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**KROES ENERGY INC.
UNAUDITED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2007**

**NOTICE OF NO AUDITOR REVIEW OF
INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim consolidated financial statements of the Corporation have been prepared by and are the responsibility of the Corporation's management.

The Corporation's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim consolidated financial statements by an entity's auditors.

KROES

ENERGY INC.

THIRD QUARTER REPORT
For the Nine Months Ended September 30, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is management's discussion and analysis ("MD&A") of the operating and financial results of Kroes Energy Inc. ("Kroes" or the "Company") for the quarter ended September 30, 2007. The information is provided as of November 29, 2007. On August 1, 2007 the Company closed the sale of its wholly owned subsidiary Zhoda 2001 Corporation that holds a 45% interest in a Ukrainian oil field rehabilitation project and as a result the financial statements are prepared on the basis of those assets and operations being classified as discontinued operations. The third quarter results have been compared to the same period in 2006 with both periods taking into account the discontinued operations of the Ukraine assets. This discussion and analysis should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2006, together with the accompanying notes, and the December 31, 2006 MD&A and Annual Information Form. These documents and additional information about Kroes are available on SEDAR at www.sedar.com.

This discussion and analysis contains forward-looking statements relating to future events or future performance. In some cases forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates", and similar expressions. These statements represent management's expectations or beliefs concerning, among other things, future operating results and various components thereof or the economic performance of Kroes. The projections, estimates and beliefs contained in such forward-looking statements necessarily involve known and unknown risks and uncertainties, including the business risks discussed in the MD&A and Annual Information Form as at and for the years ended December 31, 2006 and 2005, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted.

Barrel of oil equivalent (BOE) volumes are reported at 6:1 with 6 MCF = 1 BOE. BOE's may be misleading, particularly if used in isolation. A BOE conversion ratio of 6MCF:1Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Business of the Company

Kroes Energy Inc. is a junior oil and gas company headquartered in Calgary, Alberta, Canada and is listed on the TSX Venture Exchange. As described below, the Company sold its interest in a Ukrainian joint venture on August 1, 2007 and during 2007, continued to expand its exploration program for shallow gas in western Canada. As of the date of this report, it has drilled or acquired 12 wells in central Alberta and has 11 wells capable of production. It also holds a 25% interest in a small oil field in Trinidad.

Sale of Zhoda 2001 Corporation

On August 1, 2007 Kroes closed the sale of its wholly owned subsidiary, Zhoda 2001 Corporation (“Zhoda”) to Shelton Canada Corporation (“Shelton”). Zhoda owns a 45% interest in the Kashtan Petroleum Ltd. oil field rehabilitation joint venture in Ukraine. Consideration from the sale included 6,997,507 shares of Shelton, \$1 million cash and Shelton’s Canadian oil and gas properties located in Flat Rock, northeastern British Columbia and Alexander, in west central Alberta. The Shelton shares were distributed to Kroes’ shareholders of record on August 17, 2007 and at that date, the distribution represented \$2 million of value. The Shelton shares received by Kroes shareholders had a hold period for trading that expired on November 18, 2007.

The seven month results from the 45% interest in the Ukrainian joint venture have been reflected in Kroes financial statements at September 30 as discontinued operations. The financial results for the western Canada and Trinidad production operations will be reflected in a normal manner as continuing operations.

FINANCIAL AND OPERATING

Nine Months 2007

Kroes Energy Inc. incurred a net loss of \$3,864,034 for the first nine months of 2007 due to the \$3,236,585 loss from discontinued Ukrainian joint venture operations as outlined in the notes to the Company’s third quarter financial statements. During this period the Company also incurred a net loss of \$627,449 on continuing operations due to the start up nature of the western Canada program and administration costs associated with the sale of Zhoda. This compares to a loss of \$677,285 from continued operations for the same period in 2006.

Third Quarter 2007

Net loss from continuing operations for the three months ended September 30, 2007 was \$272,314 compared to a net loss of \$196,455 in the same period in 2006. Cash flow from operations was a negative \$33,764 in the third quarter compared to a negative \$141,248 last year.

