



ANNUAL REPORT 2003

CORPORATE PROFILE

Compliance Energy Corporation is a newly formed energy company focused on optimisation of the resources of the Tulameen Coal Basin located near Princeton, BC. The main areas of focus are Coal Production, Electrical Power Generation, and Coalbed Methane.

The Company has a highly-experienced management team and is debt-free.

CORPORATE HIGHLIGHTS

Symbol:	CEC
Stock Exchange:	TSX.V
Current Share Price:	\$0.45
12 Month Range:	\$0.22 - \$0.82
Shares Issued:	27.1 million
Options & Warrants:	3.0 million
Mgm't / Directors (FD):	25%

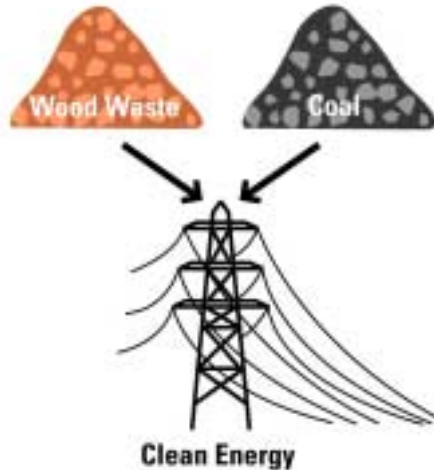
CORPORATE VISION

COAL PRODUCTION



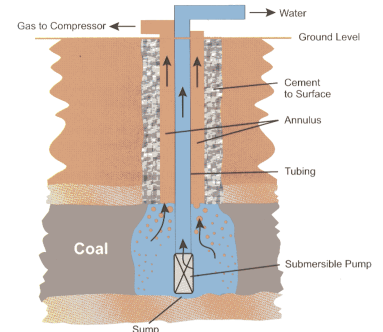
Wash Plant financed, constructed and commissioned in late 2002. First year of operation 2003.

ELECTRICAL POWER GENERATION



Pre-Feasibility study completed showing potential revenue of \$26 million per year wood waste /coal power

METHANE EXPLOITATION



Company was recently awarded the Coalbed Methane rights for the Tulameen basin.

INVESTMENT HIGHLIGHTS

- Experienced Management team
- Growth Sustaining Cash Flow

- > 20 Years Coal Resource
- Debt Free

- Tight Capital Structure
- Ground Floor Opportunity in Energy Growth Company



Highlights:

- *Compliance completes first year of production at BC's newest mine.*
- *Compliance completes positive power plant studies.*
- *Compliance acquires coalbed methane gas rights to the Tulameen basin.*

Inside:

Chairman's Report	2
Compliance Basin Coal Joint Venture	3 -5
Power General	6
Management Discussion and Analysis	7
Financial Statements	10 -21
Corporate Information	22

Chairman's Report

The Company has continued to build upon its success achieved in 2002. The year started out with Compliance making initial trial shipments of washed thermal coal to selected customers and by mid year Compliance had signed its first coal supply contract. The contract was for the total supply of thermal coal to one plant of a leading cement producer in BC and by year end Compliance had sold a little over 12,000 tonnes of clean coal. Compliance's wash plant capacity is 400,000 tonnes per year, and management expects that it will take approximately four years to reach full production.

At the same time that Compliance was making trial shipments of its new thermal coal product to potential customers, the Company also engaged the services of Willis Energy Services Ltd to prepare a scoping study on the viability of a wood waste/coal power plant. The plant would be located in the vicinity of the new mine site, near Princeton British Columbia. The proposed power plant is welcome in the Princeton area as it will strengthen the local economy base that has been badly eroded with the loss of approximately 275 jobs when the Similco mine closed its doors a number of years ago.

Immediately following the positive scoping study, the Company engaged Stothert Engineering Ltd to complete a pre-feasibility study for the wood waste/coal power plant. This study concluded that Compliance should proceed to the next stage of development on the project which includes: the commencement of permitting, additional investigations regarding capital costs, confirming fuel supplies, and further refinements to certain aspects of the project that will enable the Company to negotiate potential power sales contracts, including bidding on the 2004 BC Hydro energy call.

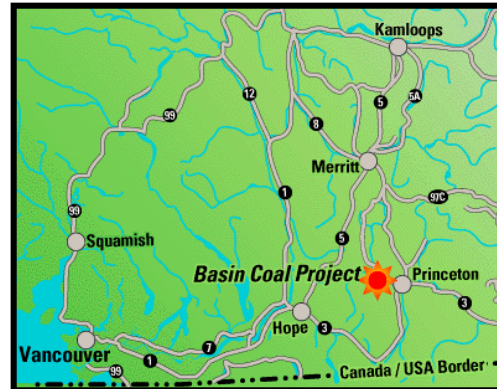
Late in the year the Company and the Upper Similkameen Indian Band applied to have the government post the Tulameen coalbed methane gas rights in the next government competition for gas rights. Subsequent to year end, Compliance was the successful bidder and the Company now controls the coalbed methane gas rights in conjunction with the Upper Similkameen Indian Band. Management is now investigating potential methane gas companies who may be brought in to help evaluate and develop this asset.

On behalf of the board, I would like to thank our employees, contractors and suppliers for an outstanding job. We are also grateful to our shareholders for their interest and support as we move this new energy Company forward.

