

Management's Report

The accompanying Consolidated Financial Statements of Blackpearl resources Inc. and related financial information presented in this annual report are the responsibility of Management and have been approved by the Board of Directors. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles. The Consolidated Financial Statements and related financial information reflect amounts which must, of necessity, be based upon informed estimates and judgments of Management with appropriate consideration to materiality. All financial information contained in the annual report is consistent, where appropriate, with that contained in the Consolidated Financial Statements.

The Company has developed and maintains systems of internal controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguard of assets.

PricewaterhouseCoopers LLP, independent external auditors appointed by the shareholders of the Company, review Blackpearl Resources Inc.'s systems of internal controls and conduct their work to the extent they deem appropriate. They have examined the Consolidated Financial Statements and they have expressed an opinion on the statements. Their report is included in the Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the financial statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim financial statements prior to their release, as well as annually to review the Company's annual financial statements and Management's discussion and analysis, and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.



John L. Festival
President and Chief Executive Officer

February 25, 2011



Donald W. Cook
Chief Financial Officer

Auditors' Report

February 25, 2011

To the Shareholders of Blackpearl Resources Inc.

We have audited the accompanying consolidated financial statements of BlackPearl Resources Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of operations, comprehensive loss and deficit, and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained from our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of BlackPearl Resources Inc and its subsidiaries as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP
Chartered Accountants
Calgary, Alberta

Consolidated Balance Sheets

As at December 31 (Cdn\$ in thousands)	2010	2009
ASSETS		
Current assets		
Cash	\$ 169,596	\$ 56,352
Accounts receivable	19,551	11,977
Income and other taxes receivable	2,083	4,817
Prepaid expenses and deposits	883	1,167
	192,113	74,313
Investments (note 4)	1,839	1,284
Petroleum and natural gas properties (note 5)	349,874	392,712
	\$ 543,826	\$ 468,309
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 48,081	\$ 16,318
Asset retirement obligation (note 7)	18,860	25,435
	66,941	41,753
SHAREHOLDERS' EQUITY		
Share capital (note 8)	857,813	779,809
Contributed surplus (note 8)	19,041	15,444
Deficit	(399,969)	(368,697)
	476,885	426,556
	\$ 543,826	\$ 468,309

Commitments and contingencies (note 10)
See accompanying notes to consolidated financial statements

Signed on behalf of the Board:



Keith C. Hill
Chairman and Director



Brian D. Edgar
Director

Consolidated Statement of Operations, Comprehensive Loss and Deficit

Year ended December 31	2010	2009
(Cdn\$ in thousands, except for per share amounts)		
Revenue		
Oil and gas sales	\$ 142,867	\$ 89,637
Royalties	(36,798)	(21,262)
	106,069	68,375
Other income	3,132	–
Interest income	895	321
	110,096	68,696
Expenses		
Production	36,824	29,461
Transportation	2,734	3,466
General and administrative	6,788	6,913
Depletion, depreciation and accretion	91,026	81,100
Stock-based compensation (note 8)	3,995	1,461
Interest and bank charges	74	277
Foreign currency exchange loss	295	762
Revaluation of investments (note 4)	(555)	556
	141,181	123,996
Loss before income taxes	(31,085)	(55,300)
Income taxes (note 9)		
Current income tax (recovery)	187	(2,351)
Future income tax (recovery)	–	(5,634)
	187	(7,985)
Comprehensive loss for the year	(31,272)	(47,315)
Deficit, beginning of year	(368,697)	(321,382)
Deficit, end of year	\$ (399,969)	\$ (368,697)
Basic and diluted loss per share	\$ (0.12)	\$ (0.19)
Weighted average number of common shares used in computing loss per share:		
basic and diluted ⁽¹⁾	269,029,016	243,185,591

See accompanying notes to consolidated financial statements

⁽¹⁾ Any impact of unexercised stock options or warrants are not included in the calculation of net loss per share or weighted average number of shares outstanding as they would be anti-dilutive.

