



**FINANCIAL STATEMENTS  
FOR THE NINE MONTHS ENDED  
SEPTEMBER 30, 2005**

**Suite 584 – 885 Dunsmuir Street  
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## **MANAGEMENT'S DISCUSSION & ANALYSIS ("MD&A") OF FINANCIAL CONDITION & THE RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 (Form 51-102F1)**

November 29, 2005

### **Introduction**

*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 unaudited consolidated financial statements for the nine months ended September 30, 2005 and the Company's 2004 audited consolidated financial statements and the related notes contained therein. 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 for the year ended December 31, 2004. Additional information on the Company is available in the Company's Annual Information Form, which can be found at [www.sedar.com](http://www.sedar.com) or [www.complianceenergy.com](http://www.complianceenergy.com).*

### **Overall Performance**

The Company recorded a loss of \$293,767 or \$0.01 per share for the nine months ended September 30, 2005 as compared to a loss of \$206,110 or \$0.01 per share for the nine months ended September 30, 2004. In order to better understand Compliance Energy's financial results for the nine months ended in 2005, it is important to gain an understanding of the stage of development of the Company's main assets: (1) the Basin Coal Mine (formerly the Compliance Basin Coal Joint Venture) of which Compliance now holds a 100% interest and processes and sells thermal coal; (2) the Bear Metallurgical Coal Deposit which was recently drilled and is the subject of a development evaluation; (3) the Wolf Mountain Mine and other coal assets on Vancouver Island which are being evaluated for development; (4) the wood waste/coal power plant development near the Company's Basin Coal Mine; and (5) the coalbed methane rights in the area of the Basin Coal Mine.

Production recommenced at the Basin Coal Mine in mid April 2005 after the wash plant relocation was completed and as a result all expenses associated with the Basin Coal Mine have been deferred during the quarter. The Company is only expensing administrative expenses not related to the Basin Coal Mine that were incurred during the quarter. Once the Basin Coal Mine reaches commercial production, which is expected in 2006, the Company will no longer defer start-up costs.

Professional fees were \$69,891 for the nine months ended September 30, 2005 as compared to \$94,478 for the period ended September 30, 2004. General and Administrative expenses were \$89,296 for the period as compared to \$16,621 for the same period last year. The Company incurred \$35,536 in transfer agent and filing fees for the nine months ended September 30, 2005 as compared to \$18,499 for the same period last year. Consulting fees of \$57,150 were incurred during the nine months ended September 30, 2005 as compared to \$18,750 from the same period last year. Shareholder communication expenses increased to \$64,635 for the nine months ended September 30, 2005 as compared to \$24,954 for the same period last year. This increase in expenditures is as a result of increased public relation activities surrounding the Company's activities. Travel expenses were \$8,245 for the nine months ended September 30, 2005 as compared to \$6,554 for the same period last year.

### **Selected Annual Information**

Selected consolidated financial information of the Company for each of the last three completed financial years is detailed in the MD&A accompanying the Company's 2004 audited consolidated financial statements.

### **Liquidity and Capital Resources**

As of September 30, 2005, the Company had working capital of \$2.4 million (comprised of \$2.5 million of cash, \$1.2 million of receivables, inventory and prepaid expenses, offset by \$1.3 million of liabilities) compared with a working capital of \$1.1 million (comprised of \$1.3 million of cash, \$1.0 million of receivables and prepaid expenses, offset by \$1.2 million of liabilities) at December 31, 2004.

The increase in working capital between December 31, 2004 and September 30, 2005 was a result of the Company completing a 8.1 million common share brokered private placement to raise gross proceeds of \$6.1 million.

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 and the audited financial statements for the year ended December 31, 2004.

### **Summary of Quarterly Results**

<b>Quarter</b>	<b>Revenue</b>	<b>Net Income (Loss)</b>	<b>Basic Earnings (Loss) per Share</b>	<b>Fully Diluted Earnings (Loss) Per Share</b>
September 30, 2005	-	(\$95,410)	(\$0.00)	(\$0.00)
June 30, 2005	-	(\$127,195)	(\$0.00)	(\$0.00)
March 31, 2005	-	(\$71,162)	(\$0.00)	(\$0.00)
December 31, 2004	-	(\$193,177)	(\$0.01)	(\$0.01)
September 30, 2004	-	(\$92,073)	(\$0.00)	(\$0.00)
June 30, 2004	-	(\$73,063)	(\$0.00)	(\$0.00)
March 31, 2004	-	(\$40,974)	(\$0.00)	(\$0.00)
December 31, 2003	-	(\$230,128)	(\$0.01)	(\$0.01)
September 30, 2003	-	(\$26,567)	(\$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 2004. There was an increase in expenditures during the last quarter of 2004 and 2003 as there were 180,000 stock options issued to directors and employees during the quarter (675,000 stock options issued 2003), which were valued using the Black-Scholes Option Pricing Model. As a result the Company recorded a \$57,000 (2003 - \$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 of 2003

and incurred additional travel costs as the Company was in the process of getting ready to raise financing by year end December 31, 2003.