James O'Rourke
Chief Executive Officer

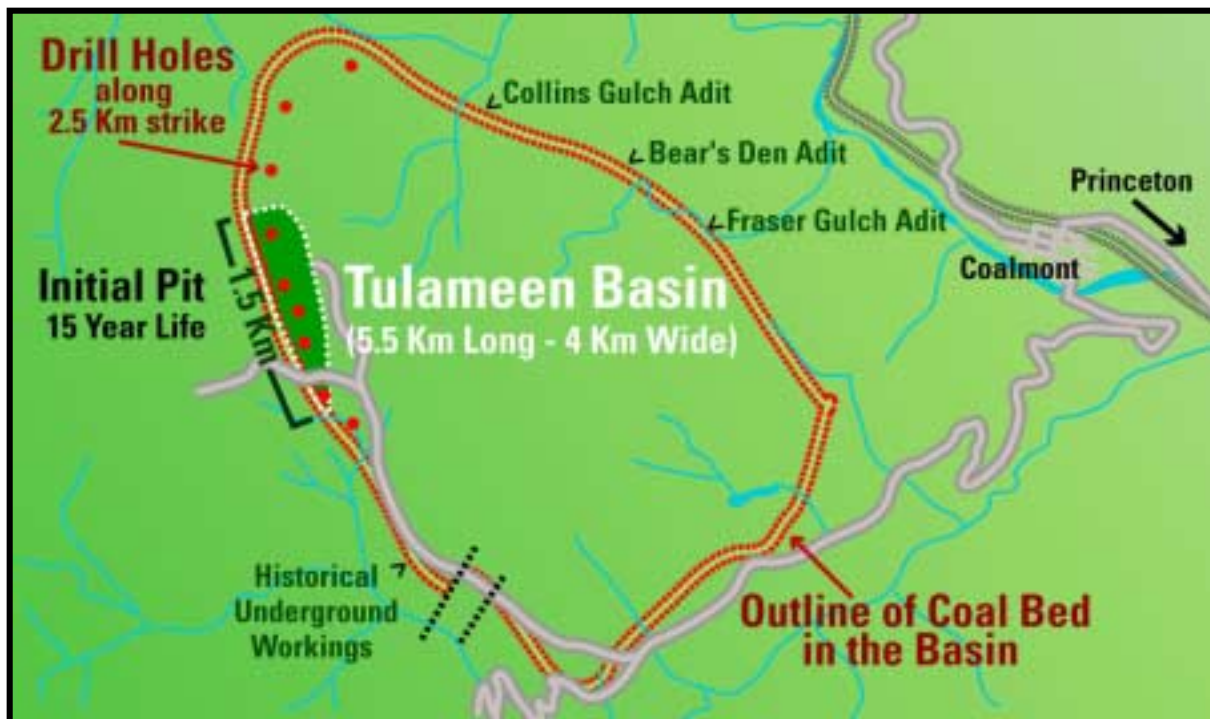
Compliance Basin Coal Joint Venture

The Compliance Basin Coal Joint Venture (“CBCJV”) project is located just outside of Princeton, British Columbia. The mine site is located 30 km northwest of Princeton, while the wash plant site is located 15 km west of Princeton at the old Similco mine site where the Company owns 13 acres of fee simple land to house its processing facilities.



“Located just outside of Princeton, British Columbia”

The Company has the rights to mine coal from the Tulameen Coal Basin. The Basin is 4.0 km wide by 5.0 km long and, as reported by the BC government, hosts an estimated 240 million tonne resource of coal.



“Tulameen Coal Basin provides a large coal resource as well as coalbed methane potential”

The initial pit is designed to be 1.5 km long and is located on the western flank of the coal basin where the deposit has been drilled out over a 2.5 km strike length. Based on the Company’s feasibility study, this initial pit will supply sufficient coal for the initial 15 years at a low strip ratio.

Compliance Basin Coal Joint Venture

The CBCJV mines the coal from an open pit mine that has coal outcropping along the basin rim, which provides for a favorable stripping ratio in the early years.

“Open pit along the outcrop provides a low strip ratio for coal release in the early years”

The deposit has two coal seams; the main seam is 23 to 34 meters thick while the lower seam is approximately 7 to 8 meters thick. The lower seam is not included in the current mine plans.



“Waste rock is broken with a D8 dozer equipped with a two tooth ripper. No drilling and blasting is required”

One of the main items confirmed during the test mining stage of the development was rock ripability. Waste rock mining is conducted using a Cat D8 dozer equipped with a two tooth ripper that breaks up the rock for removal with a dozer to expose the coal seam. There is no drilling and blasting required. Once exposed, the coal is selectively mined with an excavator, crushed down to minus three inches and trucked to the wash plant with 42 tonne bottom dump B-Train transport units.

“Raw coal is transported to the wash plant site with 42 tonne bottom dump B-Train transport units”



Compliance Basin Coal Joint Venture

Raw coal trucked from the coal mine is weighed and dumped via Compliance's newly constructed dump pocket. Raw coal is stockpiled and fed into the wash plant at a rate of 100 tonnes per hour.



“New Truck Dump Facility Built by Compliance during the 2003 year”



“Conveyor feeds the wash plant at 100 tonnes raw coal per hour”

Once the raw coal enters the wash plant it is screened into a coarse coal and fine coal circuit. The coarse coal circuit uses a heavy media bath to separate the coal from the reject waste rock, while the fine coal circuit separates the coal from the rock rejects via a series of water only cyclones. The fine coal is then delivered to the newly installed centrifuge to reduce the moisture content before being sent to the clean coal stockpile.