Western Canada Operations

The shallow gas program in western Canada has continued during the third quarter with considerable success, although the full impact will not be felt until the fourth quarter and beyond. Production for the quarter averaged 227,000 cubic feet per day, with two new wells coming on stream late in the quarter. A total of five wells were on production at the end of the quarter and exit production at September 30 totalled 271,000 cubic feet per day (mcf/d) or 45 barrels of oil equivalent per day (boe/d). Wet weather and competitive considerations delayed the connection of two additional wells but in October the sixth well was put on production and a seventh well is expected to be producing early in December. In addition, on November 1 the Company acquired a 25% interest in a producing gas well. By year end 2007 production volumes should total approximately 700 mcf/d or 120 boe/d.

In July the Company participated in a Crown land sale and acquired a 25% interest in 640 acres offsetting one of our successful wells and an additional 480 acres in adjacent sections. The Company now holds 1,520 acres of developed land and 840 acres of undeveloped lands.

On November 1, 2007 the Company acquired a 25% interest in a five section Viking gas development project from our joint venture partner, Montane Resources Ltd. that operates the shallow gas exploration program. This project has four wells capable of production, one of which is currently producing approximately 150 mcf/d (Kroes' share 37.5 mcf/d). The other wells will be brought on-stream during 2008 after compression and pipeline facilities have been installed. There are at least four additional prospective drilling locations on these lands of which two are expected to be drilled in the third quarter of 2008. Total consideration paid for the lands, existing wells and natural gas reserves was \$250,000.

As partial consideration from the sale of Zhoda 2001 Corporation, the Company acquired interests in two minor oil and gas properties from Shelton Canada Corp. In the Flat Rock area of northeastern BC the Company now holds a 6.43% interest in three wells where its share of oil and gas production amounted to 4 barrels per day in the third quarter. The field is fully developed but has long life reserves. On the Alexander lands in west central Alberta, the company acquired a minor amount of natural gas production although the agreement covering this area provides potential for future exploration.

Wells Drilled/Acquired

	Three Months Ended September 30				Nine Months Ended September 30			
	2007		2006		2007		2006	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Net Wells Drilled								
Canada	-	-	-	-	4.0	1.0	1.0	0.125
Well Acquired								
Canada	-	-	1.0	0.125	-	-	2.0	0.375
Total	-	-	1.0	0.125	4.0	1.0	3.0	0.50

Revenue

Gross revenue from continuing operations for the nine months of 2007 totalled \$464,139, a five-fold increase from the \$91,340 generated in the same period last year. The western Canada shallow gas program and a small amount of production from the Canadian properties acquired from Shelton Canada accounted for this increase in revenue. Daily natural gas production volumes averaged 218 mcf per day for the nine months compared with 13 mcf per day for the same period in 2006. Natural gas prices averaged \$6.77 per mcf in 2007 compared with \$5.60 in 2006. Oil prices in Trinidad averaged \$61.53 in 2007 compared to \$63.71 per barrel in 2006.

Third quarter continuing operations provided 227 mcf of natural gas per day and eight barrels of oil per day resulted in \$159,780 in revenue. This compares with 13 mcf of natural gas per day with 5 barrels of oil per day and \$29,201 of revenue in 2006. Prices received in Canada for natural gas for the quarter ended September 30, 2007 averaged \$5.33 per mcf as compared to \$5.60 per mcf in the comparable period in 2006.

The table below sets out the relevant statistics for Kroes' oil and gas production from continued operations.

	Three Months Ended September 30		Nine Months Ended September 30	
	2007	2006	2007	2006
Revenue				
Trinidad – Crude Oil	\$46,056	\$26,934	\$79,617	\$89,073
Canada – Natural gas	113,724	2,267	384,522	2,267
	\$159,780	\$29,201	\$464,139	\$91,340
Royalties				
Trinidad – Crude Oil	\$16,015	\$8,726	\$26,926	\$28,662
Canada – Natural gas	24,842	383	93,430	383
	\$40,857	\$9,109	\$120,356	\$29,045
Crude Oil Daily Production Volumes				
Trinidad (Bbls per day)	7	5	5	5
Canada (Bbls per day)	1	-	-	-
Natural Gas Daily Production Volumes				
Canada (Mcf per day)	227	13	218	13
Boe equivalent Daily Production Volumes (6 mcf to 1 barrel)				
	46	7	42	7
Prices per Barrel				
Trinidad - Crude Oil	\$67.24	\$64.59	\$61.53	\$63.71
Canada - Crude Oil	\$73.26	-	\$73.26	-
Prices per Mcf				
Canada – Natural Gas	\$5.33	\$5.60	\$6.77	\$5.60

Royalties/Production Taxes

Royalty payments arising from continuing operations in the nine months of 2007 were \$120,356 as compared to \$29,045 in the same period of 2006, an average rate of 26% of gross revenue. In western Canada, royalty payments were \$93,430 or approximately 25% of natural gas revenue. The western Canada shallow gas program began late in 2006 and there was very little revenue or royalty payments in the nine months of 2006.

