



**Interim Unaudited Condensed Consolidated
Financial Statements for the three and six months
ended June 30, 2011 and 2010**

August 5, 2011

**Epsilon Energy Ltd.
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EPSILON ENERGY LTD.
Interim Unaudited Condensed Consolidated Balance Sheets
(All amounts stated in US\$)

	June 30, 2011	December 31, 2010 (note 5)	January 1, 2010 (note 5)
ASSETS			
Current assets			
Cash and cash equivalents	\$ 15,494,578	\$ 18,670,574	\$ 15,288,547
Accounts receivable	905,625	2,746,406	1,488,429
Notes receivable	724,029	-	-
Assets held for sale	-	-	100,000
Restricted cash - current (Note 8)	344,820	598,036	-
Other current assets	119,112	209,079	62,382
Total current assets	<u>17,588,164</u>	<u>22,224,095</u>	<u>16,939,358</u>
Oil and gas interests			
Intangible exploration and evaluation assets (Note 6)	29,833,681	41,282,688	20,099,107
Net property and equipment (Note 7)	76,290,340	42,627,490	46,591,967
Total oil and gas interests	<u>106,124,021</u>	<u>83,910,179</u>	<u>66,691,074</u>
Other assets:			
Restricted cash - long-term (Note 8)	-	242,024	732,240
Other	8,010	8,010	18,504
Total other assets	<u>8,010</u>	<u>250,034</u>	<u>750,744</u>
Total assets	<u>123,720,195</u>	<u>106,384,308</u>	<u>84,381,176</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities	3,509,469	2,196,966	3,460,740
Total current liabilities	<u>3,509,469</u>	<u>2,196,966</u>	<u>3,460,740</u>
Other liabilities			
Asset retirement obligations (Note 9)	451,950	347,338	220,618
Deferred tax liability	11,834,000	-	-
Deferred farmout proceeds (Note 5 (a))	1,996,047	21,469,603	-
Total other liabilities	<u>14,281,997</u>	<u>21,816,941</u>	<u>220,618</u>
Total liabilities	<u>17,791,466</u>	<u>24,013,907</u>	<u>3,681,358</u>
Shareholders' Equity			
Share capital (Note 10)	136,001,220	136,001,220	138,272,250
Contributed surplus (Note 10)	6,875,283	6,323,776	6,098,296
Deficit	(37,866,166)	(60,603,455)	(63,670,728)
Accumulated other comprehensive income	918,393	648,860	-
Total shareholders' equity	<u>105,928,729</u>	<u>82,370,401</u>	<u>80,699,818</u>
Total liabilities and shareholders' equity	<u>\$ 123,720,195</u>	<u>\$ 106,384,308</u>	<u>\$ 84,381,176</u>

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements

Commitments and Contingencies (Note 11)

Related party transactions (Note 13)

(signed) Nick Orlando _____

(signed) Raymond Savoie _____

EPSILON ENERGY LTD.
Interim Unaudited Condensed Consolidated Statements of Earnings
(All amounts stated in US\$)

	Three months ended June 30,		Six months ended June 30,	
	2011	2010 (note 5)	2011	2010 (note 5)
Revenues:				
Oil & gas revenues	\$ 1,675,910	\$ 3,869,425	\$ 3,687,423	\$ 7,865,549
Total revenues	<u>1,675,910</u>	<u>3,869,425</u>	<u>3,687,423</u>	<u>7,865,549</u>
Operating costs and expenses:				
Project operating costs	112,442	1,055,515	548,251	1,577,764
Depletion, depreciation & amortization	650,047	1,324,994	1,482,335	2,838,781
Asset retirement accretion (Note 9)	2,953	(235)	5,745	7,587
Impairment on exploration & evaluation asset	1,057,187	-	1,057,187	-
General and administrative	1,446,290	1,131,835	2,159,298	3,091,875
Total operating costs and expenses	<u>3,268,919</u>	<u>3,512,109</u>	<u>5,252,817</u>	<u>7,516,007</u>
Operating income/(loss)	<u>(1,593,009)</u>	<u>357,316</u>	<u>(1,565,394)</u>	<u>349,542</u>
Other income:				
Gain on farmout agreement (Note 7)	24,281,556	-	24,281,556	-
Other income	10,128	22,596	21,127	40,451
Total other income	<u>24,291,684</u>	<u>22,596</u>	<u>24,302,683</u>	<u>40,451</u>
Net income	<u>\$ 22,698,675</u>	<u>\$ 379,912</u>	<u>\$ 22,737,289</u>	<u>\$ 389,993</u>
Net income per share, basic	\$ 0.46	\$ 0.01	\$ 0.46	\$ 0.01
Net income per share, diluted	\$ 0.45	\$ 0.01	\$ 0.45	\$ 0.01
Weighted average number of shares outstanding, basic	49,716,252	49,840,185	49,716,252	50,186,169
Weighted average number of shares outstanding, diluted	50,403,463	51,175,431	50,403,463	51,521,415

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements

EPSILON ENERGY LTD.
Interim Unaudited Condensed Consolidated Statements of Shareholders' Equity
(All amounts stated in US\$)

	Six months ended June 30,	
	2011	2010
		(note 5)
Share Capital:		
Balance, January 1	\$ 136,001,220	\$ 138,272,250
Exercise of stock options	-	524,158
Share repurchase	-	(2,741,078)
Balance, June 30	\$ 136,001,220	\$ 136,055,330
Contributed Surplus		
Balance, January 1	\$ 6,323,776	\$ 6,098,296
Buy back of shares	-	271,828
Stock options:		
<i>Amortized</i>	649,925	536,712
<i>Exercised</i>	-	(207,073)
<i>Forfeited</i>	(98,418)	(33,760)
Balance, June 30	\$ 6,875,283	\$ 6,666,003
Deficit		
Balance, January 1	\$ (60,603,455)	\$ (63,670,728)
Net earnings	22,737,289	389,993
Balance, June 30	\$ (37,866,166)	\$ (63,280,735)
Accumulated Other Comprehensive Income		
Balance, January 1	\$ 648,860	\$ -
Foreign currency translation adjustment	269,533	128,369
Balance, June 30	\$ 918,393	\$ 128,369
Total Shareholders' Equity	\$ 105,928,729	\$ 79,568,967

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements

EPSILON ENERGY LTD.
Interim Unaudited Condensed Consolidated Statements of Cash Flows
(All amounts stated in US\$)

	Six months ended June 30,	
	2011	2010 (note 5)
Cash flows from operating activities:		
Net income for the period	\$ 22,737,289	\$ 389,993
Items not involving cash:		
Depletion, depreciation and amortization	1,482,335	2,805,526
Asset retirement accretion	5,745	7,587
Impairment of unproved properties	1,057,187	33,255
Stock-based compensation	551,507	502,951
Net gain on derecognition of farmout assets	(24,281,556)	-
Disposal of other assets	1,751	-
Changes in non-cash balances related to operations (Note 14)	(1,151,333)	(15,892)
Net cash provided by operating activities	402,925	3,723,420
Cash flows from investing activities:		
Additions to oil and natural gas properties (Note 14)	(4,184,389)	(6,298,924)
Additions to other property and equipment	(1,862)	-
Proceeds from farmout agreement	-	5,000,000
Proceeds from assets sold	3,850	-
Changes in restricted cash - current	253,216	-
Changes in restricted cash - long-term	242,024	(200,700)
Proceeds from assets held for sale	-	-
Net cash provided by (used in) investing activities	(3,687,161)	(1,499,624)
Cash flows from financing activities:		
Proceeds from options exercised	-	317,085
Common share buy back	-	(2,469,250)
Net cash provided by (used in) financing activities	-	(2,152,165)
Effect of currency rates on cash and cash equivalents		
	108,240	162,386
Increase (decrease) in cash and cash equivalents	(3,175,996)	234,017
Cash and cash equivalents, beginning of period	18,670,574	15,288,547
Cash and cash equivalents, end of period	\$ 15,494,578	\$ 15,522,564
Supplementary cash flow information		
Interest received	\$ 23,183	\$ 36,809
Interest paid	\$ 467	\$ 4,320
Income taxes paid	\$ -	\$ -
Income taxes received	\$ -	\$ -
Cash and cash equivalents consist of:		
Cash	\$ 2,152,647	\$ 1,432,088
Money market funds	11,256,125	13,825,314
Interest bearing short-term deposits	2,085,806	265,163
Cash and cash equivalents	\$ 15,494,578	\$ 15,522,564
Non-cash items:		
Increase to asset retirement obligation	\$ 104,613	\$ (14,609)
Additions to oil and gas interests	\$ (19,473,556)	\$ 447,054