Consolidated Statements of Cash Flow

Year ended December 31 (Cdn\$ in thousands)	2010	2009
Operating activities		
Net loss	\$ (31,272)	\$ (47,315)
Items not involving cash:		
Depletion, depreciation and accretion	91,026	81,100
Stock-based compensation	3,995	1,461
Future income tax (recovery)	–	(5,634)
Foreign exchange loss	295	762
Provision for bad debts (reduction)	–	(1,322)
Revaluation of investments	(555)	556
Abandonment costs	(905)	(604)
	62,584	29,004
Changes in non-cash working capital balances related to operations	(3,750)	(29,593)
	58,834	(589)
Financing activities		
Proceeds on issue of common shares, net of costs	77,604	43,838
	77,604	43,838
Investing activities		
Additions to petroleum and natural gas properties	(95,829)	(27,878)
Proceeds from sale of petroleum and natural gas properties	41,969	250
Proceeds from sale of investment	–	4
Cash received on acquisition of BlackCore Resources Inc.	–	5,589
Changes in non-cash working capital from investing	30,666	11,079
	(23,194)	(10,956)
Net increase in cash	113,244	32,293
Cash, beginning of year	56,352	24,059
Cash, end of year	\$ 169,596	\$ 56,352
Supplementary Information		
Cash interest paid	\$ 32	\$ 87
Cash taxes paid	\$ 172	\$ 1,004

See accompanying notes to consolidated financial statements

Notes to the Consolidated Financial Statements

(tabular amounts in thousands of Cdn\$, except as noted)

1. Nature of Operations

BlackPearl Resources Inc. (collectively with its subsidiaries, the “Company” or “BlackPearl”) is engaged in the business of oil and gas exploration, development and production in North America. BlackPearl is listed and traded on the TSX Exchange under the trading symbol “PXX”. The Company’s Swedish Depository Receipts trade on the NASDAQ OMX First North market under the symbol “PXXS”.

2. Summary of Significant Accounting Policies

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP). The significant accounting policies used in these consolidated financial statements are as follows:

(a) Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries.

(b) Cash and cash equivalents

Cash and cash equivalents include short-term highly liquid interest-bearing investments with maturities of three months or less from the date of acquisition.

(c) Measurement Uncertainty

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and the disclosure of contingencies. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

Purchase price allocations, depletion, depreciation and amortization, and amounts used in impairment calculations are based on estimates of crude oil and natural gas reserves. By nature, estimates of reserves and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

The calculation of asset retirement obligations includes estimates of the future costs to settle the asset retirement obligation, the timing of the cash flows to settle the obligation, and the future inflation rates. The impact of differences between actual and estimated costs, timing and inflation on the consolidated financial statements of future periods may be material.

The calculation of income taxes requires judgement in applying tax laws and regulations, estimating the timing of the reversals of temporary differences, and estimating the realizability of future tax assets. These estimates impact current and future income tax assets and liabilities, and current and future income tax expense (recovery).

The calculation of stock-based compensation requires estimates relating to volatility, forfeiture rates and market prices surrounding the issuance of stock options. These estimates impact stock-based compensation expense and contributed surplus.

(d) Foreign Currency Translation

The Company's reporting and functional currency is Canadian dollars.

The Company's U.S. operations are considered integrated. Accordingly, the Company uses the temporal method of accounting for the foreign currency transactions of its U.S. subsidiaries. Under the temporal method, monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the historical exchange rates. Revenues and expenses are translated at the average rate for the period, except for charges related to non-monetary assets which are translated at the historical rate for the assets to which the charge relates, and material items where a specific date can be identified for the transaction which is translated at the rate on that specific date. Exchange gains or losses are included in the determination of net income.

(e) Joint Operations

A substantial portion of the Company's activities are conducted jointly with others through joint ventures. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

(f) Petroleum and Natural Gas Properties

The Company follows the full cost method of accounting for its petroleum and natural gas properties whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized in country-by-country cost centres and charged against income as set out below. Capitalized costs include lease acquisition costs, geological and geophysical expenditures, costs of drilling exploration and development wells, gathering and production facilities and other development expenditures. Gains and losses are not recognized upon disposition of petroleum and natural gas properties unless such a disposition would alter the rate of depletion by 20 percent or more.

