

CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal year ended December 31, 2007

Pacific Energy Resources LTD Annual Report

PACIFIC ENERGY RESOURCES LTD.

**CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007 AND 2006**



PACIFIC ENERGY



CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal year ended December 31, 2007

Pacific Energy Resources LTD Annual Report

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MANAGEMENT'S REPORT TO THE SHAREHOLDERS

The preparation of the accompanying financial statements in accordance with accounting principles generally accepted in Canada is the responsibility of management.

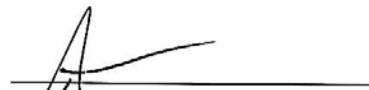
Management is responsible for the integrity and objectivity of the financial statements. Where necessary, the financial statements include estimates, which are based on management's informed judgments. Management has established systems of internal control, which are designed to provide reasonable assurance those assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors has reviewed the financial statements with management and the auditors and has approved the financial statements.

MEYERS NORRIS PENNY LLP are independent auditors ratified by Pacific Energy Resources Ltd.'s shareholders. The auditors have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express an opinion on the fairness of the presentation of the financial statements in accordance with Canadian generally accepted accounting principles.



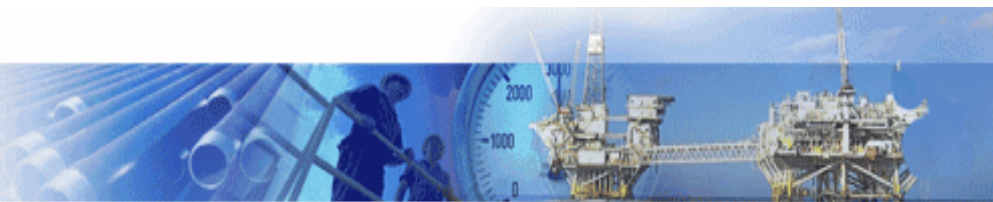
Darren Katic
President



Jerrett Creed
Chief Financial Officer



PACIFIC ENERGY



INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Pacific Energy Resources Ltd.

We have audited the accompanying consolidated balance sheets of Pacific Energy Resources Ltd. as of December 31, 2007 and 2006, and the related consolidated statements of operations, accumulated deficit and comprehensive loss, 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 the audit to obtain reasonable assurance about 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, the consolidated financial statements present fairly, in all material respects, the financial position of Pacific Energy Resources Ltd. as of 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.

Meyer Norris Penny LLP

Calgary, Alberta
March 18, 2008

Chartered Accountants



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CONSOLIDATED BALANCE SHEETS (STATED IN US DOLLARS AND THOUSANDS)

ASSETS

	December 31,	
	2007	2006 (Restated)
CURRENT ASSETS		
Cash	\$ 10,680	\$ 15,000
Cash – restricted (Notes 17(c) and 19)	–	73,654
Accounts receivable	15,935	1,537
Other receivables	2,402	–
Derivative assets (Note 14)	–	917
Inventory	8,556	–
Prepays and other current assets	7,489	2,775
	<u>45,062</u>	<u>93,883</u>
LONG-TERM ASSETS		
Deferred charges (Notes 3 and 5)	–	8,091
Derivative assets (Note 14)	–	1,855
Performance bonds and deposits	5,592	1,660
Investments - abandonment (Note 6)	94,483	–
Equity investment (Note 8)	13,626	–
Asset retirement receivable (Notes 7 and 11)	630	585
Property and equipment (Note 9)	4,780	352
Petroleum and natural gas properties (Note 9)	527,698	40,589
	<u>646,809</u>	<u>53,132</u>
	<u>\$ 691,871</u>	<u>\$ 147,015</u>

The accompanying notes are an integral part of the consolidated financial statements.



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CONSOLIDATED BALANCE SHEETS (STATED IN US DOLLARS AND THOUSANDS) (Continued)

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES

Accounts payable and accrued liabilities	\$	38,256	\$	10,537
Due to related parties (Note 13)		61		6
Notes payable (Note 10)		430		1,500
Derivative liability (Note 14)		34,247		—
Other liabilities		—		737
		<u>72,994</u>		<u>12,780</u>

LONG-TERM LIABILITIES

Notes payable (Note 10)		449,166		37,456
Asset retirement obligation (Note 11)		58,025		1,655
Derivative liability (Note 14)		55,251		—
Other liabilities		6,170		272
		<u>568,612</u>		<u>39,383</u>

Non-controlling interests (Notes 10 and 16) 7,755 7,755

Economic Dependence (Note 1)

Commitments and Contingencies (Note 15)

SHAREHOLDERS' EQUITY

Share capital (Note 17b)		19		8
Subscriptions and subscriptions receipts (Note 17d and 19)		9,308		61,127
Contributed surplus (Note 17d)		5,452		1,984
Warrants (Note 17e)		24,117		6,797
Additional paid in capital (Note 17b)		207,429		39,531
Accumulated other comprehensive loss	(82,716)		—
Deficit	(<u>121,099</u>)	(<u>22,350</u>)
		42,510		87,097
	\$	<u>691,871</u>	\$	<u>147,015</u>

The accompanying notes are an integral part of the consolidated financial statements.



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CONSOLIDATED STATEMENTS OF OPERATIONS (STATED IN US DOLLARS AND THOUSANDS EXCEPT PER SHARE AMOUNTS)

	For the Years Ended, December 31,	
	2007	2006
REVENUES		
Oil and gas production revenue	\$ 105,204	\$ 11,463
Production expenses	(58,677)	(3,779)
Transportation expense	(2,359)	—
Royalty payments	(19,840)	(227)
Net oil and gas income	24,328	7,457
Unrealized gain/ (loss) on derivatives (Note 14)	(6,782)	2,772
Realized gain / (loss) on derivatives (Note 14)	(11,766)	29
Extinguishment of debt	—	(1,854)
Interest and dividends	3,009	—
Loss from nonconsolidated subsidiary (Note 8)	(321)	—
Other revenue	1,908	490
	<u>10,376</u>	<u>8,894</u>
EXPENSES		
General and administrative	10,147	4,377
Stock compensation expense (Note 17c)	3,468	1,652
Liquidated damages	6,049	—
Interest	59,948	10,386
Depreciation, depletion and amortization	29,513	1,476
	<u>109,125</u>	<u>17,891</u>
LOSS BEFORE INCOME TAX	(98,749)	(8,997)
Income tax expense (Note 12)	—	3,026
NET LOSS FOR THE YEAR	(98,749)	(12,023)
BASIC AND DILUTED LOSS PER SHARE (Note 18)	<u>(\$ 0.70)</u>	<u>(\$ 0.20)</u>

The accompanying notes are an integral part of the consolidated financial statements.



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CONSOLIDATED STATEMENTS OF ACCUMULATED DEFICIT AND COMPREHENSIVE LOSS (STATED IN US DOLLARS AND THOUSANDS)

	For the Years Ended, December 31,	
	<u>2007</u>	<u>2006</u> (Restated)
CONSOLIDATED STATEMENT OF ACCUMULATED DEFICIT		
ACCUMULATED DEFICIT - BEGINNING OF YEAR	(\$ 22,350)	(\$ 10,327)
NET LOSS FOR THE YEAR	(<u>98,749</u>)	(<u>12,023</u>)
ACCUMULATED DEFICIT - END OF YEAR	<u>(\$ 121,099)</u>	<u>(\$ 22,350)</u>
CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS		
NET LOSS FOR THE YEAR	(\$ 98,749)	(\$ 12,023)
OTHER COMPREHENSIVE LOSS	(<u>82,716</u>)	—
COMPREHENSIVE LOSS	<u>(\$ 181,465)</u>	<u>(\$ 12,023)</u>
ACCUMULATED OTHER COMPREHENSIVE LOSS, BEGINNING OF YEAR	\$ —	\$ —
UNREALIZED HEDGING LOSSES	(<u>82,716</u>)	—
ACCUMULATED OTHER COMPREHENSIVE LOSS END OF YEAR	<u>(\$ 82,716)</u>	<u>\$ —</u>

The accompanying notes are an integral part of the consolidated financial statements.



CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED STATEMENTS OF CASH FLOWS (STATED IN US DOLLARS AND THOUSANDS)

	For the Years Ended, December 31,	
	<u>2007</u>	<u>2006</u> (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	(\$ 98,749)	(\$ 12,023)
Adjustments to reconcile net loss to net cash from operating activities:		
Loss on extinguishment of debt	-	1,854
Future income taxes	25	3,081
Depreciation, depletion and amortization	29,513	1,327
Accretion	19,412	3,730
Non cash interest and dividend income	(3,014)	
Stock compensation expense	3,468	1,652
Non-cash financing expenses	14,930	5,320
Loss from unconsolidated subsidiary	321	-
Changes in operating assets and liabilities:		
Cash restricted	-	3,100
Receivables	(609)	5
Derivative asset	2,772	(2,772)
Inventory	5,032	-
Prepaid expenses and other current assets	1,355	(163)
Accounts payable and accrued liabilities	11,976	1,551
Other liabilities	(444)	207
Derivative liability	6,782	-
Due to related parties	55	(48)
Net Cash Provided By (Used In) Operating Activities	<u>(7,175)</u>	<u>6,821</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash paid for restricted and short-term investments	(6,085)	(515)
Petroleum and natural gas expenditures	(21,304)	(7,794)
Payments on asset retirement obligation	(142)	-
Business acquisitions	(444,013)	(6,125)
Net Cash Used In Investing Activities	<u>(471,544)</u>	<u>(14,434)</u>
CASH ACQUIRED FROM ACQUISITIONS	<u>-</u>	<u>1,142</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash received for common shares issued	75,967	2,740
Payments on notes payable	(40,114)	(2,113)
Cash received for notes payable issued	438,546	16,435
Net Cash Provided By Financing Activities	<u>474,399</u>	<u>17,062</u>
NET CHANGE IN CASH	<u>(4,320)</u>	<u>10,591</u>
CASH, BEGINNING OF YEAR	<u>15,000</u>	<u>4,409</u>
CASH, END OF YEAR	<u>\$ 10,680</u>	<u>\$ 15,000</u>
Supplementary cash flow information		
Interest paid	\$ 23,405	\$ 1,360
Taxes paid	\$ -	\$ -

The accompanying notes are an integral part of the consolidated financial statements.



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NOTE 1 – Nature and Continuance of Operations

Pacific Energy Resources Ltd. (“PERL”) was incorporated under the laws of the province of British Columbia, Canada and in February 2005 PERL domesticated under the laws of the State of Delaware, United States.

In March 2005 PERL acquired 100% of the outstanding shares of, and then merged with, PetroCal Incorporated (“PetroCal”), with PERL surviving as the continuing entity. PERL also acquired a 100% interest in PetroCal’s wholly-owned subsidiary, Petrocal Acquisition Corporation (“PAC”), through this acquisition and merger.

In May 2006 PERL formed Carneros Acquisition Corporation (“CAC”) which in June 2006, acquired a 100% interest in Carneros Energy, Inc. (CEI) and its wholly owned subsidiary Gotland Oil, Inc. (“GOI”).

In October 2006, the wholly owned-subsiary El Ricoro Petroleum Corp. (“ERPC”) was merged into PERL.

In March 2007, PERL acquired certain assets in the Beta oil field (the “Beta Unit”) located offshore California, including Platforms Eureka, Elly and Ellen and 100% of the stock of San Pedro Bay Pipe Line Company (“SPBPC”).

In June 2007, PERL formed Pacific Energy Alaska Holdings, LLC (“PEAH”), which in August 2007 acquired 100% of the membership interests in Forest Alaska Operating LLC, which was renamed Pacific Energy Alaska Operating LLC (“PEAO”), 50% of the outstanding shares of Cook Inlet Pipe Line Company (“CIPL”), and other related oil and gas assets in Alaska.

PERL and its wholly-owned subsidiaries’ (collectively referred to as the “Company”) principal activities are acquisition, development and exploitation of established producing oil and natural gas properties in the Western United States.

Economic Dependence

The Company’s primary sources of borrowings are the notes payable and various credit facilities from an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC. The notes and facilities contain covenants and restrictions which provide these parties the ability to restrict the Company’s cash sources through the lockbox mechanism (Note 10) as well as certain recourse in the event of default. The Company’s ability to continue viable operations is dependent upon maintaining good standing under these agreements. As at December 31, 2007, the Company was not in compliance with all covenants and restrictions. However, the lenders have waived the prior events of default (Note 10).

Subsequent to year end, the Company was in violation of its covenants (Note 21).



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NOTE 2 – Summary of Significant Accounting Policies

Basis of Presentation

These financial statements include the accounts of PERL and its wholly-owned subsidiaries PAC (from date of acquisition), ERPC (through merger date), CAC and its wholly-owned subsidiaries CEI and GOI (from date of acquisition), SPBPC (from date of acquisition), and PEAH and PEO (from date of acquisition), all of which are incorporated or organized under the laws of the State of Delaware, except for GOI, which is incorporated under the laws of the State of Texas, and SPBPC, which is incorporated under the laws of the State of California. All intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all unrestricted highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Cash – Restricted

The restricted cash consists of the proceeds from the issuance of common stock that were held in escrow pending the closing of the Company's acquisition of the Beta Unit. In March 2007, the cash was released upon satisfaction of the escrow release conditions (Note 4).

Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount. The Company does not have any off-balance sheet credit exposure to its customers. The Company assesses credit risk and allowance for doubtful accounts on a customer-specific basis and its historical experience was only minor credit losses on the sale of oil and gas. For the year ended December 31, 2007, the Company recorded an allowance for doubtful accounts of \$149.0 thousand. For the year ended December 31, 2006, the Company did not have an allowance for doubtful accounts because all accounts were considered collectible.

Investments - Abandonment

Investments – abandonment are made up of time deposits, money market accounts and marketable debt securities, which are considered to be held to maturity investments and recorded at amortized cost.



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NOTE 2 – Summary of Significant Accounting Policies (Continued)

Equity Investment

The Company utilizes the equity method of accounting for investments subject to significant influence. Under this method, investments are initially recorded at cost and adjusted thereafter to include the Company's pro rata share of post-acquisition earnings. Any dividends received or receivable from the investee would reduce the carrying value of the investment.

Inventory

Crude oil inventory is valued at the lower of average cost or net realizable value on a first-in, first-out basis.

Property and Equipment

Property and equipment is stated at cost. Depreciation is provided for using the straight-line method over the useful lives of the assets as follows:

- Vehicles
- Office equipment
- Pipeline equipment
- Other
- Computer equipment and software

Petroleum and Natural Gas Properties

The Company uses the successful efforts method to account for its petroleum and natural gas properties. Lease acquisition costs are amortized on a straight-line basis over their lease term prior to the discovery of proved producing reserves. Geological and geophysical costs are expensed in the period in which they are incurred and costs of drilling an unsuccessful well are expensed when it becomes known the well did not result in a discovery of proved reserves or where one year has elapsed since the completion of drilling and near-term efforts to establish proved reserves are not foreseeable, intended, or in the Company's control. All other costs of exploring and developing for proved reserves become capitalized petroleum and natural gas properties.

Capitalized proved producing petroleum and natural gas properties, including related property and equipment, are depleted on a unit-of-production basis using the Company's working interest share of proved petroleum and natural gas reserves, before royalties. Unproved properties are not subject to depletion. Petroleum and natural gas properties are recorded at cost less accumulated amortization and depletion.



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NOTE 2 – Summary of Significant Accounting Policies (Continued)

Petroleum and Natural Gas Properties (Continued)

Petroleum and natural gas properties and property and equipment are assessed periodically for potential impairment to ensure that the carrying value of properties on the balance sheet is recoverable. If a property's carrying value exceeds the sum of undiscounted future cash flows resulting from its use and eventual disposition, its value is impaired. The property is then assigned a fair value equal to its estimated discounted future cash flows from proved plus probable reserves and the excess carrying value is charged to amortization and depletion expense.

Joint Interests

Certain of the Company's exploitation, development and production activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

Income Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus future taxes. Future taxes are recognized for differences between the bases of assets and liabilities for financial statement purposes and income tax purposes.

The Company accounts for future tax assets and liabilities attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their tax bases, and are measured using tax rates expected to apply in the years in which those temporary differences are expected to be settled. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the potential future benefit is taken and the net asset is recognized. The Company was recorded a valuation allowance for 100% of its future tax assets at December 31, 2007 and 2006.

Convertible Term Notes

Financial instruments that contain both a liability and an equity element are required to have the instrument's component parts classified separately under Canadian generally accepted accounting principles ("GAAP"). The Company uses the Black-Scholes model to determine the fair value of the conversion feature at the issue dates of convertible secured subordinated notes and discloses the liability and equity components separately on its balance sheet.



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NOTE 2 – Summary of Significant Accounting Policies (Continued)

Asset Retirement Obligations

The Company's asset retirement obligations relate primarily to retirement obligations associated with tangible assets, such as well-sites and associated facilities. The fair value of an asset retirement obligation ("ARO") is recognized in the period in which it is incurred and when a reasonable estimate of the fair value 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 the related asset. The capitalized amount is depleted on a unit-of-production basis over the life of the associated proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to the net loss in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted costs also result in an increase or decrease to the ARO. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the accreted liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company's income or statement of operations at that time.

Revenue Recognition

Revenues associated with sales of crude oil and natural gas are recognized when title passes to the customer, net of discounts and allowances, as applicable. Revenues from crude oil and natural gas production from properties in which the Company has an interest with other producers are recognized on the basis of the Company's net working interest using the entitlement method.

Production and Mineral Taxes

Costs paid by the Company to non-mineral interest owners based on production of petroleum and natural gas are recognized when the product is produced.

Transportation and Selling Costs

Costs paid by the Company for the transportation and selling of petroleum and natural gas products are recognized when the product is delivered and the services are provided.



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NOTE 2 – Summary of Significant Accounting Policies (Continued)

Stock-Based Compensation

Stock-based compensation expense is based on the estimated fair value of options granted at the time of the grant. The fair value is recognized in current earnings as stock-based compensation expense with a corresponding increase in contributed surplus over the vesting period of the options. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that vested options expire, previously recognized compensation expense associated with such stock options is not reversed. In the event that unvested options are cancelled, previously recognized compensation expense associated with such stock options is reversed.

