

**INTERNATIONAL SOVEREIGN ENERGY
CORP.**

**MANAGEMENT'S DISCUSSION AND
ANALYSIS**

Form 51-102F2

**FOR THE THREE & SIX MONTH PERIODS ENDED
June 30, 2009**

August 07, 2009

INTERNATIONAL SOVEREIGN ENERGY CORP.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS
AND FINANCIAL CONDITION OF THE COMPANY
FOR THE THREE MONTH AND SIX MONTH PERIODS ENDED JUNE 30, 2009

The following is management's discussion and analysis ("MD&A") of International Sovereign Energy Corp.'s (the "Company" or "ISR") operating and financial results for the six month period ended June 30, 2009 as well as information concerning the Company's future outlook based on currently available information. This MD&A should be read in conjunction with the Company's unaudited consolidated financial statements and the accompanying notes for the periods ended June 30, 2009 and 2008. This MD&A is based on financial statements prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). This MD&A is dated August 07, 2009. Disclosure contained in this document is current to that date, unless otherwise noted. All amounts in this MD&A are in Canadian dollars, except where otherwise stated. Additional information relating to the Company is available on www.sedar.com.

Forward-Looking Information

This MD&A contains forward-looking or outlook information which reflects management's expectations regarding the Company's growth, results of operations, performance and business prospects and opportunities. The use of words such as "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe", "outlook", "forecast", and similar expressions are intended to identify forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results of events to differ materially from those anticipated in these forward-looking statements. Such factors include, among others, the following: general economic and business conditions, both nationally and in the regions in which the Company operates; changes in business strategy or development/acquisition plans; environmental exposures, financing risk; existing governmental regulations; liability and other claims asserted against the Company; and other factors referred to in the Company's filings with Canadian securities regulators. Although management believes the expectations reflected in these forward-looking statements are reasonable, there can be no assurance that actual results will be consistent with these forward-looking statements. Readers should not put undue reliance on forward-looking information. These statements are made as of the date hereof and management assumes no obligation to update or revise these statements to reflect new events or circumstances, except as required by law.

ISR is a Canadian based petroleum and gas exploration and production company. The Company is active in the exploration and development of hydrocarbon reserves in Western Canada and internationally, primarily in low to medium risk exploration and exploitation opportunities. This approach provides the Company with a substantial asset base from which to identify and pursue late stage exploration or early stage development opportunities internationally.

Overall Performance

Revenues for the six month period ending June 30, 2009 ("2009") were \$4,653,271, compared to \$9,367,025 for the six month period ending June 30, 2008 ("2008") a decrease of 50%. Average production increased from, 843 Boe/d in 2008 to 975 Boe/d, in 2009, an increase of 16%. Average oil prices received in the six-month period reduced from \$86.47/Bbl in 2008 to \$50.21/Bbl in 2009. Average gas prices received for the six-month period decreased from \$8.66/Mcf in 2008 to \$3.91/Mcf in 2009, a reduction of 55% over the corresponding period.

The Company exited the quarter at 899 Boe/d. The production at certain wells had been stopped for maintenance lowering the exit rate. If the production at these wells had not been halted the exit rate would have been 964 Boe/d. Average oil production for the second quarter of 2009 was 99 Bopd as compared to 168 Bopd in the second quarter of 2008. The decrease of 41% in oil production was primarily due to watering out of Marwayne oil field. During the same period, average gas production increased from 3,831 Mcf/d in 2008 to 4,988 Mcf/d in 2009 (from 639 Boe/d to 831 Boe/d, an increase of, 192 Boe/d) or 30%, primarily due to the increased gas production from Peace River and Medicine River areas.

Summary

In the six months ended June 30, 2009, the Company operated a sustainable oil and gas business with a net cash flow from operations of approximately \$1,099,965. Despite economic challenges, commodity prices for oil products, recovered to \$50-\$60/Bbl level. Prices of natural gas however did not show the same level of recovery and prices hovered around \$3-\$4/Mcf during the six-month period.

On May 27, 2009 the Company was informed by Mari Gas Company Limited (“MGCL”), the operator of the Sukkur Block with a 50% working interest (“WI”), and Sujawal Block with a 85% WI, that the Company was in default of non-payment of cash calls of its 15% WI in these Blocks if payment of all outstanding cash calls of approximately US\$1.2 million were not paid within 7 days. Under the Joint Operating Agreement (“JOA”), the Company has the right to remedy the default during a period of 60 days by making payment of all its share of the cash calls with interest at 3% over LIBOR or forfeit its WI. In the event of forfeiture, the Company will not be entitled to receive any consideration for such forfeited WI.