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements

EPSILON ENERGY LTD.
Interim Unaudited Condensed Consolidated Statements of Comprehensive Income
and Accumulated Other Comprehensive Income
(All amounts stated in US\$)

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
		(note 5)		(note 5)
Comprehensive income:				
Net income	\$ 22,698,675	\$ 379,912	\$ 22,737,289	\$ 389,993
Other comprehensive income:				
Currency translation adjustments	(30,620)	(304,869)	269,533	128,369
Comprehensive income	<u>\$ 22,668,055</u>	<u>\$ 75,043</u>	<u>\$ 23,006,822</u>	<u>\$ 518,362</u>
Accumulated other comprehensive income:				
Balance, beginning of period	\$ 949,013	\$ 433,238	\$ 648,860	\$ -
Currency translation adjustments	(30,620)	(304,869)	269,533	128,369
Balance, end of period	<u>\$ 918,393</u>	<u>\$ 128,369</u>	<u>\$ 918,393</u>	<u>\$ 128,369</u>

The accompanying notes are an integral part of these interim unaudited condensed consolidated financial statements

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

1. Description of Business

Epsilon Energy Ltd. (the “Corporation” or “Epsilon”) was incorporated under the laws of the Province of Alberta on March 14, 2005. On October 24, 2007, the Corporation became a publicly traded entity on the Toronto Stock Exchange under the trading symbol “EPS”. The Corporation is engaged in the acquisition, exploration, development and production of oil and natural gas reserves in the United States, Canada, and the Federal Democratic Republic of Ethiopia (“Ethiopia”).

Epsilon is a publicly traded company, incorporated and domiciled in Canada. The address of its registered office is 150 Jardin Drive, Suite 9, Concord, ON L4K 3P9.

These interim unaudited condensed consolidated financial statements (“the interim financial statements”) were approved and authorized for issuance by the Board of Directors (“the Board”) on August 4, 2011.

2. Basis of preparation

The interim financial statements have been prepared in accordance with the International Financial Reporting Standards (“IFRS”) as adopted by Canada on January 1, 2011. This represents Epsilon’s first application of IFRS as at and for the three and six months ended June 30, 2011, including 2010 comparative periods. The financial statements have been prepared in accordance with IFRS 1, “First – time Adoption of International Financial Reporting Standards” and with International Accounting Standard (“IAS”) 34, “Interim Financial Reporting”, as issued by the International Accounting Standards Board (“IASB”).

A summary of Epsilon’s significant accounting policies under IFRS is presented in Note 3. These policies have been retrospectively and consistently applied except where specific exemptions permitted an alternative treatment upon transition to IFRS in accordance with IFRS 1 “First-time Adoption of International Financial Reporting Standards”. Previously, the Corporation prepared its interim and annual consolidated financial statements in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”).

The interim financial statements have been prepared under the historical cost convention. The preparation of financial information in conformity with IFRS requires the use of certain accounting estimates. It also requires management to exercise its judgment in the process of applying Epsilon’s accounting policies. The key accounting estimates and judgments are explained in Note 4 below. Actual results could differ from those estimates.

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

3. Significant accounting policies

Principles of Consolidation

The Corporation's interim financial statements include the accounts of the Corporation and its wholly owned subsidiaries, Epsilon Energy USA, Inc. and Epsilon Energy International Ltd and their wholly owned subsidiaries. All material inter-company transactions have been eliminated.

Revenue recognition

Revenues from the sale of crude oil, natural gas and other petroleum products are recognized, net of royalties, when the title passes to the purchaser and collectability is assured. Revenues from crude oil and natural gas production from properties in which Epsilon has an interest together with other producers are recognized on the basis of Epsilon's net working interest in those properties.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and short-term, highly liquid investments and restricted cash balances with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Restricted cash balances with maturity dates greater than one year are presented as a long-term asset.

Property and equipment

Property and equipment are stated at cost, less accumulated depreciation and accumulated impairment losses. They are initially recorded in the consolidated balance sheets if it is probable that they will generate future economic benefits. This includes capitalization of decommissioning and restoration costs associated with provisions for asset retirement (see "Asset retirement obligations") and certain development costs (see "Development costs"). Accounting for exploration costs is described separately below ("Exploration and evaluation assets"). Expenditures on renewals, improvements and transformations that extend the useful lives of the related asset are capitalized to property and equipment.

Depletion, depreciation, and amortization

Property and equipment related to oil and natural gas production activities are depleted from the moment they are available for use on a unit-of-production basis over the proved developed reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. License acquisition, field development and future decommissioning costs are amortized over total proved reserves of the relevant area. Where individually insignificant, unproved properties may be grouped and amortized based on factors such as the average lease term and past experience of recognizing proved reserves.

Other property and equipment are depreciated on a straight-line basis over their expected useful lives. The expected useful lives of property and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

When tangible assets are composed of more than one significant element with different useful lives, each component is depreciated separately. The amount to be depreciated is represented by the book value reduced by the estimated net realizable value at the end of the useful life, if it is significant and can be reasonably determined.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

3. Significant accounting policies (continued)

Property and equipment (continued)

Replacement costs of identifiable components in complex assets are capitalized and depreciated over their useful lives; the residual book value of the component that has been substituted is charged to the profit and loss account. Expenditures for ordinary maintenance and repairs are expensed as incurred.

Pre-acquisition expenditures

Pre-acquisition expenditures on oil and natural gas assets are recognized as an expense in the income statement when incurred. These are costs incurred prior to obtaining legal title to the property and include legal costs to verify the legal title to the property, technical services and studies, seismic acquisition, geological and geophysical costs, and directly attributable labour, administrative and overhead costs. Once legal title is obtained, these costs are capitalized as exploration and evaluation assets.

Exploration and evaluation assets

Exploration and evaluation ("E&E") assets are initially capitalized by well, field or exploration area, as appropriate, and include payments to acquire the legal right to explore, technical services and studies, seismic acquisition, geological and geophysical costs, exploratory drilling and testing, consumed materials and directly attributable administrative and overhead costs. E&E costs are classified as intangible or tangible oil and natural gas assets according to the nature of the asset and are capitalized until the technical feasibility and commercial viability of the well or project has been established.

The technical feasibility and commercial viability of E&E assets is considered to be determinable when proven reserves are determined to exist. A review of each E&E asset is completed at least annually when impairment indicators are present, to ascertain whether proven reserves have been discovered. Upon determination of proven reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to property and equipment.