### **Project Review**

Efforts at the Basin Coal Mine in the third quarter of 2005 were concentrated on commissioning the wash plant that was relocated to the mine site early in the year and finishing construction on some of the other site facilities. Therefore, all costs associated with the Basin Coal Mine have been deferred for the quarter. During the quarter, the Company deferred a total of \$0.5 million (net of sales revenues of \$1.2 million) at the Basin Coal Mine. During the quarter, the Company completed construction on a storage pad at the Cheam Indian Band site that allows the Company to store coal from which it can then be hot-loaded on to a barge at a nearby barge loading facility. With the storage pad completed, the Company was able to deliver via a barge its first load of coal. This first barge load of approximately 4,500 tonnes of clean coal was loaded on Friday, September 16, 2005. The loading went smooth taking 18 hours versus the scheduled 24 hours and a total of 14 B-Train truck units were used for transportation to the barge. With this first barge load shipment now completed, the Company can concentrate on more deliveries via the water, including potential offshore sales.

During the quarter the Company also continued to advance its development of its proposed wood waste/coal power plant that is to be located near the Basin Coal Mine. The Company completed numerous studies on the power plant project during the 2004 year and signed a letter of intent to acquire land near Princeton, BC sufficient in size to develop a 49 MW wood waste /coal power plant. The selected site has extensive existing infrastructure, including one large building that could house the boiler and turbine for the development. A 138 KV power line extends onto the site which has the capacity to deliver the power to the B.C. power grid. During the first nine months of 2005 the Company completed an interconnection study with the British Columbia Transmission Corporation that confirmed that the projected interconnection costs associated with this line are less than \$500,000. The Company has engaged consultants to evaluate the air emission considerations and is proceeding with studies required under the Environmental Management Act. The Company continues to investigate potential power sales contracts, including bidding on the 2006 BC Hydro energy call which is expected to be announced in late December 2005. A total of \$23,087 of power plant project costs have been deferred during the first nine months of 2005.

During the quarter the Company also continued with its exploration drilling program on the Bear Metallurgical coal deposit located on Vancouver Island. The first phase of the drill program was focused on an area known as Block A and it was successful in identifying near surface coal in the Block A area that would be suitable for mining and processing prior to shipping out to customers, however, it proved not to be suitable for a bulk sample of run-of-mine coal as the ash content was above 10%. The balance of the program on Block B and E intersected coal as expected and also confirmed the extent of some of the near surface coal. The exploratory infill drill program consisted of 13 drill holes with 430 meters total drilling completed in Block B and E. Of the 9 holes drilled in Block B, near surface coal seams were intersected between 3 to 12 metres down hole in 7 of the holes drilled. The two holes that did not intersect coal seams were at the western edge of Block B and defined the extent of the near surface coal measures. The cored hole in Block B intersected 5 separate coal seams varying in thicknesses from 0.3m to 2.1m over the total drill depth of 60 metres. Trenching by excavator has intersected shallow coal seam sections which substantiates the drill hole information. Analyses will be carried out on the cores samples, drill chip samples and coal trench sections. In Block E three holes were drilled

and confirm the extension from Block A of one of the coal seams. ResourceEye Services Inc, the Company's consulting geologists are preparing a final geological report for this years drilling program, which will include the 1978 and 1984 drilling and assays. A total of \$204,232 of costs was deferred during the quarter relating to the Bear project.

### **Risks and Uncertainties**

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, maintaining adequate liquidity, and by cost control initiatives.