The Company had taken a provision of \$2.8 million in 2008 against international expenditures in Pakistan. The Company has provided for the capital expenditures and the cash calls relating to these Blocks. In addition the Company had posted performance bonds of PKR 25,966,080 and US\$450,000, which have been fully provided for in the current quarter.

The Company is of the opinion that capital is presently better spent on its domestic drilling program that currently has a high success rate coupled with substantially shorter payback periods. The Company has thus elected not to remedy the default, but to seek out parties that would take over its obligations. Although the Koonj Well, in the Sukkur Block, drilled in July 2008 has proven reserves, the operator has yet to start production despite assurances made in November 2008. The Company is not confident that the production will commence in a timely manner, and is concerned that the initial reserve estimates subsequent to drilling have been downgraded substantially.

On August 1st 2009 the Company filed and was granted a temporary injunction until August 8th 2009 that stays MGCL or any other party from seeking forfeiture of the Company’s WI in the Sukkur Block in order to sell the WI to a party that had expressed serious interest. On August 8, 2009 the court set , August 25, 2009 as the date for the defendants to reply to the application, and extended the injunction to September 2, 2009.

Overview

	Three Months Ended			Six Months Ended		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Revenues:						
Petroleum and natural gas sales	2,108,350	5,389,527	(61)	4,653,271	9,367,025	(50)
Royalties	(411,928)	(1,074,952)	(62)	(929,781)	(1,896,229)	(51)
Lease operating costs	(579,181)	(643,386)	(10)	(1,218,840)	(1,319,863)	(8)
Transportation	(159,221)	(115,130)	38	(306,275)	(212,756)	44
Operating netback	958,020	3,556,059	(73)	2,198,375	5,938,177	(63)
Other income	912	21,060	(96)	14,235	48,012	(70)
Interest	(6,359)	(43,604)	(85)	(6,359)	(87,024)	(93)
General and administrative	(359,157)	(2,295,424)	(84)	(1,106,286)	(2,750,621)	(60)
Funds from operations	593,416	1,238,091	(52)	1,099,965	3,148,544	(65)
Unrealized loss/gain on exchange	(19,646)	(3,923)	401	-	(2,865)	(100)
Depletion, depreciation and accretion	(1,989,740)	(1,940,551)	3	(3,936,398)	(2,952,946)	33
Provision for impairment of international assets	(954,064)	(4,234,660)	(77)	(954,064)	(4,234,660)	(77)
Stock based compensation expense	(44,734)	(47,328)	(5)	(89,467)	(94,656)	(5)
Income before taxes	(2,414,768)	(4,988,371)	(52)	(3,879,964)	(4,136,583)	(6)
Future income tax (expense), recovery	483,509	1,208,389	(60)	843,392	846,065	0
Net income (loss)	(1,931,259)	(3,779,982)	(49)	(3,036,572)	(3,290,518)	(8)
Funds from operations per share:						
Basic (\$)	0.04	0.09	(56)	0.07	0.23	(70)
Diluted (\$)	0.04	0.09	(56)	0.07	0.23	(70)
Net income (loss) per share						
Basic (\$)	(0.12)	(0.27)	(56)	(0.19)	(0.23)	(17)
Diluted (\$)	(0.12)	(0.27)	(56)	(0.19)	(0.23)	(17)
Average number of shares outstanding						
Basic	16,096,084	13,928,084	16	16,096,084	13,928,084	16
Diluted	16,096,084	13,928,084	16	16,096,084	13,928,084	16

(1) Funds from operations is a non-GAAP measure that does not have a standardized meaning as prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other oil and gas companies. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

(2) Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

(3) Definitions:

Boe/d: barrel of oil equivalent per day

Bopd: barrel of oil per day

Mcf/d: Thousand cubic feet per day

MMcf/d: Million cubic feet per day

Bbl: barrel

Funds from Operations and Net Earnings (Loss)

	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Funds from operations	593,416	1,238,091	(52)	1,099,965	3,148,544	(65)
Per share:						
Basic (\$)	0.04	0.09	(56)	0.07	0.23	(70)
Diluted (\$)	0.04	0.09	(56)	0.07	0.23	(70)

Funds from operations for the three months ended June 30, 2009 totaled \$593,416 or \$0.04 per share, compared to \$1,238,091 or \$0.09 per share for the same period in 2008. This decrease is due to the significantly low commodity prices.

