



Consolidated Financial Statements

For the quarters ended March 31, 2006 and 2005

AUSAM ENERGY CORPORATION

Consolidated Balance Sheets (unaudited)

(in Canadian dollars)

	<u>March 31, 2006</u>	<u>December 31, 2005</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 7,840,581	\$ 8,634,332
Accounts receivable	45,855	25,818
Loan receivable (Note 6)	397,087	419,723
Inventory	8,242	8,432
Prepaid expenses and deposits	50,063	8,205
	<u>8,341,828</u>	<u>9,096,510</u>
Advances to joint venture partner	425,986	629,209
Property and equipment (Note 3)	4,739,064	4,303,450
	<u>\$ 13,506,878</u>	<u>\$ 14,029,169</u>
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 453,935	\$ 568,140
Asset retirement obligations (Note 4)	160,521	164,207
Shareholders' equity		
Common shares (Note 5b)	32,109,399	32,109,399
Share purchase warrants (Note 5c)	997,137	997,137
Contributed surplus (Note 5f)	3,109,881	2,970,709
Cumulative translation adjustment	(1,568,132)	(1,568,499)
Deficit	(21,755,863)	(21,211,924)
	<u>12,892,422</u>	<u>13,296,822</u>
Operations (Note 1)		
Related party transactions (Note 6)		
Subsequent event (Note 7)		
	<u>\$ 13,506,878</u>	<u>\$ 14,029,169</u>

See accompanying notes to consolidated financial statements.

AUSAM ENERGY CORPORATION

Consolidated Statement of Operations and Deficit (unaudited)

(in Canadian dollars)

	Three months ended March 31, 2006	Three months ended March 31, 2005
Revenues		
Interest and other income	\$ 82,077	\$ 41,106
Expenses		
General and administration	477,663	637,409
Stock option expense	139,172	220,544
Depreciation and accretion	9,181	7,699
	<u>626,016</u>	<u>865,652</u>
Net loss	(543,939)	(824,546)
Deficit, beginning of period	(21,211,924)	(9,853,511)
Deficit, end of period	<u>\$ (21,755,863)</u>	<u>\$ (10,678,057)</u>
Loss per share:		
Basic and diluted	\$(0.01)	\$(0.02)

See accompanying notes to consolidated financial statements.

AUSAM ENERGY CORPORATION

Consolidated Statements of Cash Flows (unaudited)

(in Canadian dollars)

	Three months ended March 31, 2006	Three months ended March 31, 2005
	<u> </u>	<u> </u>
Cash provided by (used for):		
Operations		
Net loss	\$ (543,939)	\$ (824,546)
Add (deduct) non-cash items:		
Stock based compensation	139,172	220,544
Depreciation and accretion expense	9,181	7,699
Funds used for operations	(395,586)	(596,303)
	<u> </u>	<u> </u>
Change in non-cash working capital	(175,910)	(828,525)
	(571,496)	(1,424,828)
	<u> </u>	<u> </u>
Financing activities		
Proceeds from issue of shares	-	110,000
Repayment of loan receivable	22,636	-
	22,636	110,000
	<u> </u>	<u> </u>
Investing activities		
Capital asset additions	(244,891)	(349,520)
Advances to joint venture partner	-	(2,484,554)
	(244,891)	(2,834,074)
	<u> </u>	<u> </u>
Decrease in cash and cash equivalents	(793,751)	(4,148,902)
Cash and cash equivalents, beginning of period	8,634,332	7,812,948
	<u> </u>	<u> </u>
Cash and cash equivalents, end of period	\$ 7,840,581	\$ 3,664,046
	<u> </u>	<u> </u>

See accompanying notes to consolidated financial statements.