Each E&E asset is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. When a potential impairment is indicated, an assessment of the E&E asset is performed by allocating the E&E to cash-generating units to which the exploration cost is attributed. To the extent that the capitalized expenditure is not expected to be recovered through use or disposal, it is expensed. If no future related activity is planned, the E&E costs are also expensed. E&E costs are not amortized prior to the completion of exploration and evaluation activities.

Exploration and evaluation costs expended on behalf of Epsilon under a joint operating agreement as part of the carry amount are capitalized as expenditures are made.

Development costs

Development costs are those costs incurred to obtain access to proved reserves and to provide facilities for extracting, gathering and storing oil and natural gas. Such capitalized oil and natural gas interests generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold property or component is derecognized with a gain or loss recognized in the income statement. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

3. Significant accounting policies (continued)

Development costs (continued)

The development costs are capitalized within property and equipment and amortized generally on a unit of production basis, as their useful life is closely related to the availability of oil and gas reserves. This method provides for residual costs at the end of each quarter to be amortized at a rate representing the ratio between the volumes extracted during the quarter and the proved developed reserves at the beginning of the quarter with consideration to the estimated future development costs necessary to bring those reserves into production. A separate depletion calculation is performed for each field or geotechnical area. Costs related to unsuccessful development wells or damaged wells are expensed immediately as losses on disposal.

Development costs expended on behalf of Epsilon under a joint operating agreement as part of the carry amount are capitalized as expenditures are made.

Impairment of assets

The carrying value of property and equipment is reviewed for impairment whenever events indicate that the carrying amounts for those assets may not be recoverable. Such indicators include changes in the Corporation's business plans, changes in commodity prices leading to unprofitable performance, and, for oil and gas properties, significant downward revisions of estimated proved reserve quantities or significant increase of the estimated development costs.

For the purpose of impairment testing, assets are grouped into smaller groups of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash generating unit" or "CGU"). Assets are grouped based on separately identifiable and largely independent cash flows which is typically done at the field level. If CGU's are determined to be impaired, the carrying amounts of those assets are written down to recoverable amount, which is the higher of fair value less costs to sell and value in use determined as the amount of estimated discounted future cash flows for productive assets.

The expected future cash flows used for impairment analyses are based on judgmental assessments of future production volumes, prices and costs, considering available information at the date of review and are discounted by using a pre-tax rate related to the activity involved that takes into account the market risk in the sectors where the entity operates.

For oil and natural gas properties, the expected future cash flows are estimated principally based on developed and non-developed proved reserves including, among other elements, operating costs, production taxes and the costs to be incurred for the reserves yet to be developed.

Impairments are reversed as applicable to the extent that the events or circumstances that triggered the original impairment have changed. Impairment changes and reversals are reported within depletion, depreciation, and amortization.

The basis for future depletion, depreciation and amortization will take into account the reduction in the value of the asset as a result of any accumulated impairment losses. When an impairment loss subsequently reverses, the carrying amount of the asset (or the cash-generating unit) is increased to the revised estimate of its recoverable amount, so that the increased carrying amount does not exceed the carrying amount that would have been determined in case no impairment loss had been recognized for the asset (or the cash-generating unit) in prior years. After such reversal, the depletion charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

3. Significant accounting policies (continued)

Asset retirement obligations

The Corporation recognizes the present value of its decommissioning liabilities associated with tangible properties in the period in which the liability arises and when reasonable estimates of this fair value can be made. The present value of these obligations is calculated at each period end as the present value of the expected future costs of abandonment of such property using the risk free rate.

The liability is recorded as a long-term liability with a corresponding increase to the carrying amount of the related asset. The liability is increased each reporting period through the accretion of interest up to the future amount of the liability. The accretion is recorded as a finance expense in the Corporation's consolidated financial statements. The addition to the carrying amount of the asset is depleted on the same basis as the corresponding asset. Revisions to the estimated amount or timing of the obligations are reflected as increases or decreases to the recorded liability and related asset. Actual costs incurred upon settlement of the abandonment obligation are charged against the liability as incurred.

Deferred farmout proceeds

Exploration, evaluation and development costs incurred on behalf of Epsilon under a joint operating agreement as part of the carry amount are capitalized to an appropriate asset account with an offsetting entry to the deferred farmout proceeds. Upon reaching expenditure milestones and once the conditions for sale have been met, disposal of the property is triggered with a difference between deferred farmout proceeds and the carrying amount of the property disposed recorded as gain on disposal.

Income taxes

Income tax on profit or loss for the year comprises of current and deferred tax. Current tax is the expected tax paid or payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax paid or payable in respect of previous years.

Deferred tax is recorded using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. The effect on deferred income tax assets and liabilities of a change in income tax rates is recognized in the period that includes the date of the enactment or substantive enactment of the change. Deferred tax assets and liabilities are presented separately except where there is a right of set-off within fiscal jurisdictions.

Leases

Agreements under which the Corporation makes payments to owners in return for the right to use an asset for a period are accounted for as leases. Leases that transfer substantially all the risks and rewards of ownership are recorded at inception as finance leases within property and equipment and debt. Assets acquired under capital leases are amortized over the estimated useful lives of the underlying assets. All other leases are accounted for as operating leases and the related lease payments are charged to expense as incurred.

Joint interests

The majority of the Corporation's oil and natural gas exploration, development and production activities are conducted jointly with others and, accordingly, these interim financial statements reflect only the Corporation's proportionate interest in such jointly controlled assets.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

3. Significant accounting policies (continued)

Earnings per share

Basic net income (loss) per share is calculated using the weighted average number of shares outstanding. Diluted earnings / (loss) per share is calculated using the treasury stock method. The treasury stock method assumes that any proceeds from the exercise of dilutive stock options and warrants would be used to repurchase common shares at the average market price during the period, with the incremental number of shares being included in the denominator of the diluted loss per share calculation, except when anti-dilutive.

Foreign currencies translation

Items included in the financial statements of each subsidiary are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in US dollars, which is the Corporation's functional and presentation currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates prevailing at the dates the fair value was determined.

The results and financial position of subsidiaries (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (a) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that statement of financial position;
- (b) income and expenses for each statement of operations and statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (c) all resulting exchange differences are recognised as a separate component of equity. On consolidation, exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Financial instruments

All financial instruments are initially recognized at fair value on the balance sheet. The Corporation has classified each financial instrument into one of the following categories: (1) financial assets or liabilities at fair value through profit or loss ("FVTPL"), (2) loans and receivables, (3) financial assets available-for-sale, (4) financial assets held-to-maturity, and (5) other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

Financial assets and liabilities at FVTPL are subsequently measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are subsequently measured at fair value with changes in fair value recognized in other comprehensive income (loss), net of tax.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

3. Significant accounting policies (continued)

Financial instruments (continued)

Financial assets “held-to-maturity”, “loans and receivables”, and “other financial liabilities” are subsequently measured at amortized cost using the effective interest method.

The Corporation’s financial assets and liabilities are recorded and measured as follows:

<u>Asset or Liability</u>	<u>Category</u>	<u>Measurement</u>
Cash and cash equivalents	Loans and receivables	Amortized cost
Accounts receivable.....	Loans and receivables	Amortized cost
Restricted cash.....	Loans and receivables	Amortized cost
Accounts payables and accrued liabilities ...	Other liabilities	Amortized cost

The Corporation classifies the fair value of financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument.

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Corporation does not have any Level 1, 2 or 3 disclosures.

Comprehensive income (loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss) and represents the change in shareholders’ equity which results from transactions and events from sources other than the Corporation’s shareholders. These transactions and events include unrealized gains or losses on translation of the parent company Canadian dollar financial statements into the \$U.S. functional and reporting currency.

