



FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED
JUNE 30, 2006

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MANAGEMENT'S DISCUSSION & ANALYSIS ("MD&A") OF FINANCIAL CONDITION & THE RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2006

August 25, 2006

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, 2006 and the Company's 2005 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, 2005. Additional information on the Company is available and can be found at www.sedar.com or www.complianceenergy.com.

Overall Performance

The Company recorded a loss of \$329,962 or \$0.01 per share for the six months ended June 30, 2006 as compared to a loss of \$198,357 or \$0.01 per share for the six months ended June 30, 2005. In order to better understand Compliance Energy's financial results for the six months ended in 2006, it is important to gain an understanding of the stage of development of the Company's main assets: (1) the Basin Coal Mine of which Compliance holds a 100% interest and processes and sells thermal coal; (2) the Raven and Bear Metallurgical Coal Deposits which are currently undergoing a development evaluation; (3) the wood waste and coal power plant development near the Company's Basin Coal Mine that has been awarded an Electricity Purchase Agreement from BC Hydro.

Production recommenced at the Basin Coal Mine in late April 2006. All expenses associated with the Basin Coal Mine have been deferred during the quarter. As a result \$0.5 million of 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, the Company will no longer defer start-up costs.

Professional fees were \$95,746 for the six months ended June 30, 2006 as compared to \$48,541 for the period ended June 30 2005. General and Administrative expenses were \$176,903 for the six months ended June 30, 2006 as compared to \$53,388 for the six months ended June 30, 2005. The increase in General & Administrative charges is a result of incurring additional head office costs to support the increased activity levels on the Vancouver Island project and the Company now treating the CEO's salary as an expense in G&A as opposed to allocating out part of the expense to the individual projects.

The Company incurred \$28,755 in transfer agent fees and \$53,644 in shareholder communications fees during the six months ended June 30, 2006 as compared to \$29,320 and \$47,375 respectively 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 2005 audited consolidated financial statements.

Liquidity and Capital Resources

As of June 30 2006, the Company had working capital of \$1.6 million (comprised of \$1.5 million of cash, \$1.2 million of receivables and prepaid expenses, offset by \$1.1 million of liabilities) compared with a working capital of \$5.3 million (comprised of \$5.9 million of cash, \$0.1 million of receivables, prepaid expenses and inventory offset by \$0.6 million of liabilities) at December 31, 2005.

The decrease in working capital between December 31, 2005 and June 30, 2006 was a result of the Company continuing with waste rock mining activities at the Basin Coal Mine during the first three months of the year as opposed to shutting down during the winter months like the Company had done in the previous year. As a result of keeping the mining activities ongoing during the first quarter, with limited sales from inventory, cash resources were reduced. Sales revenues commenced during the second quarter of this year with the start-up of the wash plant in April 2006 and new deliveries to customers commenced shortly thereafter.

The Company currently has 6 million warrants outstanding that if exercised would generate approximately \$6.4 million dollars of new equity money for the Company. These warrants have an exercise price ranging from \$0.95 per share to \$1.25 per share. Subsequent to the end of the quarter, the Company extended the term of the \$0.95 warrants to November 10, 2006 from the original expiry date of August 10, 2006. If these options are not exercised, the Company would need to complete another financing at some point during the next year in order to meet its general cash requirements. In addition, with the current exploration program on the Raven Metallurgical Coal Deposit on Vancouver Island, and the cash requirements for the Company on its Princeton Power Project bid, the Company will require additional sources of money. It is anticipated that these additional sources of money would take the form of debt and equity, financed specific to each project.

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, 2005.

Summary of Quarterly Results

Quarter	Revenue	Net Loss	Basic Loss per Share	Fully Diluted Loss Per Share
June 30, 2006	-	\$203,804	\$0.00	\$0.00
March 31, 2006	-	\$126,159	\$0.00	\$0.00
December 31, 2005	-	\$499,432	\$0.01	\$0.01
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	-	\$155,186	\$0.01	\$0.01
September 30, 2004	-	\$92,073	\$0.00	\$0.00

The Company's quarterly results are fairly consistent over the last eight quarters with the exception of the last quarter in the year ending 2005. There was an increase in expenditures during the last quarter of 2005 as there were 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 \$370,000 charge in 2005 to stock compensation expense as required under the fair value method of accounting for stock options.