AUSAM ENERGY CORPORATION

Notes to Consolidated Financial Statements

1. Nature of Operations and Basis of Presentation

Ausam Energy Corporation (the "Company" or "Ausam") is incorporated under the Business Corporations Act (Alberta). On June 7, 2004 Ausam changed its name from Northlinks Limited to Ausam Energy Corporation. The Company is considered to be a development stage enterprise as it has yet to generate significant revenue from operations. Its principal activities relate to oil and gas exploration and development in Australia.

The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The financial statements include the accounts of Ausam and the accounts of its wholly owned subsidiary, Ausam Resources Pty Ltd ("ARL"). The acquisition of ARL has been accounted for as a reverse takeover of Ausam by ARL effective July 30, 2004, and as a result the financial statements of the Company treat ARL as the acquiring company and therefore all pre acquisition date results reflect the operations of ARL only.

A portion of the Company's exploration, development and production activities are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate working interest in such activities.

Presently Ausam has no production and therefore no operating cash flow, and at this time all exploration activities and overhead expenses are financed by way of equity. The recovery of petroleum and natural gas property costs is dependent on Ausam's ability to generate profitable operations or realize sufficient proceeds from the sale of such properties.

2. Significant Accounting Policies

a) Foreign currency translation

The Company's Australian operations are considered self-sustaining and are translated into Canadian dollars using the current rate method. Under this method, assets and liabilities are translated at period-end exchange rates and items included in the statements of operations and retained earnings and cash flows are translated at the rates in effect at the time of the transaction. The gain or loss on translation is charged to cumulative translation adjustment in shareholders equity. At balance sheet date amounts payable and receivable in foreign currencies are translated to the reporting currency at rates in effect. Resulting exchange differences are recognized in determining the profit or loss for the period.

b) Property and equipment

The Company has interests in oil and gas properties and is in the process of exploring and developing its various properties, the economic viability of which has not been assessed. The realization of the Company's investment in its properties is dependent upon various factors, including the existence of economically recoverable reserves, the ability to obtain the necessary financing to complete the exploration and development of the properties, future profitable operations, or, alternatively, upon the disposal of the investment on an advantageous basis.

The Company reviews the carrying values of property acquisition and exploration expenditures regularly, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable, assesses whether there has been any impairment in value. In the event that the estimated undiscounted cash flows expected from its use or eventual disposition is determined to be insufficient to recover the carrying value of any property, the carrying value will be written down to the estimated fair value.

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Notes to Consolidated Financial Statements

Following the discovery of reserves and the commencement of production, the Company accounts for oil and natural gas properties and equipment in accordance with Canadian full cost accounting in the oil and gas industry. Under this method, all costs associated with the acquisition of, exploration for and the

development of, natural gas and oil reserves, are capitalized on a country-by-country cost centre basis. Costs accumulated within each cost centre net of estimated salvage value are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Proceeds from the disposal of properties are normally deducted from the full cost pool without recognition of gain or loss unless that deduction would result in a change to the rate of depreciation, depletion and amortization of 20% or greater in which case a gain or loss is recorded. Costs of major development projects and costs of acquiring and evaluating significant unproved properties are excluded, on a cost centre basis, from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties, or impairment has occurred.

Capitalized costs, together with estimated future capital costs associated with proven reserves, are depleted and depreciated using the unit-of-production method based on estimated gross proven 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 oil based on relative energy content of six thousand cubic feet of gas to one barrel of oil. Costs of significant unproved properties, net of impairments, are excluded from the depletion and depreciation calculation.

c) Asset retirement obligations

An asset retirement obligation is recorded as a liability in the period in which a legal obligation is incurred as a result of an acquisition, construction, development and/or normal use of the assets. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depleted and depreciated using a unit-of-production method over the estimated gross proved reserves. Subsequent to the initial measurement of the asset retirement obligations, the obligations are adjusted at the end of each year to reflect the passage of time of changes in the estimated future cash flows underlying the obligation.

d) Stock-based compensation plan

The Company has a stock-based compensation plan as described in Note 6. The Company follows the fair value method for valuing stock option grants. Under this method, compensation cost attributable to all share options granted is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

e) Loss per share

Basic loss per share is computed using the weighted average number of shares outstanding during the period. Diluted loss per share is computed in accordance with the treasury stock method. Diluted loss per share reflects the dilution that would occur if outstanding stock options and warrants were exercised or converted into common shares using the treasury stock method. For periods ended March 31, 2006 and 2005, the inclusion of the Company's stock options and warrants in the computation of diluted loss per share would have an anti-dilutive effect on loss per share and therefore options and warrants are excluded from the computation.