Foreign Currency Translation

All monetary assets and liabilities expressed in foreign currencies are translated at rates of exchange in effect at the end of the year. All other assets and liabilities are translated at the rates prevailing at the dates the assets were acquired or liabilities incurred. Revenue and expenses are translated at the average exchange rate for the period. The resulting foreign currency translation gains and losses are included in the determination of net loss.

Deferred Financing Fees

Financing fees and other costs related to the long-term debt are deferred and amortized over the term of the related debt using the effective interest rate method. The Company's deferred financing fees and other costs pertaining to long-term debt have been reclassified from other assets to long-term debt in accordance with the recommendations of the Canadian Institute of Chartered Accountants ("CICA") for financial instruments.

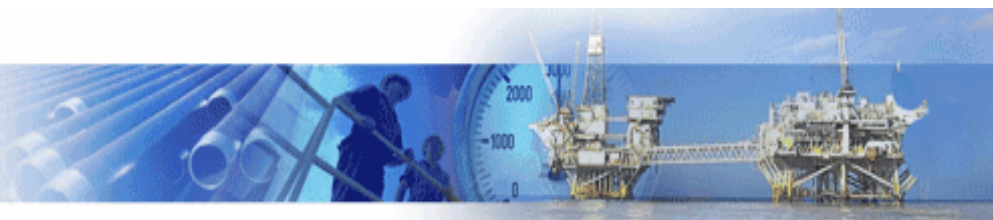
Measurement Uncertainty

The timely preparation of the consolidated financial statements in conformity with GAAP requires that management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly actual results may differ from estimated amounts as future events occur.

Amounts recorded for depreciation, depletion and amortization, asset retirement costs and obligations, and impairment calculations are based on estimates of petroleum and natural gas reserves, retirement costs and date. By their nature, these estimates including the estimates of future prices and costs, and the related future cash flows are subject to measurement uncertainty, and the impact in the consolidated financial statements of future periods could be material. Tax interpretations, regulations and legislation in the various jurisdictions in which the Company and its subsidiaries operate are subject to change. As such, income taxes are subject to measurement uncertainty.



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CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 2 – Summary of Significant Accounting Policies (Continued)

Derivative Financial Instruments

In conducting its business, the Company uses various instruments, including forward contracts and swaps to manage its risks from fluctuations in commodity prices. All such instruments are used only to manage risk and not for trading purposes.

CICA recommendations require the recognition and measurement of derivative instruments embedded in host contracts that were issued, acquired or substantively modified on or after January 1, 2003.

The Company designates each derivative instrument as either a hedging instrument or non-hedge derivative:

- (a) A hedging instrument is designated as either:
 - (i) a fair value hedge of a recognized asset or liability or,
 - (ii) a cash flow hedge of either:
 - (a) a specific firm commitment or anticipated transaction or
 - (b) the variable future cash flows arising from a recognized asset or liability

At the inception of a hedge, the Company documents the relationship between the hedging instrument and the hedged item, including the method of assessing retrospective and prospective hedge effectiveness. At the end of each period, the Company assesses whether the hedging instrument has been highly effective in offsetting changes in fair values or cash flows of the hedged item and measures the amount of any hedge ineffectiveness. The Company also assesses whether the hedging instrument is expected to be highly effective in the future.

A hedging instrument is recorded on the consolidated balance sheet at fair value. Payments or receipts on a hedging instrument that is determined to be highly effective as a hedge are recognized concurrently with, and in the same financial category as, the hedged item. Subsequent changes in the fair value of a fair value hedge are recognized in earnings concurrently with the hedged item. For a cash flow hedge, the effective portion of changes in fair value is recognized in other comprehensive income (loss) and is subsequently transferred to earnings concurrently with the hedged item, whereas the portion of the changes in fair value that is not effective at offsetting the hedged exposure is recognized in earnings.

If a hedging instrument ceases to be highly effective as a hedge, is de-designated as a hedging instrument or is settled prior to maturity, then the Company ceases hedge accounting prospectively for that instrument; for a cash flow hedge, the gain or loss deferred to that date remains in accumulated other comprehensive income (loss) and is transferred to earnings concurrently with the hedged item. Subsequent changes in the fair value of that derivative instrument are recognized in earnings.



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NOTE 2 – Summary of Significant Accounting Policies (Continued)

Derivative Financial Instruments (Continued)

If the hedged item is sold, extinguished or matures prior to the termination of the related hedging instrument, or if it is probable that an anticipated transaction will not occur in the originally specified time frame, then the gain or loss deferred to that date for the related hedging instrument is immediately transferred from accumulated other comprehensive income (loss) to earnings.

Hedge gains or losses that were recognized in other comprehensive income (loss) are added to the initial carrying amount of a non-financial asset or non-financial liability when:

- (i) an anticipated transaction for a non-financial asset or non-financial liability becomes a specific firm commitment for which fair value hedge accounting is applied or
 - (ii) a cash flow hedge of an anticipated transaction subsequently results in the recognition of the non-financial asset or non-financial liability
- (b) A non-hedge derivative instrument is recorded on the consolidated balance sheet at fair value and subsequent changes in fair value are recorded in earnings.

The Company applies settlement date accounting to the purchases and sales of financial assets. Settlement date accounting implies the recognition of an asset on the day it is received by the Company and the recognition of the disposal of an asset on the day that it is delivered by the Company. Any gain or loss on disposal is also recognized on that day.

Per Share Amounts

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated based on the treasury stock method, which assumes that any proceeds obtained on the exercise of options or warrants would be used to purchase common shares at the average price during the period.

Recent Accounting Pronouncements

As of January 1, 2008, the Company will be required to adopt two new CICA standards, Section 3862 - Financial Instruments – Disclosures, and Section 3863 – Section 3863 – Financial Instruments – Presentation, which will replace Section 3861 – Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.



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NOTE 2 – Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

As of January 1, 2008, the Company will be required to adopt CICA Handbook Section 1535 – Capital Disclosures, which requires entities to disclose objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. The Company is assessing the impact of this new standard on its financial statements and anticipates that the main impact will be in terms of additional disclosures required.

Effective January 1, 2009, the Company will be required to adopt CICA Handbook Section 3031 – Inventories which replaces corresponding Section 3030 and establishes new standards for the measurement and disclosure of inventories. The new Section prescribes that inventories should be measured at the lower of cost and net realizable value and provides guidance on the determination of cost.

The Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

CICA Handbook Section 1400 General Standards of Financial Statement Presentation has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern. This amendment is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company does not expect the adoption of these changes to have a material impact on its consolidated financial statements.

In January 2006, the CICA Accounting Standards Board (“ASCB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) by 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

NOTE 3 – Change in Accounting Policy

The Company has adopted the new CICA accounting standards related to Comprehensive Income (Section 1530), Equity (Section 3251), Financial Instruments Recognition and Measurement (Section 3855), Financial Instruments Disclosure and Presentation (Section 3861) and Hedges (Section 3865). As required by the standards prior periods have not been restated.



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NOTE 3 – Change in Accounting Policy (Continued)

Financial Instruments

Financial instruments and derivatives CICA Handbook Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount, requiring fair-value or cost-based measures under different circumstances. All financial instruments must be classified as one of the following five categories, loans and receivables, held-to-maturity investments; held-for-trading instruments; available-for-sale financial assets; or other financial liabilities. All financial instruments, with the exception of loans and receivables, held-to-maturity investments and other financial liabilities, are reported on the balance sheet date at fair value. Subsequent measurement and changes in fair value will depend on their initial classification. Transaction costs are included in the initial carrying amount of financial instruments except, for held-for-trading items, which are expensed as incurred.

Financial assets and liabilities “held-for-trading” are subsequently measured at fair value, with changes in fair value recognized in net income. Financial assets “available-for-sale” are subsequently measured at fair value, with changes in fair value recognized in other comprehensive income, net of tax.

Financial assets “held-to-maturity”, “loans and receivables”, “financial liabilities” and “other financial liabilities” are subsequently amortized using the effective interest rate method.

Cash and cash equivalents, and performance bonds are classified as “held-for-trading” and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. Accounts receivable and certain other assets that are financial instruments are classified as “loans and receivables”. Investments – abandonment are classified as “held to maturity”. The Company’s equity investment is classified as “available for sale”. Accounts payable and accrued liabilities, other long-term obligations and current and long-term debt are classified as “other financial liabilities”. The Company capitalizes long-term debt transaction costs, premiums and discounts. These costs are capitalized within long-term debt and amortized using the effective interest rate method.

Risk management assets and liabilities are derivative financial instruments classified as “held-for-trading” unless they are designed for hedge accounting.

All derivative instruments, including embedded derivatives, are recorded on the balance sheet at fair value unless they qualify for the normal sale and purchase exception. All changes in fair value are included in earnings, unless cash flow hedge or net investment accounting is used, in which case changes in fair value are recorded in other comprehensive income, to the extent the hedge is effective, and in earnings to the extent it is ineffective.