	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Net income (loss)	(1,931,259)	(3,779,982)	(49)	(3,036,572)	(3,290,518)	(8)
Per share:						
Basic (\$)	(0.12)	(0.27)	(56)	(0.19)	(0.23)	(17)
Diluted (\$)	(0.12)	(0.27)	(56)	(0.19)	(0.23)	(17)

Net loss for the three month period ended June 30, 2009 was \$1,931,259 or \$0.12 per share compared to a loss of \$3,779,982 or \$0.27 per share, for the same period in 2008. In addition to significantly lower commodity prices the Company provided for forfeiture of its interest in the Sukkur and Sujawal Blocks in Pakistan in the current period in the amount of \$954,064.

Petroleum and natural gas sales

Sales volumes		Three Months Ended			Six Months Ended		
		June 30			June 30		
		2009	2008	Change	2009	2008	Change
		\$	\$	%	\$	\$	%
Natural gas	<i>Mcf/d</i>	4,988	3,831	30	5,139	3,673	40
Crude oil	<i>Bbl/d</i>	99	168	(41)	104	188	(45)
Natural gas liquids	<i>Bbl/d</i>	24	48	(50)	15	43	(65)
Combined (6:1)	<i>Boe/d</i>	954	854	12	975	843	16

Sales volumes, on a Boe basis, averaged 954 Boe per day during the second quarter of 2009, up 12% from the 854 Boe per day average in the second quarter of 2008. The increase in sales volumes for natural gas is primarily the result of the new production coming online from Sylvan Lake and Boundary Lake areas. *The actual production volumes for the month of June were approximately 899 Boe/d.*

Natural gas sales volumes increased 30% during the second quarter 2009 as compared to the comparative period in 2008. With the anticipated addition of production from the 2009 capital program, management expects sales volumes for the remainder of 2009 to increase over the average levels experienced during the first six months of the year.

Revenues	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Natural gas	1,535,353	3,574,987	(57)	3,633,831	5,790,384	(37)
Crude oil	501,991	1,442,052	(65)	941,456	2,961,293	(68)
Natural gas liquids	71,006	372,488	(81)	77,984	615,348	(87)
Total oil and gas	2,108,350	5,389,527	(61)	4,653,271	9,367,025	(50)

Gross revenue from the sale of petroleum and natural gas in the second quarter of 2009 totaled \$2,108,350 down by 61% from the same quarter last year. Overall natural gas sales were \$1,535,353 for the three months ended June 30, 2009, 57% lower than \$3,574,987 received in the second quarter of 2008, due to the significant drop in natural gas prices. The decrease in total revenues was a result of decreased commodity prices for the first six months of 2009

Average Sales Prices		Three Months Ended			Six Months Ended		
		June 30			June 30		
		2009	2008	Change	2009	2008	Change
		\$	\$	%	\$	\$	%
Natural gas	<i>\$/Mcf</i>	3.38	10.25	(67)	3.91	8.66	(55)
Crude oil	<i>\$/Bbl</i>	55.96	94.40	(41)	50.21	86.47	(42)
Natural gas liquids	<i>\$/Bbl</i>	31.99	85.81	(63)	28.72	78.99	(64)
Combined (6:1)	<i>\$/Boe</i>	24.28	69.34	(65)	26.37	61.38	(57)

Benchmark Pricing		Three Months Ended			Six Months Ended		
		June 30			June 30		
		2009	2008	Change	2009	2008	Change
		\$	\$	%	\$	\$	%
AECO natural gas (Daily index)	<i>Cdn\$/GJ</i>	3.28	7.69	(57)	3.99	8.55	(53)
AECO natural gas (Monthly spot)	<i>Cdn\$/GJ</i>	3.47	8.86	(61)	4.41	7.81	(44)
WTI crude oil	<i>US\$/Bbl</i>	59.51	123.95	(52)	51.19	110.91	(54)
Edmonton par crude oil	<i>Cdn\$/Bbl</i>	66.16	126.75	(48)	58.16	112.48	(48)
Hardisty heavy crude oil	<i>Cdn\$/Bbl</i>	58.07	96.57	(40)	48.72	83.31	(42)
Exchange rate	<i>US\$/Cdn\$</i>	0.8581	0.9905	(13)	0.8311	0.9931	(16)

The overall average price received from sale of oil and gas products in the second quarter of 2009 was down 65%, to \$24.28/Boe, from the \$69.34/Boe received during the second quarter last year. Oil prices reduced during the second quarter of 2009, with ISR's oil price received averaging 41% lower than the second quarter last year. Natural gas prices have weakened significantly in the second quarter of 2009 down 67% to \$3.38 compared to \$10.25 in the second quarter 2008.