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Notes to Consolidated Financial Statements

3. Property and equipment

December 31, 2005	Cost	Accumulated depreciation	Write down	Net book value
Petroleum and natural gas properties	\$10,800,589	-	\$6,605,948	\$4,194,641
Other assets	160,046	51,237	-	108,809
	\$10,960,635	\$51,237	\$6,605,948	\$4,303,450

March 31, 2006	Cost	Accumulated depreciation		Net book value
Petroleum and natural gas properties	\$11,246,295	-	\$6,605,948	\$4,640,347
Other assets	159,505	60,788	-	98,717
	\$11,405,800	\$60,788	\$6,605,948	\$4,739,064

4. Asset Retirement Obligation

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of oil and gas properties.

	March 31, 2006
Asset retirement obligation, beginning of year	\$ 164,207
Changes due to exchange rates	3,686
Asset retirement obligation, end of period	\$ 160,521

The undiscounted amount of cash flows, required over the estimated reserve life of the underlying assets, to settle the obligation, adjusted for inflation, is estimated at \$172,210. The obligation was calculated using a credit-adjusted risk free discount rate of 9 percent. The majority of expenditures are expected to be incurred in 2006.

5. Share Capital

a) Authorized

Unlimited number of common shares without nominal or par value and unlimited number of preferred shares, issuable in series.

b) Issued – common shares

Balance, December 31, 2004	38,506,835	22,368,505
Issue of common shares for cash	8,895,285	7,006,892
Issue costs	-	(432,708)
Issue of common shares for cash, upon exercise of warrants	2,920,644	3,166,710
Balance, December 31, 2005 and March 31, 2006	50,322,764	\$32,109,399

Under reverse takeover accounting the authorized and issued share capital is that of Ausam while the stated value is that of ARL. Included in share issue costs and contributed surplus is \$428,900 relating to the fair value of broker/agent options and warrants issued as part of the private placements completed on during 2004 and 2005. The fair value was estimated using the Black-Scholes option-pricing model.

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Notes to Consolidated Financial Statements

c) Issued - share purchase warrants

Balance, December 31, 2005 and March 31, 2006	\$ 977,137
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As part of the private placements completed on July 30, September 3, and November 8, 2004, the Company issued 8,228,847 share purchase warrants, exercisable at \$1.00 per common share until July 30, September 3, and November 8, 2005. As part of the private placements completed in June and July 2005, the Company issued 4,447,642 share purchase warrants, exercisable at \$1.20 per common share until December 1, 2006. The fair value of the warrants was estimated using the Black-Scholes option-pricing model.

d) Stock options

The Company has established a stock option plan for its directors, officers, employees and consultants, whereby options may be granted subject to certain terms and conditions. Stock options vest over a period of up to three years and expire at various dates through 2010.