Business combinations

The acquisition method of accounting is used to account for all business combinations, including business combinations involving entities or businesses under common control, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the fair values of the assets transferred, the liabilities incurred and the equity interests issued.

Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Corporation recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest’s proportionate share of the acquiree’s net identifiable assets.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

3. Significant accounting policies (continued)

Business combinations (continued)

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the subsidiary acquired and the measurement of all amounts has been reviewed, the difference is recognised directly in profit or loss as a bargain purchase.

Stock-based compensation

The Corporation estimates the fair value of all stock options awarded to employees and directors using the Black-Scholes option pricing model. Compensation expense and a corresponding increase to contributed surplus are recorded over the vesting period based on the fair value of the options granted using a graded vesting approach. When stock options are exercised for common shares, consideration paid by the stock option holders and contributed surplus associated with the stock options are recorded as share capital. If stock or stock options are repurchased, the excess of the consideration paid over the carrying amount of the stock or stock option cancelled is charged to retained earnings (deficit). The Corporation estimates a forfeiture rate and adjusts the corresponding expense each period based on an updated forfeiture estimate.

New pronouncements adopted

June 30, 2011 is Epsilon's second reporting period under IFRS. Accounting standards effective for periods beginning on or after January 1, 2011 have been adopted as part of the transition to IFRS.

Application of new and revised International Financial Reporting Standards (IFRSs) issued but not yet effective

Epsilon has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Corporation:

As of January 1, 2013, Epsilon will be required to adopt IFRS 9 "Financial Instruments", which is the result of the first phase of the International Accounting Standards Board ("IASB") project to replace IAS 39 "Financial Instruments: Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. Portions of the standard remain in development and the full impact of the standard on Epsilon's Consolidated Financial Statements will not be known until the project is complete.

In May 2011, the IASB released the following new standards: IFRS 10, "Consolidated Financial Statements", IFRS 11, "Joint Arrangements", IFRS 12, "Disclosures of interests in other entities" and IFRS 13, "Fair Value Measurement". Each of these standards is to be adopted for fiscal years beginning January 1, 2013 with earlier adoption permitted. A brief description of each new standard follows below:

- IFRS 10, "Consolidated Financial Statements" supersedes IAS 27 "Consolidation and Separate Financial Statements" and SIC-12 "Consolidation – Special Purpose Entities". This standard provides a single model to be applied in control analysis for all investees including special purpose entities.
- IFRS 11, "Joint Arrangements" divides joint arrangements into two types, joint operations and joint ventures, each with their own accounting model. All joint arrangements are required to be reassessed on transition to IFRS 11 to determine their type to apply the appropriate accounting.
- IFRS 12, "Disclosure of Interests in Other Entities" combines in a single standard the disclosure requirements for subsidiaries, associates and joint arrangements as well as unconsolidated structured entities.
- IFRS 13, "Fair Value Measurement" defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. This standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Epsilon is currently analysing the expected impact, if any, that the adoption of each of these standards will have on its Consolidated Financial Statements.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

4. Management's Critical Accounting Judgments and Key Sources of Estimation Uncertainty

In the application of the Corporation's accounting policies, which are described in Note 3, management is required to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the interim financial statements and reported amounts of revenues and expenses during the period. Accordingly, actual results may differ from estimated results.

While management believes that its estimates have been reasonable in the circumstances, the volatility in the price of oil and natural gas, the recession in Canada and the slowdown of economic growth in the rest of the world have created a substantially more volatile business environment. These conditions will limit certain of the Corporation's previously planned business development activities and they will continue to present future risks. To prepare these interim financial statements, management has recorded adjustments and included disclosures based on their best estimates of projected business activity and future cash flows.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical accounting judgments

(a) Estimation of reserves

Engineering estimates of the Corporation's oil and natural gas reserves are inherently uncertain. Proved reserves are the estimated volumes of crude oil, natural gas and gas condensates, liquids and associated substances which geological and engineering data demonstrate that can be economically producible with reasonable certainty from known reservoirs under existing economic conditions and operating methods. Although there are authoritative guidelines regarding the engineering criteria that must be met before estimated oil and natural gas reserves can be designated as "proved", the accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. Field reserves will only be categorized as proved when all the criteria for attribution of proved status have been met. At this stage, all booked reserves will be classified as proved undeveloped. Volumes will subsequently be reclassified from proved undeveloped to proved developed as a consequence of development activity. The first proved developed bookings will occur at the point of first oil or natural gas production. Epsilon reassesses its estimate of proved reserves periodically. The estimated proved reserves of oil and natural gas may be subject to future revision and upward and downward revision may be made to the initial booking of reserves due to production, reservoir performance, commercial factors, acquisition and divestment activity and additional reservoir development activity. In particular, changes in oil and natural gas prices could impact the amount of Epsilon's proved reserves in regards to the initial estimate and, in the case of production-sharing agreements and buy-back contracts, the share of production and reserves to which Epsilon is entitled. Accordingly, the estimated reserves could be materially different from the quantities of oil and natural gas that ultimately will be recovered. Oil and natural gas reserves have a direct impact on certain amounts reported in the consolidated financial statements. Estimated proved reserves are used in determining depletion, depreciation and amortization expenses and impairment expense. Depletion rates on oil and natural gas assets using the unit-of-production basis are determined from the ratio between the amount of hydrocarbons extracted in the quarter and proved developed reserves existing at the end of the quarter increased by the amounts extracted during the quarter.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

4. Management's Critical Accounting Judgments and Key Sources of Estimation Uncertainty (continued)

(a) Estimation of reserves (continued)

Assuming all other variables are held constant, an increase in estimated proved developed reserves for each field decreases depletion, depreciation, and amortization expense. Conversely, a decrease in estimated proved developed reserves increases depletion, depreciation, and amortization expense. In addition, estimated proved reserves are used to calculate future cash flows from oil and natural gas properties, which serve as an indicator in determining whether or not property impairment is to be carried out. The larger the volume of estimated reserves, the lower the likelihood of asset impairment.

(b) Impairments

The estimated future level of production is based on assumptions concerning: future commodity prices, lifting and development costs, field decline rates, market demand and supply, economic regulatory climates and other factors. Oil, natural gas and petroleum product prices used to quantify the expected future cash flows are estimated based on forward prices prevailing in the marketplace for the first year and management's long-term planning assumptions thereafter. The estimate of the future amount of production is based on assumptions related to the commodity future prices, lifting and development costs, market demand and other factors. The discount rate reflects the current market valuation of the time value of money and of the specific risks of the asset not reflected in the estimate of the future cash flows.

Determination as to whether and how much an asset is impaired involves management estimates on highly uncertain matters such as future commodity prices, the effects of inflation and technology improvements on operating expenses, production profiles and the outlook for global or regional market supply and demand conditions for crude oil, natural gas, commodity chemicals and refined products.

(c) Depletion, depreciation and amortization

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment, the liability for retirement obligations and the amount recorded for deferred income taxes are based on estimates. The impairment test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, estimates of reserves and the related future cash flows are subject to measurement uncertainty and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

(d) Asset retirement obligations

The calculation of decommissioning liabilities includes estimates of the future costs to settle the asset retirement obligation, the timing of the settlement of the obligation and the future interest rates. The impact of differences between actual and estimated costs, timing and inflation on the consolidated financial statements of future periods could be material.

(e) Future revenues and operating costs

Due to the volatile nature of oil and natural gas exploration, development, and production activities, there are numerous uncertainties with respect to projecting future revenues and operating costs, which are integral components of future net income projections. These uncertainties include such items as production levels, capital expenditure levels, oil and natural gas commodity prices, reserve estimates, and lease operating costs.