Comprehensive Income and Equity

Section 1530 provides for a new statement of comprehensive income and establishes accumulated other comprehensive income (AOCI) as a separate component of shareholders’ equity. The statement of comprehensive income reflects the changes in AOCI.



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NOTE 3 – Change in Accounting Policy (Continued)

Initial Adoption of Standards

These accounting standards require prospective adoption of the standards, and since the Company did not use hedge accounting at the date of adoption, the adoption of the required standards had no material impact on the financial statements.

The adjustment required to the balance sheet to implement the change in accounting standards was to reclassify deferred charges of \$8.1 million from a long-term asset to a reduction of long-term debt.

NOTE 4 – Business Acquisitions

All business acquisitions have been accounted for using the purchase method, whereby the excess of the purchase price over the estimated fair value of identifiable tangible and intangible net assets acquired is recorded as goodwill. No goodwill has been recognized by the Company for its acquisitions in 2007 and 2006.

Alaska Property

In August 2007, PERL, through PEAH, acquired the Alaska oil and gas properties and operations of Forest Oil Corporation (“FOC”), including 100% of the membership interests in its wholly-owned subsidiary, Forest Alaska Operating LLC, and a 50% interest in CIPL, for \$400.0 million in cash, the issuance of 10.0 million shares of PERL’s common stock to FOC and a seven year accreting note to FOC with an initial value of \$29.25 million. The acquisition of these assets and operations provided the Company with the ability to expand its operational base outside of Southern California and was in line with its business strategy of acquiring oil and gas operations that have redevelopment and exploitation potential. The cash portion of the purchase price was funded from a \$425.0 million credit facility from an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point (Note 10). Of the 10.0 million shares of PERL’s common stock issued, 5.5 million shares, along with the shares of CIPL stock representing the 50% interest, were held in escrow pending regulatory approval of the transfer of the CIPL shares from their current owner to PEAH. Regulatory approval to become an operator of certain properties and transfer of the shares of CIPL stock was obtained in February 2008.

The Company has included the Alaska results of operation in its statement of operations from August 2007 forward.



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NOTE 4 – Business Acquisitions (Continued)

The acquisition was recorded as follows (in thousands):

Assets Acquired:

Petroleum and natural gas properties	\$	443,021
Accounts receivable		14,878
Inventory		12,611
CIPL stock		13,946
Other assets		6,069
		<u>490,525</u>

Liabilities Assumed:

Operating liabilities (including asset retirement obligations of \$10,243)		<u>(28,217)</u>
	\$	<u>462,308</u>

Payment for Net Assets Acquired:

Long-term debt	\$	396,470
Long-term debt – Forest Oil Corporation		29,250
Issuance of 10,000 shares of PERL common stock		24,630
Cash		11,958
	\$	<u>462,308</u>

Beta Unit

In March 2007, PERL completed its acquisition of the Beta Unit from Aera Energy LLC (a Shell-Exxon Mobil joint venture), SWEPI, LP (a Shell subsidiary) and Noble Energy, Inc. As a result of this acquisition, the Company was able to expand its operations in Southern California. The acquisition agreements required PERL to deposit \$90.0 million in U.S. Treasury notes in a supplemental bond decommissioning trust account for abandonment and decommissioning purposes, provide an operating offshore bond of \$1.5 million a working interest owner offshore bond of \$300 thousand, five years of insurance premiums for third party liability and well control of \$12.0 million, a one-time payment of \$6.93 million when certain production levels are met as defined in the purchase agreement with Aera Energy LLC, and a new lease agreement with Mineral Management Services (“MMS”) of the United States Department of the Interior. The one-time payment of \$6.93 million has been discounted to \$5.6 million and included in the payment for net assets acquired and recorded in other liabilities at the balance sheet date. The acquisition was partially financed from a November 2006 credit facility from an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC (Note 10).

The Company has included the Beta Unit’s results of operations in its statement of operations from March 2007 forward.



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NOTE 4 – Business Acquisitions (Continued)

Beta Unit (Continued)

The acquisition was recorded as follows (in thousands):

Assets Acquired:	
Petroleum and natural gas properties	\$ 53,813
Other assets	25
	<hr/>
	53,838
Liabilities Assumed:	
Asset retirement obligations	(43,210)
	<hr/>
	\$ 10,628
Payment for Net Assets Acquired:	
Long-term debt, production notes	5,605
Cash	5,023
	<hr/>
	\$ 10,628

Acquisition of Carneros Energy, Inc.

In June 2006, PERL, through its wholly-owned subsidiary CAC, acquired 100% of the outstanding shares of CEI and its wholly-owned subsidiary GOI based in Bakersfield, California for \$27.2 million in cash. CAC funded the acquisition through a secured term note to Laurus Master Fund, Ltd. (“Laurus”) in the amount of \$21.2 million (Laurus Note) and equity infused from PERL in the amount of \$6.13 million. Warrants to purchase a 45% interest in CEI for \$0.01 per share were issued to induce Laurus to fund the Laurus Note. Additionally, an overriding royalty of 3.0% of CEI’s and GOI’s working interest was issued to Laurus as a further inducement to fund the Laurus Note.

The Company has included CEI’s results of operations in its statement of operations from June 2006 forward.



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NOTE 4 – Business Acquisitions (Continued)

Acquisition of Carneros Energy, Inc. (Continued)

The acquisition of 100% of CEI and its wholly-owned subsidiary was recorded as follows (in thousands):

Assets Acquired:	
Petroleum and natural gas properties	\$ 24,996
Other assets	2,659
	<hr/>
	27,655
	<hr/>
Liabilities Assumed:	
Current liabilities	(132)
Asset retirement obligation	(351)
	<hr/>
	(483)
	<hr/>
	\$ 27,172
	<hr/>
Payment for Net Assets Acquired:	
Long-term debt, net of costs	\$ 20,458
Liabilities assumed – Bonuses	589
Cash	6,125
	<hr/>
	\$ 27,172
	<hr/>

NOTE 5 – Deferred Charges

Deferred financing charges for the year ended December 31, 2006 were as follows (in thousands):

	2006
Deferred charges, opening	\$ 1,208
Deferred financing costs incurred	8,460
Amortization	(1,577)
	<hr/>
	\$ 8,091
	<hr/>

For the year ended December 31, 2007, deferred charges were recorded as a reduction of long-term debt (Note 3).



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NOTE 6 – Investments - Abandonment

The cost and fair value of investments – abandonment are classified as held-to-maturity and were recorded as follows at December 31, 2007 (in thousands):

	Amortized Cost	Unrealized Holding Gain (Loss)	Fair Value
2007			
U.S. Treasury and Agency	\$ 89,930	\$ 1,265	\$ 91,195
U.S. Treasury	1,800	(13)	1,787
Certificates of deposit	378	-	378
Money market accounts	2,375	-	2,375
	<u>\$ 94,483</u>	<u>\$ 1,252</u>	<u>\$ 95,735</u>

NOTE 7 – Asset Retirement Receivable

The Company has an agreement with Chevron Corp. to be reimbursed an undiscounted aggregate of \$1.43 million or \$21.0 thousand per well for abandonment costs in the Wilmington oil field in Long Beach. The Company has discounted the receivable on the same basis followed in computing the ARO.

NOTE 8 – Equity Investment

The Company's equity investment consists of its 50% interest in CIPL, which operates a pipeline in Alaska for the Company and other operators. For the year ended December 31, 2007, the Company paid CIPL \$4.71 million to transport oil on the Company's behalf. The Company's investment in CIPL exceeds the book basis by \$1.9 million. The shares of CIPL stock representing the 50% interest were held in escrow pending regulatory approval of the transfer of shares from their previous owner to PEAH. In February 2008, regulatory approval was obtained.



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NOTE 8 – Equity Investment (Continued)

Summary financial information for CIPL as of December 31, 2007 and for the year then ended is as follows (in thousands):

Current assets (primarily cash)	\$	24,512
Long-term assets		37,591
Total Assets	\$	62,103
Current liabilities	\$	736
Long-term liabilities (ARO)		37,961
Stockholders' equity		23,406
Total Liabilities and Stockholders' Equity	\$	62,103
Net income for the year ended December 31, 2007	\$	66

The Company's share of CIPL's net income (loss) from the date of acquisition (August 2007) forward was a loss of (\$321.0 thousand) for the year ended December 31, 2007.

