

Sefton Resources, Inc. and Subsidiaries

**Consolidated Financial Statements
December 31, 2008 and 2007**

FULL ANNUAL REPORT DATED May 20, 2009

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INDEPENDENT AUDITOR'S REPORT TO THE SHARHOLDERS OF SEFTON RESOURCES, INC

We have audited the financial statements of Sefton Resources, Inc ("Sefton" or the "Company") for the years ended 31 December 2008 and 2007, which comprise the consolidated balance sheets, consolidated statement of operations, consolidated statement of stockholders equity and comprehensive income (loss), consolidated statement of cash flows and accompanying notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with the terms of our engagement letter. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As described in the statement of directors' responsibilities the Company's directors are responsible for the preparation of financial statements in accordance with applicable law and accounting principles generally accepted in the United States of America.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with generally accepted accounting principles in the United States of America. We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding transactions with the Company is not disclosed.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Group and Company as at 31 December 2008 and 2007 and of the results of the Group for the year then ended and have been properly prepared in conformity with accounting principles generally accepted in the United States of America.

CHANTREY VELLACOTT DFK LLP

Chartered Accountants

Registered Auditor

London

20 May 2009

SEFTON RESOURCES, INC. AND SUBSIDIARIES

**CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2008 AND 2007**

	December 31, 2008 \$	December 31, 2007 \$
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	97,357	5,789
Accounts receivable	451,264	414,801
Other receivables - related party	273,040	159,692
Prepaid expenses and other assets	26,974	6,769
Total current assets	<u>848,635</u>	<u>587,051</u>
OIL and GAS PROPERTIES FULL COST METHOD, net	14,595,804	9,789,223
EQUIPMENT AND VEHICLES, net	<u>23,577</u>	<u>30,871</u>
TOTAL ASSETS	<u><u>15,468,016</u></u>	<u><u>10,407,145</u></u>
<u>LIABILITIES AND STOCKHOLDERS EQUITY</u>		
CURRENT LIABILITIES:		
Accounts payable	939,477	810,942
Accrued expenses	347,508	162,666
Accrued expenses - related parties	221,083	179,549
Note payable, current portion	211,515	385,059
Total current liabilities	<u>1,719,583</u>	<u>1,538,216</u>
NOTES PAYABLE:		
Note payable	390,000	338,335
Note payable – bank	3,436,513	911,317
	<u>3,826,513</u>	<u>1,249,652</u>
RETIREMENT OBLIGATION	1,112,109	-
ASSET RETIREMENT OBLIGATION	1,164,263	504,096
Total liabilities	<u>7,822,468</u>	<u>3,291,964</u>
STOCKHOLDERS EQUITY:		
Common stock, no par value, 200,000,000 shares authorized, 116,387,779 and 116,040,354 December 31, 2008 and 2007 shares issued and outstanding	13,254,180	13,049,227
Stock subscription receivable	(30,047)	(30,047)
Treasury stock	(66,393)	(58,602)
Accumulated (deficit)	(5,512,192)	(5,845,397)
Total stockholders equity	<u>7,645,548</u>	<u>7,115,181</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u><u>15,468,016</u></u>	<u><u>10,407,145</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

SEFTON RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	For the years ended December	
	2008	2007
	\$	\$
OPERATING REVENUE:		
Oil and gas sales	4,688,183	2,977,691
OPERATING COSTS AND EXPENSES:		
Oil and gas production	1,040,573	672,845
Depletion and depreciation	462,685	304,965
General and administrative	1,774,819	1,519,848
Share based compensation	162,528	197,220
Total costs and expenses	3,440,605	2,694,878
PROFIT FROM OPERATIONS	1,247,578	282,813
OTHER INCOME (EXPENSE)		
Interest and other income	390,000	417
Interest expense	(192,264)	(78,578)
Retirement liability	(1,112,109)	-
Total other income (expense)	(914,373)	(78,161)
NET INCOME	333,205	204,652
NET INCOME PER SHARE		
Basic and diluted	0.0029	0.0018

The accompanying notes are an integral part of these consolidated financial statements.

The annual financial statements set out on pages 5 to 24 were approved by the board of directors and signed on their behalf on 20 May 2009.

J Delmar-Morgan - Chairman

J. J. Ellerton - Chief Executive Officer

SEFTON RESOURCES, INC. AND SUBSIDIARIES

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND
COMPREHENSIVE INCOME (LOSS)
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007**

	Common stock no par value		Stock subscription receivable \$	Treasury stock \$	Accumulated deficit \$	Total \$
	Shares	Amount \$				
Balances, January 1, 2007	115,109,587	12,742,521	(30,047)	(58,602)	(6,050,049)	6,603,823
Stock issued for cash	600,000	70,176	-	-	-	70,176
Stock issued on conversion of notes payable	330,767	39,310	-	-	-	39,310
Compensation expense related to stock options	-	197,220	-	-	-	197,220
Net income	-	-	-	-	204,652	204,652
Balances, December 31, 2007	116,040,354	13,049,227	(30,047)	(58,602)	(5,845,397)	7,115,181
Stock issued for cash	300,000	35,425	-	-	-	35,425
Stock issued on conversion of notes payable	47,425	7,000	-	-	-	7,000
Compensation expense related to stock options	-	162,528	-	-	-	162,528
Stock repurchased	-	-	-	(7,791)	-	(7,791)
Net income	-	-	-	-	333,205	333,205
Balances, December 31, 2008	116,387,779	13,254,180	(30,047)	(66,393)	(5,512,192)	7,645,548

The accompanying notes are an integral part of these consolidated financial statements.