## **Corporate Information**

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### **Head Office**

Compliance Energy Corp  
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Tel: (604) 689-0489  
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### **Mine Office**

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

Tel: (250) 295-5026  
Fax: (250) 295-5028

### **Registrar and Transfer Agent**

Computershare Trust  
Corporation of Canada  
Vancouver, British Columbia

### **Exchange Listing**

TSX Venture Exchange  
"CEC"

### **Web Page**

[www.complianceenergy.com](http://www.complianceenergy.com)

**COMPLIANCE ENERGY CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

	September 30, 2005	December 31, 2004
<b>ASSETS</b>		
Current Assets		
Cash	\$ 2,489,312	\$ 1,327,437
Amounts receivable	872,723	990,694
Inventory	286,416	-
Prepaid expenses	8,014	8,014
	<u>3,656,465</u>	<u>2,326,145</u>
Reclamation bonding	123,500	120,000
Property, plant and equipment (note 3)	5,521,922	3,487,705
Resource property (note 4)	3,070,324	1,096,918
	<u>\$ 12,372,211</u>	<u>\$ 7,030,768</u>
<b>LIABILITIES</b>		
Current Liabilities		
Accounts payable	\$ 1,277,865	\$ 1,206,686
	<u>1,277,865</u>	<u>1,206,686</u>
Non-current Liability		
Long term debt	666,832	725,395
	<u>1,944,697</u>	<u>1,932,081</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share Capital (note 5)	11,328,265	5,705,671
Contributed surplus	137,500	137,500
Deficit	(1,038,251)	(744,484)
	<u>10,427,514</u>	<u>5,098,687</u>
	<u>\$ 12,372,211</u>	<u>\$ 7,030,768</u>

Interim Financial Statements (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**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004**

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
<b>REVENUES</b>				
Interest Income	\$ 14,038	\$ 458	\$ 30,986	\$ 2,877
	14,038	458	30,986	2,877
<b>EXPENSES</b>				
Professional fees	21,350	52,478	69,891	94,478
General & admin	35,908	4,251	89,296	16,621
Consulting fees	27,150	7,500	57,150	26,250
Transfer agent & filing fees	6,216	6,672	35,536	18,499
Shareholder communications	17,260	15,948	64,635	40,902
Travel	1,564	5,682	8,245	12,237
Net loss before other item	109,448	92,531	324,753	208,987
<b>NET LOSS FOR THE PERIOD</b>	95,410	92,073	293,767	206,110
<b>DEFICIT (RETAINED EARNINGS), BEGINNING OF PERIOD</b>	942,841	497,225	744,484	383,188
<b>DEFICIT (RETAINED EARNINGS), END OF PERIOD</b>	\$ 1,038,251	\$ 589,298	\$ 1,038,251	\$ 589,298
<b>LOSS PER SHARE</b>	\$ 0.00	\$ 0.01	\$ 0.01	\$ 0.01

The accompanying notes are an integral part of this financial statement

**COMPLIANCE ENERGY CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004**

	Three Months Ended Sep 30, 2005	Three Months Ended Sep 30, 2004	Nine Months Ended Sep 30, 2005	Nine Months Ended Sep 30, 2004
<b>OPERATING ACTIVITIES</b>				
Net loss for the period	\$ (95,410)	\$ (92,073)	\$ (293,767)	\$ (206,110)
Items not involving cash:				
Net change in non-cash working capital items	77,986	(161,512)	(97,266)	(270,247)
	(17,424)	(253,585)	(391,033)	(476,357)
<b>INVESTING ACTIVITIES</b>				
Purchase of reclamation bond		-	(3,500)	
Purchase of capital assets	(738,145)	(116,501)	(2,034,217)	(267,390)
Resource property costs	(794,710)	(377,612)	(1,973,406)	(885,187)
	(1,532,855)	(494,113)	(4,011,123)	(1,152,577)
<b>FINANCING ACTIVITIES</b>				
Long term debt (repaid)	235,106	-	(58,563)	-
Shares issued for cash	56,500	-	5,622,594	2,762,140
	291,606	-	5,564,031	2,762,140
<b>INCREASE IN CASH</b>	(1,258,673)	(747,698)	1,161,875	1,133,206
<b>CASH, BEGINNING OF PERIOD</b>	\$ 3,747,985	2,936,995	1,327,437	1,056,081
<b>CASH, END OF PERIOD</b>	\$ 2,489,312	\$ 2,189,287	\$ 2,489,312	\$ 2,189,287

The accompanying notes are an integral part of this financial statement

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2005**

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**1. BASIS OF PRESENTATION**

These interim period consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles (“GAAP”) with respect to the preparation of interim financial information. Accordingly, they do not include all of the information and disclosures required by Canadian GAAP in the preparation of our annual consolidated financial statements. Certain information and footnote disclosure normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted. The accounting policies used in preparation of the accompanying unaudited interim consolidated financial statements are the same as those described in our annual consolidated financial statements and the notes thereto for the two years ended December 31, 2004.