Royalties	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Crown	350,063	761,819	(54)	833,710	1,405,881	(41)
Freehold	43,364	235,395	(82)	48,343	359,795	(87)
Gross overriding	18,501	77,738	(76)	47,728	130,553	(63)
Total	411,928	1,074,952	(62)	929,781	1,896,229	(51)
As % of oil and gas revenues	19.54	19.95	(2)	19.98	20.24	(1)

Royalties decreased in the second quarter of 2009, totaling \$411,928 versus \$1,074,952 in the same period of 2008, a 62% change over the corresponding period. The significant decrease in absolute dollar amount was due to lower commodity prices and The New Royalty Framework (“NRF”) that came into effect on January 1, 2009. Royalty calculations under NRF are price dependant.

Royalties as a percentage of working interest revenues amounted to 19.54% during the second quarter of 2009, compared to 19.95%.

Lease Operating Costs	Three Months Ended			Six Months Ended		
	June 30			June 31		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Lease Operating Costs	579,181	643,386	(10)	1,218,840	1,319,863	(8)
Per Boe (\$)	6.67	8.28	(19)	6.91	8.65	(20)

Lease operating costs decreased 10% from \$643,386 in the second quarter last year to \$579,181 in the second quarter of 2009. Overall operating costs per unit were slightly lower in the first half of 2009. The new gas properties that came online in 2008 have low operating costs mainly due to the quality of the gas being processed along with minimal water disposal required. On a Boe basis, lease operating costs decreased 19% in the three months ended June 30, 2009 to \$6.67 per Boe from \$8.28 per Boe in the same period of 2008, and overall by 20% in the first half of 2009, from \$8.65 in 2008 to \$6.91 in 2009.

Transportation	Three Months Ended			Six Months Ended		
	June 30			June 31		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Transportation	159,221	115,130	38	306,275	212,756	44
Per Boe (\$)	1.83	1.48	24	1.74	1.39	25

Transportation costs for the three months ended June 30, 2009 amounted to \$159,221 with the transportation costs for the comparative period in 2008, amounting to \$115,130. This was an increase of 38% over the relevant periods. On a Boe basis, transportation costs increased 24% in the three months ended June 30, 2009 to \$1.83 per Boe from \$1.48 per Boe in the same period of 2008. The increase in absolute amount and per Boe amount is a result of the new gas production in the latter half of 2008.

Operating Netback (\$/Boe)	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Petroleum and natural gas sales	2,108,350	5,389,527	(61)	4,653,271	9,367,025	(50)
Royalties	(411,928)	(1,074,952)	(62)	(929,781)	(1,896,229)	(51)
Lease operating costs	(579,181)	(643,386)	(10)	(1,218,840)	(1,319,863)	(8)
Transportation	(159,221)	(115,130)	38	(306,275)	(212,756)	44
Operating netback	958,020	3,556,059	(73)	2,198,375	5,938,177	(63)
Per Boe (\$)	11.03	45.75	(76)	12.46	38.70	(68)

(1) Operating netback is a non GAAP measure that does not have a standardized meaning as prescribed by GAAP. We consider it an important measure as it demonstrates our ability to generate the cash flow necessary to fund future growth through capital investment.

Operating netbacks were significantly lower for the three and six months ended June 30, 2009, when compared to the prior year periods, due mainly to the decrease in commodity prices.

General and Administrative ("G&A")	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Management severance	-	1,224,139	-	112,500	1,224,139	(91)
Proxy solicitation, management and board change	-	465,380	-	-	465,380	-
Other general and administrative expenses	514,546	1,014,081	(49)	1,149,175	1,814,056	(37)
	514,546	2,703,600	(81)	1,261,675	3,503,575	(64)
G&A Capitalized	(155,389)	(408,178)	(62)	(155,389)	(752,954)	(79)
General and Administrative Expenses	359,157	2,295,424	(84)	1,106,286	2,750,621	(60)
Per Boe (\$)	4.14	29.21	(86)	6.27	17.92	(65)

General and administrative expenses decreased 84% in the second quarter of this year to \$359,157 from \$2,295,424 in the same period last year. The decrease is primarily due to the management's strict control over spending. In 2008 the previous management group considered themselves to be terminated and issued \$1,200,000 in severance. The Company is pursuing legal remedies to recover these amounts.

Management expects that G&A costs on a per unit basis will continue to trend downward as a result of increased production volumes from new wells coming online in the second half of 2009, and the benefits of ISR's capital program for the remainder of the year. However the trend will be dependent on current pressure on commodity prices.