Depreciation, Depletion and Amortization

Capitalized costs, along with estimated future costs to develop proved reserves, are depleted on a unit-of-production basis using estimated proved oil and gas reserves before royalties, as determined by independent engineers. Natural gas reserves and production are converted to equivalent barrels of oil based upon the relevant energy content (6:1). Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion until it is determined whether proved reserves are attributable to the properties or impairment occurs. Unproved properties are evaluated for impairment on at least an annual basis. If an unproved property is considered to be impaired, the amount of the impairment is added to costs subject to depletion.

Office furniture and equipment is depreciated on the declining balance basis at rates ranging from 10 to 30 percent per year.

Ceiling Test

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the “ceiling test”). The ceiling test is an impairment test whereby the carrying amount of petroleum and natural gas properties, excluding the cost of unproved properties, is compared to the undiscounted cash flows from proved reserves using future forecast prices, adjusted for the Company’s contract prices and quality differentials. If the carrying value exceeds the undiscounted cash flows, an impairment loss would be recorded against income. The impairment is measured as the amount by which the carrying amount of petroleum and natural gas properties exceeds the discounted cash flows from proved and probable reserves. The Company’s risk-free interest rate is used to arrive at the net present value of future cash flows.

(g) Revenue Recognition

Revenue from the sale of petroleum and natural gas is recorded when title passes to an external party.

(h) Investments

Long-term investments include interest-bearing investments with maturities longer than one year. Long-term investments whereby the Company has significant influence are accounted for using the equity method. All other long-term investments are designated as held-for-trading and available-for-sale and are carried at fair value (see note 11(a) for classification).

(i) Stock-based Compensation

Stock options granted are accounted for using the fair value method. Fair values are determined, at the grant date, using the Black-Scholes option-pricing model. The compensation expense associated with these options is charged to earnings over the vesting period with a corresponding increase in contributed surplus. When stock options are exercised, the consideration paid to the Company, along with amounts previously credited to contributed surplus, is credited to common shares. Forfeitures are accounted for as they occur and result in a reduction in compensation expense.

(j) Asset Retirement Obligation

The fair values of the estimated asset retirement obligations are recorded as a liability when incurred and the associated cost is capitalized as part of the cost of the related asset. Over time, the liability is accreted for the change in its present value and the initial capitalized costs are depleted on a unit-of-production basis over the life of the reserves. The associated accretion is charged to earnings in the period. Actual expenditures incurred are charged against the accumulated obligation. Revisions to the estimated timing of cash flows or the original estimated undiscounted cost would also result in an increase or decrease to the obligation and related asset.

(k) Earnings per Share

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated based upon the treasury stock method which assumes that any proceeds from the exercise of in-the-money stock options or warrants would be used to purchase the Company's common shares at the average market price during the year (or period if applicable). Diluted earnings per share do not include any anti-dilutive conversions, nor is diluted earnings per share presented where the total effect would be anti-dilutive.

(l) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future tax liabilities and assets are measured using enacted or substantially enacted tax rates. The effect on future tax liabilities and assets of a change in tax rates is recognized in income in the period that the change occurs.

(m) Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Financial assets and financial liabilities are recognized on the consolidated balance sheet at the time the Company becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument. These instruments will be classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale or other financial liabilities.

Financial assets and liabilities held-for-trading instruments are subsequently measured at fair value with changes in fair value recognized in net income. Financial assets available-for-sale are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are subsequently measured at amortized cost using the effective interest rate method.

The Company has no financial instruments that give rise to other comprehensive income. Cash and cash equivalents are designated as held-for-trading. Accounts receivable are designated as loans and receivables. The Company's investment in MAV notes are designated as held-for-trading and accounts payable and accrued liabilities are designated as other financial liabilities.

The Company will assess at each reporting period whether there is any objective evidence that a financial asset, other than those classified as held-for-trading, is impaired.

3. Recent Accounting Pronouncements (IFRS)

The CICA Accounting Standards Board (AcSB) has confirmed that the use of International Financial Reporting Standards (IFRS) will be required for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011 for publicly accountable profit-oriented enterprises. Companies will be required to provide comparative IFRS information for 2010. The Company is assessing the potential impacts of this changeover and has developed a plan for the conversion. Additional information regarding the Company's IFRS conversion can be found in the accompanying MD&A.