(f) Identification of cash-generating units ("CGU's")

Management reviews the CGU determination on a periodic basis. The recoverability of property and equipment carrying values are assessed at the CGU level. Determination of what constitutes a CGU is subject to management judgments. The asset composition of a CGU can directly impact the recoverability of the assets within.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

**4. Management's Critical Accounting Judgments and Key Sources of Estimation Uncertainty
(continued)**

Key sources of estimation uncertainty

The following are the key assumptions concerning the key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing adjustments to the carrying amounts of assets and liabilities within the next financial year.

- a) Estimates of recoverable quantities of proved and probable reserves include judgmental assumptions and the economic, geological and technical factors used to estimate reserves may change from period to period
- b) Forward price estimates of the oil and natural gas prices are used in the impairment model. Commodity prices have fluctuated widely in recent years due to global and regional factors including supply and demand fundamentals, inventory levels, weather, economic and geopolitical factors.
- c) The impairment model uses discount rate to calculate the net present value of cash flows based on weighted average cost of capital estimates. Changes in the general economic environment could result in significant changes in this estimate.
- d) Amounts recorded from joint venture partners are based on the Corporation's interpretation of underlying agreements and may be subject to joint approval. The Corporation has recorded balances due from its joint venture partners based on costs incurred and its interpretation of allowable expenditures. Any adjustment required as a result of joint venture audits are recorded in the period of settlement with joint venture partners.
- e) The provision for site restoration and abandonment is based on current legal and constructive requirements, technology, price levels and expected plans for remediation. Actual costs and cash outflows can differ from estimates because of changes in laws and regulations, public expectations, prices and discovery and analysis of site conditions and changes in clean-up technology.

The above judgments, estimates and assumptions relate primarily to unsettled transactions and events as of the date of the interim financial statements. Actual results could differ from these estimates and the differences could be material.

Impairment tests carried out at June 30, 2011 were based on the commodity price estimates as disclosed in the consolidated financial statements for the years ended December 31, 2010 and 2009. A 1% increase in the discount rate and a 5% decrease in the forward curve would not result in any additional impairment.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS

The following discussion explains the significant differences between Epsilon's Canadian GAAP accounting policies and those applied by the Corporation under IFRS. IFRS policies have been retrospectively and consistently applied except where specific IFRS 1 optional and mandatory exemptions permitted an alternative treatment upon transition to IFRS for first-time adopters.

Canadian GAAP differs in certain respects from IFRS and comparative information as at January 1, 2010, as at and for the three and six months ended June 30, 2010, and as at and for the twelve months ended December 31, 2010, has been restated as necessary in accordance with IFRS. Reconciliations and descriptions of the effect of the transition from Canadian GAAP to IFRS on equity and income are given below, including a description of the nature of the changes in accounting policies. As part of Epsilon's adoption of IFRS, the following elections were made under IFRS 1 "First-time Adoption of International Financial Reporting Standards" as at January 1, 2010:

- (a) IAS 21 was applied prospectively to eliminate cumulative currency translation differences by transfer to deficit.
- (b) Business combinations prior to transition date have not been restated.
- (c) Net property and equipment were recorded at historical cost using the oil and gas deemed cost exemption.

The remaining IFRS 1 exemptions were not applicable or material to the preparation of Epsilon's consolidated balance sheet at the date of transition to IFRS on January 1, 2010.

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

IFRS Adjustments

(a) Exploration and evaluation assets and expenses

Exploration and evaluation assets at January 1, 2010 were deemed to be \$20,099,107 including \$16,748,727 in the US, \$1,009,423 in Canada, \$2,340,957 in Ethiopia and the Middle East, representing the unproved properties balance under Canadian GAAP. This resulted in a reclassification of \$20,099,107 from property and equipment to exploration and evaluation assets on Epsilon's consolidated balance sheet as at January 1, 2010.

Under IFRS, joint venture partner's drilling expenditures made on behalf of Epsilon have been capitalized to the Corporation's cost pool and allocated between exploration and evaluation assets and development costs. Expenditures classified as development costs have been amortized on a unit of production basis. The exploration and evaluation assets have been tested for impairment. At June 30, 2010 and December 31, 2010, there has been no impairment of these assets. Epsilon's share of the lease operating expenses has also been recorded as an operating cost to the Corporation as these are additional payments that the joint venture partner is making on Epsilon's behalf as part of carried interest. The exploration and evaluation assets and the lease operating expenses have previously been excluded from the Corporation's financial reporting under Canadian GAAP.

As a result of the application of IFRS to the joint venture assets, Epsilon capitalized additional assets totalling \$5,101,337 and \$20,780,114 at June 30, 2010 and December 31, 2010 respectively, which were originally classified as E&E assets. The offsetting amount at June 30, 2010 of \$5,548,391 (December 31, 2010: \$21,469,603) was recorded as deferred farmout proceeds, where the balance accumulates until conditions for the disposal of the property subject to the joint operating agreement are met. As a result of the application of IFRS to the joint venture lease operating expenditures, Epsilon expensed additional \$351,581, \$447,054 and \$689,489 for the three and six months ended June 30, 2010 and December 31, 2010, respectively, which reduced the Corporation's previously reported Canadian GAAP income by the same amount for these reporting periods.

As at December 31, 2010, the Corporation's exploration and evaluation assets were \$41,282,688 including \$35,325,005 in the US, \$3,569,122 in Canada and \$2,388,561 in Ethiopia. The exploration and evaluation assets in the Middle East in the amount of \$246,920 were written off during the twelve months ended December 31, 2010.

Under Canadian GAAP, exploration and evaluation costs were capitalized as property and equipment in accordance with the CICA's full cost accounting guidelines. Under IFRS, Epsilon capitalizes these costs initially as exploration and evaluation assets. Once technical feasibility and commercial viability of the area has been determined, the capitalized costs are transferred from exploration and evaluation assets to property and equipment. Under IFRS, unrecoverable exploration and evaluation costs associated with an area and costs incurred prior to obtaining the legal rights to explore are expensed.

During the three and six months ended June 30, 2010, and twelve months ended December 31, 2010, Epsilon transferred \$nil of capitalized exploration and evaluation costs to property and equipment. During the same periods Epsilon expensed \$263,338, \$263,338 and \$328,004 of previously capitalized pre-acquisition costs and \$27,000, \$27,000 and \$51,769 previously capitalized salaries incurred prior to obtaining legal title to explore. The application of IFRS to exploration and evaluation costs resulted in a decrease of \$290,338, \$290,338 and \$379,773 to Epsilon's Canadian GAAP net earnings for the three and six months ended June 30, 2010 and December 31, 2010, respectively.

As at the date of transition, the Corporation tested all of its CGUs for impairment. The recoverable amount of each CGU was estimated based on the higher of the value in use and the fair value less costs to sell. The fair value less costs to sell was determined using discounted proved forecasted cash flows, with escalating prices and future development costs, as obtained from the Corporation's reserve report. Based on the above assessment, there were no adjustments to the carrying amounts of exploration and evaluation assets at January 1, 2010.

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

(b) Depletion, depreciation and amortization (“DD&A”)

Net development costs at January 1, 2010 were deemed to be \$46,591,967, representing the full cost pool balance under Canadian GAAP. Consistent with Canadian GAAP, these costs are capitalized as property and equipment under IFRS. Under Canadian GAAP, development costs, whose life is equal to the lifetime of the field, were depleted using the unit-of-production method calculated at the established area level consistent with IFRS, with \$nil effect on the DD&A expense and net earnings for the twelve months ended December 31, 2010.

