

Interim Condensed Consolidated Financial Statements  
(Expressed in Canadian dollars)

## **CHANGFENG ENERGY INC.**

Three-month periods ended March 31, 2011 and 2010  
(Unaudited)

# CHANGFENG ENERGY INC.

Interim Condensed Consolidated Balance Sheets  
(Expressed in Canadian dollars)  
(Unaudited)

	March 31, 2011	December 31, 2010	January 1, 2010
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 3,549,258	\$ 2,670,113	\$ 3,782,250
Trade and other receivables	1,723,140	2,034,762	1,129,924
Prepaid expenses and deposits	321,303	334,887	299,660
Inventories (note 7)	879,689	572,566	581,570
Due from related parties (note 11)	373,702	380,301	385,140
<b>Total current assets</b>	<b>6,847,092</b>	<b>5,992,629</b>	<b>6,178,544</b>
Non-current assets:			
Long-term deposits (note 6)	884,510	917,657	169,692
Plant and equipment (note 5)	38,327,485	37,317,603	29,077,168
Intangible assets	519,318	528,150	536,550
Deferred income tax assets	—	—	169,840
<b>Total non-current assets</b>	<b>39,731,313</b>	<b>38,763,410</b>	<b>29,953,250</b>
<b>Total assets</b>	<b>\$ 46,578,405</b>	<b>\$ 44,756,039</b>	<b>\$ 36,131,794</b>
<b>Liabilities and Equity</b>			
Current liabilities:			
Trade and other payables	\$ 3,406,077	\$ 4,262,759	\$ 2,637,320
Deferred revenue	4,040,423	4,683,502	3,586,710
Interest payable	1,933,797	1,965,051	1,996,304
Current portion of bank loan (note 8)	4,232,250	754,500	8,400,840
Due to related parties (note 11)	356,073	320,879	200,510
<b>Total current liabilities</b>	<b>13,968,620</b>	<b>11,986,691</b>	<b>16,821,684</b>
Non-current liabilities:			
Long-term bank loan (note 8)	14,471,170	15,451,037	3,066,000
Due to related parties (note 11)	5,940,000	6,036,000	6,132,000
Deferred income tax liabilities	2,659	—	(27,600)
<b>Total non-current liabilities</b>	<b>20,413,829</b>	<b>21,487,037</b>	<b>9,170,400</b>
<b>Total liabilities</b>	<b>34,382,449</b>	<b>33,473,728</b>	<b>25,992,084</b>
Equity attributable to owners of the parent:			
Share capital (note 9)	12,121,808	12,121,808	12,121,808
Contributed surplus	1,762,168	1,762,168	1,190,509
Warrants	—	—	321,724
Accumulated other comprehensive loss	(260,565)	(63,762)	—
Deficit	(2,093,743)	(3,209,347)	(4,175,528)
<b>Total equity attributable to owners of the parent</b>	<b>11,529,668</b>	<b>10,610,867</b>	<b>9,458,513</b>
Non-controlling interest	666,288	671,444	681,197
<b>Total equity</b>	<b>12,195,956</b>	<b>11,282,311</b>	<b>10,139,710</b>
<b>Total liabilities and equity</b>	<b>\$ 46,578,405</b>	<b>\$ 44,756,039</b>	<b>\$ 36,131,794</b>

The accompanying notes form an integral part of these interim condensed consolidated financial statements.

# CHANGFENG ENERGY INC.

Interim Condensed Consolidated Statements of Comprehensive Income  
(Expressed in Canadian dollars)  
(Unaudited)

	Three months ended March 31,	
	2011	2010
Revenue	\$ 6,534,312	\$ 5,089,456
Cost of sales	2,515,323	1,917,615
Gross margin	4,018,989	3,171,841
Expenses:		
General and administrative	1,038,712	1,428,968
Interest on long-term debt (note 8)	295,180	137,693
Travel and business development	756,153	852,601
Amortization	485,092	277,960
	<u>2,575,137</u>	<u>2,697,222</u>
Income from operations	1,443,852	474,619
Interest income	1,282	1,935
Income before income taxes	1,445,134	476,554
Income taxes	334,686	41,915
Net income	1,110,448	434,639
Other comprehensive loss:		
Exchange differences on translation of foreign operations	(196,803)	(299,195)
<b>Total comprehensive income</b>	<b>\$ 913,645</b>	<b>\$ 135,444</b>
Net income attributable to:		
Owners of the company	\$ 1,115,604	\$ 434,639
Non-controlling interest	(5,156)	-
	<u>\$ 1,110,448</u>	<u>\$ 434,639</u>
Total comprehensive income attributable to:		
Owners of the company	\$ 918,801	\$ 135,444
Non-controlling interest	(5,156)	-
Earnings per share attributable to owners of the parent:		
Basic and diluted	\$ 0.017	\$ 0.007

The accompanying notes form an integral part of these interim condensed consolidated financial statements.

# CHANGFENG ENERGY INC.

Interim Condensed Consolidated Statements of Changes in Equity  
(Expressed in Canadian dollars)  
(Unaudited)

Three months ended March 31, 2011	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Non-controlling interest	Total
Equity, January 1, 2011	\$ 12,121,808	\$ 1,762,168	\$ (3,209,347)	\$ (63,762)	\$ 671,444	\$ 11,282,311
Net income (loss)	–	–	1,115,604	–	(5,156)	1,110,448
Currency translation adjustment	–	–	–	(196,803)	–	(196,803)
Equity, March 31, 2011	\$ 12,121,808	\$ 1,762,168	\$ (2,093,743)	\$ (260,565)	\$ 666,288	\$ 12,195,956

Three months ended March 31, 2010	Share capital	Contributed surplus	Warrants	Deficit	Accumulated other comprehensive loss	Non-controlling interest	Total
Equity, January 1, 2010	\$ 12,121,808	\$ 1,190,509	\$ 321,724	\$ (4,175,528)	\$ –	\$ 681,197	\$ 10,139,710
Net income	–	–	–	434,639	–	–	434,639
Currency translation adjustment	–	–	–	–	(299,195)	–	(299,195)
Warrants expired	–	321,724	(321,724)	–	–	–	–
Equity, March 31, 2010	\$ 12,121,808	\$ 1,512,233	\$ –	\$ (3,740,889)	\$ (299,195)	\$ 681,197	\$ 10,275,154

The accompanying notes form an integral part of these interim condensed consolidated financial statements.

