

International Sovereign Energy Corp.

Interim Consolidated Financial Statements

For the three and six month period ended June 30, 2009

(unaudited- See Notice to Reader)

Notice to Reader

The accompanying unaudited interim financial statements have been prepared by the Company's management and the Company's independent auditors have not performed a review of these financial statements.

Calgary, Alberta

August 7, 2009

International Sovereign Energy Corp.

Unaudited Consolidated Balance Sheets

As at June 30

	2009	2008
Assets		
<i>Current assets:</i>		
Cash	\$ -	\$ 1,379,683
Accounts receivable	785,329	1,573,217
Advance to operators	7,967	7,967
Prepaid expenses and deposits	151,938	121,439
	945,234	3,082,306
Restricted cash (Notes 6)	2,720,250	3,819,628
Property and equipment (Note 3)	27,465,933	30,215,710
	\$ 31,131,417	\$ 37,117,644
Liabilities		
<i>Current liabilities:</i>		
Operating loan (Note 5)	\$ 1,529,303	\$ -
Accounts payable and accrued liabilities	2,081,603	5,733,149
	3,610,906	5,733,149
Letter of guarantee (Notes 6)	2,720,250	2,865,564
Future income tax liability	1,301,035	2,144,427
Asset retirement obligation (Note 4)	2,568,266	2,496,439
	10,200,457	13,239,579
Shareholders' equity:		
Share capital (Note 7)	21,546,430	21,546,430
Warrants (Notes 8)	493,234	493,234
Contributed surplus (Note 10)	1,531,861	1,442,394
Retained (deficit) earnings	(2,640,565)	396,007
	20,930,960	23,878,065
	\$ 31,131,417	\$ 37,117,644

See accompanying notes to consolidated financial statements.

Commitments and contingencies (Note 14)

Approved by the Board

Signed- "John Lokker"-Director

Signed- "Peter Proszanski" -Director

International Sovereign Energy Corp.

Unaudited Consolidated Statements of Operations, Comprehensive (Loss)/Income and (Deficit)/Retained Earnings

For the six month period ended June 30

	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Revenues:				
Petroleum and natural gas revenues	\$ 2,108,350	\$ 5,389,527	\$ 4,653,271	\$ 9,367,025
Royalties	(411,928)	(1,074,952)	(929,781)	(1,896,229)
Other income	912	21,060	14,235	48,012
	1,697,334	4,335,635	3,737,725	7,518,808
Expenses:				
Operating	579,181	643,386	1,218,840	1,319,863
Transportation	159,221	115,130	306,275	212,756
Depletion, depreciation and accretion	1,989,740	1,940,551	3,936,398	2,952,946
Impairment	954,064	4,234,660	954,064	4,234,660
General and administrative	359,157	2,295,424	1,106,286	2,750,621
Interest	6,359	43,604	6,359	87,024
Stock based compensation	44,734	47,328	89,467	94,656
Unrealized (gain)/loss on foreign exchange	19,646	3,923	-	2,865
	4,112,102	9,324,006	7,617,689	11,655,391
Loss before income taxes	(2,414,768)	(4,988,371)	(3,879,964)	(4,136,583)
Income taxes:				
Future income tax recovery	(483,509)	(1,208,389)	(843,392)	(846,065)
Net loss and comprehensive loss	(1,931,259)	(3,779,982)	(3,036,572)	(3,290,518)
Retained (deficit) earnings, beginning of period	(709,306)	4,685,134	396,007	4,195,670
Retained (deficit) earnings, end of period	\$ (2,640,565)	\$ 905,152	\$ (2,640,565)	\$ 950,152
Loss per common share				
Basic	\$ (0.12)	\$ (0.27)	\$ (0.19)	\$ (0.23)
Diluted	\$ (0.12)	\$ (0.27)	\$ (0.19)	\$ (0.23)
Weighted average number of common shares				
Basic	16,096,084	13,928,084	16,096,084	13,928,084
Diluted	16,096,084	13,928,084	16,096,084	13,928,084

See accompanying notes to consolidated financial statement.