Stock Based Compensation and Other Stock Based Compensation

Stock-based compensation expense, net of capitalized stock-based compensation, for the three months ended June 30, 2009 was \$44,734 as compared to stock-based compensation expense of \$47,328 in the comparative period of 2008. The stock-based compensation expense decreased due to expiration of options.

Depletion, Depreciation and Accretion	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Impairment of international assets	954,064	4,234,660	(77)	954,064	4,234,660	(77)
Depletion	1,938,038	1,915,807	1	3,836,662	2,906,363	32
Depreciation	3,995	3,538	13	7,822	6,862	14
Accretion of asset retirement obligations	47,707	21,206	125	91,914	39,720	131
	1,989,740	1,940,551	3	3,936,398	2,952,946	33
Total	2,943,804	6,175,211	(52)	4,890,462	7,187,606	(32)
Per Boe (\$)	33.20	79.45	(58)	27.37	46.84	(42)

Depletion, depreciation and accretion expense decreased 52% in the three months ended June 30, 2009 to \$2,943,804 from \$6,175,211 in the same period of 2008. This decrease in absolute dollar amount is a result of the provision against the value of an international cost centre after the Company had performed an impairment test calculation on June 30, 2008 in accordance with "AcG-16, Oil and Gas Accounting – Full Cost" to assess the recoverable value of the asset. As a result the Company has made a provision on its petroleum and natural gas property in Ecuador. In 2009 the Company provided for a potential forfeiture of the Company's WI in Sukkur and Sujawal blocks in Pakistan. On a Boe basis depletion, depreciation and accretion expense decreased by 58% to \$33.20/Boe compared to \$79.45/Boe in the same period of 2008.

Income Taxes

The future income tax provision for the three months ended June 30, 2009 was a recovery of \$483,509 compared to \$1,208,389 in the comparative period of 2008.

Income taxes are comprised of two components: current and future income taxes. The expected 2009 income tax rate as a percentage of pre-tax income is 25%.

Capital Expenditures

During the second quarter ended June 30, 2009, \$194,027 (2008 - \$1,099,303) was expended on capital additions as summarized below:

Capital Expenditures	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2009	2008	Change	2009	2008	Change
	\$	\$	%	\$	\$	%
Land and acquisitions	195,735	923,501	(79)	237,909	1,326,426	(82)
Geological and geophysical	(57,841)	1,526	(3,890)	561,185	32,271	1,639
Drilling and completion	41,801	(118,652)	(135)	1,569,296	1,423,190	10
Facilities and equipment	9,343	285,976	(97)	65,394	319,233	(80)
Furniture, fittings and fixtures	4,989	6,952	(28)	6,582	8,443	(22)
Total capital expenditures	194,027	1,099,303	(82)	2,440,366	3,109,563	(22)

Capital expenditures decreased in the three months ended June 30, 2009. In the six month period the company carried out drilling of two wells. Both the drillings were unsuccessful. Since the start of 2008, the Company has drilled 8 gross gas wells (5.2 net), which included 2.2 (net) D&A wells for a 58% success rate. During the first six months of 2009, the Company capitalized \$155,390 of general and administration expenses.

Liquidity and Capital Resources

At June 30, 2009 the Company's market value of common shares was \$7,565,159 based on the closing price of \$0.47 per share on the 16,096,084 shares outstanding. This compares to a market value of \$17,549,386 at the end of June 30, 2008 based on the closing price of \$1.26 per share and 13,928,084 shares outstanding. Funds from operations for three month period were \$593,416 down 52% from \$1,238,091 at the end of the corresponding period of 2008. The funds from operations on a per share basis decreased from \$0.09 per basic weighted average share in 2008 to \$0.04 per basic weighted average share in 2009. This decrease of 56% is attributable to significantly lower commodity prices. Funds from operations details are provided to assist investors in determining the ability of the Company to generate cash from operations. Funds from operations are calculated as being net earnings adjusted for items that do not affect cash. This measure does not have any standardized meaning prescribed by Canadian GAAP and may not be comparable to similar measures presented by other companies.

The oil and gas business is inherently risky and capital intensive and can require significant capital and cash resources to expand by growing reserves, production and cash flow. Given the nature of the oil and gas business, and the size of ISR, it must be able to continue to access capital markets to raise additional monies to grow.

The Company has budgeted approximately \$5 million in capital expenditures for balance of 2009 and expects to rely on internally generated cash flows and available lines of credit to fund its capital program. Currently the Company has unused capacity of approximately \$8.5 million on its operating loan.