4. Investments

	December 31, 2010	December 31, 2009
MAV Notes at beginning of year	\$ 1,284	\$ 1,284
Fair value adjustment	555	–
MAV Notes at end of year	\$ 1,839	\$ 1,284

The Company acquired an interest in third party asset-backed commercial paper (ABCP) on October 19, 2007 as part of a corporate acquisition. As a result of liquidity issues in the ABCP market, these investments did not settle on maturity. The ABCP was restructured and the Company received Master Asset Vehicle Notes (MAV Notes) with a face value of \$5 million. As at December 31, 2010, the Company estimated the fair value of the notes at \$1,839,000 (December 31, 2009 – \$1,284,000).

5. Petroleum and Natural Gas Properties

	December 31, 2010		
	Cost	Accumulated depreciation and depletion	Net book value
Petroleum and natural gas properties	\$ 696,937	\$ 348,868	\$ 348,069
Office equipment	3,169	1,364	1,805
	\$ 700,106	\$ 350,232	\$ 349,874

	December 31, 2009		
	Cost	Accumulated depreciation and depletion	Net book value
Petroleum and natural gas properties	\$ 650,744	\$ 259,903	\$ 390,841
Office equipment	2,916	1,045	1,871
	\$ 653,660	\$ 260,948	\$ 392,712

During 2010, the Company sold a number of non-core properties for net proceeds of \$42.0 million. The proceeds were recorded as a reduction in petroleum and natural gas properties.

The depletion and ceiling test calculations have excluded the cost of unproved properties of \$76.0 million (December 31, 2009 – \$33.6 million) and included future development costs of \$104.5 million (December 31, 2009 – \$63.6 million). The majority of the Company's unproved properties relate to the Blackrod area and the construction of the SAGD pilot. This project is currently in the pre-production stage and is not generating any revenues. The Company does not capitalize any interest or general and administrative expenses.

The Company performed ceiling test calculations at December 31, 2010 to assess whether the carrying value of the petroleum and natural gas properties were recoverable. A write-down of \$0.7 million (December 31, 2009 – \$2.9 million) in the carrying value of the U.S. assets has been included in depletion, depreciation and accretion in the consolidated financial statements. The following represent the prices that were used in the December 31, 2010 ceiling test:

Average Price Forecast ⁽¹⁾				
Year	WTI Cushing 40° API (US\$/bbl)	Hardisty Lloydblend 20.5° API (CDN\$/bbl)	Alberta AECO-C Spot (CDN\$/MMBtu)	Exchange rate (US\$/Cdn\$)
2011	88.40	80.04	4.04	0.93
2012	89.14	80.71	4.66	0.93
2013	88.77	78.48	4.99	0.93
2014	88.88	76.70	6.58	0.93
2015	90.22	77.86	6.69	0.93
2016	91.57	79.03	6.80	0.93
2017	92.94	80.23	6.91	0.93
2018	94.34	81.44	7.02	0.93
2019	95.75	82.67	7.14	0.93
2020	97.19	83.92	7.26	0.93
Escalation rate of 1.5% thereafter ⁽²⁾				

⁽¹⁾ The benchmark prices listed above are adjusted for quality differentials, heat content, distance to market and other factors in performing the ceiling test.

⁽²⁾ Percentage change represents the change in each year after 2020 to the end of the reserve life.

6. Credit Facility

The Company has a credit facility with a Canadian financial institution which is comprised of a \$25 million revolving 364-day extendible term facility. The Company may borrow, repay and re-borrow advances with the aggregated outstanding amount not to exceed the total credit facility. The facility bears interest, at the Company's option at either the institution's prime rate or at banker's acceptance or LIBOR loan rates, plus applicable margins, which varies depending on the Company's working capital ratio. At December 31, 2010, a prime rate based drawdown would be at the institution's prime rate plus 0.75%. The Company also incurs a standby fee for undrawn amounts. The facility is secured by a fixed and floating charge on the assets of the Company and is secured by a general securities agreement. At December 31, 2010, there were no advances outstanding under this facility.

The facility is subject to annual reviews. The next scheduled review is to be completed by May 31, 2011.