Project Reviews

Raven Metallurgical Coal Project

Exploration activities for the Raven Metallurgical Coal deposit commenced in earnest in May 2006 with the receipt of exploration permits from the Province of British Columbia, Ministry of Energy, Mines & Petroleum Resources. The Company's \$2.1 million exploration program commenced with rehabilitating access roads and construction of drill pad sites. By the end of the quarter, a majority of the drill pad sites had been constructed and two drill holes had been completed. Both intersected mineable thicknesses of coal and appear to have extended the known coal resource by up to one half kilometer to the north with the deposit still open on strike. Hole #RAV-06-01 is located approximately one half kilometer northeast of the existing inferred coal resources and it intersected both Seam #1 and Seam #3 in mineable thicknesses of 2.37 meters and 1.51 meters respectively. Drill Hole #RAV-06-02 was drilled on the northern boundary of the existing inferred resource and it intersected Seam #1 in a mineable thickness of 3.35 meters. (Please see news release dated June 21, 2006 for location map on the company's web page as www.complianceenergy.com.) Geophysical logging commenced subsequent to the quarter end and is targeted to be completed by the end of the summer. Drill core samples were collected under the supervision of Owen R. Cullingham, P. Geo., who is the Qualified Person for reporting purposes on this exploration program. Clearing of access for seismic lines also begun late in the quarter and is expected to be completed by the end of the summer. A total of \$616,000 has been deferred on this project during the first half of 2006.

Princeton Power Project

During the quarter the Company continued to advance its development of its proposed wood waste and coal power plant that is to be located near the Basin Coal Mine. Early in the quarter the Company formerly submitted the 56MW project for the 2006 BC Hydro Open Call for Power to BC Hydro. Other activities on the project continued during the quarter including baseline environmental monitoring studies, aerial photography of the Power Plant Site, and additional plant design engineering. Subsequent to the quarter end, BC Hydro awarded the Company a long term 30 year contract to build the 56MW power plant. A total of \$112,000 was incurred on this project during the quarter. All of these costs have been deferred.

Basin Coal Mine

During the quarter, mining activities continued at the Basin Coal Mine with the start-up of the Company's wash plant in early April 2006. A total of 27,982 tonnes of clean coal were produced and 14,511 were delivered to customers. The Company anticipates producing enough clean coal to satisfy its existing contracts before the end of the third quarter, well ahead of last years pace. As a result of the limited production all costs associated with the Basin Coal Mine have been deferred for the quarter. A total of \$0.5 million in expenditures have been deferred during the quarter relating to the Basin Coal Mine. Marketing efforts continued on the Basin during the quarter to attract new customers. With the awarding of the BC Hydro power contract to the Company, the Basin will plan for increased production as that project nears completion.

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.

Disclosure Controls

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to permit timely discussions regarding public disclosures. Management, including the Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2005. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings*, are effective to ensure that information required to be disclosed in reports that we file or submit under Canadian securities legislation are recorded, processed and reported within the time period specified in those rules.

COMPLIANCE ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS

	June 30, 2006	December 31, 2005
ASSETS		
Current Assets		
Cash	\$ 1,258,537	\$ 5,853,682
Accounts receivable	1,159,353	140,541
Investments	37,500	37,500
Prepaid expenses	8,014	8,014
	2,463,404	6,039,737
Reclamation bonding	195,000	173,500
Resource property (note 4)	9,283,110	5,808,815
Capital assets (note 3)	5,255,196	5,151,105
	\$ 17,196,710	\$ 17,173,157
LIABILITIES		
Current Liabilities		
Accounts payable	\$ 1,106,073	\$ 658,586
	1,106,073	658,586
Non-current Liability		
Long term debt	830,164	903,137
	1,936,237	1,561,723
SHAREHOLDERS' EQUITY		
Share Capital (note 5)	16,438,051	16,459,050
Contributed surplus	690,067	690,067
Deficit	(1,867,645)	(1,537,683)
	15,260,473	15,611,434
	\$ 17,196,710	\$ 17,173,157

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, 2006 AND 2005

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
REVENUES				
Interest Income	33,786	\$ 8,266	45,045	\$ 16,948
	33,786	8,266	45,045	16,948
EXPENSES				
Professional fees	70,408	26,958	95,746	48,541
General & admin	107,486	37,337	176,903	53,388
Consulting fees	-	22,500	-	30,000
Transfer agent & filing fees	15,941	17,225	28,755	29,320
Shareholder communications	35,232	26,049	53,664	47,375
Travel	8,523	5,392	19,939	6,681
Total Expenses	237,590	135,461	375,007	215,305
NET LOSS FOR THE PERIOD	203,804	127,195	329,962	198,357
DEFICIT (RETAINED EARNINGS), BEGINNING OF PERIOD	1,663,841	815,646	1,537,683	744,484
DEFICIT (RETAINED EARNINGS), END OF PERIOD	\$ 1,867,645	\$ 942,841	\$ 1,867,645	\$ 942,841
LOSS PER SHARE	\$ 0.00	\$ 0.00	\$ 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 SIX MONTHS ENDED JUNE 30, 2006 AND 2005