SEFTON RESOURCES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	For the years ended	
	December 31,	
	2008	2007
	\$	\$
	<hr/>	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	333,205	204,652
Adjustments to reconcile net loss to net cash used in operating activities:		
Depletion and depreciation	462,685	304,965
Share based compensation	162,528	197,220
Changes in operating assets and liabilities:		
Accounts receivable	(36,463)	(42,627)
Prepaid expenses	(20,206)	13,080
Other assets - related party	(113,348)	(69,115)
Accounts payable	128,535	326,499
Accrued retirement obligation	1,112,109	-
Accrued expenses - related party	41,534	154,549
Accrued expenses	184,843	126,985
Net cash provided by operating activities	<hr/> 2,255,422	<hr/> 1,216,208
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase/development of oil and gas properties	(4,589,000)	(2,184,816)
Purchase of property and equipment	(12,805)	(4,857)
Net cash used by investing activities	<hr/> (4,601,805)	<hr/> (2,189,673)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes payable	2,647,695	948,318
Payments on notes payable	(244,378)	(147,473)
Proceeds from sale of common stock	42,425	109,486
Purchase of treasury stock	(7,791)	-
Net cash provided by financing activities	<hr/> 2,437,951	<hr/> 910,331
Effect of exchange rate changes on cash	-	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<hr/> 91,568	<hr/> (63,134)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	5,789	68,923
CASH AND CASH EQUIVALENTS AT END OF YEAR	<hr/> 97,357	<hr/> 5,789
	<hr/> <hr/>	<hr/> <hr/>

The accompanying notes are an integral part of these consolidated financial statements.

1. NATURE OF ORGANIZATION:

Organization – Sefton Resources, Inc. (the “Company”) (f/k/a TEG Resources, Inc.) was incorporated on January 17, 1995, as a British Virgin Islands corporation and has been primarily engaged in the exploration, development, and production of oil and natural gas in the continental United States. The Company’s oil and gas properties are located in California and Kansas, USA and until July of 2006 in Canada.

Capital Reorganization - At the annual meeting held on July 10, 2006, the Company's shareholders approved a fifteen to one reverse stock split. Fractional shares resulting from the consolidation were acquired by the Company and contributed to the Employee Benefit and Incentive Plan. All prior period common stock and applicable share and per share amounts have been retroactively adjusted to reflect the 2006 reverse stock split.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Preparation - The accompanying consolidated financial statements include the accounts of the Company and its wholly owned US subsidiaries, TEG Oil and Gas USA, Inc., (“TEG USA”) and TEG MidContinent, Inc. All inter-company accounts and transactions between the entities have been eliminated in consolidation.

Use of Estimates – The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

The Company’s financial statements are based on a number of significant estimates; determination of the estimated fair value of oil and gas properties, assumptions affecting the estimated fair value of stock-based compensation, asset retirement obligation, and oil and gas reserve quantities which are the basis for the calculation of depreciation, depletion, and impairment of oil and gas properties. Management emphasizes that reserve estimates are inherently imprecise and that estimates are expected to change as future information becomes available.

Financial Results and Liquidity – The Company reported net income of \$333,205 and \$204,652 for the years ended December 31, 2008 and 2007, respectively. The Company had working capital deficits of \$870,948 and \$951,165, respectively, at December 31, 2008 and 2007. These deficits do not reflect additional availability of \$2,563,487 and \$588,683 in 2008 and 2007, under the Company’s bank loan with its primary lender (Note 8).

Significant oil field development expenditures of approximately \$11,000,000 are necessary to fully access the reserves of the Tapia field, which if funded out of cash flows from the properties may delay the development of the field. The Company's continued operation is contingent upon its ability to expand its borrowing base or to raise additional capital, and on ultimately attaining and maintaining positive cash flow and profitability from its oil and gas operations. Any financing obtained through the sale of Company equity will likely result in substantial dilution to the Company's stockholders. If the Company is forced to sell an asset to meet its current liquidity needs, it may not realize the full market value of the asset and the sales price could be less than the Company's carrying value of the asset.

Statement of Cash Flows – For statement of cash flow purposes, the Company considers short-term investments with original maturities of three months or less to be cash equivalents.

Fair Value of Financial Instruments – The Company’s short-term financial instruments consist of cash, accounts receivable, other receivables, accounts payable and notes payable. The carrying amounts of these financial instruments approximate fair value because of their short-term maturities. Based upon the borrowing rates currently available to the Company for loans with similar terms and average maturities, the fair value of long-term debt approximates its carrying value.