In Trinidad, the government amended the petroleum royalties in 2005 and imposed a royalty that varies between 0% and 35% for onshore operations dependent on crude oil prices. The rate is 35% on prices over \$49.51 US per barrel. In the nine months 2007, the royalty payment in Trinidad was \$26,926 as compared with \$28,662 in the same period of 2006.

Operating Expenses

In the third quarter 2007, total production costs from continuing operations were \$52,558 compared with \$10,916 in the same period last year. On a year-to-date basis, production costs increased to \$143,456 from \$35,507 in the nine months of 2006. The overall increase in operating costs reflects the six-fold increase in production in western Canada.

General and Administrative

General and administrative expenses from continuing operations for the nine months were \$423,591 compared to \$546,488 in 2006. A reduction in management fees in 2007, the repatriation of our consultant based in Ukraine and the termination of Kroes' investor relations consultant accounted for the majority of the decrease in general and administrative expenses during the period.

The table below provides a summary of general and administrative expenses.

	Three Months Ended September 30		Nine Months Ended September 30	
	2007	2006	2007	2006
Canada/Trinidad				
Administration	\$29,541	\$43,595	\$88,043	\$189,606
Accounting & Audit	17,098	30,496	77,568	83,546
Legal	47,423	5,209	48,424	25,542
Consultant's Fees	11,544	7,674	67,222	76,435
Trustee, Listing Fees & Compliance	5,015	3,644	29,268	15,128
Investor Relations & Communications	1,270	21,210	8,022	64,478
Office Rent	16,677	16,698	44,055	46,856
Other	11,128	29,479	60,989	44,897
	<u>\$139,696</u>	<u>\$158,005</u>	<u>\$423,591</u>	<u>\$546,488</u>
Discontinued operations	<u>3,440</u>	<u>47,138</u>	<u>85,647</u>	<u>118,207</u>
	<u>\$143,136</u>	<u>\$205,143</u>	<u>\$509,238</u>	<u>\$664,695</u>

Stock Based Compensation

In the nine months of 2007, stock based compensation expenses of \$88,805 were charged against earnings. This compares with \$157,151 charged to earnings in the nine months of 2006. Under policies mandated by the Security and Exchange Commissions, the Company records compensation expense for stock options granted to directors, officers and employees using the fair value method. Fair values are determined using the Black-Scholes option pricing model. Compensation costs are recognized over the vesting period of the stock options.

Depletion and Depreciation

In the third quarter of 2007, depletion and depreciation from continuing operations increased to \$60,672 from \$1,837 in 2006, due to the ongoing capital spending on wells and facilities in western Canada. On a year-to-date basis depletion and depreciation costs increased to \$220,795 from \$5,304 in the nine months of 2006.

Loss on Distribution of Paid Up Capital

On August 17, 2007 the Shelton Canada shares that were received as partial consideration for the sales of Zhoda 2001 were distributed to shareholders. The difference between the share price on June 30, 2007, the date of the transaction, and the date the shares were distributed to shareholders is accounted for as a capital loss.

Capital Expenditures

The capital expenditures for the period are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2007	2006	2007	2006
Canada				
Land acquisition	\$504,343	\$-	\$636,342	\$37,500
Seismic	-	35,960	78,120	135,960
Exploration drilling	165,059	47,496	360,300	125,712
Production equipment and facilities	72,231	36,956	113,600	39,620
	<u>741,633</u>	<u>120,412</u>	<u>1,188,362</u>	<u>338,792</u>

Netbacks

The consolidated operating netback from continuing operations of the Company in the nine months of 2007 averaged \$18.81 per barrel compared with \$18.29 in 2006. The breakdown between Canada and Trinidad operations is shown in the following table.