Contractual Obligations

As part of normal operations, the Company is party to various financial guarantees, letters of credit and other contractual commitments. Oil sales from Company production are contracted on a month-to-month evergreen basis and gas sales from Company production are contracted on an annual basis commencing each November. The Chief Executive Officer and the Chief Financial Officer are each party to a separate employment services agreement with the Company. The Company also has a letter of credit outstanding totaling \$7,500 to maintain its status as a licensed well operator in the province of British Columbia.

The Company also has a legal obligation to reclaim the lands on which it has production wells and/or facilities. These obligations come due at varying times, dependent upon when economic production ceases and the property is then available for abandonment and reclamation operations.

Disclosure Controls and Procedures

The Company has established disclosure controls, procedures and policies so that the consolidated financial results are presented accurately, fairly and timely. The disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in reports filed or submitted under applicable securities regulation is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. All internal control systems, no matter how well designed, have inherent limitations. Therefore, these systems provide reasonable, but not absolute assurance, that financial information is accurate and complete.

Internal Controls over Financial Reporting

Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external reporting purposes in accordance with Canadian GAAP. The Chief Executive Officer and Chief Financial Officer have designed internal controls over financial reporting or have caused them to be designed under their supervision to provide reasonable assurance regarding the reliability of financing reporting and the preparation of financial statement for external reporting purposes in accordance with Canadian GAAP.

Although management does not believe that any significant deficiencies exist in the Company's internal controls over financial reporting at June 30, 2009 that would result in a material misstatement of the Company's financial reporting, ISR continues to evaluate its processes and internal controls on an ongoing basis. There were changes in internal control over financial reporting during 2009.

Business Risks

The oil and gas industry is subject to numerous risks, including commodity prices, interest rates, exchange fluctuations, as well as environmental concerns and the success of future drilling. ISR attempts to reduce and manage those risks that are controllable.

Safety and Environmental

Safety and environmental concerns are addressed through a corporate contingency plan and by continued emphasis on complying with environmental regulations.

Critical Accounting Estimates

The preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates. Due to timing of when activities occur compared to the reporting of those activities, management estimate and accrue operating results and capital spending. Changes in these judgments and estimates could have a material impact on the Company's financial results and financial condition.

The CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the start of 2011. The Company is in the process of:

- Developing a plan to assess the impact of convergence of Canadian GAAP and IFRS.
- Identifying appropriate training.
- Identifying the relevant systems upgrade requirements
- Implementation timetable to commence dual reporting for 2010 ensuring the Company's ability to report under IFRS in 2011.

The table below outlines the Company's approach to implementing IFRS.

Activity	Action plan
Financial Statement preparation:	
Phase 1 Identify differences in Canadian GAAP and IFRS accounting policies	Document the differences
Phase 2 Identify IFRS accounting policies for ISR	Executive management sign off on all key IFRS accounting policies
Phase 3 Develop financial statements based on IFRS Quantify effects of change in initial IFRS disclosure and 2010 financial statements	Develop draft financial statement format
Education	
Define and introduce appropriate level of IFRS expertise for the following groups: Accounting and financial reporting Executive management Audit Committee Board of Directors	Controller and CFO to attend industry specific training Identify appropriate level of information for management, and directors of the Company.
Management Information Systems	
Review all business processes and systems are IFRS compliant Software changes and upgrades Systems for gathering data for IFRS disclosure	Systems upgrade will be available by fall of 2009
Control Environment	
For all accounting policies identified assess the implication and effectiveness of internal controls	All key controls, design and effectiveness to be assessed in conjunction with identifying the differences and accounting policies adopted.

The Company has commenced Phase 1 of the project.

Depletion

The Company accounts for oil and gas properties using the full-cost method of accounting. Under this method, depletion and restoration expenses are recorded using the unit-of-production method. All costs related to exploration and development of oil and gas reserves are capitalized on a country-by-country basis. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling productive and non-productive wells and overhead charges related directly to acquisition, exploration and development activities.

Depletion is an estimate of the reduction in recoverable costs of oil and gas properties during the year, matched against the related income. It is based on reserve estimates, which are evaluated by an independent third party. The determination of the quality and quantity recoverable reserves is also an area of risk. Oil and gas reserves are integral to assessing expected future financial performance, preparing financial statements and making investment decisions. There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves, including many factors beyond the Company's control. The reserves used in calculating depletion and impairment of capital assets represents estimates only.

The Company mitigates this risk by having the reserves evaluation performed by a reputable third party consultant. The Company's Reserves Committee of the Board of Directors reviews the work and independence of this firm.