# CHANGFENG ENERGY INC.

Interim Condensed Consolidated Statements of Cash Flows  
(Expressed in Canadian dollars)  
(Unaudited)

	Three months ended March 31,	
	2011	2010
<b>Cash flows from operating activities:</b>		
Net income	\$ 1,110,448	\$ 434,639
Items not involving cash:		
Amortization	485,092	277,960
Long-term debt accretion	14,761	7,761
Interest expense	295,180	137,693
Taxes paid	(397,063)	(410,383)
Interest paid	(295,180)	(197,297)
Change in non-cash operating working capital (note 12)	(962,701)	(270,608)
Net cash flows from (used in) operating activities	250,537	(20,235)
<b>Cash flows from financing activities:</b>		
Long-term debt	2,771,300	6,366,140
Net cash flows from financing activities	2,771,300	6,366,140
<b>Cash flows from investing activities:</b>		
Plant and equipment	(2,090,026)	(2,640,020)
Long-term deposits	-	(652,833)
Net cash flows used in investing activities	(2,090,026)	(3,292,853)
Increase in cash and cash equivalents	931,811	3,053,052
Effects of foreign exchange on cash balances	(52,666)	(170,372)
Cash and cash equivalents, beginning of period	2,670,113	3,782,250
<b>Cash and cash equivalents, end of period</b>	<b>\$ 3,549,258</b>	<b>\$ 6,664,930</b>

The accompanying notes form an integral part of these interim condensed consolidated financial statements.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 1. Corporate information:

Changfeng Energy Inc. (the "Company" or "Changfeng") was incorporated under the Canada Business Corporations Act on May 4, 2006. Through its subsidiaries, the Company's core business activity is the distribution of natural gas for industrial, commercial and residential users in the People's Republic of China ("China" or "PRC").

The address of the Company's corporate office is 25 Adelaide Street East, Suite 1612, Toronto, Ontario, M5C 3A1, and the principal place of business is in China.

The ability to build and operate gas pipeline infrastructure and distribute piped gas in China is established by concession rights obtained from the applicable municipal and provincial governments. Natural gas distribution operations in China are subject to certain government regulations regarding the purchase and sale of natural gas, including pricing.

## 2. Basis of presentation:

### (a) Statement of compliance:

The interim condensed consolidated financial statements of the Company and all its subsidiaries for the three-month period ended March 31, 2011 have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"). These interim condensed consolidated financial statements for the three-month period ended March 31, 2011 have been prepared in accordance with International Accounting Standard ("IAS") 34, Interim Financial Reporting. As these statements are the Company's first IFRS financial statements, IFRS 1, First-time Adoption of International Financial Reporting Standards ("IFRS 1"), has been applied.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in note 17.

The interim condensed consolidated financial statements were authorized for issue by the Board of Directors on June 27, 2011.

### (b) Basis of measurement:

The interim condensed consolidated financial statements have been prepared on a historical cost basis for all its recognized assets and liabilities, and are presented in Canadian dollars, except when otherwise indicated.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies:

The accounting policies set out below are expected to be those in force for the year ending December 31, 2011 and have been applied consistently to all periods presented in these interim condensed consolidated financial statements and in preparing the opening IFRS balance sheet as at January 1, 2010 for the purposes of the transition to IFRS ("date of transition"), unless otherwise indicated.

All amounts in these interim condensed consolidated financial statements are stated in Canadian dollars unless indicated with "RMB" to represent the Chinese Renminbi or "U.S." to represent the United States dollar. Outlined below are those policies considered significant:

(a) Basis of consolidation:

Subsidiaries:

Where the Company has the power, either directly or indirectly, to govern the financial and operating policies of another entity or business so as to obtain benefits from its activities, it is classified as a subsidiary. The interim condensed consolidated financial statements present the results of all of the Company's subsidiaries as if they formed a single entity. Intercompany balances, transactions, and any unrealized income and expenses arising from intercompany transactions within the Company are eliminated in preparing the interim condensed consolidated financial statements.

The Company's subsidiaries include its wholly owned subsidiaries, Hainan Energy Limited, Sanya Changfeng Offshore Natural Gas Distribution Co., Ltd., its 99.4% interest in Sanya Changfeng Offshore Natural Gas Engineering Construction Co., Ltd., its 99.99% interest in Sanya Changfeng New Energy Investment Co., Ltd., its 98% interest in Sanya Changfeng Offshore Natural Gas Design Co. Ltd., its 58% interest in Hunan Changfeng CNPC Energy Co., Ltd. ("Hunan CF CNPC"), its 60% interest in Hunan CNPC New Energy Investment Co., Ltd. ("Hunan CNPC NEI") and its 80% interest in Pingxiang Changfeng Natural Gas Co. Ltd.

(b) Foreign currency translation:

The Canadian dollar is the functional currency of the parent company's operations, and the RMB is the functional currency of the Company's subsidiaries. The Canadian dollar is the reporting currency of the Company. Since the RMB is not a fully convertible currency, all foreign exchange transactions involving RMB must take place either through the People's Bank of China or other institutions authorized to buy and sell RMB.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies (continued):

Transaction amounts denominated in foreign currencies are translated into the Company's functional currency at exchange rates prevailing at the transaction dates. Carrying values of foreign currency monetary assets and liabilities are translated at exchange rates in effect at the interim condensed consolidated balance sheet dates.

Non-monetary assets and liabilities are translated at historical exchange rates, unless such items are carried at market value, in which case, they are translated at the exchange rates in effect on the interim condensed consolidated balance sheet dates.

On consolidation, the results of foreign operations are translated into Canadian dollars at rates approximating those in effect when the transactions took place. All assets and liabilities of operations in China are translated at the rate in effect at the reporting date. Exchange differences arising on translating the opening net assets at the opening rate and the results of foreign operations at the actual rate are recognized and accumulated in other comprehensive income.

For presentation purposes, the results of the Company are translated into Canadian dollars at rates approximating those in effect when the transactions took place. All assets and liabilities of the Company are translated at the rate in effect at the reporting dates. Exchange differences arising on translating the opening net assets at the opening rate and the results of the Company at the actual rates are recognized and accumulated in other comprehensive income.

(c) Plant and equipment, construction in progress and amortization:

(i) Recognition and measurement:

On initial recognition, plant and equipment are recorded at cost, being the purchase price and directly attributable costs of acquisition or construction required to bring the asset to the location and condition necessary to be capable of operating in the manner intended by the Company, including appropriate borrowing costs.

Assets in the course of construction are shown in a separate category and are also recognized at cost. On completion, the costs of construction are transferred to the appropriate category of plant and equipment.

Plant and equipment is subsequently measured at cost, net of accumulated amortization and/or accumulated impairment losses, if any.



# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies (continued):

When parts of an item of plant and equipment have different useful lives, they are accounted for as separate items (components) of plant and equipment.

(ii) Subsequent costs:

The cost of replacing part of an item of plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of plant and equipment are recognized in profit or loss as incurred.

(iii) Gains and losses:

Gains and losses on disposal of an item of plant and equipment are determined by comparing the proceeds from disposal with the carrying amount, and are recognized net within other income in profit or loss.

(iv) Amortization:

Amortization of plant and equipment is recorded on a straight-line basis over their estimated useful lives as follows:

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Buildings	30 - 35 years
Pipelines	30 - 35 years
Land use rights	Term of agreement
Motor vehicles	3 - 10 years
Furniture and equipment	3 - 20 years
Computer equipment	3 - 5 years
Lease improvements	Term of agreement

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Assets classified as construction in progress are not amortized until they are ready for their intended uses, at which point, they are transferred to plant and equipment.

(d) Intangible assets:

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets with finite lives are carried at cost less accumulated amortization and accumulated impairment losses, if any.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies (continued):

The Company's intangible assets consist of gas purchase contract rights, which are recorded at cost and are amortized on a straight-line basis over their contractual useful lives commencing from the delivery of gas.

(e) Leased assets:

Where substantially all of the risks and rewards incidental to ownership are not transferred to the Company, the total rentals payable under the lease are charged to the interim condensed consolidated statements of comprehensive income on a straight-line basis over the lease term. The aggregate benefit of lease incentives is recognized as a reduction of the rental expense over the lease term on a straight-line basis.

(f) Impairment of long-lived assets:

The Company reviews and evaluates its tangible long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. An impairment loss, if any, would be recorded as the excess of the carrying amount of the asset over its recoverable amount, measured by either fair value, if available, or estimated by calculating the present value of expected future cash flows related to the asset.

Intangible assets with finite lives are tested for impairment when events or changes in circumstances indicate that their carrying values may not be recoverable. Any impairment loss will be charged against current period income. If there is an indication that the recoverable amount of the asset subsequently increases, any previously recognized impairment loss is reversed.

(g) Financial instruments:

The Company's financial assets and financial liabilities are classified as held-for-trading, loans and receivables or other financial liabilities. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Held-for-trading financial instruments are measured at fair value with changes in fair value recognized in the interim condensed consolidated statements of comprehensive income in the periods in which such changes arise. Loans and receivables and other financial liabilities are initially recorded at fair value and subsequently measured at amortized cost.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies (continued):

Financial assets are assessed at each reporting date to determine whether there is any objective evidence of impairment. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effective on the estimated future cash flows of that asset, with impairment losses recognized in the interim condensed consolidated statements of comprehensive income.

(h) Inventories:

Inventories, including construction materials, gas appliances and meters and spare parts, are stated at the lower of cost and net realizable value, with cost being determined using the weighted average cost basis. Cost includes the purchase price, transportation costs and other costs to bring the inventories to their present locations and conditions. Reversal of previous write-downs is required when there is a subsequent increase in the value of inventories.

(i) Cash and cash equivalents:

Cash and cash equivalents include cash on hand and balances with banks, cashable guaranteed investment certificates and short-term investments with original maturities of three months or less that are readily convertible to known amounts of cash and subject to an insignificant risk of change in value. For the purposes of presentation in the interim condensed consolidated statements of cash flow, cash and cash equivalents include bank overdrafts.

(j) Trade and other receivables:

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost, less provision for doubtful receivables. Collectability of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off as impaired. A provision for doubtful receivables is established when there is objective evidence that the Company will not be able to collect all amounts due to it. The amount of the provision is the difference between the asset's carrying amount and the present value of future cash flows. The charge to establish the provision is recognized in the interim condensed consolidated statements of comprehensive income.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies (continued):

#### (k) Revenue recognition:

Revenue is derived from the delivery of natural gas and from the installation and connection of natural gas pipelines for end users.

The Company recognizes revenue when gas has been delivered and is recorded on the basis of regular meter readings and estimates of usage since the last meter reading to the end of the reporting period. Revenue from supply of gas is recorded using relatively fixed prices approved by the provincial government.

Gas connection revenue is deferred and only recognized when the outcome of a contract can be estimated reliably and the stage of completion at the reporting date can be measured reliably.

Revenue from gas connection contracts is recognized on the percentage-of-completion method, measured by reference to the value of work carried out during the periods.

When it is probable that total contract costs will exceed contract revenue, the expected loss is recognized as an expense immediately. Sales of gas appliances are recognized when goods are delivered and title has passed.

Interest income is recorded on an accrual basis.

#### (l) Income taxes:

##### (i) Current income taxes:

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute current income tax assets and liabilities are measured at future anticipated tax rates, which have been enacted or substantively enacted at the reporting dates.

Current tax assets and current tax liabilities are only offset if a legally enforceable right exists to offset the amounts, and the Company intends to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Current and deferred tax is recognized in profit and loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies (continued):

#### (ii) Deferred income taxes:

Deferred taxation is provided on all qualifying temporary differences at the reporting dates between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax assets are only recognized to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future and future taxable profit will be available against which the temporary difference can be utilized.

Deferred tax liabilities and assets are not recognized for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority.

#### (m) Finance income and finance costs:

Finance income comprises interest income on funds invested (cash and short-term investments). Interest income is recognized as it accrues in profit or loss, using the effective interest method.

Finance cost comprises interest expense, which is recognized as it accrues in profit or loss, using the effective interest method, and impairment losses recognized on financial assets, if any. Interest incurred on borrowings directly attributable to fund the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale is capitalized as part of the cost of the respective asset.

Borrowing costs that are not attributable to a qualifying asset are expensed in the periods in which they are incurred and reported within interest expense in the interim condensed consolidated statements of comprehensive income.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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### 3. Significant accounting policies (continued):

#### (n) Share-based payments:

Equity-settled share-based payments for directors, officers, employees and advisors are measured at fair value at the dates of grant and recorded as compensation expense in the interim condensed consolidated financial statements. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period of each tranche separately based on the Company's estimate of shares that will eventually vest. Any consideration paid by directors, officers, employees and advisors on exercise of equity-settled share-based payments is credited to share capital.

Compensation expense on stock options granted to non-employees is measured using the earlier of the date of completion of performance and the date that the options are vested using the fair value method, and is recorded as an expense in the same period as if the Company had paid cash for the goods or services received.