Concentration of Credit Risk – Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of temporary cash investments, trade and related party receivables.

The Company places its cash investments with high quality financial institutions and, by policy, attempts to limit the amount of credit exposure to any one institution. The Company had deposits in excess of federally insured limits during the years ended December 31, 2008 and December 31, 2007.

The Company has recorded trade accounts receivable from its business operations. The Company periodically evaluates the collectibility of trade receivables and believes the receivables to be fully realizable and the risk of loss to be minimal. Related party receivables are also considered to be fully collectible.

The oil and gas industry is subject, by its nature, to environmental hazards and cleanup costs for which the Company carries catastrophe insurance. In addition, the Company’s oil and gas business is vulnerable to changes in wellhead prices of crude oil and natural gas. Such prices have been volatile in the past and can be expected to be volatile in the future. The Company’s proved reserves are based on current oil and gas prices and related industry economic factors and, therefore, are subject to volatility. Price declines can reduce the estimated quantity of proved reserves and can increase annual amortization expense (which is based on proved reserves).

Significant Customers – Although the Company sells its production to a few purchasers, there are other purchasers in the areas in which the Company produces oil and natural gas; therefore, the loss of its significant customers would not adversely affect the Company’s operations. For the years ended December 31, 2008 and 2007, oil and gas revenues were generated from the following significant customers:

	2008	2007
Customer A	94%	93%
Customer B	6%	7%

Oil and Gas Producing Activities – The Company follows the “full cost” method of accounting for its oil and gas properties. Under this method of accounting, all property acquisition costs and costs of exploratory and development wells are capitalized when

incurred. All costs are accumulated in to the continental United States cost pool. No gains or losses are recognized on the sale or abandonment of oil and gas properties, unless disposition of significant reserves is involved.

Depletion and amortization of the full cost pool, excluding amounts attributable to unproved properties of \$418,000 at December 31, 2008 and \$274,373 at December 31, 2007 is computed using the units-of-production method based on proved reserves as determined annually by independent engineers.

An impairment is recorded if the costs incurred on oil and gas properties, or revisions in reserve estimates, cause the total capitalized costs of oil and gas properties in the cost center to exceed the capitalization ceiling. The capitalization ceiling is the sum of (1) the present value of future net revenues from estimated production of proved oil and gas reserves applicable to the cost center plus (2) the lower of cost or estimated fair value of the cost center's unproved properties less (3) applicable income tax effects.

Impairment of Long-Lived Assets – Long-lived assets of the Company are reviewed annually as to whether their carrying value has become impaired, pursuant to guidance established in Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” The Company assesses impairment whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. When an assessment for impairment of long-lived assets, long-lived assets to be disposed of and certain identifiable intangibles related to those assets is performed, the Company is required to compare the net carrying value of long-lived assets on the lowest level at which cash flows can be determined on a consistent basis to the related estimates of future undiscounted net cash flows for such properties. If the net carrying value exceeds the net cash flows, then impairment is recognized to reduce the carrying value to the estimated fair value, generally equal to the future discounted net cash flow.

Property and Equipment – Property and equipment are recorded at cost. Depreciation of property and equipment are expensed in amounts sufficient to relate the expiring costs of depreciable assets to operations over estimated service lives, principally using the straight-line method. Estimated service lives range from three to seven years. When such assets are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations in the period realized. The cost of normal maintenance and repairs is charged to expense as incurred. Significant expenditures that increase the useful life of an asset are capitalized and depreciated over the estimated useful life of the asset.

Treasury stock – Purchases by the Company of its own outstanding shares are recorded at fair value, any excess of cost over fair value being recognized in the statement of operations, and classified as treasury stock within stockholders equity. Shares shown as authorized and issued include treasury stock. Shares shown as outstanding do not include treasury stock.

Income Taxes – The Company has adopted the provisions of SFAS No. 109, “Accounting for Income Taxes.” SFAS No. 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets

and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

Temporary differences between the time of reporting certain items for financial and tax reporting purposes consist primarily of exploration and development costs on oil and gas properties, depreciation and depletion, asset retirement obligation, and amortization of discount on convertible debentures.

Revenue Recognition – The Company records revenues (net of royalties paid) from the sale of crude oil and natural gas when the product is delivered at a fixed and determinable price, title has transferred, and collection is reasonably assured.

Net Income Per Share – The Company has adopted SFAS No. 128, “Earnings Per Share.” Basic income (loss) per share is computed by dividing net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted income (loss) per share reflects the potential dilution that could occur if dilutive securities and other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

The Company had net income of \$333,205 and \$204,652 for the years ended December 31, 2008 and 2007, respectively. Dilutive securities include shares issuable upon exercise of stock options for which market price exceeds exercise price, less shares which could have been purchased by the Company with the related proceeds. Because of the anti-dilutive effect of the assumed exercise of outstanding options, the basic and diluted weighted average shares outstanding for 2008 and 2007 are equivalent.