Changes in the number of options, with their weighted average exercise prices, are summarized below:

	2006		2005	
	Number #	Weighted average exercise price \$	Number #	Weighted average exercise price \$
Outstanding, beginning of year	4,400,000	0.91	2,375,000	0.76
Granted	-		450,000	1.30
Outstanding, end of period	4,400,000	0.91	2,825,000	0.85
Options exercisable, end of period	2,408,333	0.92	941,667	0.85

The following table summarizes information about the stock options at March 31, 2006:

Exercise Price	Options outstanding			Options exercisable	
	Number outstanding, March 31, 2006	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable, March 31, 2006	Weighted average exercise price
\$0.75	2,275,000	3.3	\$0.75	1,516,668	\$0.75
\$1.10	100,000	3.5	\$1.10	66,666	\$1.10
\$1.15	1,575,000	4.2	\$1.15	525,000	\$1.15
\$1.30	350,000	3.8	\$1.30	233,333	\$1.30
\$1.30	100,000	3.9	\$1.30	66,666	\$1.30
	4,400,000	3.7	\$0.91	2,408,333	\$0.92

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e) Contributed surplus

The following table sets out the changes in contributed surplus related to the stock based compensation expense:

Balance at December 31, 2005	\$ 2,970,709
Stock based compensation during 2006	139,172
Balance at March 31, 2006	\$ 3,109,881

f) Warrants and broker/agent options

The following table summarizes warrants and broker warrants and options outstanding as at March 31, 2006:

	Number	Exercise price	Expiry date
Unit warrants	4,447,642	\$1.20	December 1, 2006
Broker/agent options	611,477	\$0.75	May 8, 2006
Broker/agent options	276,888	\$1.20	December 1, 2006
Other warrants	500,000	\$0.75	July 30, 2006
Total	5,836,007		

Each option or warrant entitles the option or warrant holder to acquire one common share of the Company at the exercise price. The May 8, 2006 broker warrants expired unexercised.

The broker/agent options and warrants have been fair valued and the value is included in share issue costs.

g) Per share amounts

Per share amounts are calculated using the weighted average number of common shares outstanding during the period. The weighted average number and the diluted weighted average number due to options and warrants outstanding, of common shares outstanding after the five for one share exchange during the quarters ending at March 31, 2005, and March 31, 2004 are as follows:

	2006	2005
Weighted average number of common shares outstanding during the period	50,322,764	38,546,836
Diluted weighted average number of common shares outstanding during period	50,322,764	40,598,590

h) Escrow shares

5,231,861 shares acquired by certain directors and related parties as part of the transaction with Ausam Resources Pty Ltd and as part of a private placement completed in April 2004 are subject to escrow agreements. 10% of the escrowed shares were released upon issuance of the final Notice of the TSX Venture Exchange regarding the completion of the Transaction (the "Initial Release"). The remaining shares are releasable on each of the 6, 12, 18, 24, 30 and 36 months following the Initial Release. At March 31, 2006, 2,354,337 (45%) shares remained in escrow.

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6. Related party transactions

The following summarizes related party transactions during 2006 and 2005:

- a) The loan receivable comprises \$397,087 of advances to a director and officer. A new promissory note in the amount of \$397,087, secured by shares of the Company, was signed on March 31, 2006 for the indebtedness outstanding at that time, which specifies interest at bank prime, the maximum amount outstanding at June 15, 2006 to be \$160,000 and full repayment by September 20, 2006. During the three months ended March 31, 2006, \$13,037 of interest was charged and paid on this loan, which is included in interest income. As at May 30, 2006, the balance on the loan was \$356,227.
- b) During the quarter ended March 31, 2005, included in general and administrative costs were \$62,660 of management and consulting fees paid to companies where two directors and officers of the Company are the shareholders.

All related party transactions in the normal course of operations have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties and which is similar to those negotiated with third parties.

7. Subsequent event

On May 24, 2006 the Company executed a farmin agreement in Australia, under which Ausam can earn up to 35% interest in PL 119 (Downlands and Downlands East gas fields), the Bainbilla Block of ATP 471P (Brynog oil prospect) and PPL 58 (Downlands pipeline licence), all located in southeast Queensland's Surat / Bowen Basin. Ausam's interest is earned by spending up to approximately \$5.5 million (contract amount is AU\$6.5 million) in seismic acquisition and through drilling of up to four wells in two stages. Ausam's ultimate ownership in the permits will reflect expenditures actually made during the term of the agreement.