7. Asset Retirement Obligation

The Company's asset retirement obligation results from ownership interest in oil and gas assets, including well sites, gathering systems, batteries and processing facilities. The Company's total estimated undiscounted costs required to settle the asset retirement obligation is approximately \$27.5 million (December 31, 2009 – \$38.3 million) which will be incurred over the next 27 years, with the majority of costs incurred between 2011 and 2024. Settlement of the obligation is expected to be funded from general corporate funds at the time of retirement. As at December 31, 2010, no funds have been set aside to settle these obligations.

The asset retirement obligation was discounted using a credit-adjusted risk-free rate of 6.5 percent and an inflation rate of 2 percent.

Changes to the asset retirement obligation were as follows:

	Year ended December 31, 2010	Year ended December 31, 2009
Asset retirement obligation at beginning of year	\$ 25,435	\$ 20,064
Liabilities acquired through acquisitions, net of dispositions	(8,206)	2,939
Liabilities incurred during the year	1,165	1,516
Actual remediation costs	(905)	(604)
Accretion	1,371	1,520
Asset retirement obligation at end of year	\$ 18,860	\$ 25,435

8. Share Capital

(a) Authorized

The Company is authorized to issue an unlimited number of common shares.

(b) Common Shares Issued

	Number of Shares	Attributed Value
Balance as at December 31, 2008	189,241,716	\$ 723,122
Shares issued for BlackCore acquisition	17,600,000	10,560
Shares issued for property acquisitions	2,500,000	1,500
Shares issued from treasury	52,334,000	46,046
Shares issued upon exercise of stock options	285,001	214
Transferred from contributed surplus on exercise of stock options	–	112
Share issuance costs	–	(1,745)
Balance as at December 31, 2009	261,960,717	\$ 779,809
Shares issued from treasury	20,350,000	80,015
Shares issued upon exercise of stock options	904,670	800
Transferred from contributed surplus on exercise of stock options	–	400
Share issuance costs	–	(3,211)
Balance as at December 31, 2010	283,215,387	\$ 857,813

(c) Warrants Outstanding

The Company has 10,000,320 warrants outstanding as a result of the acquisition of BlackCore Resources Inc in 2009 (note 12). Each warrant allows the holder to acquire, on or before January 13, 2013, one common share of the Company at \$0.60.

(d) Stock Options Outstanding

The Company has a stock option plan (the "Plan") whereby options to purchase common shares may be granted to directors, officers, employees and certain consultants of the Company and its subsidiaries. Under the Plan, the number of common shares to be reserved and authorized for issuance pursuant to options granted under the Plan cannot exceed ten percent of the total number of issued and outstanding shares in the Company. The term and the vesting period of any options granted are determined at the discretion of the board of directors. The maximum term for options granted is ten years. The exercise price of the option cannot be less than the five-day volume weighted average trading price of the common shares on the TSX Exchange immediately preceding the day the option is granted.

The following summarizes stock options outstanding as at December 31, 2010 and December 31, 2009:

	Number of Options	Weighted Average Exercise Price (\$)
Outstanding at December 31, 2008	11,138,436	2.16
Granted	6,325,500	1.59
Exercised	(285,001)	0.75
Forfeited	(3,724,602)	3.32
Outstanding at December 31, 2009	13,454,333	1.60
Granted	2,786,500	4.74
Exercised	(904,670)	0.89
Forfeited	(366,165)	2.95
Outstanding at December 31, 2010	14,969,998	2.20

Options outstanding and exercisable as at December 31, 2010 are summarized below:

Range of Exercise Prices (\$)	Options Outstanding			Options Exercisable		
	Number of Options	Weighted Average Exercise Price (\$)	Weighted Average Remaining Life (Years)	Number of Options	Weighted Average Exercise Price (\$)	Weighted Average Remaining Life (Years)
0.40 – 1.50	6,541,166	0.73	3.04	4,215,343	0.73	3.03
1.51 – 3.00	5,071,332	2.26	3.50	2,208,011	2.28	3.03
3.01 – 4.50	219,000	3.27	2.81	144,000	3.38	1.84
4.51 – 5.15	3,138,500	5.09	3.95	757,000	5.10	1.03
	14,969,998	2.20	3.38	7,324,354	1.70	2.80