“Dewatering Centrifuge Installation 2003”

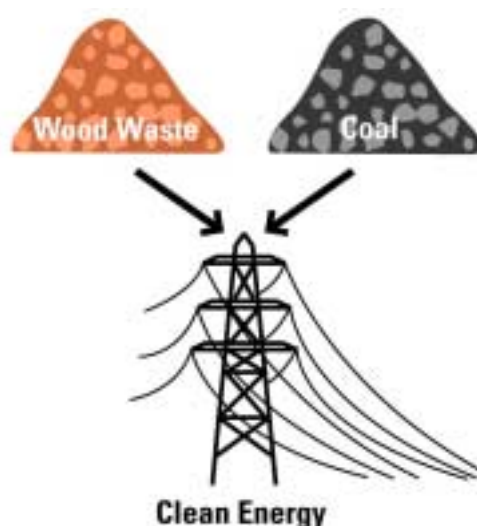


“Clean Coal finished product coming off conveyor ”

Focus on the Future – Power Generation

Coal has been burned for centuries as a source of heat and energy. Today’s advanced technology provides the assurances that coal can be utilized to provide a clean and efficient power source which meets ridged environmental regulations. Compliance’s coal is low in sulphur and suits the power industry well. Output comparison to natural gas power plant would be useful (ie compare pollutants).

Compliance Energy is focused on addressing the growing need for independent power projects in British Columbia. Under the B.C. government’s recently released energy policy, the province is promoting independent power projects including coal. Compliance Energy is investigating the possibilities of utilizing wood waste from the forestry industry and combining it with coal from the Company’s new mine to produce electricity that meets the classification of “Clean Energy”.



During the year Compliance engaged two independent firms to review the Company’s proposal of a 50 MW wood waste / coal fired power plant located in the Princeton area. Both Willis Energy Services and Stothert Engineering Ltd. concluded that the power plant would be economical and should be persued.

After receiving the Stothert Engineering Ltd. report in the fall of last year Compliance made a decision to move forward on the project so that the Company would be in a position to bid on the fall 2004 energy call expected to come from BC Hydro.

The work currently being completed includes site selection, commencement of permitting, capital cost and design refinements, confirming fuel supplies, and further refinements to certain aspects of the study that will enable the Company to negotiate potential power sales contracts including bidding on the 2004 BC Hydro energy call.

In addition to the proposed Princeton Power Plant and subsequent to year end, Compliance signed a memorandum of understanding with Northland Power Inc whereby Compliance will assist in securing the fuel supply for the development of a 49 MW biomass/coal fuelled power generation project to be located on Vancouver Island. In return, Compliance will have the right to acquire up to a 15% equity interest in that Power Project. Northland headquartered in Toronto and one of Canada’s largest independent private power developers. Northland Power has earned a reputation for flexibility, responsiveness, innovation and reliability through the success of its projects. Northland Power and its subsidiaries operate three power facilities in Canada and one in the Ukraine. Compliance view this association with a major power producer as a valuable component to our development in the energy sector.

Subsequent to year end, Compliance entered into an agreement to acquire a coal deposit located on Vancouver Island. The agreement is subject to regulatory and board approval. Based on the Company’s internal report, this deposit has enough coal reserves to fuel the proposed 49 MW biomass/coal fuelled power plant for 20 years.

Management Discussion and Analysis

Management's discussion and analysis ("MD&A") focuses on significant factors that affected Compliance Energy Corporation performance and such factors that may affect its future performance. In order to better understand the MD&A, it should be read in conjunction with the audited consolidated financial statements and the related notes contained herein. The Company reports its financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The Company's significant accounting policies are set out in Note 2 of the audited consolidated financial statements.

	Dec 31 2003	Dec 31 2002	Dec 31 2001
Gross Revenue	Nil	Nil	Nil
Net income (loss)	(318,338)	(35,146)	(13,448)
Net income (loss) per share	(0.01)	(0.00)	(0.00)
Total assets	3,630,569	1,977,601	269,546
Long-Term debt	Nil	Nil	Nil
Cash dividends per share	0.00	0.00	0.00

In order to better understand Compliance Energy's financial results in 2003, it is important to gain an understanding of the stage of development of the Company, its main asset, the Compliance Basin Coal Joint Venture ("CBCJV") of which Compliance holds a 65% interest and is the operator, its future plans for a wood waste coal power plant development and the recently acquired coalbed methane rights in the area of the coal mine.

The 2003 year was the first year of operation for the CBCJV. As such, efforts were focused on selected thermal coal market customers and delivering them a quality product. By mid year, the CBCJV was successful in obtaining its first coal sales contract. The contract was for the total supply of thermal coal to one plant of a leading cement producer in BC and by year end Compliance had sold a little over 12,000 tonnes of clean coal. Compliance's wash plant capacity is 400,000 tonnes per year, and management expects that it will take approximately four years to approach full production. Therefore, all costs that related to the CBCJV were deferred during the year and all associated revenues were offset against those deferred costs.

The following table is selected annual financial information derived from the Company's financial statements and should be read in conjunction with the consolidated financial statements.

As 2002 was the first year of operation for the CBCJV, and the mine has not reach commercial production, all expenses during the year associated with the CBCJV have been deferred and the Company's income statement only reflects administrative expenses incurred during the year, as well as the power plant investigation costs, and the required stock based compensation expenses. Once the CBCJV reaches commercial production, the Company will no longer defer start-up costs.