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in international cost centers are initially excluded from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are determined or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost center. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

Future Income Taxes

The Company accounts for future income taxes using the liability method. Future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax bases. Future income tax expense is computed based on the change during the year in the future tax assets and liabilities. Future income tax expense is computed based on the change during the year in the future tax assets and liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary tax differences are expected to reverse effects of changes in tax laws, and tax rates are recognized when enacted. For the three month period ended June 30, 2009 this future income tax recovery was calculated to be \$282,175 compared to a tax expense of \$1,208,391 at the end of the corresponding period in 2008.

Reserves Disclosure

The process of estimating reserves is critical to several accounting estimates. It required significant judgments based on available geological, geophysical, engineering and economic data. These estimates may change substantially as data from ongoing development and production activities becomes available, and as economic conditions impacting oil and gas prices, operating costs and royalty burdens change. Reserve estimates impact net income through depletion, the determination of asset retirement obligations and the application of an impairment test. Revisions or changes in the reserve estimates can have either a positive or a negative impact on net income and the asset retirement obligation.

Where any disclosure of reserves data is made in this MD&A that does not reflect all reserves of the Company, it should be noted that the estimates of reserves and future net revenue for individual properties or groups of properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties. Any reference to "established reserves" has the meaning of the January 1, 2003, COGE (Canadian Oil and GAS Evaluation) Handbook, proved plus 50% of probable reserves, which is similar but not identical to the January 1, 2004 definition of proved plus probable reserves.

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.

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.

Outlook

The Company’s management has been immersed in the review of the assets of the Company and appraising the opportunities to enhance the financial performance from those assets. The volatility of the oil and gas markets affects all producers and in the past the higher prices have benefited the Company. However the current decline in energy prices impacted the Company’s performance adversely in the first half of 2009. There is much discussion on the pricing levels of oil and gas and it is difficult for the Company to project where these will be at any point in time. However we see opportunities to expand our presence in the Canadian market place through a selective program of acquisition of oil and gas producing properties under acceptable financial conditions based on our strong balance sheet. Through such a program, the Company will increase production, revenue and profit streams and be able to generate the funds to fund further acquisitions as those become available.

Natural gas prices declined significantly in the second quarter of 2009 to \$3.28/Mcf in the second quarter of 2009 from the highs reached at \$9.69/Mcf in the second quarter of 2008Mcf. While partially influenced by the strength of crude oil price changes, natural gas price changes are predominantly based on supply and demand fundamentals in the North American market.

Crude oil prices experienced a significant drop from the peak in mid July for West Texas Intermediate (WTI) of more than US\$145.00 per barrel to a range of between US\$60.00 to \$70.00 per barrel in late October. For the three months ended June 30, 2009, WTI averaged \$59.62 per barrel.

The Company will continue to review its capital expenditure program in light of the current economic climate. Since the present portfolio is approximately 85% gas, the Company will focus on opportunities that increase the oil component because we feel that the present outlook for near term gas prices versus oil prices is less favorable.

Hedging

The Company is prepared to participate in such a program at the appropriate price point; however given the size of the Company it must recognize the risk inherent in prices moving against any hedge in this market of volatile gas prices.

Domestic

At Berwyn, Alberta, the Company recently drilled a step-out exploration well that unfortunately was abandoned upon log results. The Company is currently evaluating the option of bringing on the estimated 300 Boe/d of “behind pipe production” within the Berwyn area.

The Company plans to remain active within the Peace River Arch during the second half of 2009 with the drilling of potentially 3-5 more wells before year end. The feasibility of the projects will be subject to where commodity prices are headed, with a primary focus of diversifying the company’s production portfolio by drilling light oil prospects.

Strategic Direction

The Company realizes that although it presently possesses a relatively strong balance sheet, its sector is currently out of favour with the investing public and has and continues to explore avenues to increase shareholder value. Since our portfolio is heavily weighted towards gas we are captive to the North American economic recovery, which is presently subject to an overabundance of supply.

In this environment we can choose to simply “weather the storm” and wait for gas prices to recover, or merge with another equal or sell to a major producer. We have formulated a strategy, which is flexible enough to accommodate any one of the three mentioned possibilities to maximize shareholder value. Natural gas prices will come back, the question is when.

International

The international properties in Pakistan and Ecuador will receive appropriate attention so that the Company can best benefit from those significant investments.

Pakistan

The Company signed two farm-in agreements with Mari Gas Company (MGCL) of Pakistan, the second largest producer of gas in Pakistan. The Company’s direct working interest (WI) in each block is fifteen percent (15%) with all the work and management performed by a local seasoned and well established gas producer. The farm-in agreement provides that the Company be responsible for 25% of the development costs of the three wells in the Sukkur field. This 2,416.43 sq. km. block is situated in Sindh Province (100 kms from Karachi), Southern Pakistan. The Block is situated next to the Badin area which contributes some 50% of Pakistan’s hydrocarbon production. Numerous oil and gas discoveries exist to the East of the block. MCGL has completed the re-interpretation of vintage 2D seismic from which a Lower Goru sand lead has been identified.