These interim period statements have not been reviewed by the Company’s auditors and should be read together with the audited consolidated financial statements and the accompanying notes included in the Company’s latest annual report.

**2. CONTINUANCE OF OPERATIONS**

These interim 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’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.

**3. PROPERTY, PLANT AND EQUIPMENT**

	September 30, 2005	December 31, 2004*
Land	\$ 50,000	\$ 50,000
Building	254,056	227,787
Equipment – other	104,652	11,961
Equipment – wash plant	2,681,135	1,547,028
Equipment – mining	2,420,350	1,650,271
	<u>5,510,193</u>	<u>3,487,047</u>
Office equipment	11,729	658
	<u>\$ 5,521,922</u>	<u>\$ 3,487,705</u>

\* These reflect the full historical costs incurred by the CBCJV on these assets; the residual valuation adjustment arising from the CBCJV dissolution on December 31, 2004 was allocated entirely to deferred resource property costs.

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2005**

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**4. RESOURCE PROPERTY**

**a) Basin Coal Mine**

The Basin Coal Mine consists of 9 coal licenses covering 2,172 hectares, and was acquired pursuant to a Mining Agreement dated August 30, 2002. Under this agreement, the Company 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 Company granted a royalty of \$1.50 per tonne on all coal production thereafter.

**b) Bear Metallurgical Coal Deposit**

The Bear Coal Deposit consists of 5 coal licenses covering 4,325 hectares, and was acquired pursuant to a Mining Agreement dated July 29, 2004. Under the terms of the agreement, the Company made option payments totaling \$140,000. The property is subject to a sales royalty of 2.5%.

**c) Wolf Mountain Mine**

During 2004 the Company entered into an agreement to acquire 100% of the common shares of a private company that holds the coal licenses, permits and physical assets of the Wolf Mountain Mine located on Vancouver Island. Under the terms of the agreement, the Company has made an initial \$50,000 option payment and must make an additional payment of \$200,000 on or before December 24, 2009.

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

	Cumulative to September 30, 2005	December 31, 2004*
Basin Coal Mine		
Mining	\$ 3,153,024	\$ 2,184,092
Processing	1,802,068	1,049,303
Development	2,527,212	1,819,172
Marketing	238,467	192,293
Environmental	245,323	218,804
Legal	52,508	52,508
	<u>8,018,602</u>	<u>5,516,172</u>
Less: start-up Coal Revenue	(4,196,644)	(2,348,219)
	\$ 3,821,958	\$ 3,167,953
Valuation adjustment on purchase of remaining 35% interest in the BCM	(2,332,639)	(2,332,639)
Other development costs	1,581,005	261,604
	<u>\$ 3,070,324</u>	<u>\$ 1,096,918</u>

\* 100% of costs incurred by the CBCJV are reflected upon the Company's acquisition of the residual 35% interest

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2005**

**5. 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, 2004	29,146,796	\$ 5,705,671
• Shares issued for cash (net of costs)	8,374,513	5,622,594
Issued at June 30, 2005	37,521,309	\$ 11,328,265

- (c) Escrowed Shares

Pursuant to the terms of the business combination completed during the year, at March 31, 2005 there are 8,661,504 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, Computershare Investor Services Inc.

- (d) Stock Options

As at September 30, 2005, the Company has reserved stock options to directors and officers enabling them to acquire up to 1,638,000 common shares of the Company as follows:

Options Outstanding	2005		2004	
	Number of shares	Weighted average exercise price Cdn. \$	Number of shares	Weighted average exercise price Cdn. \$
Beginning of period	940,000	0.34	810,000	0.30
Granted during period	830,000	0.84	180,000	0.50
Exercised during the period	132,000	0.30	50,000	0.30
End of period	<u>1,638,000</u>	0.60	<u>940,000</u>	0.34

The weighted-average remaining life of options outstanding at September 30, 2005 is 3.6 years.

- (e) Warrants

As at September 30, 2005 4,130,732 warrants are outstanding entitling the holders to acquire shares of the Company at prices ranging between \$0.45 and \$0.95 per share exercisable at various dates ranging up until August 10, 2006.

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2005**

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**6. 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 one of its officers legal, management and administration fees aggregating \$63,000 during the period ended September 30, 2005 (period ended September 30, 2004-\$63,000).
- The Company incurred consulting fees for project development costs of \$85,500 for the period ended September 30, 2005 (period ended September 30, 2004-\$45,000) with a private company controlled by the family of a director and officer.