Stock-Based Compensation – In 2002 the Company established an unapproved share option scheme (the “Scheme”) under which the Board may grant options to purchase shares of the Company’s common stock to employees and such other persons as they may nominate. In addition to issuing shares under the Scheme the Company has from time to time granted options to and other non-employees or directors for property or services. The Scheme is discussed further in Note 9 below.

Prior to January 1, 2006, the Company accounted for these options under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB No. 25”) as permitted by SFAS No. 123 “Accounting for Stock-Based Compensation”. Under APB No. 25, compensation expense for employees and directors is recognized for stock options with an exercise price that is less than the market price on the grant date of the option. For stock options with exercise prices at or above the market value of the stock on the grant date, the Company adopted the disclosure-only provisions of SFAS No. 123 “Accounting for Stock-Based Compensation”. Accordingly, no compensation cost has been recognized for these options.

Effective January 1, 2006 the Company adopted SFAS No. 123(R), “Share-Based Payment,” (SFAS No. 123(R)) using the “modified prospective” method. Under this method, the Company’s prior year results remain the same.

The Company has and will continue to recognize the fair value of those options which were granted before January 1, 2006 but do not vest until after that date. In addition, the Company has recognized the expense of options granted since January 1, 2006, based on

the fair value of the option at the date of grant in accordance with SFAS No. 123(R) on a straight line basis over the service period of each award.

If options are granted in the future, the Company will continue to recognize the expense of such options in accordance with the provisions of SFAS No. 123(R).

Compensation expense relating to stock options for the years ended December 31, 2008 and 2007 was \$162,528 and \$197,220, respectively. The total intrinsic value of options exercised for the year ended December 31, 2008 was \$3,891. As of December 31, 2008 there was \$441,604 of total unrecognized compensation cost related to non-vested options.

The fair value of the common stock options granted during 2008 and 2007, for disclosure purposes, was estimated on the grant dates using the Black-Scholes Pricing Model and the following assumptions:

	For the Years Ended December 31,	
	2008	2007
Expected dividend yield	-	-
Expected price volatility	67.17%	73.34%
Risk-free interest rate	2.48%	4.00%
Expected life of options	6.5 years	6.5 years

Stock issued for property or services is valued at the trading price on the date of grant.

A summary of stock option activity is presented in Note 9 below.

Asset Retirement Obligations – In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, “Accounting for Asset Retirement Obligations.” SFAS No. 143 requires an entity to recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred. SFAS No. 143 generally applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset. Under SFAS No. 143, the Company has recognized an estimated liability for the plugging and abandonment of its oil and gas wells. A liability for the fair value of an asset retirement obligation with a corresponding increase in the carrying value of the related long-lived asset is recorded at the time a well is completed and ready for production. The Company will amortize the amount added to the oil and gas properties and recognize accretion expense in connection with the discounted liability over the remaining life of the respective well. The estimated liability is based on historical experience in plugging and abandoning wells, estimated useful lives based on engineering studies, external estimates as to the cost to plug and abandon wells in the future and federal and state regulatory requirements. The liability is calculated as the present value of future plugging and abandonment costs using a credit-adjusted risk-free rate. Annual revisions to the liability could occur due to changes in plugging and abandonment costs, well useful lives or if federal or state regulators enact new guidance on the plugging and abandonment of wells.

3. **OIL AND GAS PROPERTIES:**

A summary of oil and gas properties is as follows:

	2008 \$	2007 \$
Oil and gas properties	13,736,635	8,800,666
Unproved property	1,509,281	1,220,668
Accumulated depletion	(1,144,114)	(726,113)
	<hr/> 14,101,802	<hr/> 9,295,221
Surface land holdings	494,002	494,002
Oil and gas properties, net	<hr/> 14,595,804	<hr/> 9,789,223

Given the uncertain nature of the oil extraction process, advancement in completion and recovery technology, and the financial and tax considerations that could effect ultimate recovery, the Board does not believe it is possible to calculate the future expected amortization expense.

4. **EQUIPMENT AND VEHICLES**

Equipment and vehicles consists of the following:

	2008 \$	2007 \$
Furniture and office equipment	63,406	63,406
Vehicles	100,119	87,314
Accumulated depreciation	(139,948)	(119,849)
Equipment and vehicle, net	<hr/> 23,577	<hr/> 30,871

Depreciation expense for equipment was \$20,099 and \$21,943 for the years ended December 31, 2008 and 2007, respectively.

5. **ASSET RETIREMENT OBLIGATION**

The Company follows the provisions of SFAS No. 143, "Accounting for Asset Retirement Obligations." The Company has calculated the present value of the future plugging and abandonment costs using a credit adjusted risk-free rate of 3.75%, the estimated reserve life and inflation factor of 3.85%.