	Three Months Ended September 30		Nine Months Ended September 30	
	2007	2006	2007	2006
Continued Operations				
Trinidad (Per Barrel)				
Revenue	\$67.24	\$64.59	\$61.53	\$63.71
Royalties	(23.38)	(20.93)	(20.81)	(20.50)
Operating	<u>(24.92)</u>	<u>(20.72)</u>	<u>(31.70)</u>	<u>(23.77)</u>
Netback	\$18.94	\$22.94	\$9.02	\$19.44
Canada (Per Mcf Equivalent)				
Revenue	\$5.59	\$5.60	\$6.85	\$5.60
Royalties	(1.22)	(0.95)	(1.66)	(0.95)
Operating	<u>(1.75)</u>	<u>(5.62)</u>	<u>(1.83)</u>	<u>(5.62)</u>
Netback	<u>\$2.62</u>	<u>(\$0.97)</u>	<u>\$3.36</u>	<u>(\$0.97)</u>

Financial, Liquidity and Solvency

At September 30, 2007 the Company had working capital of \$1,764,178 compared to \$1,923,830 at December 31, 2006.

Share Capital and Stock Options

In March 2007, 100,000 stock options were granted to a contractor at a price of \$0.155.

On August 21, 2007, 1,660,000 stock options were granted to directors and officers of the Company at a price of \$0.085.

Securities at the end of the reporting period

Common Shares (see note 5 to the financial statements)

Authorized: An unlimited number of common and preferred shares without par value
Issued: 36,233,488 common shares

Stock Options Outstanding

725,000 expiring February 19, 2008; exercisable at \$0.25
200,000 expiring January 8, 2009; exercisable at \$0.33
925,000 expiring June 1, 2010; exercisable at \$0.56
100,000 expiring March 21, 2011; exercisable at \$0.345
100,000 expiring March 31, 2012, exercisable at \$0.155
1,660,000 expiring August 20, 2012, exercisable at \$0.085
3,710,000

Agents Options Outstanding

220,417 expiring December 28, 2007; options to purchase two common shares at \$0.30 each

Warrants Outstanding

893,750 expiring on December 28, 2007; exercisable at \$0.45.
110,208 agents warrants expiring on December 28, 2007; exercisable at \$0.45.
1,003,958

Quarterly Information

The following table sets forth certain quarterly financial information of the company for the eight most recent quarters. This table contains the total of continued and discontinued Ukrainian operations.

	2007			2006				2005
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Financial								
Oil and gas gross revenue (\$000's)	\$611	\$1,074	\$1,746	\$1,291	\$1,998	\$551	\$1,365	\$1,411
Royalties (\$000's)	\$298	\$603	\$790	\$719	\$783	\$150	\$501	\$483
Cash flow from operations (\$000's)	(\$60)	\$197	\$335	(\$1)	\$404	\$117	\$276	\$154
Per basic share	(\$0.002)	\$0.005	\$0.009	\$0.000	\$0.011	\$0.004	\$0.009	\$0.005
Per fully diluted share	(\$0.002)	\$0.005	\$0.009	\$0.000	\$0.011	\$0.004	\$0.008	\$0.005
Net income (loss)	(\$3,934)	(\$26)	\$97	(\$151)	\$242	(\$58)	\$117	\$7
Per basic share	(\$0.109)	(\$0.001)	(\$0.003)	(\$0.005)	\$0.007	(\$0.002)	\$0.004	\$0.000
Per fully diluted share	(\$0.109)	(\$0.001)	(\$0.003)	(\$0.005)	\$0.007	(\$0.002)	\$0.004	\$0.000
Weighted shares outstanding (millions)								
Basic	36.2	36.2	36.2	36.0	35.7	32.4	32.2	32.2
Fully diluted	36.2	36.2	36.2	36.1	36.0	33.1	32.9	33.0
Operating								
Liquids production (Bbl/d)	97	229	232	238	245	232	237	259
Natural gas production (Mcf/d)	227	204	222	10	13	-	-	-
Liquids price \$/bbl - Ukraine	\$67.81	\$67.31	\$56.89	\$58.81	\$72.67	\$59.47	\$53.86	\$57.31
Liquids price \$/bbl - Trinidad	\$67.24	\$52.89	\$56.20	\$54.82	\$64.50	\$57.33	\$72.94	\$56.27
Natural gas price \$/Mcf	\$5.33	\$7.30	\$7.80	\$7.14	\$5.60	-	-	-

Internal Controls over Financial Reporting

There were no material changes in Kroes' internal controls over financial reporting during the nine months of 2007 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