(e) Stock-Based Compensation

Stock-based compensation of \$3,995,000 net of recoveries of \$67,000, has been recorded in the Consolidated Statements of Operations and Deficit for the year ended December 31, 2010 (2009 – \$1,461,000). The fair value of common share options granted is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average fair value of options granted and the assumptions used in their determination are noted below:

	December 31, 2010	December 31, 2009
Weighted average fair value of stock options granted (per option)	\$ 2.60	\$ 0.85
Expected life of stock options (years)	3.00	2.58
Volatility (weighted average)	85%	88%
Risk-free rate of return (weighted average)	1.82%	1.43%
Expected dividend yield	0%	0%

(f) Contributed Surplus Continuity

The following table summarizes changes in contributed surplus during the period:

	December 31, 2010	December 31, 2009
Balance, beginning of year	\$ 15,444	\$ 11,895
Stock-based compensation	4,062	2,751
Recovery of expense on forfeited stock options	(67)	(1,290)
Warrants issued on BlackCore acquisition	–	2,200
Transferred to share capital on exercise of stock options	(398)	(112)
Balance, end of year	\$ 19,041	\$ 15,444

9. Income Taxes

(a) Future income tax expense:

The provision for income taxes reflects an effective income tax rate which differs from Federal and Provincial statutory tax rates. The main differences are as follows:

	December 31, 2010	December 31, 2009
Loss before income taxes	\$ (31,085)	\$ (55,300)
Corporate income tax rate	29.28%	30.46%
Computed income tax recovery	\$ (9,102)	\$ (16,843)
Increase (decrease) resulting from:		
Change in valuation allowance	2,099	9,002
Non-deductible stock-based compensation expense	1,170	445
Foreign exchange	3,518	(785)
Change in enacted tax rates	823	1,768
Capital tax and Saskatchewan Resource Surcharge	165	(2,352)
Other	1,514	780
Income tax expense (recovery)	\$ 187	\$ (7,985)

(b) The components of the future income tax asset and liability are as follows:

	December 31, 2010	December 31, 2009
Future Income Tax Assets:		
Non-capital losses	\$ 54,624	\$ 32,759
Share issue costs	1,597	2,785
Asset retirement obligation	5,026	6,829
Other	956	1,152
Valuation allowance	(40,985)	(38,034)
	21,218	5,491
Future Income Tax Liabilities:		
Property, plant and equipment	(21,218)	(5,491)
Net future tax asset (liability)	\$ 0	\$ 0

The Company has \$194.9 million of non-capital losses with various expiry dates between 2011 to 2030.

Where unfavourable evidence exists, which in BlackPearl's case is primarily historical net losses, additional considerations and evidence for recognition of future tax assets is required. Management has evaluated the applicable factors necessary in making this determination and has concluded that the positive evidence in consideration of the estimated future cash flows based on reserve reports from the Company's independent engineers, does not sufficiently outweigh negative factors, such as the net loss in current and prior years. As a result, BlackPearl has determined that the Company does not meet the "more likely than not" criteria required for recognition of future tax assets and has therefore recognized a cumulative valuation allowance of \$41.0 million against the Company's future tax assets.

10. Commitments and Contingencies

The Company has a number of financial obligations in the ordinary course of business. The following table summarizes the outstanding contractual obligations and commitments of the Company as at December 31, 2010:

(\$000s)	2011	2012	2013	2014	2015	Thereafter
Long-term debt	–	–	–	–	–	–
Operating leases ^(a)	1,166	1,234	1,234	1,626	1,626	1,320
Drilling rig commitment ^(b)	–	876	319	–	–	–
Electrical service agreement ^(c)	3,012	2,969	–	–	–	–
	4,178	5,079	1,553	1,626	1,626	1,320

- (a) The Company has six years remaining on an operating lease for office space as at December 31, 2010. The Company's office lease was executed jointly with another party. Under the terms of the lease, BlackPearl and the other party are joint and severally liable for the obligations pursuant to the lease. Accordingly, if the other party or any of the subtenants of a portion of the space are unable to fulfill their lease obligation, BlackPearl would be required to pay a maximum additional \$21.3 million (including an estimate for operating costs) over the next six years.
- (b) The Company has contracted drilling rig services over the next three years. In the event that the Company does not utilize the minimum contracted days, the Company would be obligated to pay the rig operator a variable rate based on days not utilized under the contracts. The payments included herein assumes no drilling days used.
- (c) The Company has entered into an agreement whereby an electrical service connection will be physically installed at a facility over the next two years. In the event that the project is not completed at BlackPearl's request, the Company would be obligated to pay the service provider the full amount of the contract.