NOTE 9 – Property and Equipment, and Petroleum and Natural Gas Properties

The asset categories of property and equipment at December 31, 2007 and 2006 were as follows (in thousands):

2007	Cost	Accumulated Depreciation	Net
Vehicles	\$ 209	\$ 64	\$ 145
Office equipment and software	735	98	637
Pipeline equipment	4,195	233	3,962
Other	38	2	36
	<u>\$ 5,177</u>	<u>\$ 397</u>	<u>\$ 4,780</u>

2006	Cost	Accumulated Depreciation	Net
Vehicles	\$ 164	\$ 27	\$ 137
Office equipment and software	230	19	211
Other	5	1	4
	<u>\$ 399</u>	<u>\$ 47</u>	<u>\$ 352</u>



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NOTE 9 – Property and Equipment, and Petroleum and Natural Gas Properties (Continued)

The asset categories of petroleum and natural gas interests at December 31, 2007 and 2006 were as follows (in thousands):

2007	Cost	Accumulated Depreciation	Net
Proved properties including lease and well equipment	\$ 529,745	\$ 16,665	\$ 513,080
Unproved properties			
Undeveloped	11,258	-	11,258
In process of development	3,360	-	3,360
	<u>\$ 544,363</u>	<u>\$ 16,665</u>	<u>\$ 527,698</u>
2006	Cost	Accumulated Depreciation	Net
Proved properties including lease and well equipment	\$ 35,844	\$ 2,369	\$ 33,475
Unproved properties			
Undeveloped	1,411	-	1,411
In process of development	2,957	-	2,957
Beta Unit acquisition costs	2,746	-	2,746
	<u>\$ 42,958</u>	<u>\$ 2,369</u>	<u>\$ 40,589</u>

For the year ended December 31, 2007, the Company recorded an impairment write-down of \$12.0 million (2006 – nil) relating primarily to its Wyoming properties. This write-down has been included within depreciation, depletion and amortization.



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NOTE 10 – Notes Payable

The 2006 and 2007 activity of all notes payable was as follows (in thousands):

	Liability Component		Equity Component
	Face Value	Carrying Value	Fair Value
Balance at December 31, 2005	\$ 13,350	\$ 9,756	\$ 2,192
Proceeds	49,346	38,678	10,668
Payments	(13,780)	(11,314)	(2,192)
Accretion		1,836	
Balance at December 31, 2006	48,916	38,956	10,668
Less debt issue costs at December 31, 2006		(8,091)	
Proceeds	491,104	459,286	31,818
Less issue costs	-	(29,235)	-
Payments	(40,114)	(40,114)	-
Accretion, amortization and non-cash interest	8,995	28,794	-
Balance at December 31, 2007	\$ 508,901	\$ 449,596	\$ 42,486

The future annual principal payments for all notes are as follows (in thousands):

Year Ended December 31

2008	\$ 430
2009	\$ 213,226
2010	\$ 65,000
2011	\$ -
2012	\$ 200,269

The Company was in violation of certain debt covenants at December 31, 2007. Subsequent to year-end, the Company received a waiver from the lenders whereby the prior events of default have been waived. In exchange for the waiver and other extensions related to the debt agreement, the Company must pay a fee of \$6.0 million in 2008.



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NOTE 10 – Notes payable (Continued)

Alaska Acquisition Financing

First and Second Lien Credit Agreements

To fund the Company's acquisition of the Alaska oil and gas properties and operations of FOC (Note 4), PEAO borrowed an aggregate of \$425.0 million from an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC, \$108.0 million was borrowed pursuant to a \$120.0 million first lien credit agreement that is secured by substantially all of the assets of PEAO and PEAH. The Company currently does not have access to the remaining \$12.0 million available under the first lien credit agreement. The other \$317.0 million was borrowed pursuant to a second lien credit agreement and is secured by substantially all of the Company's assets, excluding the assets of CAC, CEI and GOI. The first lien credit agreement bears interest at an annual rate equal to LIBOR plus 2.25% payable monthly. Interest on the second lien credit agreement consists of cash interest at an annual rate equal to LIBOR plus 6.5% (which increases to LIBOR plus 8.5% on February 24, 2008 and to LIBOR plus 10.5% on August 24, 2008) payable on the last day of each fiscal quarter and non-cash interest at an annual rate of 8.0% that is added to the outstanding principal amount of the second lien credit agreement on the last day of each fiscal quarter. The balance outstanding at December 31, 2007 on the first lien credit agreement was \$108.0 million and on the second lien credit agreement was \$285.3 million, including \$8.3 million of non-cash interest. Total accrued cash interest at December 31, 2007 on both loans was \$3.93 million. Both the first lien and second lien credit agreements initially were scheduled to mature in February 2009. However, in December 2007 the Company entered into an amendment extending the second lien credit agreement maturity to February 2012 with mandatory principal payments of \$85.0 million in March 2009 (Note 21).

In addition to interest payable on the outstanding advances on the first lien and second lien credit agreements, each lender received, or will receive, its proportionate share of:

- 1) An aggregate 5.0% overriding royalty interest in the Company's Alaska oil and gas properties acquired from FOC and an aggregate 2.0% overriding royalty interest in the Company's Los Angeles basin properties and Beta Unit properties. The Company will record the monthly royalty payments as expense;
- 2) 4.75 million shares of PERL's common stock issued at closing, with an additional 2.06 million shares of PERL's common stock issued in January 2008. The fair market value of these shares of \$16.1 million were treated as a discount on the debt and will be expensed through accretion ; and
- 3) A closing fee of \$6.34 million paid at closing, a structuring fee of \$12.66 million paid at closing, \$500.0 thousand in administrative and documentation fees payable annually so long as any portion of the second lien credit agreement designated as "tranche B-2" remains outstanding and a conversion fee payable on February 24, 2012 in an amount equal to 2.5% of the aggregate principal amount, if any, outstanding under the first lien and second lien credit agreements on that date. These fees were recorded as deferred financing charges and will be amortized and expensed as additional interest over the life of the debt. The continuing fees will be expensed as incurred.



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NOTE 10 – Notes payable (Continued)

Alaska Acquisition Financing (Continued)

First and Second Lien Credit Agreements (Continued)

The lenders received a first priority lien on all of the Company's Alaska assets and a second priority lien on the California assets at the closing date, but excluding the assets of CAC, CEI and GOI. The first lien and second lien credit agreements require a lockbox mechanism whereby all of PEAO's and PEAH's production revenue cash receipts are swept daily.

The 2007 activity of the credit agreements was as follows (in thousands):

	Liability Component		Equity Component
	Face Value	Carrying Value	Fair Value
Balance at December 31, 2006	-	-	-
Proceeds	\$ 425,000	\$ 408,862	\$ 16,138
Less issue costs	-	(27,594)	-
Payments	(40,000)	(40,000)	-
Accretion and amortization	8,269	18,527	-
Balance at December 31, 2007	\$ 393,269	\$ 359,795	\$ 16,138

Seller Note

In connection with the Company's acquisition of the Alaska oil and gas properties and operations from FOC (Note 4), PERL issued FOC a senior subordinated accreting note with an initial accreting value of \$29.25 million. Immediately after the Company's issuance of the note, the payoff amount increased to \$31.67 million and, unless paid earlier, continues to increase on July 31 of each year until the maturity date of July 31, 2014, at which time the accreted balance would be \$60.75 million. The Company records accretion each year on the effective interest rate method. The note balance at December 31, 2007 was \$29.98 million.

Beta Unit Financing

In November 2006, PERL entered into a \$100.0 million Credit and Guaranty Agreement ("Credit Facility") with an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC.

Interest on the Credit Facility accrues at an annual rate equal to the greater of 12.75% or the adjusted Eurodollar Rate plus 7.75% and is paid quarterly in arrears (the applicable interest rate was 13.1% at December 31, 2007). Principal payments due quarterly are equal to 90.0% of Adjusted Net Cash Flow as defined in the agreement. The Credit Facility matures November 29, 2010 and includes a prepayment penalty for any payment prior to November 30, 2009 in an amount equal to the unpaid scheduled interest payments on the prepaid principal amounts calculated through November 30, 2009.



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NOTE 10 – Notes payable (Continued)

Beta Unit Financing (Continued)

In addition to interest on the outstanding advances on the Credit Facility, each lender received, or will receive, its proportionate share of:

- 1) Upon payment of the debt in full an aggregate 6.5% overriding royalty interest in any properties outside of Wyoming, and an aggregate 6.0% net profits interest in any properties in Wyoming, that are acquired or earned while the debt is outstanding. The Company will record the monthly royalty payments as an expense;
- 2) Upon the earlier of payment of the debt in full or December 2010, a 5.5% overriding royalty interest in the Beta Unit properties. The Company will record the monthly royalty payments as an expense;
- 3) Issued warrants to purchase 25.45 million shares of PERL's common stock exercisable at CAD \$1.42 (U.S. \$1.44 at December 31, 2007). The warrants vest based on funding advances defined in the agreement and have a life of five years from the vesting date. The Company valued the warrants using the Black-Scholes option pricing model at \$22.2 million, treated them as a discount of the debt and will expense the discount as interest through accretion over the life of the debt, ;
- 4) A funding fee of \$650.0 thousand paid at closing and 1.0% of any funds borrowed after closing and a commitment fee of \$5.0 million paid in 2007. These fees were recorded as deferred financing charges and will be amortized and expensed as additional interest over the life of the debt. The continuing fees will be expensed as incurred; and
- 5) A facility fee of 1.0% per annum on the unused commitment balance paid quarterly. The Company has expensed the facility fee as paid.

The lenders received a first priority lien on substantially all of the Company's assets at the closing date, including the Beta Unit, but excluding the assets of CAC, CEI and GOI.

The Credit Facility provides for certain financial statement and environmental reporting as well as negative financial covenants such as current ratio, debt to EBITDA ratio and collateral coverage ratios. The Company is also required to purchase certain oil and gas production hedging contracts upon failure to meet certain ratios and proved and developed oil and gas projections.