On behalf of the Board,

"Fred Callaway"

Fred Callaway, President
November 29, 2007

Consolidated Statements of Income and Deficit

(unaudited)

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006 Amended	September 30, 2007	September 30, 2006 Amended
Revenues				
Oil and natural gas sales	\$159,780	\$29,201	\$464,139	\$91,340
Royalties	(40,857)	(9,109)	(120,356)	(29,045)
	<u>118,923</u>	<u>20,092</u>	<u>343,783</u>	<u>62,295</u>
Expenses				
Operating	52,558	10,916	143,456	35,507
General and administrative	139,696	158,005	423,591	546,488
Stock Based compensation	37,928	53,370	88,805	157,151
Depletion and depreciation	60,672	1,837	220,795	5,304
Loss on distribution of investment	139,950	-	139,950	-
Foreign exchange (gain) loss	2,306	(1,167)	7,352	6,691
	<u>433,110</u>	<u>222,961</u>	<u>1,023,949</u>	<u>751,141</u>
Loss before other items and income taxes	(314,187)	(202,869)	(680,166)	(688,846)
Other items				
Interest and other items	41,873	7,419	52,993	12,566
Loss before income taxes	<u>(272,314)</u>	<u>(195,450)</u>	<u>(627,173)</u>	<u>(676,280)</u>
Income taxes	-	1,005	276	1,005
Loss before discontinued operations	<u>(\$272,314)</u>	<u>(\$196,455)</u>	<u>(\$627,449)</u>	<u>(\$677,285)</u>
Net earnings(loss) from discontinued operations (Note 9)	(3,661,806)	438,859	(3,236,585)	978,736
Net earnings(loss) for period	<u>(\$3,934,120)</u>	<u>\$242,404</u>	<u>(\$3,864,034)</u>	<u>\$301,451</u>
Retained earnings – Beginning of period	\$1,804,991	\$1,643,210	\$1,734,905	\$1,584,867
Premium on redemption of common shares		-		(704)
Distribution of Shelton shares	(1,959,302)		(1,959,302)	
Retained earnings(deficit) – End of period	<u><u>\$(4,088,431)</u></u>	<u><u>\$1,885,614</u></u>	<u><u>\$(4,088,431)</u></u>	<u><u>\$1885,614</u></u>
Net income(loss) attributable per common share before discontinued operations	(\$0.008)	(\$0.005)	(\$0.017)	(\$0.020)
Net income(loss) attributable per common share	(\$0.109)	\$0.007	(\$0.107)	\$0.009
Weighted average number of shares outstanding	36,233,488	35,733,488	36,233,488	33,415,860

Consolidated Statements of Accumulated Other Comprehensive Income (Loss)

<i>(unaudited)</i>	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Accumulated Other Comprehensive Income (Loss)				
Beginning of period	(\$1,375,545)	(\$1,060,845)	(\$763,370)	(\$832,610)
Other comprehensive income				
Unrealized gains(losses on translation of consolidated financial statements into reporting currency)	<u>1,375,545</u>	<u>4,749</u>	<u>763,370</u>	<u>(223,486)</u>
Accumulated Other Comprehensive Income (Loss)				
End of period	<u>\$-</u>	<u>(\$1,056,096)</u>	<u>\$-</u>	<u>(\$1,056,096)</u>

Consolidated Statements of Cash Flows

<i>(unaudited)</i>	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Operating Activities				
Net loss for period	(\$272,314)	(\$196,455)	(\$627,452)	(\$677,285)
Items not affecting cash				
Stock option compensation	37,928	53,370	88,805	157,151
Depletion, depreciation and amortization	60,672	1,837	220,795	5,304
Loss on distribution of paid up capital	139,950		139,950	
Exchange gains (losses)	-	-	-	-
Cash flow from operations	(33,764)	(141,248)	(177,902)	(514,830)
Change in non-cash working capital	<u>(85,956)</u>	<u>41,645</u>	<u>(305,872)</u>	<u>(95,368)</u>
	(119,720)	(99,603)	(483,774)	(610,198)
Financing Activities				
Issue of common shares, net of issue costs	2,954	(35,596)	2,954	971,863
Partial payment on sale of investment in subsidiary	1,000,000	-	1,000,000	-
Redemption of common shares	-	-	-	(1,700)
	<u>1,002,954</u>	<u>(35,596)</u>	<u>1,002,954</u>	<u>970,163</u>
Investing Activities				
Additions to capital assets	(311,633)	(120,412)	(758,362)	(338,792)
Restricted funds	-	-	-	-
	<u>(311,633)</u>	<u>(120,412)</u>	<u>(758,362)</u>	<u>(338,792)</u>
Increase (decrease) in cash	571,601	(255,611)	(239,182)	21,173
Net cash flows of discontinued operations(Note 10)	(339,949)	(380,098)	871,705	(569,463)
Cash and short term investments, beginning of period	1,293,050	1,645,825	892,179	1,558,406
Cash and short term investments, end of period	<u>\$1,524,702</u>	<u>\$1,010,116</u>	<u>\$1,524,702</u>	<u>\$1,010,116</u>