International Sovereign Energy Corp.

Unaudited Consolidated Statements of Cash Flows

For the six month period ended June 30

	Three months ended		Six months ended	
	June 30		June 30	
	2009	2008	2009	2008
Cash flows from operating activities:				
Net loss	\$ (1,931,259)	\$ (3,779,982)	\$ (3,036,572)	\$ (3,290,518)
Adjustments for:				
Depletion, depreciation and accretion	1,989,740	1,940,551	3,936,398	2,952,946
Impairment international assets	954,064	4,234,660	954,064	4,234,660
Unrealized loss	19,646	3,923	-	2,865
Stock based compensation	44,734	47,328	89,467	94,656
Future income tax recovery	(483,509)	(1,208,389)	(843,392)	(846,065)
Cash flow from operations	593,416	1,238,091	1,099,965	3,148,544
Asset retirement costs (Note 4)	(509,499)	(12,298)	(723,871)	(13,174)
	83,917	1,225,793	376,094	3,135,370
Changes in non-cash working capital				
Accounts receivable, prepaid expenses and deposits	457,722	(747,428)	697,775	(1,600,460)
Accounts payable and accrued liabilities	(1,271,049)	1,939,899	(954,777)	3,246,106
	(729,410)	2,418,264	119,092	4,781,016
Financing:				
Operating loan	1,529,303	(490,659)	1,529,303	905,282
	1,529,303	(490,659)	1,529,303	905,282
Investing:				
Restricted cash, letter of guarantee	-	-	-	(418,017)
Addition to property and equipment	(194,027)	(1,099,304)	(2,440,366)	(3,137,564)
Proceeds on sale of property and equipment	-	-	-	28,001
	(194,027)	(1,099,304)	(2,440,366)	(3,527,580)
Changes in non-cash working capital				
Accounts receivable and deposits	5,785	(153,275)	59,615	(1,013,178)
Accounts payable and accrued liabilities	(1,627,225)	(675,026)	(647,327)	(1,393,279)
	(1,815,467)	(1,927,605)	(3,028,078)	(5,934,037)
Net (decrease) increase in cash	(1,015,574)	-	(1,379,683)	(247,739)
Cash beginning of period	1,015,574	-	1,379,683	247,739
Cash end of period	\$ -	\$ -	\$ -	\$ -
Supplementary cash flow information:				
Interest paid	\$ 6,359	\$ 43,604	\$ 6,359	\$ 87,024

See accompanying notes to consolidated financial statements.

International Sovereign Energy Corp.

Notes to Unaudited Consolidated Financial Statements

For the Six Months Ended June 30, 2009

1. NATURE OF BUSINESS

International Sovereign Energy Corp., and its wholly owned subsidiaries, International Sovereign Energy Corp SA, and Bellwether International Inc. (“BII”), (collectively the “Company”), are in the business of exploration for and development of petroleum and gas interests. The Company is active in the exploration and development of hydrocarbon reserves in Western Canada. The Company is evaluating its international activities and is looking to reduce its obligation and underlying interests in these international places on a go forward basis. The Company intends to focus on domestic opportunities.

2. SIGNIFICANT ACCOUNTING POLICIES

The accompanying interim unaudited consolidated financial statements of International Sovereign Energy Corp. have been prepared in accordance with the Canadian generally accepted accounting principles, consistent with accounting policies disclosed in the Company’s audited consolidated financial statements for the years ended with December 31, 2008 and 2007. The note disclosure requirements for annual financial statements provide additional disclosures than required for interim financial statements. Accordingly, the financial statements and notes thereto should be read in conjunction with the Company’s Annual Report for the year ended December 31, 2008.

Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end and the results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the fiscal year. In the opinion of management, the accompanying unaudited interim consolidated financial statements include all adjustments (of a normal recurring nature) necessary to present fairly the financial position of the company as of June 30, 2009.

Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, which were inactive during the period 2009 and 2008. All inter-company transactions have been eliminated on consolidation.

Stock-based compensation plan

The Company uses the fair-value based method of accounting for stock options and recognizes stock compensation expense based on the estimated fair value of the option on the date of grant, which is determined using the Black-Scholes option-pricing model. The fair value of the options is recognized over the vesting period of the options granted as stock compensation expense and contributed surplus. The contributed surplus balance is reduced when the options are exercised and the amount initially recorded as contributed surplus is credited to share capital.

New accounting policies

Goodwill and Other Intangible Assets

On January 1 2009, the Company adopted the Section 3064 “Goodwill and Other Intangible Assets”. The new section states that upon their initial identification, intangible assets are to be recognized as assets only if they meet the definition of an intangible asset and the recognition criteria. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. As for subsequent measurement of intangible assets, goodwill and disclosure, Section 3064 carries forward the requirements of the old Section 3062 “Goodwill and Other Intangible Assets”. The adoption of this guideline does not have any material effect on the Company’s consolidated financial statements.

International Sovereign Energy Corp.
Notes to Unaudited Consolidated Financial Statements
For the Six Months Ended June 30, 2009

2. SIGNIFICANT ACCOUNTING POLICIES (CON'T)

First-time Adoption

On July 28, 2009, the IASB has issued amendments to IFRS 1. The amendments will assist entities using the full cost method for oil and gas assets and save entities with existing lease contracts from reassessment of the classification of lease arrangements under IFRIC 4, Determining Whether an Arrangement Contains a Lease.

3. PROPERTY AND EQUIPMENT

	June 30 2009	December 31, 2008
	\$	\$
Petroleum and natural gas properties		
- Canada	52,742,354	49,604,785
- International	12,366,754	12,366,754
Furniture and equipment	320,596	314,014
	65,429,704	62,285,553
Accumulated depletion and depreciation	25,597,017	21,752,533
Provision for impairment of international assets	12,366,754	10,317,310
	27,465,933	30,215,710

Costs of \$2,937,927 (June 30, 2008 – \$4,524,976) related to undeveloped properties in Canada and \$Nil (June 30, 2008 – \$9,208,924) of deferred expenditures related to international projects have been excluded from depletion during the period ended June 30, 2009. During the period the Company capitalized general and administrative expenses of \$155,390 relating to Canadian activities.

The net book value of international expenditures in Pakistan:

	June 30 2009	December 31 2008
	\$	\$
Pakistan	-	2,049,444
	-	2,049,444

On June 3, 2009 Mari Gas Company Limited ("MGCL"), the operator of the Sukkur and Sujawal Blocks, notified the Company that it considered the Company to be in default of non-payment of cash calls. The Company is evaluating its options. The Company has commenced legal action against the forfeiture. In the event of forfeiture, the Company will not be entitled to receive any consideration for such forfeited working interest. The Company has made the following provision:

	\$
Impairment of international expenditures	2,049,444
Accrual for cash call	(2,049,444)
Bank guarantees associated with international expenditures	954,064
Impairment	<u>954,064</u>

International Sovereign Energy Corp.
Notes to Unaudited Consolidated Financial Statements
For the Six Months Ended June 30, 2009

4. ASSET RETIREMENT OBLIGATIONS

	June 30 2009	December 31 2008
	\$	\$
Asset retirement obligation, beginning of year	2,496,439	1,108,664
Increase in estimated retirement obligations	674,117	1,452,347
Liabilities acquired	29,667	77,041
Retirement obligations settled	(723,871)	(224,612)
Accretion expense	91,914	82,999
Asset retirement obligation, end of period	2,568,266	2,496,439