The development costs whose useful life is shorter than the lifetime of the field were depreciated using a straight – line basis over the remaining useful life of the assets. The application of IFRS to development costs resulted in an increase of \$31,217, \$92,815 and \$110,972 to Epsilon’s Canadian GAAP net earnings for the three and six months ended June 30, 2010 and December 31, 2010, respectively.

The IFRS 1 exemption permitted the Corporation to allocate development costs to the area level using proved reserves values for each cash generating unit as at January 1, 2010.

(c) Asset retirement obligation (“ARO”)

Under Canadian GAAP, the asset retirement obligation was measured as the estimated fair value of the retirement and decommissioning expenditures expected to be incurred. Liabilities were not remeasured to reflect period end discount rates.

Under IFRS, the asset retirement obligation is measured as the best estimate of the expenditure to be incurred and requires that the asset retirement obligation be remeasured using the period-end risk free discount rate.

Epsilon was required to remeasure its asset retirement obligation upon transition to IFRS and recognize the difference in retained earnings. The application of this exemption resulted in a \$6,225 increase to the asset retirement obligation on Epsilon’s consolidated balance sheet as at January 1, 2010, and an after-tax offset to retained earnings of \$6,225. Subsequent IFRS remeasurements of the obligation are recorded through property and equipment with an offsetting adjustment to the asset retirement obligation. As at June 30, 2010 and December 31, 2010, Epsilon's asset retirement obligation increased by \$38,291 and \$98,227, respectively, which primarily reflects the remeasurement of the obligation using Epsilon's risk free discount rate of 3.79 percent as at June 30, 2010 and 3.56 percent at December 31, 2010. The increase to asset retirement accretion at June 30, 2010 and December 31, 2010 was immaterial.

(d) Foreign currency translation adjustment

As permitted by IFRS 1, the Corporation elected to apply the exemption to set the cumulative foreign currency translation adjustment to zero upon transition to IFRS. Accordingly, \$6,876,926 was recognized as an adjustment to deficit on January 1, 2010. The reclassification had no impact on total shareholders’ equity as at January 1, 2010. As a result of the election, the accounts of the Corporation have not been retrospectively restated using IFRS foreign currency principles.

The IFRS adjustments discussed above are recorded in the Corporation’s functional currency and are subject to translation for presentation purposes. The associated foreign currency impacts are reported in accumulated other comprehensive income.

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

IFRS Opening Consolidated Balance Sheet as at January 1, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 15,288,547	-	-	-	-	\$ 15,288,547
Accounts receivable	1,488,429	-	-	-	-	1,488,429
Assets held for sale	100,000	-	-	-	-	100,000
Other current assets	62,382	-	-	-	-	62,382
TOTAL CURRENT ASSETS	16,939,358	-	-	-	-	16,939,358
Oil and gas interests:						
Intangible exploration and evaluation assets (Note 6)	-	20,099,107	-	-	-	20,099,107
Net property and equipment (Note 7)	66,691,074	(20,099,107)	-	-	-	46,591,967
Total oil and gas interests	66,691,074	-	-	-	-	66,691,074
Other assets:						
Restricted cash (Note 8)	732,240	-	-	-	-	732,240
Other deferred charges and miscellaneous assets	18,504	-	-	-	-	18,504
Total other assets	750,744	-	-	-	-	750,744
Total assets	84,381,176	-	-	-	-	84,381,176
LIABILITIES AND SHAREHOLDERS' EQUITY						
Current liabilities:						
Accounts payable and accrued liabilities	3,460,740	-	-	-	-	3,460,740
Total current liabilities	3,460,740	-	-	-	-	3,460,740
Other liabilities:						
Asset retirement obligations (Note 9)	214,393	-	-	6,225	-	220,618
Total liabilities	3,675,133	-	-	6,225	-	3,681,358
Shareholders' equity:						
Share capital (Note 10)	138,272,250	-	-	-	-	138,272,250
Contributed surplus (Note 10)	6,098,296	-	-	-	-	6,098,296
Deficit	(56,787,577)	-	-	(6,225)	(6,876,926)	(63,670,728)
Accumulated other comprehensive loss	(6,876,926)	-	-	-	6,876,926	-
Sub total	80,706,043	-	-	(6,225)	-	80,699,818
Total shareholders' equity	80,706,043	-	-	(6,225)	-	80,699,818
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 84,381,176	-	-	-	-	\$ 84,381,176

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Balance Sheet as at June 30, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 15,522,564	-	-	-	-	\$ 15,522,564
Accounts receivable	2,832,727	-	-	-	-	2,832,727
Assets held for sale	100,000	-	-	-	-	100,000
Other current assets	52,826	-	-	-	-	52,826
TOTAL CURRENT ASSETS	18,508,117	-	-	-	-	18,508,117
Oil and gas interests:						
Intangible exploration and evaluation assets	-	29,433,212	-	-	-	29,433,212
Net property and equipment	62,866,747	(24,632,191)	92,815	35,961	-	38,363,332
Total oil and gas interests	62,866,747	4,801,021	92,815	35,961	-	67,796,544
Other assets:						
Restricted cash	932,940	-	-	-	-	932,940
Other deferred charges and miscellaneous assets	10,754	-	-	-	-	10,754
Total other assets	943,694	-	-	-	-	943,694
Total assets	82,318,558	4,801,021	92,815	35,961	-	87,248,355
LIABILITIES AND SHAREHOLDERS' EQUITY						
Current liabilities:						
Accounts payable and accrued liabilities	1,925,802	-	-	-	-	1,925,802
Total current liabilities	1,925,802	-	-	-	-	1,925,802
Other liabilities:						
Asset retirement obligations	166,904	-	-	38,291	-	205,195
Deferred farmout proceeds	-	5,548,391	-	-	-	5,548,391
Total other liabilities	166,904	5,548,391	-	38,291	-	5,753,586
Total liabilities	2,092,706	5,548,391	-	38,291	-	7,679,388
Shareholders' equity:						
Share capital	136,055,330	-	-	-	-	136,055,330
Contributed surplus	6,666,003	-	-	-	-	6,666,003
Deficit	(55,746,924)	(737,392)	92,815	(12,308)	(6,876,926)	(63,280,735)
Accumulated other comprehensive loss	(6,748,557)	-	-	-	6,876,926	128,369
Sub total	80,225,852	(737,392)	92,815	(12,308)	-	79,568,967
Total shareholders' equity	80,225,852	(737,392)	92,815	(12,308)	-	79,568,967
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 82,318,558	4,810,999	92,815	25,983	-	\$ 87,248,355