Consolidated Balance Sheets

Unaudited

	September 30, 2007	December 31, 2006
ASSETS		
Current		
Cash and cash equivalents	\$1,524,702	\$ 387,526
Receivables	265,568	59,827
Prepays and deposits	20,806	23,146
Inventory	416	482
Assets of discontinued operations (Note 9)	-	2,213,741
	<u>1,811,492</u>	<u>2,684,722</u>
Capital assets		
Petroleum and natural gas properties and equipment - net	1,903,438	1,044,387
Assets of discontinued operations (Note 9)	-	6,285,558
	<u>\$3,714,930</u>	<u>\$ 10,014,667</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Payables and accruals	\$47,215	\$ 160,941
Income taxes payable	99	5,842
Liabilities of discontinued operations (Note 9)	-	594,109
	<u>47,314</u>	<u>760,892</u>
Asset retirement obligations (Note 3)	38,818	24,360
Liabilities of discontinued operations (Note 9)	-	632,406
Shareholders' equity		
Capital stock (Note 4)	6,817,274	6,814,320
Warrants issued (Note 6)	131,984	131,984
Contributed surplus	767,971	679,167
Retained earnings	(4,088,431)	1,734,908
Accumulated other comprehensive income	-	(763,370)
	<u>3,628,798</u>	<u>8,597,009</u>
	<u>\$3,714,930</u>	<u>\$10,014,667</u>

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies

The Interim Consolidated Financial Statements of Kroes Energy Inc. have been prepared by management in accordance with accounting principles generally accepted in Canada. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2006. The statements should be read in conjunction with the financial statements and the notes thereto in the Company's annual report for the year ended December 31, 2006.

Change in Accounting Policy

The Corporation adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1506, Accounting Changes: Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments – Recognition and Measurement; Section 3861, Financial Instruments – Disclosure and Presentation; and Section 3865, Hedges, as of January 1, 2007.

Accounting Changes

CICA Section 1506 provides expanded disclosures for changes in accounting policies, accounting estimates and correction of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information. The application of this revised standard did not have a material impact on the financial statements.

Comprehensive Income

CICA Section 1530 introduces a new requirement to temporarily present certain gains and losses from changes in fair value outside net income. It includes unrealized gains and losses on available-for-sale investments; and the effective portion of gains or losses on derivatives designed as cash flow hedges. Upon adoption of Section 1530, the Corporation incorporated the new requirements of Comprehensive Income by creating a "Consolidated Statement of Other Comprehensive Income (Loss)". The application of this revised standard did result in comprehensive income (loss) being different from net income (loss) for the periods presented. The cumulative changes in comprehensive income have been recognized in Accumulated Other Comprehensive Income which is presented as a new category within shareholder's equity on the balance sheet.

Financial Instruments

CICA Section 3855 prescribes when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how financial instrument gains and losses are to be presented. All financial instruments have been classified into one of the following five categories: 1) assets held-to-maturity; 2) loans and receivables; 3) other financial liabilities; 4) assets available-for-sale; and 5) held-for-trading.

Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification:

- Held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net earnings.
- Available-for-sale financial assets are measured at fair value. Revaluation gains and losses are included in other comprehensive income until the asset is removed from the balance sheet.
- Held-for-trading financial instruments are measured at fair value. All gains and losses are included in net earnings in the period in which they arise.
- All derivative financial instruments are classified as held-for-trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses are included in net earnings in the period in which they arise.