The Company recorded a loss of \$318,849 or \$0.01 per share for the year ended December 31, 2003 as compared to a loss of \$35,146 or nil per share for the year ended December 31, 2002. Professional fees were \$87,482 for the year ended December 31, 2003 as compared to \$25,646 for the period ended December 31, 2002. General and Administrative expenses were \$16,541 for the year as compared to \$2,877 for the year ended December 31, 2002. The increase in professional fees and general and administrative expense is a result of the increased activity associated with advancing the company business plan. During the year the Company completed a scoping study and a pre-feasibility study on the proposed wood waste coal fired power plant to be located near the CBCJV mine site. As the Company has not yet selected a development site for the project and is continuing to investigate

Management Discussion and Analysis

the project's development options, all expenses associated with the project have been expensed. Power plant project investigation costs totaled \$62,695 for the year ended December 31, 2003, compared to nil for the year before.

During the year the Company incurred \$49,383 in shareholder communications expenses, as compared to \$139 in the prior year. This increase in expenditure is a result of the Company actively increasing its investor relations activities during the year in response to upcoming financings as well hiring a market maker late in the year. Transfer agent fees were \$18,894 for the twelve month period ended December 31, 2003 as compared to \$4,684 for the prior year. This increase reflects the increased activity and increased stock exchange and transfer agent fees incurred this year.

During the year the Company issued 675,000 stock options to directors and employees. Under the new accounting rules adopted by the Company, these options must be valued and expensed during the year. Under this method, stock based compensation expense totaled \$80,500 for the year, compared to nil for the prior year.

The following table is selected quarterly financial information derived from the Company's financial statements and should be read in conjunction with the consolidated quarterly financial statements.

Quarter	Revenue	Net Income (Loss)	Basic Earnings (Loss) per Share	Fully Diluted Earnings (Loss) Per Share
December 31, 2003	-	(\$230,128)	(\$0.01)	(\$0.01)
September 30, 2003	-	(\$26,567)	(\$0.00)	(\$0.00)
June 30, 2003	-	(\$34,406)	(\$0.00)	(\$0.00)
March 31, 2003	-	(\$27,237)	(\$0.00)	(\$0.00)
December 31, 2002	-	(\$35,146)	(\$0.00)	(\$0.00)
September 30, 2002	-	(\$10,006)	(\$0.00)	(\$0.00)
June 30, 2002	-	(\$4,478)	(\$0.00)	(\$0.00)
March 31, 2002	-	(\$6,996)	(\$0.00)	(\$0.00)

The Company's quarterly results are fairly consistent over the last eight quarters with the exception of the last quarter of 2003. There was an increase in expenditures during the last quarter of 2003 as there were 675,000 stock options issued to directors and employees during the quarter, which were valued using the Black-Scholes Option Pricing Model. As a result the Company recorded a \$80,500 charge to stock compensation expense as required under the fair value method of accounting for stock options. Also, during the last quarter of 2003 the Company decided to expense all of its costs associated with the investigation of the wood waste / coal power plant and as a result \$62,695 of expenses were charged to the income statement as a project investigation expense. In addition, the Company increased its investor relation's activity during the last quarter and incurred additional travel costs as the Company was in the process of getting ready to raise financing by year end.

As of December 31, 2003, the Company had working capital of \$990,874 (comprised of \$1,056,081 of cash, \$152,048 of receivables and prepaid expenses, offset by \$217,255 of liabilities) compared with a working capital of \$259,390 (comprised of \$441,317 of cash, \$139,138 of receivables and prepaid expenses, offset by \$321,065 of liabilities) at December 31, 2002.

Management Discussion and Analysis

The increase in working capital between December 31, 2003 and December 31, 2002 was principally the result of the Company completing private placements during the year totaling \$2.1 million. In addition, CBCJV coal sales during the year totaled \$498,752, of which Compliance's share was \$324,072. These revenues have been deferred during the year and were offset against the CBCJV mining costs incurred in the year. No stock options were exercised during the year.

Subsequent to year end, the Company completed an additional equity capital financing totaling \$1.625 million and had \$350,000 in warrants exercised bringing in a total of approximately \$2.0 million in equity into the Company. Other than these financing, the Company has no immediate plans to raise additional funds.

The Company's success depends on a number of factors, some of which are beyond the control of the Company. Typical risk factors include coal price fluctuations and operating uncertainties encountered in the mining business. Competition for the limited Pacific Northwest thermal coal market may make it difficult to penetrate the market. Future government, legal or regulatory changes could affect any aspect of the Company's business, including, among other things, environmental permitting and taxation costs and the ability of the Company to develop an independent power project. These risks and uncertainties are managed, in part by experienced managers, advisors and consultants, by maintaining adequate liquidity and by cost control initiatives.

The Company's internet Web site is provided under the accompanying logo.

Web Page:
www.complianceenergy.com



Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Compliance Energy Corporation and its subsidiary have been prepared in accordance with Canadian generally accepted accounting principals. Financial information presented throughout the Annual Report is consistent with that shown in the consolidated financial statements.

Management is responsible for the integrity of the consolidated financial statements. Systems of internal control are designed and maintained by management to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for financial reporting purposes.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee of the Board. This Committee meets with management and external auditors to satisfy itself that management's responsibilities are properly discharged and to review the consolidated financial statements before they are presented to the Board of Directors for approval.