When the value of goods or services received in exchange for the share-based payment cannot be reliably estimated, fair value is measured by using the Black-Scholes valuation model. The expected life used in the model is adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

#### (o) Accounting standards issued but not yet effective:

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are not yet effective for the three-month period ended March 31, 2011, and have not been applied in preparing these interim condensed consolidated financial statements.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 4. Use of accounting estimates and judgments:

The preparation of the interim condensed consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the periods in which the estimates are revised and in any future periods affected. Information about significant areas of estimation and critical judgments in applying accounting policies that have significant effects on the amounts recognized in the interim condensed consolidated financial statements is included in the following notes:

(a) Impairment of plant and equipment and intangible assets:

The Company reviews plant and equipment and intangible assets for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

(b) Revenue recognition:

Gas connection revenue is deferred and only recognized when the outcome of a contract can be estimated reliably and the stage of completion at the interim condensed consolidated balance sheet dates can be measured reliably.

Revenue from gas connection contracts is recognized on the percentage-of-completion method, measured by reference to the value of work carried out during the periods. When it is probable that total contract costs will exceed contract revenue, the expected loss is recognized as an expense immediately.

(c) Amortization expense:

The Company's plant and equipment are amortized over their estimated useful economic lives. Useful lives are based upon management's estimates of the length of time that the assets will generate revenue, which is reviewed at least annually for appropriateness. Changes to these estimates can result in variations in the amounts charged for amortization and in the assets' carrying amounts.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 4. Use of accounting estimates and judgments (continued):

### (d) Income taxes:

Provisions for income taxes are based on domestic and international statutory income tax rates and tax planning opportunities available to the Company in the jurisdictions in which it operates. Significant judgment is required determining income tax provisions and the recoverability of deferred tax assets. The calculation of current and deferred income tax balances requires management to make estimates regarding the carrying values of assets and liabilities that include estimates of future cash flows and income related to such assets and liabilities, the interpretation of income tax legislation in the jurisdictions in which the Company operates, and the timing of reversal of temporary differences. The Company establishes additional provisions for income taxes when, despite management's opinion that tax positions are fully supportable, there is sufficient complexity or uncertainty in the application of legislation that certain tax positions may be reassessed by tax authorities. The Company adjusts these additional accruals in light of changing facts and circumstances.

### (e) Share-based payments:

The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the dates at which they are granted. Determining fair value for share-based payment transactions requires the use of the most appropriate valuation model, which is dependent on the terms and conditions of the grant. The determination of fair value requires estimating the expected life of the share option, volatility and dividend yield. The assumptions and models used for estimating fair value for share-based payment transactions are disclosed in note 10.



# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 5. Plant and equipment:

Cost	Buildings	Pipelines	Land use rights	Motor vehicles	Furniture and equipment	Computer equipment	Lease improvements	Construction in progress	Total
Balance, January 1, 2010	\$ 55,894	\$ 26,925,472	\$ 1,136,260	\$ 818,958	\$ 2,236,001	\$ 100,418	\$ –	\$ 4,173,120	\$ 35,446,123
Additions (transfers)	–	10,052,447	–	430,800	346,563	66,364	395,506	(1,986,307)	9,305,373
Interest capitalized	–	425,263	–	–	–	–	–	–	425,263
Foreign currency translation	(875)	(421,533)	(17,789)	(12,822)	(35,006)	(1,572)	–	–	(489,597)
Balance, December 31, 2010	55,019	36,981,649	1,118,471	1,236,936	2,547,558	165,210	395,506	2,186,813	44,687,162
Additions	–	287,440	–	379	12,815	4,183	–	1,724,830	2,029,647
Foreign currency translation	(875)	(588,177)	(17,789)	(19,673)	(40,518)	(2,628)	(6,290)	–	(675,950)
Balance, March 31, 2011	\$ 54,144	\$ 36,680,912	\$ 1,100,682	\$ 1,217,642	\$ 2,519,855	\$ 166,765	\$ 389,216	\$ 3,911,643	\$ 46,040,859

Amortization	Building	Pipelines	Land use rights	Motor vehicles	Furniture and equipment	Computer equipment	Lease improvements	Construction in progress	Total
Balance, January 1, 2010	\$ 12,205	\$ 5,219,210	\$ 260,985	\$ 212,430	\$ 615,097	\$ 49,028	\$ –	\$ –	\$ 6,368,955
Amortization	1,483	746,420	29,709	147,535	104,272	47,290	23,073	–	1,099,782
Foreign currency translation	(191)	(81,177)	(4,086)	(3,326)	(9,630)	(768)	–	–	(99,178)
Balance, December 31, 2010	13,497	5,884,453	286,608	356,639	709,739	95,550	23,073	–	7,369,559
Amortization	365	355,405	7,309	41,032	42,606	10,450	686	–	457,853
Foreign currency translation	(215)	(90,573)	(4,558)	(5,672)	(11,288)	(1,520)	(212)	–	(114,038)
Balance, March 31, 2011	\$ 13,647	\$ 6,149,285	\$ 289,359	\$ 391,999	\$ 741,057	\$ 104,480	\$ 23,547	\$ –	\$ 7,713,374

Net book value	Building	Pipelines	Land use rights	Motor vehicles	Furniture and equipment	Computer equipment	Lease improvements	Construction in progress	Total
January 1, 2010	\$ 43,689	\$ 21,706,262	\$ 875,275	\$ 606,528	\$ 1,620,904	\$ 51,390	\$ –	\$ 4,173,120	\$ 29,077,168
December 31, 2010	41,522	31,097,196	831,863	880,297	1,837,819	69,660	372,433	2,186,813	37,317,603
March 31, 2011	40,497	30,531,627	811,323	825,643	1,778,798	62,285	365,669	3,911,643	38,327,485

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 6. Long-term deposits:

Good faith deposits in connection with potential acquisitions and other long-term prepaid expenses and deposits are summarized below:

	March 31, 2011	December 31, 2010
Deposits towards the purchase of natural gas (note 13(c))	\$ 175,230	\$ 178,062
Good faith deposits towards pending business acquisitions (a)	596,197	605,833
Advance on long-term lease of land (note 13(d))	113,083	133,762
	<u>\$ 884,510</u>	<u>\$ 917,657</u>

(a) Included in long-term deposits were \$596,197 (RMB 4,014,796) in advance payments for potential acquisitions as described below:

- (i) In 2010, the Company paid a good faith deposit to the existing shareholder of Hunan CF CNPC, Guangda Gas Co., Ltd. ("Guangda Gas"), a company that Changfeng is considering for acquisition. Guangda Gas owns a compressed natural gas ("CNG") primary filling station in Changsha City. The deposit is refundable if the Company is not satisfied with its due diligence procedures or a reasonable purchase price cannot be negotiated.
- (ii) In 2010, the Company paid a good faith deposit to the existing shareholders of Jiangxi Pingxiang Huaneng Energy Co. Ltd. ("Pingxiang Huaneng"), a company that Changfeng is considering for acquisition. Pingxiang Huaneng is a natural gas distributor in the Xiangdong district, Pingxiang City, Jiangxi Province. The deposit is refundable if the Company is not satisfied with its due diligence procedures or a reasonable purchase price cannot be negotiated.