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
OPERATING ACTIVITIES				
Net loss for the period	\$ (203,804)	\$ (127,195)	\$ (329,962)	\$ (198,357)
Items not involving cash:				
Net change in non-cash working capital items	(644,861)	(517,542)	(571,325)	(175,252)
	(848,665)	(644,737)	(901,287)	(373,609)
INVESTING ACTIVITIES				
Purchase of reclamation bond	(21,500)	-	(21,500)	(3,500)
Purchase of capital assets	(167,637)	(388,624)	(243,468)	(1,296,072)
Resource property costs	(2,136,519)	(908,669)	(3,134,918)	(1,178,696)
	(2,325,656)	(1,297,293)	(3,399,886)	(2,478,268)
FINANCING ACTIVITIES				
Long term debt (repaid)	(48,908)	(273,917)	(72,973)	(293,669)
Shares issued for cash	-	17,246	(20,999)	5,566,094
	(48,908)	(256,671)	(93,972)	5,272,425
DECREASE IN CASH	(3,223,229)	(2,198,701)	(4,395,145)	2,420,548
CASH, BEGINNING OF PERIOD	4,481,766	5,946,686	5,853,682	1,327,437
CASH, END OF PERIOD	\$ 1,258,537	\$ 3,747,985	\$ 1,258,537	\$ 3,747,985

The accompanying notes are an integral part of this financial statement

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

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, 2005.

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, 2006	December 31, 2005
Land	\$ 50,000	\$ 50,000
Building	297,476	278,283
Equipment – other	154,554	104,652
Equipment – wash plant	3,119,518	2,780,145
Equipment – mining	2,442,611	2,460,053
	<u>6,064,159</u>	<u>5,673,133</u>
Accumulated Depreciation	(834,773)	(547,838)
Office equipment	25,810	25,810
	<u>\$ 5,255,196</u>	<u>\$ 5,151,105</u>

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

4. RESOURCE PROPERTY

a) Basin Coal Mine

The Basin Coal Mine consists of 9 coal licenses covering 8,295 acres, and the mining rights were 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. The property is subject to a royalty of \$1.50 per tonne on all washed coal sold.

b) Bear Metallurgical Coal Deposit

The Bear Metallurgical Coal Deposit consists of 6 coal licenses totaling 4,325 acres. During the year the Company exercised its option to acquire coal leases that cover 100% of the Bear Metallurgical Coal Deposit on Vancouver Island. Under the terms of the agreement, the Company paid a total of \$215,000 and granted a royalty of 2.5% of the coal sales, FOB mine site.

c) Raven Metallurgical Coal Deposit

During the year the Company entered into an agreement to acquire coal rights that cover approximately 82,000 acres on Vancouver Island, including 100% of the Raven Metallurgical Coal Deposit on Vancouver Island. Under the terms of the agreement, the Company has made an initial \$100,000 option payment and must make an additional payment of \$2,800,000 on or before November 30, 2006; \$2,000,000 in four equal payments over the next four years based on development milestones; and \$4,000,000 by way of a \$0.50 per tonne royalty once production is achieved. The property is subject to no other royalties. In addition, the Company paid a total of \$175,000 to an independent third party on the acquisition of ground contiguous to the Raven property.

d) Anderson Lake Coal Deposit

During the year the Company entered into an agreement to acquire 100% of the coal rights that cover approximately 1,938 acres on Vancouver Island. Under the terms of the agreement, the Company paid \$50,000 during the year. The property is not subject to a royalty.

e) 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.

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

4. RESOURCE PROPERTY (continued)

f) CEC Power Project

The Company has assigned its option to purchase the former Similco mine where the Company is proposing to build a 49MW (net) power plant on a portion of the land ("Core Area") to Copper Mountain Mining Corporation ("CMMC"). Under the terms of the agreement CMMC has the option to purchase the entire 18,000 acre site for \$1.0 million and the Company has the option to purchase the Core Area for the power plant site from CMMC for \$1. The option expires on December 31, 2006. Costs incurred to date on the power plant project have been deferred. In the event CMMC does not exercise its option, the Company has the right to reclaim the option and exercise it in the name of the Company.