Compliance Energy Corporation

James C. O'Rourke
Chairman & Chief Executive Officer

Rodney A. Shier
Chief Financial Officer

Vancouver, B.C.
May 10, 2004

AUDITORS' REPORT

To the Shareholders, of
Compliance Energy Corporation:

We have audited the consolidated balance sheets of Compliance Energy Corporation as at December 31, 2003 and 2002 and the consolidated statements of operations and deficit and cash flows for the year ended December 31, 2003 and December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the year ended December 31, 2003 and December 31, 2002 in accordance with Canadian generally accepted accounting principles. As required by the British Columbia Company Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

"De Visser Gray"

Chartered Accountants

Vancouver, B.C.
May 10, 2004

COMPLIANCE ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS

	As at December 31,	
	2003	2002
ASSETS		
Current assets		
Cash	\$ 1,056,081	\$ 441,317
Amounts receivable	126,529	136,119
Prepaid expenses	25,519	3,019
	<u>1,208,129</u>	<u>580,455</u>
Reclamation bonding	65,000	65,000
Resource property (note 6)	1,474,111	732,397
Property, plant and equipment (note 5)	883,329	599,749
	<u>\$ 3,630,569</u>	<u>\$ 1,977,601</u>
LIABILITIES		
Current liabilities		
Accounts payable	132,255	245,065
Due to related parties (note 9)	\$ 85,000	\$ 76,000
	<u>217,255</u>	<u>321,065</u>
Non-current liability		
Deferred gain on joint venture formation (note 7)	772,471	772,471
	<u>989,726</u>	<u>1,093,536</u>
SHAREHOLDERS' EQUITY		
Share capital (note 8)	2,943,531	920,665
Obligation to issue shares	-	28,250
Contributed surplus	80,500	-
Deficit	(383,188)	(64,850)
	<u>2,640,843</u>	<u>884,065</u>
	<u>\$ 3,630,569</u>	<u>\$ 1,977,601</u>

Continuance of operations (Note 1)

Approved by:

"James C. O'Rourke" Director
 James C. O'Rourke

"Rodney A. Shier" Director
 Rodney A. Shier

The accompanying notes are an integral part of this financial statement

COMPLIANCE ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

	Year ended December 31, 2003	Year ended December 31, 2002
EXPENSES		
Due diligence costs	\$ -	\$ 4,900
General & admin	16,541	2,877
Professional fees	87,482	25,646
Project investigations	62,695	-
Shareholder communications	49,383	139
Stock-based compensation expense	80,500	-
Transfer agent & filing fees	18,894	4,684
Travel	5,354	-
Net loss before other item	320,849	38,246
Other item:		
Interest income	(2,511)	(3,100)
NET LOSS FOR THE YEAR	318,338	35,146
DEFICIT, BEGINNING OF YEAR	64,850	29,704
DEFICIT, END OF YEAR	\$ 383,188	\$ 64,850
LOSS PER SHARE	\$ (0.01)	\$ (0.00)

The accompanying notes are an integral part of this financial statement

COMPLIANCE ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31, 2003	Year ended December 31, 2002
OPERATING ACTIVITIES		
Net loss for the period	\$ (318,338)	\$ (35,146)
Add: non cash expense item - Stock-based compensation expense	80,500	-
	(237,838)	(35,146)
Net change in non-cash working capital items	(116,720)	203,344
	(354,558)	168,198
INVESTING ACTIVITIES		
Deposit for reclamation bonds (net)	-	(15,000)
Purchase of property, plant and equipment	(283,580)	(567,249)
Resource property costs	(741,714)	(592,048)
	(1,025,294)	(1,174,297)
FINANCING ACTIVITIES		
Initial joint venture cash calls funded by co-venturers	-	933,333
Repayment of demand loan	-	(80,000)
Shares issued for cash	2,116,500	567,610
Share issue costs	(121,884)	-
Cash acquired on capital transaction	-	24,859
	1,994,616	1,445,802
INCREASE IN CASH	614,764	439,703
CASH, BEGINNING OF YEAR	441,317	1,614
CASH, END OF YEAR	\$ 1,056,081	\$ 441,317

Supplemental Disclosure of Non-Cash Investing and Financing Activities

During the comparative year, the Company issued 142,857 common shares at \$0.35 per share to acquire a land interest. The Company also completed a reverse take-over business combination and contributed a resource property and reclamation bond to a joint venture in consideration for an interest in that joint venture.

Refer also to notes 3, 4, 8 and 9.

The accompanying notes are an integral part of this financial statement

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

1. NATURE AND CONTINUANCE OF OPERATIONS

The Company was incorporated under the provisions of the British Columbia Company Act on July 6, 2000 as 610230 B.C. Ltd. and changed its name to Beanstalk Capital Corporation on July 27, 2000. On August 30, 2002 the Company acquired all of the issued and outstanding common shares of Compliance Coal Corporation (“Coal”), a private company also incorporated in British Columbia. This transaction was accounted for as a reverse take-over, with Coal identified as the purchaser and parent company for accounting purposes, and the Company as the acquired entity. As part of the transaction the Company also changed its name to Compliance Energy Corporation. Refer to note 3.

These consolidated financial statements include all of the accounts of the Company and Coal, its wholly-owned legal subsidiary. The share capital and deficit amounts disclosed in these financial statements, are those of Coal from the date of inception of that company on March 19, 2001. The continuity of common shares issued and outstanding remains that of the Company. All significant intercompany balances and transactions have been eliminated on consolidation. Coal’s main asset is its 65% interest in the Compliance Basin Coal Joint Venture (“CBCJV”), of which it is Operator. Refer to note 4.