## 7. Inventories:

	March 31, 2011	December 31, 2010
Construction materials	\$ 661,965	\$ 392,970
Gas appliances, meters and spare parts	217,724	179,596
	<u>\$ 879,689</u>	<u>\$ 572,566</u>

The amount of inventories recognized as an expense during the three-month periods ended March 31, 2011 and 2010 was \$527,719 and \$576,619, respectively.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 8. Long-term debt:

	March 31, 2011	December 31, 2010
Term loan facility - China Development Bank (a)	\$ 1,262,250	\$ 1,509,000
Term loan facility - Bank of China (b)	14,471,170	14,696,537
	15,733,420	16,205,537
Less current portion	1,262,250	754,500
	\$ 14,471,170	\$ 15,451,037

- (a) This term loan from the China Development Bank of \$1,262,250 (RMB 8,500,000) (December 31, 2010 - \$1,509,000 (RMB 10,000,000)) was advanced from the China Development Bank to Sanya State Assets Management Corporation (an intermediary company controlled by the municipality of Sanya City (c)), and loaned to the Company, bearing interest at the floating prescribed rate of the People's Bank of China (6.40% as at March 31, 2011), with payments due quarterly. The loan matures on November 2012, secured by all pipelines, land use rights and gas distribution rights of the Company.
- (b) This term loan from the Bank of China of \$14,850,000 (RMB 100,000,000) (December 31, 2010 - \$15,090,000 (RMB 100,000,000)), bears variable interest based on the prescribed lending rate of the People's Bank of China and is due monthly, with principal repayments commencing in 2012. The loan matures in January 2019.
- (c) Also included in current portion of bank loan was \$2,970,000 (RMB 20,000,000) for a one-year bank loan from the Bank of China. On March 31, 2011, the Bank of China agreed to increase the Company's bank loan by \$4,455,000 (RMB 30,000,000) in the form of a one-year line of credit (the "Credit Line"). The Credit Line is secured by the same collateral as that for its \$14,850,000 (RMB 100,000,000) long-term loan, as noted above. As of March 31, 2011, the Company's drawing on the Credit Line amounted to \$2,970,000 (RMB 20,000,000) and is due in March 2012. The interest rate on the loan is based on the variable rate set by the People's Bank of China.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 8. Long-term debt (continued):

Long-term loan principal payments are as follows:

	RMB	Cdn. \$
2011	3,500,000	\$ 519,750
2012	10,000,000	1,485,000
2013	5,000,000	742,500
2014	10,000,000	1,485,000
2015	10,000,000	1,485,000
Thereafter	70,000,000	10,395,000
	108,500,000	16,112,250
Long-term debt discount, net of accretion	(2,508,904)	(372,572)
	105,991,096	\$ 15,739,678

As at March 31, 2011, the Company had accrued interest of \$1,933,797 (RMB 13,022,204) (December 31, 2010 - \$1,965,051 (RMB 13,022,204)) in connection with the term loans. The accrued interest payable was related to interest on loans from the Sanya State Assets Management Corporation (a state-owned company) for the periods prior to 2007 because the Sanya State Assets Management Corporation has not requested payment of interest for those periods.

## 9. Share capital:

(a) Authorized:

Unlimited common shares

(b) Issued common shares:

	Number of shares	Amount
December 31, 2010, being balance, March 31, 2011	66,025,000	\$ 12,121,808

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 10. Share-based payments:

### (a) Option plan details:

Under the Company's stock option plan (the "Plan"), the Company may grant stock options to directors, senior officers, employees and advisors, and is authorized to issue up to 10% of the issued and outstanding shares of the Company. The Board of Directors, or such other persons designated by the Board of Directors, administers the Plan and determines the vesting and terms of each award.

A summary of the Company's options granted and exercised is presented below:

	Options outstanding	Weighted average exercise price
Balance, January 1, 2010	3,450,000	\$ 0.60
Granted	1,200,000	0.60
Balance, December 31, 2010	4,650,000	0.60
Forfeited	(125,000)	0.60
<b>Balance, March 31, 2011</b>	<b>4,525,000</b>	<b>0.60</b>

### (b) Options issued during the periods:

The following table summarizes information about the options outstanding and exercisable at March 31, 2011:

Number outstanding	Number outstanding and exercisable	Remaining contractual life (in years)	Exercise price	Expiry date
3,000,000	3,000,000	1.82	\$ 0.60	2013
50,000	50,000	2.41	0.60	2013
400,000	400,000	3.25	0.55	2014
1,075,000	1,075,000	4.16	0.60	2015
<b>4,525,000</b>	<b>4,525,000</b>	<b>2.51</b>	<b>0.60</b>	

On May 28, 2010, the Company granted options to directors, senior officers, employees and advisors of the Company to acquire 1,200,000 common shares of the Company at an exercise price of \$0.60 per share on or before May 27, 2015, of which 800,000 vested immediately, and the remaining balance will vest within one year.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 10. Share-based payments (continued):

Assumptions used to determine the value of the options using the Black-Scholes option pricing model were: dividend yield 0%; risk-free interest rate 2.64%; expected volatility 69%; forfeiture rate 0%; and expected life of five years.

## 11. Related party transactions:

### (a) Related party entities:

The following is a listing of the Company's related parties in addition to key management personnel:

Name	Country of incorporation and relationship
Sanya Changkai Development Co., Ltd. (i)	China, corporation controlled by significant shareholder, officer and director
Cui JianXin	China, minority shareholder of Hunan CNPC NEI
Zhou Du (ii)	China, minority shareholder of Hunan CF CNPC

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(i) As at March 31, 2011, this corporation was controlled by a significant shareholder who is also an officer and director of the Company, owed the Company a total of \$76,702 (U.S. \$78,928) as at March 31, 2011 (December 31, 2010 - \$78,501 (U.S. \$78,928)) for various expenditures paid by the Company on behalf of this corporation. This amount, included in accounts receivable on the interim condensed consolidated balance sheets, is unsecured, non-interest bearing and with no fixed terms of repayment.

