for hydrocarbons on the Cortadera, Curamhuele and Coiron Amargo blocks in the Province of Neuquen, Argentina, and has committed to spending approximately $10.5 million USD on approved work commitment programs on these three blocks over the next three years. The Company as part of normal business operations has agreed to spend approximately $2,100,000 US on drilling an exploration well in the Remada Sud area of Tunisia.

12. Financial instruments

Fair value of financial instruments:

The Company's financial instruments consist of cash, guaranteed investment certificates, banker's acceptances, discount notes issued by financial institutions, accounts receivable, accounts payable, and accrued liabilities. At December 31, 2007, cash, and guaranteed investment certificates, which are classified as held-for-trading assets, have been recorded at fair value, and accounts receivable which are classified as loans and receivable, accounts payable, and accrued liabilities, which are classified as other financial liabilities, have been recorded at their face value which approximates their amortized cost using the effective interest method. The Company has no bank indebtedness.

At January 1, 2007 the Company owned investments in asset backed debt securities, which were included in cash and cash equivalents, and were designated as held-for-trading financial assets. During the year the Company disposed of its investments in asset backed securities as they matured and were fully realized. Proceeds from the maturity of the asset backed securities were re-invested in banker's acceptances and discount notes issued by financial institutions which were also designated as held-for-trading financial assets on acquisition. The fair value of these assets has been determined at December 31, 2007 based on trading prices supplied by financial institutions for these instruments. The following table provides information on the fair value, carrying value, maturity value, maturity date, and interest yield of the investment at December 31, 2007. The increase in fair value has been recorded as interest income in the statement of operations for the year ended December 31, 2007.

As at December 31, 2007		Cost	Maturity Value	Yield		Fair Value at December 31, 2007		Interest Income
Bank of Montreal US dollar discount note due January 29, 2008	USD $	6,527,418	6,562,000	4.54%		6,538,151		10,733
Foreign Exchange		(274,804)				(77,805)		(128)
Canadian dollar carrying value at December 31, 2007	$	6,252,614			$	6,460,346	$	10,605

Interest rate risk

The Company is exposed to interest rate risk to the extent of interest rate fluctuations compared to fixed interest associated with the interest yield on its discount notes. Fluctuations in interest rates at maturity could affect future interest income.

Credit risk

All of the Company's accounts receivable are with customers involved in the oil and gas industry and are subject to normal industry credit risks. The carrying value of accounts receivable reflects management's best estimate of the credit risk associated with these receivables. All of the Company's investments in discount notes are investments in notes issued by schedule A banking institutions which are subject to risks associated with these types of investments in the financial industry. The carrying value of the discount notes reflects management's best estimate of the credit risk associated with these notes.

Commodity price contracts

The Company is exposed to fluctuations in commodity prices and has no contracts in place to mitigate these exposures.

Foreign currency exchange risk

At December 31, 2007 the Company holds US dollars in cash and has invested in US dollar discount notes with Canadian financial institutions which are included in cash and short term deposits on the balance sheet. The Company will use these US dollars to fund its exploration and development activities in Argentina and Tunisia which are normally satisfied in US dollars. Holding US dollars and investing in US dollar discount notes can result in foreign exchange gains or losses as the US dollar fluctuates against the Canadian dollar. For the year ended December 31, 2007 the Company recorded a foreign exchange gain on its US dollar cash short-term deposits of $158,613 as a result of restating it's US dollar holdings to Canadian dollars at the year end exchange rate of .9881 Canadian dollars for each US dollar. Currently, the Company has no contracts in place to mitigate the exposure of fluctuations in the US dollar exchange rate.

13. Related party transactions

During 2007, two directors of the Company were directors of a public exploration company with which Madalena was engaged in joint venture operations. All of the Company's oil and gas revenues, royalties and operating expenses were derived from the joint venture. In November of 2007, the public exploration company was combined with another public exploration company and the two directors of Madalena resigned from the combined company board.

During 2007, one of the directors of Madalena was a partner in a law firm which the Company utilized to provide services. During 2007 the director left the law firm. During the year ended December 31, 2007 the Company expended $141,000 ($108,000 in 2006) on services obtained from this firm.

14. Subsequent events

In April of 2008 the company completed a non-brokered private placement for the issuance of 4,375,003 common shares at a purchase price of $0.56 per share for net proceeds of $2,450,000.