The Credit Facility requires a lockbox mechanism whereby all of PERL's and its subsidiaries' (excluding CAC, CEI, GOI, PEAH and PEAO) production revenue cash receipts are swept daily. The Company facilitates the payment of operating and production expenses through requests to an affiliate of The Goldman Sachs Group, Inc. to advance funds to make the required payments. The Credit Facility contains restrictions as to the type and amount of expenses which may be incurred, including a variable limit per quarter on administrative expenses.



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NOTE 10 – Notes Payable (Continued)

Beta Unit Financing (Continued)

As of December 31, 2007, the Company had received advances under the Credit Facility totaling \$65.0 million. In order to access the additional \$35.0 million available under the Credit Facility, the Company would have to reach an agreement with the lender, which may result in additional fees or other consideration payable to the lender.

As required by GAAP, the Company separates the liability and equity components of the Credit Facility. The Company determined the fair value of the liability component of the Credit Facility by calculating the present value of the associated cash flows using a discount rate that reflects its underlying rate of borrowing. The Company determined the fair value of warrants at the issue date of the Credit Facility using the Black-Scholes pricing model. The resulting pro rata fair values of the liability and equity components of the Credit Facility and warrants were \$46.41 million and \$18.6 million (Note 17), respectively. The liability will be accreted to \$65.0 million over the term of the Credit Facility through the recording of an interest expense until the Credit Facility is paid in full.

The 2006 and 2007 activity of the Credit Facility was as follows (in thousands):

	Liability Component		Equity Component
	Face Value	Carrying Value	Fair Value
Balance at December 31, 2005	\$ -	\$ -	\$ -
Proceeds	28,146	25,233	2,913
Payments	-	-	-
Accretion		61	
Balance at December 31, 2006	28,146	25,294	2,913
Less debt issue costs at December 31, 2006		(6,916)	
Proceeds	36,854	21,174	15,680
Less issue costs	-	(1,641)	-
Payments	-	-	-
Accretion and amortization	-	6,188	-
Balance at December 31, 2007	\$ 65,000	\$ 44,099	\$ 18,593

Laurus Master Fund Ltd. Financing

In June 2006, PERL's wholly-owned subsidiary, CAC, entered into a securities purchase agreement, with Laurus for proceeds of \$21.0 million evidenced by the Laurus Note, the proceeds of which were used to purchase CEI (Note 4).

The Laurus Note is secured by substantially all of CAC's, CEI's, and GOI's assets.



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NOTE 10 – Notes Payable (Continued)

Laurus Master Fund Ltd. Financing (Continued)

The Laurus Note bears interest at Prime Rate that is published in “The Wall Street Journal” plus two percent (9.25% at December 31, 2007). The interest rate has a floor of 8.0% per annum. The minimum principal and interest amount to be paid is \$150 thousand per month. The exact amount to be paid monthly for principal and interest equals 75.0% of operating revenues of CAC, CEI and GOI before general and administrative expenses are deducted. Payments are applied first to interest and then to principal. The maturity date of the Laurus Note is May 31, 2009.

Warrants to purchase 27.5 thousand shares of CEI common stock were issued to Laurus. Upon the exercise of the warrants, Laurus or the holder will own 45.0% of CEI (Note 14). The warrants are reported in the financial statements as non-controlling interest.

As required by GAAP, the Company separated the liability and equity components of the Laurus Note. The Company determined the fair value of the liability component of the Laurus Note by calculating the present value of the associated cash flows, using a discount rate that reflects the Company’s underlying rate of borrowing. The Company determined the fair value of warrants at the issue date of the Laurus Note by using the acquisition price the Company paid for the stock of CEI (CEI’s stock is not publicly traded). The resulting pro rata fair values of the liability component of the Laurus Note and warrants were \$13.45 million and \$7.75 million, respectively (Note 16). The liability will be accreted to \$21.2 million over the term of the Laurus Note through the recording of an interest expense until such date at which the Laurus Note is paid in full.

The master security agreement entered into in connection with the Laurus Note requires a lockbox mechanism whereby all of CAC, CEI and GOI’s production revenue cash receipts are swept daily. Laurus is entitled to 75.0% of the net operating revenue relating to oil and gas properties of CEI and GOI for the immediately preceding calendar month, with the remaining funds being disbursed to CEI and GOI.



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NOTE 10 – Notes Payable (Continued)

Laurus Master Fund Ltd. Financing (Continued)

The 2006 and 2007 activity of the Laurus Note was as follows (in thousands):

	Liability Component		Equity Component (Non-Controlling Interest)
	Face Value	Carrying Value	
Balance at December 31, 2005	-	-	-
Proceeds	\$ 21,200	\$ 13,445	\$ 7,755
Accretion	-	647	-
Payments	(430)	(430)	-
Balance at December 31, 2006	\$ 20,770	\$ 13,662	\$ 7,755
Less issues costs at December 31, 2006	-	(1,175)	-
Accretion and amortization	-	3,353	-
Payments	(114)	(114)	-
Balance at December 31, 2007	\$ 20,656	\$ 15,726	\$ 7,755

NOTE 11 – Accounting for Asset Retirement Obligations

The following table summarizes the changes in the Company's abandonment obligations during 2006 and 2007 (in thousands):

	Asset Retirement Obligation	Asset Retirement Receivable	Net Amount
Balance at December 31, 2005	\$ 1,176	\$ 543	\$ 633
Acquisitions	352	-	352
Additions	17	-	17
Accretion	110	42	68
Balance at December 31, 2006	1,655	585	1,070
Acquisitions	53,453	-	53,453
Retirements	(142)	-	(142)
Additions	-	-	-
Accretion	3,059	45	3,014
Balance at December 31, 2007	\$ 58,025	\$ 630	\$ 57,395

The Corporation estimates the total undiscounted amount of cash flows required to settle its ARO is \$185.0 million and \$3.7 million at December 31, 2007 and 2006 respectively, which will be incurred between 2009 and 2036.



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NOTE 12 – Income Taxes

The reconciliation of provision for income taxes at the effective federal statutory rate is as follows (in thousands):

	2007	2006
Federal Statutory rate (34.0%)	\$ (33,575)	\$ (3,060)
Increase (decrease) in taxes resulting from:		
State income tax, net of federal benefit (8.84%)	(5,761)	(468)
Miscellaneous	-	10
Permanent differences	2,462	2,274
Other differences	268	(3,057)
Change in valuation allowance	36,606	7,327
	\$ -	\$ 3,026

The Company's approximate net operating loss and other carryforwards for federal and primarily California income tax purposes as of December 31, 2007 are as follows (in thousands):

	Federal	California
Net Operating Loss	\$ 122,491	\$ 119,934
Statutory depletion	\$ 6,950	\$ 8,550

The Company's net operating loss carryforwards are available to reduce future years' taxable income, are subject to limitation as to use, and expire through 2026. The statutory depletion carryforwards can be utilized over an indefinite period.



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NOTE 12 – Income Taxes (Continued)

Summary of temporary differences giving rise to future income tax asset (in thousands):

	2007	2006
Future tax assets		
Stock-based compensation	\$ 2,219	\$ 733
Retention bonus	-	148
Net operating losses	51,786	14,900
Asset retirement obligation	1,485	500
Hedging losses	1,718	-
Statutory depletion	2,715	2,303
	<u>59,923</u>	<u>18,584</u>
Future tax liabilities		
Asset retirement receivable	251	250
Book basis of petroleum and natural gas properties in excess of tax	14,135	10,090
Prepaid expenses	1,604	-
Hedge income		917
	<u>15,990</u>	<u>11,257</u>
Valuation allowance	<u>43,933</u>	<u>7,327</u>
	<u>-</u>	<u>-</u>

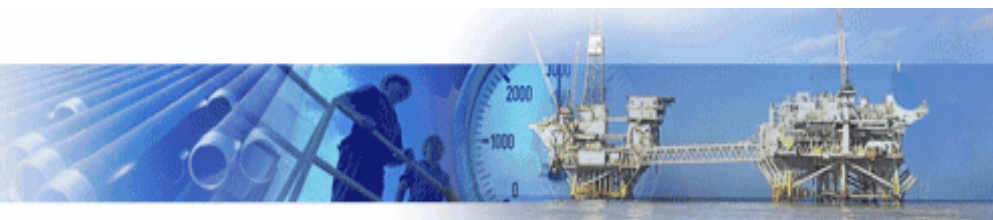
NOTE 13 – Related Party Transactions

Transactions with related parties are measured at their fair value as determined by management.

- a) As of December 31, 2007 and 2006 the Company owed \$61.0 thousand and \$6.0 thousand, respectively, to various related parties for amounts incurred by the related parties on the Company's behalf.
- b) During the years ended December 31, 2007 and 2006, the Company incurred legal costs of \$385.0 thousand and \$301.0 thousand paid to a law firm that, until October 31, 2007, was owned and operated in part by one of the Company's directors. At December 31, 2007 and 2006 the balance owing to the law firm is \$22.0 thousand and \$43.0 thousand, respectively. These balances are included in accounts payable and accrued liabilities.
- c) During the years ended December 31, 2007 and 2006, the Company recorded \$263.0 thousand and \$188.0 thousand, respectively, of royalty expense to an entity owned by an employee for an overriding royalty on its Wilmington property. At December 31, 2007, the balance owed to this related party was \$25.0 thousand, which is included in accounts payable and accrued liabilities.
- d) As of December 31, 2006 the Company had written off advances to officers of the Company totaling \$216.0 thousand.