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Balance Sheet as at December 31, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 18,670,574	-	-	-	-	\$ 18,670,574
Accounts receivable	2,746,406	-	-	-	-	2,746,406
Restricted cash - current	-	-	-	-	-	598,036
Other current assets	209,079	-	-	-	-	209,079
TOTAL CURRENT ASSETS	21,626,059	-	-	-	-	22,224,095
Oil and gas interests:						
Intangible exploration and evaluation assets (Note 6)	-	41,282,688	-	-	-	41,282,688
Net property and equipment (Note 7)	63,308,624	(20,880,585)	109,213	90,239	-	42,627,491
Total oil and gas interests	63,308,624	20,402,103	109,213	90,239	-	83,910,179
Other assets:						
Restricted cash (Note 8)	840,060	-	-	-	-	242,024
Other deferred charges and miscellaneous assets	8,010	-	-	-	-	8,010
Total other assets	848,070	-	-	-	-	250,034
Total assets	85,782,753	20,402,103	109,213	90,239	-	106,384,308
LIABILITIES AND SHAREHOLDERS' EQUITY						
Current liabilities:						
Accounts payable and accrued liabilities	2,196,966	-	-	-	-	2,196,966
Total current liabilities	2,196,966	-	-	-	-	2,196,966
Other liabilities:						
Asset retirement obligations (Note 9)	249,111	-	-	98,227	-	347,338
Deferred farmout proceeds (Note 5 (a))	-	21,469,603	-	-	-	21,469,603
	249,111	21,469,603	-	98,227	-	21,816,941
Total liabilities	2,446,077	21,469,603	-	98,227	-	24,013,907
Shareholders' equity:						
Share capital (Note 10)	136,001,220	-	-	-	-	136,001,220
Contributed surplus (Note 10)	6,323,776	-	-	-	-	6,323,776
Deficit	(52,760,254)	(1,067,500)	109,213	(7,988)	(6,876,926)	(60,603,455)
Accumulated other comprehensive loss	(6,228,066)	-	-	-	6,876,926	648,860
Sub total	83,336,676	(1,067,500)	109,213	(7,988)	-	82,370,401
Total shareholders' equity	83,336,676	(1,067,500)	109,213	(7,988)	-	82,370,401
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 85,782,753	(1,067,500)	109,213	90,239	-	\$106,384,308

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Statement of Earnings and Deficit for the Three Months Ended June 30, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Revenues:						
Oil & gas revenues	\$ 3,869,425	-	-	-	-	\$ 3,869,425
Total revenues	3,869,425	-	-	-	-	3,869,425
Operating costs and expenses:						
Project operating costs	440,595	351,581	-	-	-	792,176
Depletion, depreciation and amortization	1,354,207	-	(31,217)	-	-	1,322,990
Exploration & Evaluation	-	263,339	-	-	-	263,339
Asset retirement accretion	2,004	-	-	(235)	-	1,769
General and administrative	1,104,835	27,000	-	-	-	1,131,835
Total operating costs and expenses	2,901,641	641,920	(31,217)	(235)	-	3,512,109
Operating income	967,784	(641,920)	31,217	235	-	357,316
Other income:						
Other income	22,596	-	-	-	-	22,596
Total other income	22,596	-	-	-	-	22,596
Net income	\$ 990,380	(641,920)	31,217	235	-	\$ 379,912
Deficit, beginning of period	\$ (56,737,304)	(95,472)	61,598	(12,543)	(6,876,926)	\$ (63,660,647)
Deficit, end of period	\$ (55,746,924)	(641,920)	31,217	(12,308)	(6,876,926)	\$ (63,280,735)
Weighted average number of shares outstanding, basic	49,840,185	-	-	-	-	49,840,185
Weighted average number of shares outstanding, diluted	51,175,431	-	-	-	-	51,175,431
Net income (loss) per share, basic	\$ 0.02	-	-	-	-	\$ 0.01
Net income (loss) per share, diluted	\$ 0.02	-	-	-	-	\$ 0.01

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Statement of Earnings and Deficit for the Six Months Ended June 30, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Revenues:						
Oil & gas revenues	\$ 7,865,549	-	-	-	-	\$ 7,865,549
Total revenues	7,865,549	-	-	-	-	7,865,549
Operating costs and expenses:						
Project operating costs	867,372	447,054	-	-	-	1,314,426
Impairment of unproved properties	33,255	-	-	-	-	33,255
Depletion, depreciation and amortization	2,898,341	-	(92,815)	-	-	2,805,526
Exploration & evaluation	-	263,338	-	-	-	263,338
Asset retirement accretion	1,504	-	-	6,083	-	7,587
General and administrative	3,064,875	27,000	-	-	-	3,091,875
Total operating costs and expenses	6,865,347	737,392	(92,815)	6,083	-	7,516,007
Operating income	1,000,202	(737,392)	92,815	(6,083)	-	349,542
Other income:						
Other income	40,451	-	-	-	-	40,451
Total other income	40,451	-	-	-	-	40,451
Net income	\$ 1,040,653	(737,392)	92,815	(6,083)	-	\$ 389,993
Deficit, beginning of period	\$ (56,787,577)	-	-	(6,225)	(6,876,926)	\$ (63,670,728)
Deficit, end of period	\$ (55,746,924)	(737,392)	92,815	(12,308)	(6,876,926)	\$ (63,280,735)
Weighted average number of shares outstanding, basic	50,186,169	-	-	-	-	50,186,169
Weighted average number of shares outstanding, diluted	51,521,415	-	-	-	-	51,521,415
Net income (loss) per share, basic	\$ 0.02	-	-	-	-	\$ 0.01
Net income (loss) per share, diluted	\$ 0.02	-	-	-	-	\$ 0.01

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Statement of Earnings for the Twelve Months Ended December 31, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Revenues:						
Oil & gas revenues	\$ 14,753,440	-	-	-	-	\$ 14,753,440
Total revenues	14,753,440	-	-	-	-	14,753,440
Operating costs and expenses:						
Project operating costs	1,485,215	689,489	-	-	-	2,174,704
Impairment of unproved properties	296,423	-	-	-	-	296,423
Depletion, depreciation and amortization	4,849,615	-	(110,972)	-	-	4,738,643
Exploration and evaluation	-	328,003	-	-	-	328,003
Asset retirement accretion	70,555	-	-	1,761	-	72,316
General and administrative	4,077,536	51,769	-	-	-	4,129,305
Total operating costs and expenses	10,779,344	1,069,261	(110,972)	1,761	-	11,739,394
Operating income	3,974,096	(1,069,261)	110,972	(1,761)	-	3,014,046
Other income:						
(Loss) on sale of assets	(34,513)	-	-	-	-	(34,513)
Other income	87,740	-	-	-	-	87,740
Total other income	53,227	-	-	-	-	53,227
Net income	\$ 4,027,323	(1,069,261)	110,972	(1,761)	-	\$ 3,067,273
Deficit, beginning of period	\$ (56,787,577)	-	-	(6,225)	(6,876,926)	\$ (63,670,728)
Deficit, end of period	\$ (52,760,254)	(1,069,261)	110,972	(7,986)	(6,876,926)	\$ (60,603,455)
Weighted average number of shares						
outstanding, basic	49,953,148	-	-	-	-	49,953,148
outstanding, diluted	51,177,139	-	-	-	-	51,177,139
Net income (loss) per share, basic	\$ 0.08	-	-	-	-	\$ 0.06
Net income (loss) per share, diluted	\$ 0.08	-	-	-	-	\$ 0.06