5. OPERATING LOAN

The Company has a revolving line of credit to a maximum of \$10,000,000 (December 31 2008- \$10,000,000). The facility was renewed on May 31, 2009 and is subject to a review scheduled for September 30, 2009. The Company is covenanted to maintain a working capital ratio of 1:1, defined current assets, including undrawn availability, to current liabilities. The operating loan bears interest at prime plus 1% and is secured by a demand debenture for a maximum of \$25,000,000 providing a floating charge over all assets of the Company and a letter of undertaking not to encumber or dispose of assets, other than in the normal course of business without consent of the financial institution and to provide security under section 426 of the Bank Act and/or assign natural gas contracts. As at June 30, 2009 the operating loan outstanding was \$1,529,303 (June 30, 2008: \$3,072,282)

6. RESTRICTED CASH, LETTER OF GUARANTEE.

The restricted funds \$2,720,250 (US\$2,340,000) acquired through acquisition of BII, provide a performance guarantee of US\$2,340,000 to Petroleos del Ecuador under the terms and conditions of the Charapa Contract.

In 2008, the Company had issued an two unconditional, irrevocable bank guarantee for PKR25,966,080 and US\$450,000 in favour of Mari Gas Company Limited with respect to Sujawal and Sukkar blocks respectively, in relation to petroleum exploration, development and production in Pakistan, to guarantee the Company's financial obligations. The Company received notice of forfeiture from MGCL (see Note 4) and consequently provided in the event the guarantees is called upon. The guarantee expires for Sukkar Block July 20, 2009 which has not been renewed, however the guarantee is still considered to be active. The guarantee for Sujawal block expires October 7, 2009.

7. SHARE CAPITAL

Authorized

- Unlimited number of Class A common voting shares
- Unlimited number of Class B common non-voting shares
- Unlimited number of Class A preferred voting, 7%
- Non-cumulative, redeemable shares

Issued

Class A common shares

	Number of Shares	Value \$
Balance at June 30, 2009 and December 31, 2008	16,096,084	\$ 21,546,430

International Sovereign Energy Corp.
Notes to Unaudited Consolidated Financial Statements
For the Six Months Ended June 30, 2009

8. WARRANTS

	Number of Warrants	Weighted Average Exercise Price \$	Expiry date
Issued with private placement	330,644	3.25	November 30, 2011
Issued with private placement	1,084,000	1.50	September 18, 2009
Agents warrants, private placement	212,000	1.25	September 18, 2010
Total warrants outstanding	1,626,644	1.82	

9. STOCK OPTIONS

Under the Company's stock option plan, the Company may grant options to its directors, officers and key employees to purchase Class A common shares ("Common Shares") from the Company at a fixed price not less than the fair market value of the stock on the day preceding the grant date. The Company has reserved 1,400,000 common shares for the grant of options. The options vest equally over three years. The option's maximum term is five years.

The following table summarizes outstanding stock options at June 30, 2009:

	Number of Options	Weighted average Exercise price \$
Balance as at June 30, 2009 and at December 31, 2008	630,000	1.31
Exercisable, June 30, 2009	50,000	2.00

10. CONTRIBUTED SURPLUS

	June 30, 2009	December 31, 2008
Opening balance	\$ 1,442,394	\$ 1,174,293
Stock based compensation expense	89,467	199,898
Agent warrant expense	-	100,914
Extension of expiry date of warrants issued with private placement	-	(32,711)
Ending balance	\$ 1,531,861	\$ 1,442,394

International Sovereign Energy Corp.

Notes to Unaudited Consolidated Financial Statements

For the Six Months Ended June 30, 2009

11. FINANCIAL INSTRUMENTS

The Company is subject to normal industry credit risk with its accounts receivable with customers and joint venture partners. The Company mitigates these risks by continually monitoring credit worthiness of counterparties.

(i) Commodity price risk

The Company is exposed to fluctuations in commodity prices for natural gas, crude oil and natural gas liquids. Commodity prices are affected by many factors including supply, demand and the Canadian to US dollar exchange rate.

The Company has no financial or fixed price commodity contracts in place at June 30, 2009 and 2008.