The financial instruments recognized on Kroes' balance sheet are deemed to approximate their estimated fair values, therefore no further adjustments were required upon adoption of the new sections. There were no financial assets on the balance sheet which were designated as held-for-trading, held-to-maturity or available-for-sale. All financial liabilities were classified as other liabilities.

Hedging

CICA Section 3865 provides alternative treatments to Section 3855 for entities who choose to designate qualifying transactions as hedges for accounting purposes.

The Corporation is exposed to market risks resulting from fluctuations in commodity prices in the normal course of its business. The Corporation may use a variety of instruments to manage these exposures. The Corporation does not enter into financial instruments for trading or speculative purposes. The Corporation has not applied hedge accounting and, therefore, the Corporation accounts for such instruments using the fair value method by initially recording an asset or liability, and recognizing changes in the fair value of the instruments in income as an unrealized gain or loss on commodity contracts.

Accounting Pronouncements

The Corporation is assessing new and revised accounting pronouncements that have been issued but are not yet effective, to determine the impact on the Corporation.

As of January 1, 2008, the Corporation will be required to adopt two new CICA standards: Section 3862 Financial Instruments – Disclosures; and Section 3863 Financial Instruments – Presentation, which will replace Section 3861 Financial Instruments – Disclosure and Presentations. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006 and the Corporation is assessing the impact on its financial statements.

As of January 1, 2008, the Corporation will be required to adopt two new CICA standards: Section 1535 Capital Disclosures, which will require disclosure of objectives, policies and processes for managing capital. In addition, disclosures will include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006 and the Corporation is assessing the impact on its financial statements.

In January 2006, the CICA Accounting Standards Board ("ASB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Corporation continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

Note 2 – Restricted Funds

The Company's financing arrangement with respect to the Ukrainian project was to place a deposit of US\$787,500 with the Calyon Bank in Kyiv, Ukraine to provide 105% security for a US\$750,000 line of credit the Bank extended to Kashtan Petroleum Ltd. As at September 30, 2007 all the funds have been withdrawn from the Calyon Bank.

Note 3 – Asset Retirement Obligations

The following table represents the reconciliation of the beginning and ending aggregate carrying amount of the obligations associated with the retirement of oil and gas assets:

	Period ended	
	September 30, 2007	December 31, 2006
Asset retirement obligations, beginning of period	\$24,360	\$114,203
Liabilities incurred/revisions	14,108	3,268
Revision of estimates	-	(6,903)
Accretion expenses	350	5,097
Discontinued operations	-	(91,303)
Asset retirement obligations, end of period	<u>\$38,818</u>	<u>\$24,360</u>

Note 4 – Share Capital

Common Shares Issued	Number of Shares	Amount
Balance December 31, 2006	36,233,488	\$6,814,320
2006 Financing Costs	-	\$2,954
Balance September 30, 2007	<u>36,233,488</u>	<u>\$6,817,274</u>

Note 5 – Weighted Average Number of Common Shares

The following table summarizes the common shares used in the calculating net income and cash flow from operations per common share.

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Basic	36,233,488	35,733,488	36,233,488	33,415,860
Fully Diluted	36,233,488	35,998,299	36,233,488	33,813,815

The reconciling items between the basic and diluted weighted average common shares are outstanding options and broker warrants.

Note 6 – Share Purchase Warrants

As part of the June 2006 financing, the Company issued to subscribers 893,750 share purchase warrants, exercisable at \$0.45 for 18 months from the initial closing of June 27, 2006. The fair value of these warrants approximated \$131,984 or \$0.1477 per warrant. The fair value of these warrants were estimated using the Black-Scholes option pricing model with an average risk-free interest rate of 4.6%, expected life of 1.5 years, volatility in the price of the Company's common shares of 134% and a dividend yield of 0.00%.

As part of the agent's commission the Company issued non-transferable options to the agent to purchase 41,667 units, as well as an option to purchase non-transferable options equalling 10% of the units sold (1,787,500 units). These units have non-transferable warrants attached to them that total 110,208. These warrants are exercisable at \$0.45 for 18 months from the initial closing date of June 27, 2006. The Agent's financing warrants are accounted for as a charge to share issuance costs and a credit to contributed surplus. The fair value of these agent warrants approximated \$16,275 or \$0.1477 per warrant. The fair value of these warrants were estimated using the Black-Scholes option pricing model with an average risk-free interest rate of 4.6%, expected life of 1.5 years, volatility in the price of the Company's common shares of 134% and a dividend yield of 0.00%.