These consolidated financial statements have been prepared on a going concern basis, which assumes the ongoing capacity of the Company to realize on its assets and discharge of liabilities in the normal course of business. The Company has incurred losses since inception and the operations to date of the CBCJV have yet to achieve commercial viability; accordingly the Company’s status as a going concern is dependent on its ability to generate future profitable operations and to receive continued financial support from its lenders and shareholders. Management is of the opinion that sufficient working capital will be obtained from operations and external financing to meet the Company’s liabilities and commitments as they become due. Should the going concern assumption not be appropriate, the carrying values and classifications of assets and liabilities would change and those changes could be material. It is not possible to predict the outcome of those matters at this time.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results may differ from those estimates.

A specific area requiring significant estimates is in respect to the calculation of stock-based compensation. Refer to note 8 (d).

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

2. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(b) Loss Per Share

Loss per share is computed using the weighted average number of common shares outstanding during the period. Diluted loss per share is not presented because it is anti-dilutive.

(c) Deferred Expenditures

Deferred expenditures are comprised of the Company's proportionate share of the carrying value of the coal property and related assets on the books of the CBCJV, net of the Company's proportionate share of any gain or loss realized on its contribution of the property to the CBCJV upon the formation of the joint venture. The carrying costs of deferred expenditures on the books of the CBCJV are inclusive of the deemed value of Coal's initial vend-in of the coal property and related assets, plus all subsequent cash costs incurred on property development. Sundry initial revenue amounts from coal sales are offset against costs deferred to date. These costs will be amortized on a units-of-production basis upon the commencement of commercial production.

(d) Property, Plant and Equipment

Property, plant and equipment is recorded at cost and its use is closely integrated with the deferred expenditures described above. Accordingly, amortization will be charged upon the commencement of commercial production.

(e) Financial Instruments

The Company's financial instruments consist of cash, short-term cash investments, goods and services tax receivable and accounts payable. The fair values of these financial instruments approximate their carrying values due to the short-term nature of the items.

(f) Income Taxes

The Company accounts for and measures future tax assets and liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of the change.

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

(f) **Income Taxes** *(continued)*

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 no net asset is recognized. Such an allowance would apply fully to all potential income tax assets of the Company. The Company's accounting policy for future income taxes currently has no effect on the financial statements of either of the fiscal years presented.

(g) **Share Capital**

Common shares issued for non-monetary consideration are recorded at their fair market value based upon the lower of the trading price of the Company's shares on the TSX Venture Exchange on the date of the agreement to issue the shares and the date of share issuance.

(h) **Stock-based Compensation**

During the current year the Company adopted on a prospective basis the fair value method of accounting for stock options granted to directors and employees. Under this method, compensation expense is reported when stock options are granted to directors and employees, is measured using a fair value approach and is recorded in the accounts as the options vest with the recipients, with an offsetting credit to contributed surplus. During the comparative year, the Company would have provided this information in respect to employee and director option grants on a pro-forma basis only.

The Company measures and records compensation expense in connection with stock options granted to consultants using the fair value method, and records the expense as the options vest with the recipients.

Any consideration paid by directors and employees on the exercise of stock options is credited to share capital.

3. CAPITAL TRANSACTION

At the time of the Company's purchase of the coal assets the Company consolidated its issued share capital on a 2 for 1 basis and then issued 1.23 shares for every one outstanding common share of Coal in a capital transaction that resulted, for accounting purposes, in the purchase of the Company's net assets by Coal for proceeds equal to the aggregate fair value of those net assets. As the fair values of the Company's assets and liabilities were considered to approximate their carrying values, the deemed purchase price of \$46,669 was equal to the book value of the Company as at August 30, 2002, and was allocated to the Company's identifiable net assets as follows:

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

3. CAPITAL TRANSACTION *(continued)*

	\$
Cash	24,859
Other net working capital	21,810
	<u>46,669</u>

Prior to the completion of the capital transaction, the Company and Coal were under common management control.

4. JOINT VENTURE INTEREST

The CBCJV was formed on August 30, 2002 for the purpose of developing and subsequently operating as a commercial coal field the Basin Coal Property (“the Property”) located within the Tulameen Coal Basin near Coalmont B.C. The Company’s initial contribution to the CBCJV consisted of its pre-existing interest in the Property in the ascribed amount of \$1,683,333. Subsequently, the first \$933,333 of its cash calls to the CBCJV were funded by its co-venturers, increasing the aggregate ascribed value of the Company’s CBCJV contribution to \$2,616,666 as at December 31, 2002. Pursuant to the terms of the agreement between the co-venturers (the other venturers being Nissho Iwai Coal Development Corporation and 4056345 Canada Inc., with interests of 30% and 5%, respectively), CBCJV costs and expenses incurred to date have been funded on a cash call basis in proportion to the respective interests of the venturers. All revenues from coal production are distributed in cash to the venturers as it is received, and also in strict proportion to their respective joint venture interests.