Reconciliation of the asset retirement obligation for the years ended December 31, 2008 and 2007 is as follows:

	2008 \$	2007\$
Beginning of year	504,096	134,440
Liabilities incurred	635,581	9,697
Accretion expense	24,586	8,649
Revision to estimate	-	351,310
End of year	<u>1,164,263</u>	<u>504,096</u>

The entire amount of the retirement obligation has been classified as long term as the Company does not anticipate abandoning any wells or facilities in 2008.

6. **NOTES PAYABLE - RELATED PARTIES**

On March 5, 2007, the Company executed note agreements with three directors and officers totaling \$37,000. These notes bore interest at 10% per annum, were due and repaid on March 5, 2008. On July 11, 2008, the Company executed an additional note agreement with a director for \$20,000. Interest expense to related parties was \$925 and \$2,775 for the years ended December 31, 2008 and 2007, respectively.

7. **NOTES PAYABLE**

On March 31, 2004, TEG USA purchased 84 acres of fee simple land known as the Hartje Lease in Los Angeles County, California. The purchase price was \$400,000 and payment terms were as follows; \$50,000 in cash paid in 2004 and the remaining \$350,000 in the form of a note payable with interest paid quarterly at 8% per annum. During the year ended December 31, 2008 and 2007, principal payments of \$63,554 and \$25,000 were made. Interest of \$19,133 and \$23,826 was capitalized as surface land holdings for the years ended December 31, 2008, and 2007, respectively. The remaining principal amount of \$210,000 is due on March 31, 2012.

During 2005, the Board approved the establishment of an Employee Benefit and Incentive Plan (the "Plan"). The Plan may include cash, a net profits interest from production, stock and other items which the Board may elect to contribute. Distributions to employees will be accumulated and issued at the sole discretion of the Board of Directors of the Company. Initially the Plan acquired 406,135 shares of Sefton's common stock from a director of the Company. As consideration for these shares the Company assumed a loan note issued by the director. During the year ended December 31, 2008 and 2007, the Company made cash payments towards the outstanding principal on the assumed loan note of \$69,824 and \$63,163 resulting in a balance due on the note of \$18,510 at December 31, 2008. The assumed note matures in April 2009.

On May 12, 2006 the Company entered into loan agreements with certain individuals which totaled \$242,005. These notes are secured by the stock of TEG USA, bearing interest of 10% per annum with interest payable quarterly and the principal due May 12, 2007. The individuals have the option to convert the principal balance plus any accrued interest into shares of the Company. The conversion rates were set as of May 12, 2006 at £0.075 per share. In 2007, payments of \$20,000 were made on these notes. In 2008, additional payments of \$5,000 were made and \$7,000 of the notes was converted to

shares in the Company. In May of 2007, \$180,000 of the outstanding notes issued in May 2006 was extended until October 2008 and subsequently in 2008 were extended to October 2010. The remaining \$30,005 of the notes outstanding was extended until May 2009 and is being further extended to November 30, 2009.

On October 5, 2006, the Company entered into loan agreements with certain individuals which totaled \$102,500. During the year ended December 31, 2008 payments of \$32,000 were paid to repay individual note holders. The remaining individual note holders who are owed \$70,500 are secured by the stock of TEG USA, bearing interest of 10% per annum with interest payable quarterly and the principal due October 5, 2007, subsequently extended to October 5, 2008 and further extended to October 5, 2009. These individuals also have the option to convert the principal balance plus any accrued interest into shares of the Company. The conversion price of £0.065 per share was calculated as the daily closing price of the said shares calculated over the five day period preceding the date of a Board of Directors meeting held to approve the loan agreement. The option to convert the loan agreement into shares of the Company expires on October 5, 2009.

On December 27, 2006 the Company entered into loan agreements with an individual which totaled \$39,310. These loans were secured by the stock of TEG USA, bearing interest of 10% per annum with interest payable quarterly and the principal due December 27, 2007. The individual also had the option to convert the principal balance plus any accrued interest into shares of the Company. The conversion rates were set as of December 15, 2006 at £0.060 per share. This option was exercised in December, 2007.

On July 7, 2008, the Company entered into loan agreements with three individuals totaling \$72,500, bearing interest at 8% and due on July 7, 2009.

Future minimum debt payments on notes payable described above and in Note 6 are as follows:

<u>Year ending December 31</u>	\$
2009	211,515
2010	180,000
2011 and later	210,000
	<u>601,515</u>

8. BANK NOTE PAYABLE:

On August 14, 2007 the Company entered into a Credit Agreement, as amended and restated October 21st, 2008, with its primary bank lender for a revolving credit facility with a maximum commitment amount of \$10,000,000. The amount available under the facility is determined on a semi annual basis based on the Company's borrowing base. Re-determinations were made in October, 2008 and March, 2008 increasing the available credit limit to \$6,000,000 and \$3,000,000, respectively. The interest rate under the facility is the prime rate plus 0.5% or a LIBOR based rate, at the Company's election. The interest rate on the facility at December 31, 2008 was 4.5%. Advances under this agreement totaled \$3,436,513 and \$911,317, at December 31, 2008 and 2007. The Credit

Facility contains various covenants that include restrictions on additional debt, sale of assets, and maintenance of minimum working capital and debt service ratios. Advances outstanding under the agreement are due on August 31, 2010, are secured by a mortgage on the Company's oil and gas properties, and are supported by guarantees from the Company and its subsidiaries.

