



**FINANCIAL STATEMENTS  
FOR THE SIX MONTHS ENDED  
JUNE 30, 2004**

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**MANAGEMENT'S DISCUSSION & ANALYSIS ("MD&A") OF FINANCIAL  
CONDITION & THE RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED  
JUNE 30, 2004 (Form 51-102F1)**

August 30, 2004

**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 six months ended June 30, 2004 and the Company's 2003 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, 2003. 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 \$114,037 or \$0.01 per share for the six months ended June 30, 2004 as compared to a loss of \$82,643 or \$0.005 per share for the six months ended June 30, 2003. As a majority of expenses associated with the development of the Compliance Basin Coal Joint Venture ("CBCJV") have been deferred during the quarter, the Company is only expensing administrative expenses not related to the CBCJV that were incurred during the quarter. Once the CBCJV reaches commercial production, the Company will no longer defer start-up costs. As a result all revenues associated with coal sales from the CBCJV have been netted against the deferred cost of the operation.

Professional fees were \$42,000 for the six months ended June 30, 2004 as compared to \$38,500 for the period ended June 30, 2003. General and Administrative expenses were \$12,370 for the period as compared to \$18,527 for the same period last year. The Company incurred \$11,827 in transfer agent and filing fees for the six months ended June 30, 2004 as compared to \$11,184 for the same period last year. Consulting fees of \$18,750 were expensed during the quarter that relate to the Company's activities on Vancouver Island. Shareholder communication expenses increased to \$24,954 for the six months ended June 30, 2004 from \$12,854 for the same period last year as a result of increased public relation activities surrounding the Company's activities. Travel expenses were \$6,554 for the six months ended June 30, 2004 as compared to nil 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 2003 audited consolidated financial statements.

## Liquidity and Capital Resources

As of June 30, 2004, the Company had working capital of \$2,980,523 (comprised of \$2,936,995 of cash, \$326,435 of receivables and prepaid expenses, offset by \$282,907 of liabilities) compared with a working capital of \$990,874 at December 31, 2003 (comprised of \$1,056,081 of cash, \$152,048 of receivables and prepaid expenses, offset by \$217,255 of liabilities).

The increase in working capital between December 31, 2003 and June 30, 2004 was a result of the Company closing a private placement with Sprott Asset Management Inc of Toronto for \$1.6 million and having \$1,050,000 worth of warrants exercised.

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, 2003.

### Summary of Quarterly Results

Quarter	Revenue	Net Income (Loss)	Basic Earnings (Loss) per Share	Fully Diluted Earnings (Loss) Per Share
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)
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)

In order to better understand Compliance Energy's financial results for the quarter ended June 30, 2004 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. The first half of 2004 had the CBCJV focused on some capital improvements and the start of mining activities for the 2004 mining year. The first six months saw a new thickener tank and filter press installed at the wash plant site, while the CBCJV also added a mine crusher to its mine site operations. Marketing efforts continued during the quarter to attract new customers for the CBCJV's high quality thermal coal. Mining activities at the CBCJV are being matched to the Company's expected sales for the year.

Last 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 selected a development site for the project and is continuing to advance the project, all development expenses associated with the project are now being deferred. A total of \$79,282 of power plant project costs have been deferred during the quarter. In addition, during the six months ended June 30, 2004 the Company acquired the Coalbed methane gas rights to the area

covered by the Company's coal leases. The Company intends to joint venture these gas rights out during the current year.

**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, by maintaining adequate liquidity and by cost control initiatives.

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

	June 30, 2004	December 31, 2003
<b>ASSETS</b>		
Current Assets		
Cash	\$ 2,936,995	\$ 1,056,081
Amounts receivable	323,416	126,529
Prepaid expenses	3,019	25,519
	3,263,430	1,208,129
Reclamation bonding	65,000	65,000
Resource property (note 4)	1,981,686	1,474,111
Capital assets (note 3)	1,034,218	883,329
	\$ 6,344,334	\$ 3,630,569
<b>LIABILITIES</b>		
Current Liabilities		
Accounts payable	\$ 282,907	\$ 132,255
Due to related parties	-	85,000
	282,907	217,255
Non-current Liability		
Deferred Gain on Joint Venture Formation	772,471	772,471
	1,055,378	989,726
<b>SHAREHOLDERS' EQUITY</b>		
Share Capital (note 5)	5,705,681	2,943,531
Contributed surplus	80,500	80,500
Deficit	(497,225)	(383,188)
	5,288,956	2,640,843
	\$ 6,344,334	\$ 3,630,569

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 SIX MONTHS ENDED JUNE 30, 2004 AND 2003**