(ii) As at March 31, 2011, the Company had an outstanding loan of \$297,000 (RMB 2,000,000) (December 31, 2010 - \$301,800 (RMB 2,000,000)) due from a minority shareholder of Hunan CF CNPC, which used the funds to contribute the capital it owed to that subsidiary. The loan is unsecured and non-interest bearing. The minority shareholder has waived its right to any future profit that it would otherwise be allocated until the loan is repaid. The Company will begin recording this shareholder's profit allocation prospectively at the time the loan has been repaid.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 11. Related party transactions (continued):

### (b) Transactions with key management personnel:

In 2007, a significant shareholder, who is also an officer and director of the Company advanced loans in the aggregate amount of \$5,940,000 (RMB 40,000,000) (December 31, 2010 - \$6,036,000 (RMB 40,000,000)) to the Company, through wholly owned corporations, in accordance with a Subordination and Forbearance Agreement dated April 27, 2007, Consignment Loan Agreements dated May 23, 2007 and June 26, 2007, and other ancillary documentation. These loans are unsecured, non-interest bearing, subordinate to the claims of all other creditors, including unsecured creditors of the Company, and due on demand; however, the lender could not demand the repayment of the loans before April 27, 2010 per the original agreement. The shareholder and the Company have entered into Loan Renewal Agreements, whereby the parties have agreed to enter into further loan renewal agreements upon the same terms and conditions as the Consignment Loan Agreements every three years, in perpetuity.

On April 27, 2010, these loans were renewed for another three years with the same terms and conditions.

In addition, the Company owed an officer and director of the Company \$356,073 (December 31, 2010 - \$320,879) for unpaid salary, which is included in accounts payable and accrued liabilities as at March 31, 2011. These amounts are unsecured, non-interest bearing and with no fixed terms of repayment.

## 12. Change in non-cash operating working capital:

	Three months ended	
	March 31, 2011	March 31, 2010
Accounts receivable and due from related parties	\$ 285,772	\$ 231,913
Prepaid expenses and deposits	8,666	(159,667)
Inventories	(318,998)	9,448
Accounts payable and accrued liabilities and due to related parties	(364,573)	(399,496)
Deferred revenue	(573,568)	47,194
<b>Total</b>	<b>\$ (962,701)</b>	<b>\$ (270,608)</b>

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 13. Commitments and contingencies:

### (a) General:

Estimated losses from contingencies are accrued by a charge to income when information available prior to the issuance of the financial statements indicates that it is likely that a future event will confirm that an asset has been impaired or a liability incurred at the date of the interim condensed consolidated financial statements and the amount of the loss can be reasonably estimated.

### (b) Pipeline construction and equipment:

The Company has signed contracts with several equipment suppliers and construction supervisors for a total amount of \$7,234,717 (RMB 48,718,633) (December 31, 2010 - \$8,649,910 (RMB 57,322,135)), of which \$6,189,231 (RMB 41,678,325) (December 31, 2010 - \$7,462,336 (RMB 49,452,193)) has been paid as at March 31, 2011.

### (c) Natural gas purchase commitments:

In 2006, the Company entered into a 10-year long-term natural gas supply agreement with CNOOC (Hainan) Limited ("CNOOC") related to its distribution operations in Sanya City, Hainan Province. Pursuant to the agreement, CNOOC is committed to supply up to 24,000,000 cubic metres ("m<sup>3</sup>") of natural gas annually until 2015 with a fixed contractual price in United States dollars.

As at March 31, 2011 \$41,580 (RMB 280,000) (December 31, 2010 - \$42,252 (RMB 280,000)) was paid as a deposit on the contract that was recorded in long-term deposits and is expected to be refunded when the agreement expires.

In late 2006, the Company further entered into a letter of intent with CNOOC for the supply of natural gas. Pursuant to the letter of intent, CNOOC would commit to continuously supplying natural gas to Changfeng from its new liquefied natural gas ("LNG") receiver terminal in Hainan Island, which is now under construction and is expected to be completed and commence operation in 2015.

On March 8, 2010, the Company entered into a five-year agreement to purchase LNG from a third party for a period of five years related to its operations in Sanya City. Pursuant to this agreement, LNG will be supplied 24 hours a day, and the daily volume of LNG delivered will depend on the Company's forecast demand for the next day. As at March 31, 2011, \$74,250 (RMB 500,000) (December 31, 2010 - \$75,450 (RMB 500,000)) was paid as a deposit on the contract and was recorded in long-term deposits, and is expected to be refunded when the agreement expires.



# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 13. Commitments and contingencies (continued):

On April 7, 2010, the Company entered into a four-year CNG supply agreement from a third party to purchase compressed natural gas for its operations in Sanya City, up to 3,650,000 m<sup>3</sup> until 2014 with the annual volume of CNG to be based on Changfeng's annual demand forecast. As at March 31, 2011, \$59,400 (RMB 400,000) (December 31, 2010 - \$60,360 (RMB 400,000)) was paid as a deposit on the contract and was recorded in long-term deposits, and is expected to be refunded when the agreement expires.

In connection with the acquisition of a 60% equity interest in Hunan CNPC NEI in 2009, the Company is required to pay a one-time charge of \$445,500 (RMB 3,000,000) (December 31, 2010 - \$469,200 (RMB 3,000,000)) for a long-term CNG purchase contract related to its CNG station operation in Changsha City, Hunan Province. This CNG purchase contract gives the Company the right to acquire up to 11,000,000 m<sup>3</sup> of gas per year for a period of 19 years ending September 12, 2027. As of March 31, 2011, \$148,500 (RMB 1,000,000) (December 31, 2010 - \$150,900 (RMB 1,000,000)) was paid and recorded as intangible assets with the balance payable at the time the gas is first supplied. As at March 31, 2011, the Company had not purchased any CNG pursuant to this agreement.

In 2008, the Company acquired the rights to a gas purchase contract from a third party to purchase 10,000 m<sup>3</sup> of CNG per day (3,650,000 m<sup>3</sup> per year) until September 12, 2027 related to its CNG station operation in Changsha City. As consideration for the rights to this contract, the Company made a cash payment of \$74,250 (RMB 500,000) (December 31, 2010 - \$75,450 (RMB 500,000)) that was recorded as intangible assets, and will be required to pay a further one-time payment of \$74,250 (RMB 500,000) (December 31, 2010 - \$75,450 (RMB 500,000)) at the time the gas is first supplied. As at March 31, 2010, the Company had not purchased any CNG pursuant to this agreement.