9. **STOCKHOLDERS' EQUITY:**

Common Stock – During 2008 and 2007, 47,425 and 330,767 shares were issued to loan note holders on conversion of \$7,000 and \$39,310 of notes payable, respectively. An additional 300,000 in 2008 and 600,000 in 2007 shares were issued to Directors who exercised stock options.

Stock Options and Warrants –The Company maintains an incentive stock option plan whereby the Directors may from time to time at their discretion grant to the Directors and employees of the Company options to purchase shares. The plan specifies that the subscription exercise price of such options shall not be less than the applicable market price of the shares at the date of grant of the relevant option. The number of shares for which options may be granted will be limited so that at any time the total number of shares subject to option under the plan will not exceed 12% of the total number of shares then outstanding.

The following is a summary of stock options granted under the existing stock option plans for the years ended December 31, 2008, 2007, and 2006. It should be noted that the summary reflects the capital reorganization that occurred in July 2006.

	No. of options	Exercise price
Outstanding and exercisable, December 31 2005	9,433,333	\$0.1032-\$1.29
Granted	333,333	\$0.147
Exercised	(533,333)	\$0.117
Expired	(1,033,333)	\$0.115-\$1.47
Outstanding and exercisable, December 31 2006	8,200,000	\$0.117-\$0.1155
Granted	3,500,000	\$0.10789
Exercised	(600,000)	\$0.117
Expired	(733,333)	\$0.1075
Outstanding and exercisable, December 31 2007	10,366,667	\$0.108-\$0.123
Granted	4,450,000	\$0.09411
Exercised	(300,000)	\$0.117

Expired	--	--
Outstanding and exercisable, December 31 2008	14,516,667	\$0.076-\$0.1086

Weighted average exercise price \$0.087

Weighted average remaining contractual life 7.678 years

Options vested and exercisable at December 31, 2008 9,055,556

Weighted average fair value of options granted:

2006	\$0.080
	6
2007	\$0.066
	7
2008	\$0.077
	1

Share option exercise prices are set in sterling and have been converted to U.S. dollars at the respective year end exchange rates.

Stock Reserved for Employee Benefit Pool – During 2005, the Board approved the establishment of an employee benefit and incentive plan. This plan may include cash, a net profits interest from production, stock and other items which the Board may elect to contribute. Distributions to employees will be accumulated and issued at the sole discretion of the Board of Directors of the Company. The Company is in the process of completing the establishment of this plan.

In July 2006, the shares of the Company were consolidated at a ratio of 15:1, this event created fractional shares that were acquired by the Company and contributed to the Employee Benefit Plan.

Treasury Stock - The Company assumed a guarantee of the value of certain shares from the former Chairman and has recorded the shares as Treasury Stock. These shares have been contributed to the Employee Benefit and Incentive plan.

10. **EARNINGS PER SHARE**

Basic earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the reporting period.

The weighted average number of shares outstanding for the purposes of calculating basic and diluted earnings per share during the years ended December 31, 2008 and 2007, were 116,214,067 and 115,409,587, respectively.

11. RELATED PARTY TRANSACTIONS

Receivables

The stock subscription receivable represents \$30,347 due from the President of the Company at December 31, 2008 and 2007.

At December 31, 2008 and 2007, advance totaling \$262,952 and \$80,806, respectively, were due from the President of the Company.

At December 31, 2007, the Company had receivables of \$47,693, from other officers of the Company. These amounts were repaid in January, 2008.

The Chairman of the Board had outstanding advances from the Company of \$10,088 and \$21,834 at December 31, 2008 and 2007.

Accrued Expenses

Accrued expenses at December 31, 2008 and 2007 include \$187,530 and \$164,916 of accrued bonuses and salary due to three officers of the Company.

Employment Contracts with Officers

The three executive officers and Directors of the Company and certain key employees executed Employment Contracts with the Company. The contracts are for a period of two years and are automatically renewable if either party fails to notify the other at least one year prior to termination (Rolling Two Year Contract).

The Company will pay a base salary at the agreed upon rate per annum. The Base Salary will be guaranteed through the term of the Agreement. The Base Salary will be escalated by 7.5% at the end of each twelve month period beginning with the twelve month period ended June 30, 2008. Additionally, the contracts contain a provision for severance, retirement and death benefits based on years of service with the Company.

The Board of Directors may declare that an Employee shall be entitled to an annual bonus (whether payable in cash, stock, stock rights, or other property) as the Board of Directors shall determine.