The Company’s interest in the assets and liabilities of the joint venture have been included in these statements using the accounting method of proportionate consolidation. Current aggregate charges for rent and management services by the Company to the CBCJV of \$156,000 (2002 - \$46,000) have been recorded within deferred project costs. The CBCJV assets and liabilities included in these financial statements, after the reduction of deferred property costs by Coal’s portion of the gain it realized on the formation of the joint venture, are as follows:

	As at	
	December 31, 2003	December 31, 2002
Cash	\$ 11,369	\$ 249,374
Receivables	104,447	48,891
Reclamation bonding	65,000	65,000
Deferred costs	1,474,111	732,397
Property, plant and equipment	882,671	599,749
Accounts payable	(133,567)	(192,054)
Net equity of Coal in the CBCJV, December 31, 2003	<u>\$ 2,404,031</u>	<u>\$ 1,503,357</u>

Refer also to notes 5, 6 and 7.

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

5. PROPERTY, PLANT AND EQUIPMENT

	December 31, 2003	December 31, 2002
Proportionate interest at cost in the property, plant and equipment of the CBCJV:		
Land	\$ 32,500	\$ 32,500
Building	148,061	147,574
Equipment	702,110	419,675
	<u>882,671</u>	<u>599,749</u>
Office equipment owned outside of the CBCJV	658	-
	<u>\$ 883,329</u>	<u>\$ 599,749</u>

6. RESOURCE PROPERTY

The Property consists of 9 coal licenses covering 2,172 hectares, and was acquired by the CBCJV pursuant to a Mining Agreement dated August 30, 2002. Under this agreement, the CBCJV acquired working rights to the Property and a Right of First Offer in respect to any future disposition of the mineral tenures and related royalty comprising the Property. In consideration, the CBCJV granted a royalty of 3% on gross coal revenue from the Property prior to December 31, 2004, and of \$1.50 per tonne on all coal production thereafter.

The details of the carrying amount of the Company's resource property costs are as follows:

	December 31, 2003	Cumulative to December 31, 2002
Proportionate share of deferred costs incurred by the CBCJV:		
Mining	\$ 535,221	\$ 167,643
Processing	250,401	53,079
Development	546,819	159,425
Marketing	69,011	19,615
Environmental	105,160	41,064
Legal	34,130	34,130
	<u>1,540,742</u>	<u>474,956</u>
Less: start-up Coal Revenue	<u>(332,875)</u>	<u>(8,803)</u>
	\$ 1,207,867	\$ 466,153
Deemed project value	*1,700,833	*1,700,833
Less: the Company's interest in the aggregate gain realized to December 31, 2002 on its vend-in to the CBCJV.	<u>(1,434,589)</u>	<u>(1,434,589)</u>
	<u>\$ 1,474,111</u>	<u>\$ 732,397</u>

* Aggregate value ascribed to the Coal Project at the outset of Compliance's vend-in to the CBCJV, inclusive of a \$17,500 loss incurred on the Company's contribution of a \$50,000 reclamation bond to the joint venture.

Refer also to note 7.

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

7. DEFERRED GAIN ON JOINT VENTURE FORMATION

The Company recognized a deferred gain on the participation of the co-venturers' interest in the joint venture to the extent of their value ascribed to its aggregate contribution to the CBCJV in excess of the carrying cost of the coal project on the books of Coal immediately prior to the formation of the CBCJV.

Upon the commencement of commercial production this gain will be amortized to operations in a manner consistent with the amortization of the deferred costs to which it applies.

This gain was determined as follows:

	\$
Aggregate ascribed contribution of the Company to the CBCJV to December 31, 2002	2,616,666
Deferred project costs in Coal, August 30, 2002 (December 31, 2001 - \$333,710)	<u>(409,606)</u>
Gross gain to the Company	2,207,060
less: 65% thereof offset against deferred property costs	<u>(1,434,589)</u>
Deferred gain to the extent of the interests of the Company's co-venturers	<u>\$ 772,471</u>

8. CAPITAL STOCK

- (a) Authorized
1,000,000,000 Common shares without par value
20,000,000 Preferred shares without par value

- (b) Issued

	Common Shares	Amount
		\$
Issued at December 31, 2001	2,700,000	257,788
• Share consolidation pursuant to the terms of the capital transaction	(1,350,000)	-
• Elimination of the Company's historical share capital account balance pursuant to the acquisition of the Company by Coal for accounting purposes	-	(257,788)
• Establishment of Coal's December 31, 2001 share capital balance upon Coal's purchase of the Company for accounting purposes	-	256,386
• Shares issued on the Company's acquisition of Coal	14,837,500	*614,279
• Shares issued to acquire land	142,857	50,000
Issued at December 31, 2002	16,330,357	920,665
• Shares issued on settlement of debt	94,167	28,250
• Shares issued for cash	7,083,572	2,116,500
• Share issue costs		<u>(121,884)</u>
Issued at December 31, 2003	23,508,096	\$ 2,943,531

* Inclusive of \$46,669 representing the cost of acquiring, for accounting purposes, the net assets of the legal parent company at August 30, 2002. The remaining \$567,610 is comprised of funds raised by private placement in Coal prior to, and in anticipation of, this acquisition.

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

8. CAPITAL STOCK (cont'd)

(c) Escrowed Shares

Pursuant to the terms of the capital transaction completed during the comparative year, at December 31, 2003 there are 10,120,138 common shares (December 31, 2002 - 11,548,684 common shares) held in escrow. These shares are subject to a six year hold period and their release from escrow is subject to the terms of an agreement between the shareholders, the Company, and the transfer agent.