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

	Cumulative to	
	June 30, 2006	December 31, 2005
Basin Coal Mine		
Mining	\$ 5,547,855	\$ 4,025,491
Processing	2,671,776	2,124,220
Development	4,843,880	3,897,913
Marketing	318,516	273,998
Environmental	316,039	277,721
Legal	52,508	52,508
	<u>13,750,574</u>	<u>10,651,851</u>
Less: start-up Coal Revenue	(5,137,757)	(4,421,336)
	<u>\$ 8,612,817</u>	<u>\$ 6,530,515</u>
Valuation adjustment on purchase of remaining 35% interest in the CBCJV	(2,332,639)	(2,332,639)
Other deferred costs:		
Bear Coal Deposit		
Acquisition	215,000	215,000
Deferred Costs	771,284	752,919
Raven Coal Deposit		
Acquisition	475,000	275,000
Deferred Costs	616,094	-
Wolf Mountain Mine		
Acquisition	50,000	50,000
Deferred Costs	17,406	17,406
Other Coal Assets		
Acquisition	240,000	240,000
Deferred Costs	4,500	4,500
CEC Power Project		
Acquisition	60,000	60,000
Deferred Costs	553,648	296,114
	<u>\$ 9,283,110</u>	<u>\$ 5,808,815</u>

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

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, 2005	43,839,091	\$ 16,459,050
• Shares issued for cash (net of costs)	-	(20,999)
Issued at June 30, 2006	43,839,091	\$ 16,438,051

- (c) Escrowed Shares

Pursuant to the terms of the business combination completed during the year, at June 30, 2006 there are 5,774,349 common shares held in escrow. These shares are subject to a six year hold period, ending on September 5, 2009, and their release from escrow occurs bi-annually and 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, 2006, the Company has reserved stock options to directors and officers enabling them to acquire up to 3,025,000 common shares of the Company as follows:

Options Outstanding	2006		2005	
	Number of shares	Weighted average exercise price Cdn. \$	Number of shares	Weighted average exercise price Cdn. \$
Beginning of period	3,025,000	0.77	940,000	0.34
Granted during period	-	-	2,280,000	0.85
Exercised during the period	-	-	(195,000)	0.34
End of period	<u>3,025,000</u>	0.77	<u>3,025,000</u>	0.77

The weighted-average remaining life of options outstanding at June 30, 2006 is 3.82 years.

- (e) Warrants

As at June 30, 2006 6,093,678 warrants are outstanding entitling the holders to acquire shares of the Company at prices ranging between \$0.95 and \$1.25 per share exercisable at various dates ranging up until November 10, 2006.

COMPLIANCE ENERGY CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

5. CAPITAL STOCK *(continued)*

(f) Broker Warrants

As at June 30, 2006 921,029 broker warrants are outstanding entitling the holders to acquire shares of the Company at prices ranging between \$0.75 and \$0.95 per share exercisable at various dates ranging up until December 22, 2006.

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 \$58,500 during the period ended June 30, 2006 (period ended June 30, 2005 - \$42,000).
- The Company paid one of its directors, management consulting fees aggregating \$7,088 during the period ended June 30, 2006 (period ended June 30, 2005 - \$16,000).

7. SUBSEQUENT EVENTS

- a) On August 24, 2006 the Company closed a \$3.5 million term loan with Quest Capital Corp of Vancouver, British Columbia. Under the terms of the loan, which has been fully drawn and is due May 30, 2007 bearing a monthly interest rate of 1%, the Company has issued 646,153 common shares of the Company as "Bonus Shares" as permitted under TSX Venture Exchange rules. The Bonus Shares are subject to a four month hold period until December 24, 2006. Proceeds from the term loan will be used to provide performance security to BC Hydro under the recently awarded 30 year Electricity Purchase Agreement for the Company's 56 MW Princeton Power Project awarded on July 27, 2006.
- b) On July 28, 2006 the Company completed a non-brokered private placement financing of \$310,000. The financing consisted of 500,000 units, at a price of \$0.62 per unit which was entirely subscribed for by insiders. Each unit consisted of one common share and one share-purchase warrant. Each warrant entitles the holder to purchase one common share for a period of two years at a price of \$0.75 per share.

Corporate Information

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Vancouver, British Columbia

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TSX Venture Exchange
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