12. RETIREMENT OBLIGATIONS AND 401K PLANS

The Company has entered into a retirement payment agreement with the President of the Company, under which a total payment in the amount of \$839,832, will be due to him on reaching 65 years of age on September 15, 2009. The accrued cost at December 31, 2008 is \$784,819. The terms of the settlement are as follows:

- a. An amount of up to \$300,000 may be offset against the President's accounts receivable with the Company.
- b. The balance will be settled through the issuance of new shares in the Company at the higher of:
 - i. 110% of the price on the day that the election to exchange the liability for shares is exercised

- ii. 4 pence per share
- 3. The President has agreed to defer the settlement of this liability until January 1, 2010 and may defer it further thereafter.

The Company has similar retirement agreements with four additional officers and employees which require a retirement payment based on the monthly salary at date of retirement times a multiple for years of service. This multiple ranges from one month of base salary for 2 years of service or less to two and a half times monthly salary for 10 or more years of service. Employees covered by this arrangement have retirement dates ranging from 2 to 16 years from December 31, 2008. For the year ended December 31, 2008, the Company recognized \$327,290 as retirement expense related to these arrangements.

On June 6, 2008, the Company established the Sefton 401(k) Plan, a qualified defined contribution 401(k) plan covering substantially all employees. Under the plan, employee contributions are matched by the Company at 100% for the first 3% of compensation and at 50% for the next 2% of compensation. Company contribution into the plan for the year ended December 31, 2008 totaled \$7,875.

13. INCOME TAXES

Sefton Resources, Inc., the parent company, is a British Virgin Islands company and is not subject to taxes based on its jurisdiction. The operating subsidiaries, TEG USA and TEG MidContinent are taxed as US entities.

United States Tax Provision— A reconciliation of the provision (benefit) for income taxes computed at the United States statutory rate to the provision for income taxes as shown in the financial statements of operations for the years ended December 31, 2008, and 2007 is summarized below:

	2008	2007
Tax provision (benefit) at federal statutory rate	(34)%	(34)%
State taxes, net of federal tax effects	(5.31)%	(5.35)%
Other	(0.0)%	(0.02)%
Valuation allowance	39.31%	39.37%
Net income tax provision (benefit)	—%	—%

The components of the U.S. deferred tax assets and liabilities as of December 31, 2008 and 2007 are as follows:

	2008 \$	2007 \$
Deferred tax assets:		
Federal and state net operating loss & depletion carryovers	3,485,460	2,443,808
Accrued retirement obligation	271,656	-
Deferred tax liabilities:		
Oil and gas properties	(3,515,959)	(1,608,707)
Net deferred tax asset	241,157	69,968

Less: valuation allowance	(241,157)	(69,968)
Net deferred tax asset	<u>-</u>	<u>-</u>

The Company has a \$7,021,101 net operating loss carryover and \$1,804,812 percentage depletion carry forward for U.S. federal income tax purposes as of December 31, 2008. The net operating losses may offset taxable income through the year ended December 31, 2028 and begin expiring in the year ended December 31, 2021.

The Company provided a valuation allowance against its deferred tax assets as of December 31, 2008 and 2007, respectively, since it believes that it is more likely than not that the net deferred tax assets will not be fully utilized on future income tax returns.

14. **COMMITMENTS**

During 2008, the Company had the following operating leases:

- Office space for its Denver headquarters; the lease requires monthly payments of \$1,759 and expired in October 31, 2008 and is currently month to month.
- Office space for its California operations; the lease requires monthly payments of \$1,550 and is month-to-month.
- Office equipment for its Denver office; the lease requires monthly payments of \$229 and expires in February 2009.

Rent expense was \$38,385 and \$35,201 for the years ended December 31, 2008 and 2007, respectively.

In addition to the leasing commitments set out above the Company had commitments, as at December 31, 2008, for capital expenditures relating to drilling and completion costs for wells in progress at December 31, 2008 totaling \$1,075,000.

15. **CASH FLOW ITEMS**

Supplemental disclosures of cash flow information:

Cash paid for interest was \$181,275 and \$82,750 for the years ended December 31, 2008 and 2007, respectively.

The Company paid no income taxes for the years ended December 31, 2008 and 2007.

Supplemental non-cash financing and investing activities:

During 2008 and 2007, the Company recorded an increase in its asset retirement obligation totaling \$660,167 and \$369,656, respectively. Movements in the asset retirement obligation have been recorded in accordance with Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations".

16. **LITIGATION AND CONTINGENCIES**

The Company knows of no litigation pending, threatened, or contemplated, or unsatisfied judgments against it, or any proceedings to which the Company or any of its subsidiaries is a party, except as specified below.

During 2002, the Company experienced a blowout when drilling a well in the Tapia field. During 2003, the Company was named in a wrongful death lawsuit resulting from the blowout. The Company has denied any wrongdoing and the drilling company's insurance company has indemnified Sefton against any liability that may arise. This case was settled in 2006 at no cost to the Company.

In addition, the Company is a defendant in a lien action for expenses owed to the drilling company related to the blowout. In November 2006, the Company signed a Settlement Agreement with the drilling company that called for Sefton to pay \$250,000 plus interest from the date of settlement until full and final settlement at 10% per annum in exchange for resolution of all matters between the parties.