(d) Stock Options

As at December 31, 2003 the Company has reserved stock options to directors, officers and employees enabling them to acquire up to 810,000 common shares as follows:

	2003		2002	
	Number of shares	Weighted average exercise price Cdn. \$	Number of shares	Weighted average exercise price Cdn. \$
Options outstanding				
Beginning of year	135,000	0.30	135,000	0.30
Granted during year	675,000	0.30	-	-
End of year	810,000	0.30	135,000	0.30

The weighted-average remaining life of options outstanding at December 31, 2003 is 4.02 years.

The fair value of options reported as compensation expense in the current year has been estimated using the Black-Scholes Option Pricing Model using the following assumptions: a risk free interest rate of 3.5 to 3.75%, an expected life of 2 to 5 years; an expected volatility of 48%, and no expectation for the payments of dividends.

Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Changes in these assumptions can materially affect the fair value estimate and therefore it is management's view that the existing models do not necessarily provide a single reliable measure of the fair value of the Company's stock option grants.

Based on these variables, stock-based compensation expense of \$80,500 was recorded during the current year.

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003

8. CAPITAL STOCK (cont'd)

(e) Warrants

As at December 31, 2003 3,177,500 warrants are outstanding entitling the holders to acquire shares of the Company at prices ranging between \$0.35 and \$0.45 per share exercisable at various dates ranging up until November 25, 2005.

9. RELATED PARTY TRANSACTIONS

All transactions with related parties have occurred in the normal course of the Company's operations and have been measured at their fair value as determined by management. The year end balances payable are non-interest bearing and have no fixed terms for repayment.

- The Company paid two of its officers legal, management and administration fees aggregating \$80,500 during the year ended December 31, 2003 (period ended December 31, 2002 - \$53,250).
- The Company incurred consulting fees for project development costs of \$115,500 for the year ended December 31, 2002 (period ended December 31, 2002-\$93,400) with a private company owned by the family of a director and officer.

Refer also to note 4.

10. COMPARATIVE FIGURES

Certain of the balances from 2002 have been reclassified in conformity with the financial statement presentation adopted in the current year.

11. SUBSEQUENT EVENTS

The following occurred during the period subsequent to December 31, 2003:

- The Company signed a letter agreement to, subject to formalization and regulatory consent, acquire a coal deposit located on Vancouver Island in consideration for \$250,000 (\$200,000 cash and \$50,000, at the Company's option, in cash or in shares of the Company), and a royalty obligation.
- The Company completed a 2,500,000 common share non-brokered private placement to raise gross proceeds of \$1,625,000.

Corporate Information

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Fax: (604) 681-5910

Mine Office

Compliance Coal Corp
DBA Compliance Basin Coal JV
PO Box 1400
Princeton, British Columbia
Canada, V0X 1W0

Tel: (250) 295-0479
Fax: (250) 295-0476

Registrar and Transfer Agent

Computershare Trust Corporation
of Canada
Vancouver, British Columbia

Exchange Listing

TSX Venture Exchange
“CEC”

Notice of Annual General Meeting

2:00 p.m. June 24, 2004
Suite 584 – 885 Dunsmuir St
Vancouver, British Columbia

Directors & Management

Jim O’Rourke, P.Eng.

Director, Chairman & CEO
Mr. O’Rourke is a mining executive with over 30 years experience in mine evaluations, feasibility studies, financing, development and operations. Jim has had hands on experience with more than 5 major mine start-ups and in 1995-1996 was responsible for the financing and development of a \$140 million open pit copper mine which was completed on schedule and budget.

Directors & Management

Jamieson Merritt, B.Comm, LLB

Director
Mr. Merritt graduated from the University of British Columbia with a B. Comm and a LLB degree in 1990 and was called to the Bar of the Province of BC in 1991. Mr. Merritt operates his own construction company

Rod Shier, C.A..

Director & CFO
Mr. Shier has over 10 years experience in corporate finance and accounting in the mining industry. Rod is experienced in all aspects of corporate finance including over \$150 million of equity and debt financings, merger and acquisition structuring, negotiation of joint ventures, and commodity and foreign exchange hedging.

Michael Varabioff, LLB.,LL.M

Corporate Secretary
Mr Varabioff is Counsel at the law firm Axiom Law Group, a boutique law firm specializing in corporate securities law. In recent years Mike has served as a director and officer of numerous public companies.

Larry Belik

Site Manager
Mr Belik has over 30 years of hands on coal mine operation experience. He has extensive open pit mining experience in multi coal seam deposits. Prior to joining Compliance, Mr. Belik was Senior Production Foreman for Fording Coal Ltd. for 5 years. Mr. Belik has obtained his Open Pit Shiftboss Certificate, Blasting Certificate, and Surface Mine Rescue Certificate from the Province of British Columbia, Ministry of Energy, Mines & Petroleum Resources.

Advisors

Russell Hallbauer, P.Eng.

Advisor
Mr. Hallbauer has over 22 years of successful mining experience in the Canadian mining industry. Mr. Hallbauer was responsible for Teck’s Bullmoose and Elkview mining operations that produce approximately 7 million tones of coal annually. Mr. Hallbauer presently holds the position of General Manager Base Metal Joint Ventures for Teck Corporation.

Al Cloke,

Advisor
Mr. Cloke has over 30 years of successful experience in the Canadian mining industry. Mr. Cloke is currently President of Bucyrus Canada Ltd. a large mining supply company with revenues of \$100 million annually. Mr. Cloke is a former director of the Coal Association of Canada.