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
<b>REVENUES</b>				
Interest Income	\$ 1,444	\$ 406	\$ 2,418	\$ 406
	1,444	406	2,418	406
<b>EXPENSES</b>				
Professional fees	21,000	22,984	42,000	40,484
General & admin	6,459	11,758	12,370	18,527
Consulting fees	18,750		18,750	
Transfer agent & filing fees	6,338	5,780	11,827	11,184
Shareholder communications	15,406	4,790	24,954	12,854
Travel	6,554		6,554	-
Net loss before other item	74,507	45,312	116,455	83,049
<b>NET LOSS FOR THE PERIOD</b>	73,063	34,406	114,037	82,643
<b>DEFICIT (RETAINED EARNINGS), BEGINNING OF PERIOD</b>	424,162	92,086	383,188	64,850
<b>DEFICIT (RETAINED EARNINGS), END OF PERIOD</b>	\$ 497,225	\$ 126,492	\$ 497,225	\$ 147,493
<b>LOSS PER SHARE</b>	\$ 0.00	\$ 0.00	\$ 0.01	\$ 0.00

The accompanying notes are an integral part of this financial statement

**COMPLIANCE ENERGY CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003**

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
<b>OPERATING ACTIVITIES</b>				
Net loss for the period	\$ (73,063)	\$ (65,906)	\$ (114,037)	\$ (82,643)
Items not involving cash:				
Net change in non-cash working capital items	(204,228)	(17,839)	(108,735)	(94,547)
	(277,291)	(83,745)	(222,772)	(177,190)
<b>INVESTING ACTIVITIES</b>				
Purchase of capital assets	(47,448)	(157,943)	(150,889)	(199,623)
Resource property costs	(276,622)	(224,429)	(507,575)	(329,218)
	(324,070)	(382,372)	(658,464)	(528,841)
<b>FINANCING ACTIVITIES</b>				
Shares issued for cash	675,935	461,689	2,762,150	461,689
	675,935	461,689	2,762,150	461,689
<b>INCREASE IN CASH</b>	74,574	(4,428)	1,880,914	(244,342)
<b>CASH, BEGINNING OF PERIOD</b>	2,862,421	190,903	1,056,081	441,317
<b>CASH, END OF PERIOD</b>	\$ 2,936,995	\$ 196,975	\$ 2,936,995	\$ 196,975

The accompanying notes are an integral part of this financial statement

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

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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, 2003.

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**

	June 30, 2004	December 31, 2003
Proportionate interest at cost in the property, plant and equipment of the CBCJV:		
Land	\$ 32,500	\$ 32,500
Building	148,061	148,061
Equipment	834,787	702,110
	<u>1,015,348</u>	<u>882,671</u>
Office equipment owned outside of the CBCJV	18,870	658
	<u>\$ 1,034,218</u>	<u>\$ 883,329</u>

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

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**4. 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:

	Cumulative to June 30, 2004	December 31, 2003
Proportionate share of deferred costs incurred by the CBCJV:		
Mining	\$ 803,958	\$ 535,221
Processing	356,790	250,401
Development	745,466	546,819
Marketing	94,286	69,011
Environmental	127,113	105,160
Legal	34,130	34,130
	<u>2,161,743</u>	<u>1,540,742</u>
Less: start-up Coal Revenue	(611,018)	(332,875)
	<u>1,550,725</u>	<u>1,207,867</u>
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.	(1,434,589)	(1,434,589)
	<u>1,816,969</u>	<u>1,474,111</u>
Other deferred costs outside of the CBCJV	164,717	-
	<u>\$ 1,981,686</u>	<u>\$ 1,474,111</u>

\* Aggregate value ascribed to the Coal Project at the outset of Compliance's vend-in to the CBCJV.

**5. CAPITAL STOCK**

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

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

**5. CAPITAL STOCK (Cont'd)**

(b) Issued

	Common Shares	Amount
Issued at December 31, 2003	23,508,096	\$ 2,943,531
• Shares issued for cash (net of costs)	5,638,700	2,727,900
Issued at June 30, 2004	29,146,796	\$ 5,671,431

(c) Escrowed Shares

Pursuant to the terms of the business combination completed during the year, at June 30, 2004 there are 9,816,376 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 June 30, 2004, the Company has reserved stock options to directors and officers enabling them to acquire up to 940,000 common shares of the Company as follows:

Options Outstanding	2003		2002	
	Number of shares	Weighted average exercise price Cdn. \$	Number of shares	Weighted average exercise price Cdn. \$
Beginning of year	135,000	0.30	135,000	0.30
Granted during year	855,000	0.30	-	-
Exercised during year	50,000	0.30	-	-
End of year	<u>940,000</u>	0.30	<u>135,000</u>	0.30

The weighted-average remaining life of options outstanding at June 30, 2004 is 3.5 years.

(e) Warrants

As at June 30, 2004 100,000 warrants are outstanding entitling the holders to acquire shares of the Company at an exercise price of \$0.40 per share exercisable up until November 25, 2005.

**COMPLIANCE ENERGY CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2004**

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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 Company paid one of its officers legal, management and administration fees aggregating \$42,000 during the period ended June 30, 2004 (period ended June 30, 2003 - \$38,500).
- The Company incurred consulting fees for project development costs of \$30,000 for the period ended June 30, 2003 (period ended June 30, 2003-\$60,000) with a private company controlled by the family of a director and officer.

Refer also to note 4.