	Number of Warrants	Amount
Balance December 31, 2006	1,003,958	\$131,984
Balance September 30, 2007	1,003,958	\$131,984

Note 7 – Agent Options

In 2006, 220,417 agents financing options were issued in connection with the June 27, 2006 public financing referred to in note 6. One option is composed of two common shares and one half one common share purchase warrant. The unit price is \$0.60 per unit and one full warrant entitles the purchaser to purchase a common share for \$0.45 prior to December 28, 2007.

	Number of Shares	Exercise Price
Balance December 31, 2006	440,834	\$0.45
Balance September 30, 2007	440,834	\$0.45

Note 8 – Stock-Based Compensation Plans

The Company has a Stock Option Plan for Directors, Officers and Consultants. As of September 30, 2007 there were 3,710,000 options granted with an exercise price of \$0.13, \$0.25, \$0.33, \$0.56, \$0.0345, \$0.155 and \$0.085 per share exercisable at various dates to August 21, 2012. The exercise price of each option equalled or exceeded the market price of the Company's common shares on the date of each grant.

The following table summarises the information about the stock options:

	September 30, 2007		December 31, 2006	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Averaged Exercise Price
Options				
Outstanding, beginning	2,350,000	\$0.39	2,920,000	\$0.33
Granted	1,760,000	\$0.09	100,000	\$0.345
Exercised	-	-	(500,000)	\$0.13
Cancelled	(400,000)	\$0.29	(170,000)	\$0.13
	3,710,000	\$0.26	2,350,000	\$0.39

The new CICA requirement to determine a compensation cost associated with the granting of Stock Options was implemented by the Company on January 01, 2004

The assumptions used to calculate stock-based compensation expense for the options granted in 2007 is estimated at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

	2007	2006
Volatility factor of expected market prices (%)	168% - 170%	143%
Weighted average risk-free interest rate (%)	3.9% - 4.3%	4.10%
Weighted average expected life of options (years)	5	5
Dividend yield (%)	-	-

The options granted in 2005, 2006 and 2007 vest over a three year period and will be charged to earnings over that three year period.

Note 9 – Discontinued Operations

On August 1, 2007, the Company closed the sale of 100% of its shares of Zhoda 2001 Corporation for \$ 1,000,000 cash and 6,997,507 shares of Shelton Canada Corporation as well as Shelton's oil and gas properties located in Flat Rock, B.C. and Alexander, Alberta and recognized a loss on this sale of approximately \$3,588,672.

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Revenues – oil & gas	\$451,467	\$1,968,458	\$2,967,560	\$3,822,240
Less: Royalties	(257,166)	(773,958)	(1,571,307)	(1,405,049)
Operating costs	(103,061)	(394,242)	(508,188)	(763,578)
DD & A	(46,825)	(107,341)	(297,854)	(295,443)
G & A	(4,039)	(47,138)	(86,246)	(118,207)
Other	(1,457)	19,153	(8,061)	17,384
Income taxes	(112,053)	(226,073)	(143,817)	(278,611)
Net earnings(loss) – discontinued operations	(\$73,134)	\$438,859	\$352,087	\$978,736
Loss on sale	(3,588,672)	-	(3,588,672)	-
Net earnings(loss) of discontinued operations	(\$3,661,806)	\$438,859	(\$3,236,585)	\$978,736

Note 10 – Discontinued Cash Flow Analysis

The Company generated (used) cash from discontinued operations as described below:

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Operating	(\$174,688)	(\$328,061)	\$973,408	\$129,335
Investing	(107,709)	(52,037)	282,744	(698,798)
Cash-End of period	(57,552)	-	(384,447)	-
Total	(\$339,949)	(\$380,098)	871,705	(\$569,463)

Note 11 – Management Disclosure

These financial statements have been prepared by management and have not been reviewed by an external auditor.

Names of directors and officers as at the date of this report:

Fred Callaway	President and Director
C. Jim Cummings	Director
Stewart D. Gossen	Director, Vice President & Secretary
David R. Malarchuk	Controller
David E. Powell	Director
Edward M. Southern	Director & Executive Vice-President
Dr. James E. Werbicki	Director
Darrell M. Zakreski	Director

Corporate Information

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Solicitors: ProVenture Law LLP
Transfer Agent: Computershare Trust
Company of Canada