### (d) Lease commitment:

On September 28, 2010, the Company signed a land lease agreement for the construction of its second CNG refuelling station in Changsha City, Hunan Province. The lease term is for 21 years, ending September 27, 2032. Pursuant to the agreement, a deposit of \$14,850 (RMB 100,000) (December 31, 2010 - \$15,200 (RMB 100,000)) is required to be paid and the first year's rent of \$49,900 (RMB 336,000) (December 31, 2010 - \$51,000 (RMB 336,000)) is required to be paid upon commencement of construction. If the Company decides to terminate this agreement, a termination payment of \$148,500 (RMB 1,000,000) (December 31, 2010 - \$152,000 (RMB 1,000,000)) will be payable. As of March 31, 2011, the deposit was paid.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 13. Commitments and contingencies (continued):

The minimum lease payments in successive years for the above leases are as follows:

	RMB	Cdn. \$
2011	252,000	37,420
2012	418,250	62,110
2013	829,500	123,180
2014	829,500	123,180
2015	829,500	123,180
Thereafter	14,310,016	2,125,030
Total	17,468,766	2,594,100

## 14. Financial instruments and risk management:

The Company is exposed to foreign exchange risk, interest rate risk, credit risk, liquidity risk and regulatory risk and uncertainty. The Company has policies for managing these risks that are aligned with its overall objectives to maintain a simple and cost-effective capital structure that supports a long-term growth strategy and maximizes operating flexibility.

There have been no material changes to the Company's risk and risk management activities since December 31, 2010.

As at March 31, 2011, the carrying amounts for cash and cash equivalents, trade and other receivables, trade and other payables and interest payable on the interim condensed consolidated balance sheets approximate fair values because of the limited term to maturity of these financial instruments.

## 15. Seasonality of operations:

Seasonality can impact the Company's pipeline natural gas sales. The Company's current operations are located mainly in Sanya City, an international tourist city in the PRC's only tropical province. Sanya City attracts more tourists in winter and spring than the rest of the year. The Company's natural gas sales are higher during the high tourism seasons of winter and spring as a large portion of the Company's natural gas sales are made to hotels and restaurants.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 16. Segmented information:

The Company's operating segments are identified by grouping together businesses that deliver similar products and provide similar services, which is the basis for assessing the financial performance of the business segments and for allocating resources to the business segments.

The Company is segregated into three principal business segments: gas connection, pipeline gas sales and CNG refuelling sales. Expenses and assets of non-operational divisions are allocated to the gas connection, pipeline gas sales and CNG refuelling sales based on their portions of consolidated revenue. Transactions between reportable segments; namely, the transfer of certain pipeline assets from the gas connection segment to the pipeline gas sales segment, have been accounted for based on the carrying values of the assets transferred.

Three months ended March 31, 2011:

	Gas connection	Pipeline gas sales	CNG refuelling sales	Consolidated
Revenue	\$ 1,583,036	\$ 4,546,560	\$ 404,716	\$ 6,534,312
Cost of sales	973,029	1,214,001	328,293	2,515,323
	610,007	3,332,559	76,423	4,018,989
Expenses:				
General and administrative	301,320	672,036	65,356	1,038,712
Interest on long-term debt	–	295,180	–	295,180
Travel and business development	262,362	385,564	108,227	756,153
Amortization	26,569	424,136	34,387	485,092
	590,251	1,776,916	207,970	2,575,137
Income (loss) from operations	\$ 19,756	\$ 1,555,643	\$ (131,547)	\$ 1,443,852
Acquisition of plant and equipment	\$ 2,334	\$ 1,987,213	\$ 100,479	\$ 2,090,026
Total assets, March 31, 2011	\$ 2,342,662	\$ 41,744,429	\$ 2,491,314	\$ 46,578,405

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 16. Segmented information (continued):

Three months ended March 31, 2010:

	Gas connection	Pipeline gas sales	Consolidated
Revenue	\$ 1,835,887	\$ 3,253,569	\$ 5,089,456
Cost of sales	976,561	941,054	1,917,615
	859,326	2,312,515	3,171,841
Expenses:			
General and administrative	510,758	918,210	1,428,968
Interest on long-term debt	—	137,693	137,693
Travel and business development	271,766	580,835	852,601
Amortization	13,826	264,134	277,960
	796,350	1,900,872	2,697,222
Income from operations	\$ 62,976	\$ 411,643	\$ 474,619
Acquisition of plant and equipment	\$ 214,851	\$ 2,425,169	\$ 2,640,020
Acquisition of long-term deposits	—	652,833	652,833
Total assets, March 31, 2010	\$ 4,744,100	\$ 36,198,692	\$ 40,942,792

Geographic information:

The Company's revenue is wholly generated from China and the majority of its assets are located in China. For the three-month periods ended March 31, 2011 and 2010, there is no significant individual customer from which sales amounted to more than 10% of the Company's revenue.

## 17. First time adoption of International Financial Reporting Standards:

The Company's audited financial statements for the year ending December 31, 2011 will be the first annual financial statements that will be prepared in accordance with IFRS. As a result, application of IFRS 1 is required. IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, providing certain optional exemptions and mandatory exceptions. Prior to the transition to IFRS, the Company prepared its financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 17. First time adoption of International Financial Reporting Standards (continued):

In preparing the Company's opening IFRS balance sheet, the Company has adjusted amounts previously reported in the financial statements prepared in accordance with Canadian GAAP. The IFRS 1 applicable exemptions and exceptions applied in the conversion from Canadian GAAP to IFRS are described below:

(a) Optional exemptions:

(i) Business combinations:

The Company has applied the business combination exemption in IFRS 1 and, therefore, not restated any business combination or reverse takeover transaction prior to the January 1, 2010 transition date.

(ii) Borrowing costs:

The Company will apply the IFRS exemption in respect of capitalization of borrowing costs relating to qualifying assets and implement a prospective accounting policy for capitalization of borrowing costs only from the date of transition, where relevant.

(iii) Share-based payment transactions:

The Company has elected not to retrospectively apply IFRS 2, Share-Based Payment ("IFRS 2") to equity instruments that were granted and had vested before the transition date where the fair value of the awards determined at the measurement date in accordance with IFRS is publicly disclosed. As a result of applying this exemption, the Company will apply the provisions of IFRS 2 only to all outstanding equity instruments that are unvested as at the date of transition to IFRS.

(iv) Cumulative translation differences:

The cumulative translation difference in other comprehensive income in respect of foreign operations and translation to the presentation currency has been deemed to be zero as at the date of transition.