11. Financial Instruments and Risk Management

The Company is exposed to financial and market risk in a range of financial instruments including cash, accounts receivable, certain investments and accounts payable. The Company manages its risk through its policies and processes, but the Company generally has not used derivative financial instruments to manage these risks.

(a) Fair value of financial instruments

The fair values of financial assets and financial liabilities are calculated on the basis of information available at the balance sheet date using the following methods:

- (i) The carrying value of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities, approximates their fair value amounts due to the short-term nature of the instruments.
- (ii) The fair value of the investment in MAV notes have been measured in accordance with a three level hierarchy. The hierarchy groups financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities. The fair value hierarchy has the following levels:
 - a. Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
 - b. Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie. as prices) or indirectly (ie. derived from prices); and
 - c. Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The MAV notes have been valued using Level 3 of the hierarchy. The fair value of the investment is determined by a cash flow model considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments.

(b) Commodity price risk

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in the price of oil and natural gas. Commodity prices are impacted by world economic events that affect supply and demand, which are generally beyond the Company's control. Changes in crude oil prices may significantly affect the Company's results of operations, cash generated from operating activities, capital spending and the Company's ability to meet its obligations. The majority of the Company's production is sold under short-term contracts, consequently BlackPearl is at risk to near term price movements. A \$1.00 change in oil prices at the wellhead would have the effect of changing net earnings for the year ended 2010 by approximately \$1,876,000. The Company manages this risk by constantly monitoring commodity prices and factoring them into operational decisions, such as contracting or expanding its capital expenditures program. Natural gas currently represents less than 10% of the Company's total production and, as a result, any fluctuation in natural gas prices would have a nominal effect on current activities. As at December 31, 2010, the Company did not use derivative financial instruments to manage its exposure to this risk.

(c) Foreign currency exchange risk

The Company is exposed to risks arising from fluctuations in foreign currency exchange rates and the volatility of those rates. This exposure primarily relates to: (i) prices received for its crude oil and natural gas are primarily determined in reference to U.S. dollars; (ii) certain expenditure commitments, deposits, accounts receivable, and accounts payable which are denominated in U.S. dollars; and (iii) its operations in the United States. The Company manages this risk by monitoring foreign exchange rates and evaluating their effects on using Canadian or U.S. vendors as well as timing of transactions. As at December 31, 2010, the Company has not entered into any fixed rate contracts. As at December 31, 2010, the Company held US\$3,997,000 in cash and short-term deposits and other net working capital items of US\$1,460,000.

As at December 31, 2010, if US\$ exchange rates had been \$0.10 lower with all other variables held constant, after tax earnings for the period would have been approximately \$546,000 higher, due to a decreased foreign exchange loss. An equal opposite impact would have occurred to net earnings had exchange rates been \$0.10 higher. The Company does not hedge its foreign currency risk.

(d) Credit Risk

Credit risk is the risk that a third party fails to meet its contractual obligations that could result in the Company incurring a loss.

The Company's accounts receivable are primarily with oil and gas marketers and joint venture partners. Receivables from oil and gas marketers are generally collected on the 25th day of the month following delivery. The Company attempts to mitigate this risk by assessing the financial strength of its counterpart and entering into relationships with larger purchasers with established credit history. During 2010, the Company has not experienced any collection issues with its marketers. At December 31, 2010, over 96 percent of total accounts receivables are for revenue accruals. Receivables from joint venture partners arise when the Company conducts joint operations on behalf of its partners and invoices them for their share of costs. To mitigate the risk of non-payment from joint venture partners the Company can require partners to pay certain costs in advance as well as the Company has the ability to withhold production from partners in the event of non-payment. As at December 31, 2010, accounts receivable includes an allowance for doubtful accounts of \$815,000 from joint interest partners.