The Sukkur Joint Venture (SJV) is comprised of MCGL, the operator, with a 50% WI, Petroleum Exploration Limited, a Pakistani exploration and production company with a 35% WI and the Company, as mentioned above, with a 15% WI, The SJV committed to drill 3 exploration wells in the Sukkur Exploration Block.

On May 27, 2009 the Company was informed by Mari Gas Company Limited (“MGCL”), the operator of the Sukkur Block with a 50% working interest (“WI”), and Sujawal Block with a 65% WI, that the Company was in default of non-payment of cash calls of its 15% WI in these Blocks if payment of all outstanding cash calls of approximately US\$1.2 million were not paid within 7 days. Under the Joint Operating Agreement (“JOA”), the Company has the right to remedy the default during a period of 60 days by making payment of all its share of the cash calls with interest at 3% over LIBOR or forfeit its WI. In the event of forfeiture, the Company will not be entitled to receive any consideration for such forfeited WI.

The Company had taken a provision of \$2.8 million in 2008 against international expenditures in Pakistan. The Company has provided for the capital expenditures and the cash calls relating to these Blocks. In addition the Company had posted performance bonds of PKR 25,966,080 and US\$450,000, which have been fully provided for in the current quarter.

The Company is of the opinion that capital is presently better spent on its domestic drilling program that has substantially shorter payback periods. The Company has thus elected not to remedy the default, but to seek out parties that would take over its obligations. Although the Koonj Well, in the Sukkur Block, drilled in July 2008 has proven reserves, the operator has yet to start production despite assurances going back to November 2008. The Company is not confident that the production will commence in a timely manner, and the initial reserve estimates subsequent to drilling have been downgraded substantially.

On August 1st 2009 the Company applied to the Court ,without notice to the defendants, and was granted a temporary injunction until August 8th 2009 against MGCL or any other party from seeking forfeiture of the Company’s WI in the Sukkur Block in order to sell the WI to a party that had expressed serious interest. On August 8, 2009 the court set August 25, 2009 as the date for the defendants to reply to the application, and extended the injunction to September 2, 2009.

Ecuador

Management continues to review this investment with a view to determine if it fits the Company's risk profile. The Charapa Concession is currently being analyzed in detail and a work plan has been developed, in conjunction with the local authorities, to identify the method to achieve the maximum returns for both the Company and for Ecuador. This project is 100% owned by the Company and, as such, the Company is responsible for 100% of the costs and the attendant risks with, what is in effect, an under developed property. All environmental permits have been received. The Company continues to examine whether or not continuation of this investment is financially viable given that its banking covenants only allow cash flow from domestic operations to fund international operations.

Quarterly Financial Summary

	2009		2008				2007	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
	\$	\$	\$	\$	\$	\$	\$	\$
Petroleum and natural gas sales	2,108,350	2,544,921	3,540,511	5,563,108	5,389,527	3,977,498	2,507,172	2,487,542
Royalties	(411,928)	(517,853)	(1,148,280)	(929,812)	(1,074,952)	(821,277)	(532,693)	(446,288)
Operating expenses	(579,181)	(786,713)	(533,086)	(1,222,362)	(758,516)	(774,104)	(798,684)	(848,018)
Operating netback (per Boe)	11	4	19	38	46	34	20	19
Funds from operations	593,416	506,550	951,257	2,845,501	1,234,168	1,910,454	716,908	627,466
Per share – basic	0.04	0.03	0.07	0.20	0.09	0.14	0.05	0.05
Per share – diluted	0.04	0.03	0.07	0.18	0.09	0.14	0.05	0.05
Net income (loss)								
Per share – basic	(0.12)	(0.07)	(0.12)	0.08	(0.27)	0.04	(0.01)	(0.01)
Per share – diluted	(0.12)	(0.07)	(0.12)	0.07	(0.27)	0.04	(0.01)	(0.01)
Capital expenditures	194,027	2,246,339	3,687,993	1,146,406	1,099,303	2,038,260	1,675,893	1,390,345

For the purpose of cash flow per share calculations, cash flow is defined as "Cash flow from operations" before the charges in non-cash working capital. This definition is not a recognized measure under Canadian generally accepted accounting principles and accordingly may not be comparable to measure used by other companies.