(b) Mandatory exceptions:

(i) Derecognition of financial assets and liabilities:

The Company has applied the derecognition requirements in IAS 39, Financial Instruments, Recognition and Measurement, prospectively for transactions occurring on or after January 1, 2010. There was no impact of applying this exception.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

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## 17. First time adoption of International Financial Reporting Standards (continued):

### (ii) Non-controlling interests:

IAS 27, Consolidated and Separate Financial Statements, requires that total comprehensive income be attributed to the owners of the parent, as well as to the non-controlling interests, even if this attribution results in a deficit balance for the non-controlling interests. The Company applied this requirement prospectively from the date of transition to IFRS.

### (iii) Estimates:

The estimates previously made by the Company under Canadian GAAP were not revised for the application of IFRS, except where necessary to reflect any difference in accounting policy or where there was objective evidence that those estimates were in error. The Company has not used hindsight to revise estimates.

### (c) Reconciliation of Canadian GAAP to IFRS:

In preparing its opening IFRS interim condensed consolidated financial statements, the Company has adjusted amounts previously reported in its financial statements prepared in accordance with Canadian GAAP.

The adjustments made to the interim condensed consolidated balance sheets and interim condensed consolidated statements of comprehensive income are explained below. Changes to the net cash flows were not material as a result of the conversion to IFRS and, accordingly, no reconciliation is made for the interim condensed consolidated statements of cash flows.

#### (i) Adjustments made to the interim condensed consolidated balance sheets:

##### (a) Deferred taxes:

IAS 12, Income Taxes, provides specific guidance that prohibits the recognition of deferred tax liabilities on the acquisition of assets that were not acquired in a business combination, where a "business" is defined by specific criteria under IFRS 3, Business Combinations. Canadian GAAP does not include such a restriction. Upon its acquisition of Hunan CNPC NEI in 2009, the Company recorded a deferred tax liability related to the intangible asset acquired. Hunan CNPC NEI did not meet the criteria of a "business" under IFRS upon acquisition, resulting in the reversal of the recognized deferred tax liability of \$99,432 (December 31, 2010 - \$100,600; January 1, 2010 - \$102,200) on transition.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 17. First time adoption of International Financial Reporting Standards (continued):

### (b) Long-term debt:

IAS 1, Presentation of Financial Statements, provides guidance that requires a financial liability that is due to be settled within twelve months of the reporting date is classified as current, regardless of whether an agreement to refinance the loan was obtained after the reporting date. Canadian GAAP permits reclassification to long-term in the case where an agreement to refinance a loan is obtained between the reporting date and the completion of the financial statements. At January 1, 2010, a loan of \$6,469,260 (RMB 10,000,000), with no fixed repayment terms, payable to the Sanya State Assets Management Corporation was reclassified as current because the Company had not finalized a refinancing with its RMB 100,000,000 long-term bank loan until after December 31, 2009, a loan which was used to repay the RMB 10,000,000 loan due in 2010.

### (ii) Reconciliation of shareholders' equity as reported under Canadian GAAP to total equity under IFRS:

	January 1, 2010	March 31, 2010	December 31, 2010
Shareholders' equity reported under Canadian GAAP	\$ 9,595,110	\$ 9,802,565	\$ 10,801,374
Reclassification of non-controlling interest to total equity under IFRS	681,197	681,197	671,444
Differences increasing reported total equity:			
Plant and equipment (a)	(136,597)	(147,643)	(190,507)
Deferred income taxes (b)	–	–	–
Cumulative translation adjustment (c)	–	(60,965)	–
<b>Total equity under IFRS</b>	<b>\$ 10,139,710</b>	<b>\$ 10,275,154</b>	<b>\$ 11,282,311</b>

### (a) Plant and equipment:

IFRS provides more specific guidance than Canadian GAAP on the capitalization and componentization of plant and equipment. Specifically, IFRS requires that each part of an identifiable item of plant and equipment with a cost that is significant in relation to the total cost of the item shall be capitalized and amortized separately. As a result of this difference, the Company determined that certain assets must be separately capitalized components under IFRS. The retrospective application of this standard resulted in a decrease in total equity, being the cumulative incremental amortization that would have been expensed in prior periods had these assets been separately identified and amortized.

# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 17. First time adoption of International Financial Reporting Standards (continued):

(b) Deferred income taxes:

The increase in total equity related to deferred taxes reflects the change in temporary differences resulting from the effect of the other transitional adjustments.

(c) Cumulative translation adjustment ("CTA"):

The Company elected to reset the CTA balance to zero as of January 1, 2010 in accordance with IFRS I. The CTA balance as of January 1, 2010 of \$778,791 was recorded as an adjustment to equity. The application of the exemption had no impact on total equity.

(iii) Reconciliation of net income as reported under Canadian GAAP to IFRS:

	Three months March 31, 2010	Year ended December 31, 2010
Net income under Canadian GAAP	\$ 445,685	\$ 1,020,091
Add back - non-controlling interest (a)	–	(9,754)
Difference decreasing reported amount:		
Amortization of assets components (b)	(11,046)	(53,910)
<b>Net income under IFRS</b>	<b>\$ 434,639</b>	<b>\$ 956,427</b>

(a) Non-controlling interest:

Non-controlling interests is included in the determination of net income under Canadian GAAP. Under IFRS, net income is attributed to both the controlling and non-controlling interests. This adjustment includes non-controlling interest in the determination of net income, resulting in an increase to net income.

(b) Amortization of assets components:

The impact of componentization of assets with different depreciation methods or rates, as required under IFRS, resulted in an increase in amortization expense and decrease in net income under IFRS compared to Canadian GAAP.

(c) Income taxes:

Deferred income taxes are impacted by the changes in temporary differences resulting from the effect of the IFRS reconciling items.



# CHANGFENG ENERGY INC.

Notes to Interim Condensed Consolidated Financial Statements (continued)  
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month periods ended March 31, 2011 and 2010

## 17. First time adoption of International Financial Reporting Standards (continued):

(iv) Reconciliation of comprehensive income as reported under Canadian GAAP to IFRS:

	Three months March 31, 2010	Year ended December 31, 2010
Comprehensive income under Canadian GAAP	\$ 207,455	\$ 956,329
Difference increasing (decreasing) reported amount:		
Differences in net income (a)	(11,046)	(63,664)
Currency translation adjustment	(60,965)	–
<b>Comprehensive income under IFRS</b>	<b>\$ 135,444</b>	<b>\$ 892,665</b>

(a) Differences in net income:

Reflects the differences in net income between Canadian GAAP and IFRS, as described in the reconciliation of net income as reported under Canadian GAAP to IFRS.

## 18. Subsequent event:

In June 2011, the Company withdrew \$1,485,000 (RMB 10,000,000) from the Credit Line discussed in note 8, increasing total drawings on this line of credit to \$4,455,000 (RMB 30,000,000).