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NOTE 13 – Related Party Transactions (Continued)

- e) The Company has entered into numerous transactions with an affiliate of The Goldman Sachs Group Inc. and Silver Point Finance LLC, who are significant stockholders, note holders, and have other influence as disclosed in notes 1 and 10.
- f) As discussed in Note 4, in June 2006, the Company acquired all of the issued and outstanding shares of CEI and its wholly-owned subsidiary, for an aggregate purchase price of approximately \$25.2 million. One of the Company's board members received \$218.0 thousand from the Company as consideration for the shares of CEI capital stock sold as a result of the CEI acquisition.

NOTE 14 – Commodity Derivative Instruments

As part of the Company's financing agreements, the Company is required to enter into derivative financial instruments, options, and swaps to hedge the impact of oil and natural gas price fluctuations.

A summary of these contracts in place at December 31, 2007 is as follows:

Crude Oil

Expiry	Annual Volume (in thousands) (Bbl/period)	Type	Strike Price (US\$/Bbl)
December 2008	1,451	Swap	\$65.30
December 2009	1,283	Swap	\$64.35
December 2010	1,023	Swap	\$63.76
December 2011	569	Swap	\$61.80
December 2012	307	Swap	\$61.14

At December 31, 2007, the derivative liabilities on the consolidated balance sheet reflect the net unrealized loss position of \$89.5 million for contracts outstanding at that date (current liability of \$34.25 million, and long-term liability of \$55.25 million). At December 31, 2006, the derivative assets on the consolidated balance sheet reflect the net unrealized gain position of \$2.77 million for contracts outstanding at that date.

For the year ended December 31, 2007, the total unrealized loss was \$6.78 million on the consolidated statement of operations and \$82.72 million on the statement of accumulated deficit and comprehensive loss. For the year ended December 31, 2006, the total unrealized gain was \$2.77 million. The financial impact on the settlement of contracts during 2007 and 2006 was a realized (loss) gain of (\$11.77 million) and \$29.0 thousand, respectively.



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NOTE 15 – Commitments and Contingencies

Contractual Obligations:

Operating Leases

The Company has non-cancelable operating leases for its office facilities. The leases have scheduled increases, require the Company to pay its share of operating costs, and expire from 2009 to 2012. The leases include options to extend the terms of the leases for three to five years.

Future minimum payments under operating leases for the next five years are as follows (in thousands):

2008	\$796
2009	\$811
2010	\$671
2011	\$451
2012	\$160

Drilling Commitments

The Company shares interests in various oil and gas properties with other companies. The Company may be required to provide funds for drilling and completion costs related to these oil and gas properties. At December 31, 2007 the Company had no material drilling commitments.

NOTE 16 – Non-Controlling Interests

As part of the financing for the Company's acquisition of CEI (Note 10), warrants to purchase 27.5 thousand shares of CEI common stock were issued to Laurus. The exercise price for the warrants is \$.01 per share. The warrants became exercisable when the Laurus Note is paid in full. Since CEI's stock is not publicly traded the fair value of the warrants was based on the purchase price paid by the Company for CEI's stock in relationship to the fair value of the debt. The warrants are assignable, contain anti-dilutive rights, and have no expiration date. Upon exercise of the warrants in full Laurus will own 45.0% of CEI's outstanding common stock.



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NOTE 17 – Stockholders' Equity

a) Authorized 50.0 million preferred shares with a par value of \$.01. Authorized 500.0 million common shares with a par value of \$0.0001 per share.

b) Issued (in thousands)

	Number of Shares	Share Capital	Additional Paid In Capital
Balance – December 31, 2005	56,964	\$ 6	\$ 16,109
Warrants exercised	4,981	-	6,049
Debentures converted	536	-	403
Laurus debt converted	3,398	-	3,545
Bateman debt converted	803	-	900
Common stock issued	10,916	2	12,525
Balance – December 31, 2006	77,598	\$ 8	\$ 39,531
Warrants exercised	2,068		3,332
Shares issued for acquisitions	10,000	1	24,630
Shares issued for debt	4,750	1	11,255
Shares issued for debt issue costs	3,097	-	7,000
Stock options exercised	31	-	27
Shares issued for damages	648	-	1,624
Common stock issued	88,450	9	120,030
Balance – December 31, 2007	186,642	\$ 19	\$ 207,429



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NOTE 17 – Stockholders' Equity (Continued)

c) Subscription receipts

On August 27, 2007, in connection with credit agreements with an affiliate of The Goldman Sachs Group, Inc. and affiliates of Silver Point Finance LLC (the “lenders”) for the acquisition of the Alaska assets, the Company agreed to issue additional shares of PERL’s common stock as incentives for the lenders based on the Company’s equity raise in October 2007. Accordingly, 2.06 million additional shares, which were valued at the date of the Alaska acquisition, were issued in January 2008. The Company has recorded subscription receipts of \$4.88 million at December 31, 2007 in relation to these shares.

The Company did not file its registration statement in September, October, November or December of 2007. Accordingly, the Company issued 647.0 thousand shares in December with a value of \$1.62 million and has recorded 1.94 million shares issuable at a value of \$4.43 million (Note 17 (f)).

On November 1, 2006 the Company signed and closed on a purchase and sale agreement with Aera Energy LLC (“AERA”) to purchase its 71.0% portion of the Beta Unit (Note 4). In conjunction with the purchase of the Beta Unit PERL offered up to 45.3 million subscription receipts at a price of \$1.30 CAD per subscription receipt. The closing for the subscription receipts occurred in November and December of 2006 and PERL issued 45.3 million subscription receipts for net proceeds of \$61.13 million. For each subscription receipt the holder was entitled to receive one common share and one half warrant of PERL and the shares and warrants were issued in March 2007.

d) Stock options

The Corporation has a stock option plan for its directors, officers, employees and key consultants. The total number of options issuable under the stock option plan at December 31, 2007 was 18.5 million.

	December 31, 2007		December 31, 2006	
	Number of Options (in tl)	Weighted Average Exercise Price per Share (CAD\$)	Number of Options (in thousands)	Weighted Average Exercise Price per Share (CAD\$)
Outstanding, beginning of year	5,160	\$1.15CAD	3,350	\$0.84CAD
Granted during the year	7,068	\$2.75CAD	2,010	\$1.55CAD
Exercised during the year	(31)	\$0.84CAD		
Forfeited during the year	(195)	\$0.84CAD	(200)	\$1.18CAD
Outstanding, end of year	12,002	\$2.06CAD	5,160	\$1.15CAD
Exercisable, end of year	4,389	\$1.22CAD	1,766	\$1.15CAD



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NOTE 17 – Stockholders' Equity (Continued)

d) Stock options (continued)

The following table summarizes information about the Company's outstanding stock options at December 31, 2007

Exercise Price (CAD)	Options Outstanding		Options Exercisable		
	Number of Options (in thousands)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Outstanding (in thousands)	Weighted Average Exercise Price
\$0.84	3,069	2.92	\$0.84 CAD	2,111	\$0.84CAD
\$0.84	100	.92	\$0.84 CAD	68	\$0.84CAD
\$1.40 to \$1.60	1,910	2.5	\$1.55 CAD	1,910	\$1.55CAD
\$1.73 to \$3.00	6,923	4.10	\$2.75 CAD	300	\$1.93CAD
	12,002	3.50	\$2.06 CAD	4,389	\$1.22 CAD

A modified Black-Scholes option pricing model, with the following weighted-average assumptions, was used to estimate the fair value of options on the date of the grant, for the inclusion as stock-based compensation expense:

	2007	2006
Risk free interest rate (%)	3.9 – 4.7%	4.84%
Expected lives (years)	3 – 5	2.8 – 5
Expected volatility (%)	87 – 94%	99.5%
Dividend per share	\$0.0	\$0.0

The grant date weighted-average fair value of options granted during 2007 and 2006 was \$1.83 and \$0.50 per option, respectively. The impact of stock-based compensation on contributed surplus is (in thousands):

Contributed surplus	2007	2006
Opening balance	\$ 1,984	\$ 59
Additions from issuance of stock options	3,468	1,652
Extinguishment of Laurus debt	-	273
Closing balance	\$ 5,452	\$ 1,984



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NOTE 17 – Stockholders' Equity (Continued)

e) Warrants (in thousands)

	December 31, 2007		December 31, 2006	
	Number	Amount	Number	Amount
Balance, beginning of year	37,723	\$ 6,797	5,772	\$ 1,986
Granted during the year	54,387	-	2,401	2,981
Securities purchase agreement (Note 10)	-	15,680	25,451	2,912
Issued with U.S. shares in escrow	-	-	5,458	-
Agent warrants on U.S. private placements	-	-	819	-
Finders fee per securities purchase agreement	-	1,640	2,803	652
Converted on issuance of shares	(2,069)	-	(4,981)	(1,734)
Balance, end of year	90,041	\$ 24,117	37,723	\$ 6,797