Subsequent to the Settlement Agreement, the Parties negotiated an agreement that recognized Sefton's "good faith" efforts and allowed Sefton to make partial/installment payments. On April 24, 2007, the final payment to the drilling company was made satisfying all of Sefton's obligations under the Settlement Agreement. Sefton has received confirmation from the drilling company's legal representatives that the claim against the Company has been withdrawn from the courts.

17. **OIL & GAS ACTIVITIES**

Results of Operations from Oil and Gas Producing Activities

The following is a summary of costs incurred in oil and gas producing activities:

	<u>December 31,</u>	
	<u>2008 \$</u>	<u>2007 \$</u>
Property acquisition costs	112,837	164,195
Development costs	4,476,163	2,020,720
Exploration costs	-	-
Total	<u>4,589,000</u>	<u>2,184,915</u>

Results of operations from oil and gas producing activities (excluding operator fees, general and administrative expense, and interest expense) are presented below:

	<u>December 31,</u>	
	<u>2008 \$</u>	<u>2007 \$</u>
Oil and gas sales	4,688,183	2,977,691
Production costs	(1,040,573)	(672,845)
Exploration costs	-	-
Depletion and depreciation	(462,685)	(304,965)

Results of operations from oil and gas producing Activities	3,184,925 1,999,881
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Oil and Gas Reserve Quantities (Unaudited) – Proved oil and gas reserves are the estimated quantities of crude oil, natural gas, and natural gas k/liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed oil and gas reserves are those reserves expected to be recovered through existing wells with existing equipment and operating methods.

Reserve data for the United States properties for the year ended December 31, 2008, was obtained from a report prepared by an independent engineer dated February 6, 2009. All proved reserves of oil and gas at December 31, 2008 and 2007 were located in the United States.

The following table presents estimates of the Company's net proved oil and gas reserves by country as of December 31, 2008 and 2007. However, additional oil field development expenditures of approximately \$11,000,000 are necessary before the Company can access and produce a significant portion of reserves of the Tapia and Eureka fields. Such expenditures may be funded from operations; however, the Company may borrow or sell additional equity to accelerate the development of the fields.

	United States			
	2008		2007	
	Oil (bbls)	Gas (mcf)	Oil (bbls)	Gas (mcf)
Proved reserves, beginning of year	3,953,311	–	3,940,049	–
Revisions of previous estimates	(574,447)	–	59,512	–
Production	(52,780)	–	(46,250)	–
Purchased reserves	–	–	–	–
Proved reserves, end of year	3,326,084	–	3,953,311	–

The Company's proved developed reserves at December 31, 2008 and 2007 were 1,354,700 and 463,900 barrels of oil, respectively.

Standardized Measure of Discounted Future Net Cash Flows (Unaudited) – SFAS No.69, "Disclosures about Oil and Gas Producing Activities", prescribes guidelines for computing a standardized measure of future net cash flows and changes therein relating to estimated proved reserves. The Company has followed these guidelines, which are briefly discussed below.

Future cash inflows and future production and development costs are determined by applying year-end prices and costs to the estimated quantities of oil and gas to be produced. Estimated future income taxes are computed using current statutory income tax rates including consideration for estimated future statutory depletion and tax credits. The resulting future net cash flows are reduced to present value amounts by applying a 10% annual discount factor.

The assumptions used to compute the standardized measure are those prescribed by the Financial Accounting Standards Board and, as such, do not necessarily reflect the Company's expectations of actual revenues to be derived from those reserves nor their present worth. The limitations inherent in the reserve quantity estimation process, as discussed previously, are equally applicable to the standardized measure computations since these estimates are the basis for the valuation process.

	December 31,	
	2008 \$	2007 \$
<u>Total Properties</u>		
Future cash inflows	93,952,562	332,325,458
Future production costs	(43,597,223)	(82,525,165)
Future development costs	(10,810,000)	(14,858,000)
Future income tax expense	(10,912,516)	(89,497,556)
	<hr/>	<hr/>
Future net cash flows (undiscounted)	28,632,823	145,444,737
Annual discount of 10% for estimated timing of cash flows	(14,219,553)	(69,488,880)
	<hr/>	<hr/>
Standardized measure of future net discounted cash flows	14,413,270	75,955,857

Changes in Standardized Measure (Unaudited) – The following are the principal sources of change in the standardized measure of discounted future net cash flows:

	December 31,	
	2008 \$	2007 \$
Standardized measure, beginning of period	75,955,857	26,227,611
Sale of oil and gas produced, net of production costs,	(3,647,610)	(2,304,846)
Extensions and discoveries	–	–
Net changes in prices and production costs	(90,554,291)	51,175,086
Net change in estimated development costs	3,119,829	865,198
Revisions of previous quantity estimates	(4,220,092)	1,763,756
Accretion of discount	11,400,421	5,787,660
Changes in income taxes, net	36,208,777	(13,234,481)
Other	(13,849,621)	5,675,873
	<hr/>	<hr/>
Standardized measure, end of period	14,413,270	75,955,857