(ii) Interest rate risk

The Company's operating loan (Note 5) is exposed to fluctuations in short-term Canadian interest rates and as such the required cash flow to service the debt will fluctuate as a result of changes in interest rates. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rates.

(iii) Foreign currency exchange rate risk

At June 30, 2009, the Company had PKR 25,966,080 (CAD\$370,536) of cash held in a bank account denominated in Pakistan rupees, and US\$2,340,000 (CAD\$2,720,250), and US\$450,000 (CAD\$523,125) of cash was held in a bank account denominated in United States dollars. These amounts are in restricted cash account to support bank guarantees and performance bonds. The Company considers PKR 25,966,080 (CAD\$370,536) of cash held in a bank account denominated in Pakistan rupees, and US\$450,000 (CAD\$523,125) to be at risk and has been fully provided for the potential exposure (Note 6). The Company had no outstanding forward exchange contracts in place at June 30, 2009.

(iv) Credit risk

A substantial portion of the Company's accounts receivable are with customers in the natural gas industry and are subject to normal industry credit risks. The carrying amount of accounts receivable reflects management's assessment of the credit risk associated with these customers. The Company has no receivables that it considers as being past due.

(v) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure and financial leverage, as outlined in Note 5 to the unaudited interim consolidated financial statements. It also manages liquidity risk by continuously monitoring actual and projected cash flows to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

Liquidity risks may necessitate the need for the Company to pursue equity issuances, obtain project or debt financing, or enter into joint arrangements. There is no assurance that the necessary financing will be available in a timely manner.

As at June 30, 2009, the Company has working capital deficit of \$2,665,672 and access to a credit facility of \$8,550,000 (Note 5).

International Sovereign Energy Corp.

Notes to Unaudited Consolidated Financial Statements

For the Six Months Ended June 30, 2009

11. FINANCIAL INSTRUMENTS (CON'T)

Fair value of financial instruments

The fair values of financial instruments consisting of cash, accounts receivable, accounts payable and accrued liabilities approximate their carrying values due to their short-term nature. Carrying value of restricted cash and guarantee also approximates its fair value as it is translated at the foreign exchange rate prevailing at end of the period. The Company's management assesses quarterly whether there should be any impairment of the financial assets of the Company and as such makes the necessary provisions (Note 3).

12. CAPITAL MANAGEMENT

The Company's objective is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

Shareholders' equity is defined as share capital plus contributed surplus plus warrant plus retained earnings, less any deficit. The capital structure of the Company is as follows

	June 30, 2009	December 31, 2008
Total Shareholders' equity	\$ 21,546,430	\$ 21,546,430
Working capital deficit	2,665,672	2,650,843
Total capital	\$ 24,212,102	\$ 24,197,273

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other factors that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

The Company's capital structure is not subject to external restrictions; however, the Company's operating facility (Note 5) is determined by the lender and based on the lender's borrowing base model which is based on the Company's petroleum and natural gas reserves. There have been no changes in the Company's approach to capital management.

13. SEGMENTED INFORMATION

The Company's core area of operation is in Canada.

Period end June 30	Canada		International	
	2009	2008	2009	2008
Revenue net of Royalties	\$ 3,723,490	\$ 7,470,796	\$ -	\$ -
Property Plant and Equipment (Note 3)	27,465,933	30,215,710	-	2,049,444

International Sovereign Energy Corp.

Notes to Unaudited Consolidated Financial Statements

For the Six Months Ended June 30, 2009

14. COMMITMENTS AND CONTINGENCIES

The Company is committed under an operating lease which expires on August 31, 2011. The minimum annual payment required on the office lease for the remainder of the period is \$240,000.

The Company also has a standby letter of credit of \$7,500 (June 30, 2008- \$7,500) to maintain its status as a licensed well operator in the province of British Columbia.

As a part of its ongoing operations, the Company may be involved in potential litigation or claims associated with its international operations. Management is of the opinion that there will be no material impact on the financial position, results of operations or liquidity of the Company, as a result of such claims.