December 31, 2007

Exercise Price	Number (in thousands)	Warrants Outstanding		Warrants Exercisable	
		Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number (in thousands)	Weighted Average Exercise Price
\$1.60 to \$1.70 CAD	34,639	1.93	\$1.67 CAD	34,639	\$1.67 CAD
\$0.90 U.S.	790	0.99	\$0.90 U.S.	790	\$0.90 U.S.
\$1.42 CAD	28,254	3.90	\$1.42 CAD	28,254	\$1.42 CAD
\$2.65 CAD	16,263	1.33	\$2.65 CAD	16,263	\$2.65 CAD
\$1.50 to \$1.70 CAD	9,276	1.95	\$1.67 CAD	9,276	\$1.67 CAD
\$1.625 to \$1.95 CAD	819	2.00	\$1.79 CAD	819	\$1.79 CAD
	90,041	2.43	\$1.76 CAD*	90,041	\$1.76 CAD*



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NOTE 17 – Stockholders' Equity (Continued)

e) Warrants (continued)

December 31, 2006

Exercise Price	Warrants Outstanding			Warrants Exercisable	
	Number (in thousands)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number (in thousands)	Weighted Average Exercise Price
\$1.60 to \$1.70 CAD	2,402	4.42	\$1.62 CAD	2,402	\$1.62 CAD
\$0.90 U.S.	790	1.99	\$0.90 U.S.	790	\$0.90 U.S.
\$1.42 CAD	28,254	4.90	\$1.42 CAD	3,504	\$1.42 CAD
\$1.70 CAD	5,458	3.00	\$1.70 CAD	-	-
\$1.625 to \$1.95 CAD	819	3.00	\$1.79 CAD	-	-
	37,723	4.49	\$1.47 CAD*	6,696	\$1.43CAD*

* Assumes exchange rate of \$1.00 U.S. = \$1.00CAD

f) Liquidated damages

The registration rights agreements the Company entered into in connection with the equity and debt financings relating to the Beta Unit acquisition require the Company to, among other things, register for resale the common stock and shares underlying warrants issued in those financings and to maintain the effectiveness of the registration statement for an extended period of time. Because the Company's acquisition of the Alaska assets on August 27, 2007 necessitated that it include in the registration statement audited financial information regarding the Alaska assets, which information was unavailable at that time, the Company did not meet the August 29, 2007 filing deadline for the registration statement.

The Company initially was subject to liquidated damages assessments of 1.0% (capped at 10.0%) of the number of shares of common stock issued in the equity financing related to the Beta Unit acquisition and still held by the original holders as of the end of each 30 days of non-compliance, subject to pro ration for partial months. The shares of common stock and warrants related to the equity financing for the Beta Unit acquisition were not issued and outstanding until March 2007, when the Beta Unit acquisition closed.

The Company is not obligated to repurchase either the shares or the warrants that were issued in the equity financing. If the Company is unable to gain and maintain compliance with its registration obligations, then it may be required to issue up to 7.4 million shares of PERL's common stock as liquidated damages for no additional consideration. However, the Company believes that the total number of shares that ultimately will be issued as liquidated damages will be less than 7.4 million because a substantial portion of the shares issued in the equity financing relating to the Beta Unit acquisition have become no longer entitled to liquidated damages assessments.



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NOTE 17 – Stockholders' Equity (Continued)

f) Liquidated damages (continued)

The Company did not file its registration statement in September, October, November or December of 2007. Accordingly, the Company recorded an additional expense of \$6.05 million, which represents the estimated value of the estimated 2.4 million additional shares to be issued, with the same amount being recorded in subscription receipts until the shares are issued by the Company. This represented the Company's best estimate of the number of additional shares required to be issued by December 31, 2007 as liquidated damages; however, the actual number of these additional shares issued by December 31, 2007 was 647.0 thousand, with 1.75 million more shares issued after that date to cover liquidated assessments through December 31, 2007.

NOTE 18 – Earnings Per Share

(a) **Basic:** Earnings per share are calculated using the weighted average number of shares outstanding during each of the years presented in the consolidated financial statements. The following table sets forth the weighted average number of common shares outstanding for each of those years (in thousands):

<u>Year</u>	<u>Outstanding</u>
2007	140,632
2006	61,138

(b) **Diluted:** The Company follows CICA Handbook Section 3500, "Earnings per Share". The statement requires the presentation of both basic and diluted earnings (loss) per share ("EPS") in the statement of operations, using the "treasury stock" method to compute the dilutive effect of stock options and warrants and the "if converted" method for the dilutive effect of convertible instruments. For the years ended December 31, 2007 and 2006 the assumed exercise of outstanding stock options and warrants would have an anti dilutive effect on EPS.

NOTE 19 – Restatement

During 2007, the Company determined that the 2006 financial statements erroneously included January 2007 subscription receipts in the cash – restricted and stock subscriptions and subscription receipts as of December 31, 2006. The following outlines the adjustment to the 2006 financial statements (in thousands):

	<u>As previously reported</u>	<u>Adjustments</u>	<u>As restated</u>
Cash – restricted	\$ 83,616	\$ (9,962)	\$ 73,654
Subscriptions and subscription receipts	\$ 71,089	\$ (9,962)	\$ 61,127



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NOTE 20 – Financial Instruments

All significant financial assets, financial liabilities and equity instruments of the Company are either recognized or disclosed in the financial statements together with other information relevant for making a reasonable assessment of the future cash flows and interest rate, currency or credit risk.

Financial instruments primarily consist of receivables, accounts payable, accrued expenses, derivatives and short- and long-term notes payable. The fair value of receivables, accounts payable, and accrued expenses closely approximates their carrying value due to their short-term maturities. The carrying amounts of substantially all of the Company's outstanding long-term debt approximate fair value, because their interest rates are based on variable reference rates or rates currently available to the Company for debt with similar terms. The derivatives are carried at fair value.

Credit risk and concentration

The Company maintains its cash accounts primarily with a bank with locations in California and Alaska. The total cash balances are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to \$100.0 thousand per bank. The Company's cash balances on deposit in bank accounts in California and Alaska at December 31, 2007 exceeded the balance insured by the FDIC in the aggregate amount of \$10.6 million.

A significant portion of the Company's revenues and trade receivables are from the oil and gas industry and, as such the Company is exposed to many of the risks associated with that industry.

All of the Company's accounts receivable are due from entities in the oil and gas industry and are subject to normal industry credit risk. Concentration of credit risk is mitigated by having concentrations with credit worthy customers. The Company has two customers that make up 56.0% and 26.0% of the accounts receivable balance at December 31, 2007 and one customer that makes up 59.0% of accounts receivable balance at December 31, 2006.

Interest rate risk

The Company is exposed to fluctuations in interest rates on its notes payable. The Company will be exposed to higher interest costs if the average prime rate should increase.

Commodity Derivative Instruments

The Company uses financial instruments to manage its exposure to fluctuations in commodity prices. The Company does not use financial instruments for speculative trading purposes. The commodity derivative instruments are marked-to-market with the resulting gain or loss reflected in earnings and other comprehensive income (loss) for the year.



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NOTE 21 – Subsequent Events

Capital raise

In January 2008, the Company raised additional capital of \$20.69 million through an incentive warrant financing by issuing an aggregate of 12.2 million shares of common stock upon exercise of then-outstanding warrants and an additional 12.2 million of new incentive warrants that expire in January 2013. The Company paid an advisory fee of \$805.0 thousand for the capital raise.

Amendments to financing agreements with an affiliate of The Goldman Sachs Group, Inc. and Silver Point Finance LLC

In January 2008, the Company's credit agreements were amended and as part of this amendment, the Company has agreed to:

- 1) Raise an amount at least equal to \$85.0 million by March 31, 2009 from the sale of its common stock or other agreed upon capital raising transactions or asset disposition or the freeing of restricted cash and apply this amount against the debt under the second lien credit agreement;
- 2) Explore investment strategies with respect to CEI, including the active solicitation of bids for sale by no later than May 31, 2008;
- 3) Hire certain management and executive management personnel in consultation with the lenders;
- 4) Appoint two additional independent directors of the Company in consultation with the lenders; and
- 5) Raise at least \$50.0 million by June 30, 2008 from the sale of its common stock or other agreed upon capital raising or asset disposition transactions or the freeing of restricted cash, to be used for approved plans of development; and
- 6) Obtain an interest rate swap by March of 2008.

The Company has not yet acquired an interest rate swap which is a technical violation of its debt covenants but, since interest rates have fallen and it is management's opinion that interest rates will continue to fall, the Company does not believe the lenders will consider the covenant in violation. In the event the lender does consider this a violation the Company may incur additional fees or the lender could call the debt.

Syndication agreement

In January 2008, the Company agreed to use its best efforts to facilitate the sale of the first lien credit agreement loan (\$108.0 million at December 31, 2007) to new lenders on or before February 15, 2008. This syndication has not yet taken place and the Company is therefore required to pay a 1.0% liquidated damage fee on the outstanding balances of the first lien credit agreement loan starting February 16, 2008 and every thirty days following until the debt is paid in full or syndicated.



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