The Company typically does not obtain collateral or security from its joint venture partners or oil and gas marketers. The carrying amounts of accounts receivable represent the maximum credit exposure.

The Company is not the operator of certain oil and gas properties in which it has an ownership interest. The Company is dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the Corporation's activities may be impacted by the ability, expertise, judgment and financial capability of the operators.

As at December 31, 2010, the Company held \$169.6 million in cash at various major financial institutions throughout Canada and the USA, as well as \$1.8 million in investments. At December 31, 2010, three Canadian financial institutions held approximately 99 percent of our cash and short-term deposits. Cash balances in excess of the Company's day-to-day requirements are invested in short-term deposits of less than 30 days.

(e) Interest Rate Risk

Interest rate risk refers to the risk that a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility due to the floating interest rate charged on advances. At this time, the Company is not drawn on this facility and, as a result, the Company considers this risk to be limited. In addition, the Company is exposed to interest rate risk on its excess cash balances and certain investments. As at December 31, 2010, if interest rates had been 1 percent higher with all other variables held constant, after tax earnings for the period would have been approximately \$881,000 higher.

(f) Liquidity Risk

Liquidity risk is the risk the Company is unable to meet its financial obligations as they come due. The Company uses operating cash flows, credit facilities and equity offerings to fund its capital requirements.

The Company manages this risk by maintaining a conservative balance sheet with minimal use of long-term debt. As at December 31, 2010, the Company had an undrawn \$25 million credit facility, and working capital of \$144.0 million. The Company believes it has sufficient funding from these sources to meet its foreseeable obligations. The maturity dates for the Company's financial liabilities are as follows:

	<6 Months	6 months – 1 Year	1 – 2 Years
Accounts payable and accrued liabilities	\$ 48,081	–	–

(g) Capital Management

The Company defines capital as working capital, total debt and equity. The current capital management strategy is designed to minimize the use of long-term debt and maintain positive working capital. This strategy should provide the financial flexibility to fund the Company's capital program and profitable growth opportunities. The unutilized \$25 million credit facility capacity provides additional liquidity to the Company. This structure can be adjusted as a result of changes in economic conditions or risks associated with its oil and gas assets. In order to maintain or adjust its capital structure, the Company may from time to time issue additional common shares. In addition, the Company's credit facilities are based on its petroleum and natural gas reserves whose values are impacted by, among other things, global commodity prices. The Company will adjust its capital spending if access to external capital sources is unavailable. In order to manage the balance in the Company's capital structure, some of the financial tests that BlackPearl considers are debt-to-equity ratios, debt-to-cash-flow from operating activities and interest coverage tests. To facilitate the management and control of these ratios, the Company prepares annual operating and capital budgets. These budgets are generally updated quarterly, or more frequently if circumstances change. In order to improve its financial flexibility, the Company raised \$80 million of additional equity during 2010 (See note 8(b)). These funds will be used to fund exploration and development programs over the next 12 – 18 months.

Financial covenants associated with the Company's credit facility are reviewed regularly and controls are in place to maintain compliance with these covenants. The only financial covenant in the Company's credit facility is to maintain a working capital ratio of 1:1 at the end of each fiscal quarter. Working capital ratio is defined as current assets plus unutilized credit under the credit facility compared to current liabilities. The Company had a working capital ratio of 4.5:1 at December 31, 2010 and is in compliance with these covenants.

12. ACQUISITIONS

On January 8, 2009, the Company acquired all of the issued and outstanding shares of BlackCore Resources Inc., a private oil and gas company, in exchange for 17,600,000 common shares of the Company, as well as share purchase warrants to acquire one BlackPearl share for a price of \$0.60.

The consideration, including transaction costs, for the BlackCore acquisition totaled \$12.9 million. The allocation of the purchase price is as follows:

Net assets acquired	
Petroleum and natural gas properties	\$ 12,691
Working capital	5,468
Asset retirement obligation	(3,023)
Future income tax	(2,274)
Total net assets acquired	\$ 12,862
Consideration paid	
Common shares	\$ 10,560
Warrants	2,200
Acquisition costs	102
Total purchase price	\$ 12,862

13. Comparative Figures

Certain comparative figures have been reclassified to conform to the presentation adopted in 2010.