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Cash Flows for the six months ended June 30, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Cash flows from operating activities:						
Net income for the year	\$ 1,040,653	(737,392)	92,815	(6,083)	-	\$ 389,993
Items not affecting cash:						
Depletion, depreciation and amortization	2,898,341	-	(92,815)	-	-	2,805,526
Asset retirement accretion	1,504	-	-	6,083	-	7,587
Impairment of unproved properties	33,255	-	-	-	-	33,255
Loss on sale of assets	-	-	-	-	-	-
Stock-based compensation	502,951	-	-	-	-	502,951
Changes in non-cash balances related to operations	(15,892)	-	-	-	-	(15,892)
Net cash provided by operating activities	4,460,812	(737,392)	-	-	-	3,723,420
Cash flows from investing activities:						
Additions to oil and natural gas properties	(7,036,316)	737,392	-	-	-	(6,298,924)
Additions to other property and equipment	-	-	-	-	-	-
Proceeds from the farmout agreement	5,000,000	-	-	-	-	5,000,000
Proceeds from assets sold	-	-	-	-	-	-
Changes in restricted cash	(200,700)	-	-	-	-	(200,700)
Proceeds from assets held for sale	-	-	-	-	-	-
Net cash (used in) investing activities	(2,237,016)	737,392	-	-	-	(1,499,624)
Cash flows from financing activities:						
Proceeds from options exercised	317,085	-	-	-	-	317,085
Common share buy back	(2,469,250)	-	-	-	-	(2,469,250)
Net cash (used in) financing activities	(2,152,165)	-	-	-	-	(2,152,165)
Effect of currency rates on cash and cash equivalents	162,386	-	-	-	-	162,386
Increase in cash and cash equivalents	234,017	-	-	-	-	234,017
Cash and cash equivalents, beginning of period	15,288,547	-	-	-	-	15,288,547
Cash and cash equivalents, end of period	\$ 15,522,564	-	-	-	-	\$ 15,522,564
Cash and cash equivalents consist of:						
Cash	\$ 1,432,088	-	-	-	-	\$ 1,432,088
Money market funds	13,825,313	-	-	-	-	13,825,313
Interest bearing short-term deposits	265,163	-	-	-	-	265,163
Cash and cash equivalents	\$ 15,522,564	-	-	-	-	\$ 15,522,564
Non-cash transactions:						
Increase to asset retirement obligation						\$ (14,609)
Additions to oil and natural gas interests						\$ 447,054

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Cash Flows for the twelve months ended December 31, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Cash flows from operating activities:						
Net income for the year	\$ 4,027,323	(1,069,261)	110,972	(1,761)	-	\$ 3,067,274
Items not affecting cash:						
Depletion, depreciation and amortization	4,847,856	-	(110,972)	-	-	4,736,884
Asset retirement accretion	72,314	-	-	1,761	-	74,075
Impairment of unproved properties	296,423	-	-	-	-	296,423
Loss on sale of assets	34,513	-	-	-	-	34,513
Stock-based compensation	262,983	-	-	-	-	262,983
Changes in non-cash balances related to operations	(394,179)	-	-	-	-	(394,179)
Net cash provided by operating activities	9,147,233	(1,069,261)	-	-	-	8,077,973
Cash flows from investing activities:						
Additions to oil and natural gas properties	(8,908,993)	1,069,261	-	-	-	(7,839,733)
Additions to other property and equipment	(5,423)	-	-	-	-	(5,423)
Proceeds from the farmout agreement	5,000,000	-	-	-	-	5,000,000
Proceeds from assets sold	26,700	-	-	-	-	26,700
Changes in restricted cash	(107,820)	-	-	-	-	(107,820)
Proceeds from assets held for sale	100,000	-	-	-	-	100,000
Net cash (used in) investing activities	(3,895,536)	1,069,261	-	-	-	(2,826,276)
Cash flows from financing activities:						
Proceeds from options exercised	488,119	-	-	-	-	488,119
Common share buy back	(2,796,654)	-	-	-	-	(2,796,654)
Net cash (used in) financing activities	(2,308,535)	-	-	-	-	(2,308,535)
Effect of currency rates on cash and cash equivalents	438,865	-	-	-	-	438,865
Increase in cash and cash equivalents	3,382,027	-	-	-	-	3,382,027
Cash and cash equivalents, beginning of period	15,288,547	-	-	-	-	15,288,547
Cash and cash equivalents, end of period	\$ 18,670,574	-	-	-	-	\$ 18,670,574
Cash and cash equivalents consist of:						
Cash	\$ 4,264,286	-	-	-	-	\$ 4,264,286
Money market funds	14,406,288	-	-	-	-	14,406,288
Cash and cash equivalents	\$ 18,670,574	-	-	-	-	\$ 18,670,574
Non-cash transactions:						
Increase to asset retirement obligation						\$ 90,239
Additions to oil and natural gas interests						\$ 14,157,626

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Comprehensive Income and Accumulated Other Comprehensive Income for the three months ended June 30, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E	DD&A	ARO	Foreign currency translation adjustment	
		Note 5 (a)	Note 5 (b)	Note 5 (c)	Note 5 (d)	
Comprehensive income:						
Net Income	\$ 990,380	(641,920)	31,217	235	-	\$ 379,912
Other comprehensive income:						
Currency translation adjustments	(304,869)	-	-	-	-	(304,869)
Comprehensive income	\$ 685,511	(641,920)	31,217	235	-	\$ 75,043
Accumulated other comprehensive income:						
Balance, beginning of period	\$ (6,443,688)	-	-	-	6,876,926	\$ 433,238
Currency translation adjustments	(304,869)	-	-	-	-	(304,869)
Balance, end of period	\$ (6,748,557)	-	-	-	6,876,926	\$ 128,369

Consolidated Comprehensive Income and Accumulated Other Comprehensive Income for the six months ended June 30, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E	DD&A	ARO	Foreign currency translation adjustment	
		Note 5 (a)	Note 5 (b)	Note 5 (c)	Note 5 (d)	
Comprehensive income:						
Net Income	\$ 1,040,653	(737,392)	92,815	(6,083)	-	\$ 389,993
Other comprehensive income:						
Currency translation adjustments	128,369	-	-	-	-	128,369
Comprehensive income	\$ 1,169,022	(737,392)	92,815	(6,083)	-	\$ 518,362
Accumulated other comprehensive income:						
Balance, beginning of period	\$ (6,876,926)	-	-	-	6,876,926	\$ -
Currency translation adjustments	128,369	-	-	-	-	128,369
Balance, end of period	\$ (6,748,557)	-	-	-	6,876,926	\$ 128,369

Epsilon Energy Ltd.**Notes to the Interim Unaudited Condensed Consolidated Financial Statements***For the three and six months ended June 30, 2011 and 2010***5. Reconciliation from Canadian GAAP to IFRS (continued)***Consolidated Comprehensive Income and Accumulated Other Comprehensive Income for the twelve months ended December 31, 2010*

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Comprehensive income:						
Net Income	\$ 4,027,323	(1,069,261)	110,972	(1,761)	-	\$ 3,067,273
Other comprehensive income:						
Currency translation adjustments	648,860	-	-	-	-	648,860
Comprehensive income	\$ 4,676,183	(1,069,261)	110,972	(1,761)	-	\$ 3,716,133
Accumulated other comprehensive income:						
Balance, beginning of period	\$ (6,876,926)	-	-	-	6,876,926	\$ -
Currency translation adjustments	648,860	-	-	-	-	648,860
Balance, end of period	\$ (6,228,066)	-	-	-	6,876,926	\$ 648,860

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Statement of Changes in Shareholders' Equity as at January 1, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Share capital:						
Balance, beginning of period	\$ 138,272,250	-	-	-	-	\$ 138,272,250
Exercise of stock options	-	-	-	-	-	-
Balance, end of period	<u>\$138,272,250</u>	-	-	-	-	<u>\$138,272,250</u>
Contributed surplus:						
Balance, beginning of period	\$ 6,098,296	-	-	-	-	\$ 6,098,296
Stock options amortized, granted, exercised & forfeited	-	-	-	-	-	-
Balance, end of period	<u>\$ 6,098,296</u>	-	-	-	-	<u>\$ 6,098,296</u>
Deficit						
Balance, beginning of period	\$ (56,787,577)	-	-	(6,225)	(6,876,926)	\$ (63,670,728)
Net Earnings	-	-	-	-	-	-
Balance, end of period	<u>\$ (56,787,577)</u>	-	-	<u>(6,225)</u>	<u>(6,876,926)</u>	<u>\$ (63,670,728)</u>
Accumulated other comprehensive income:						
Balance, beginning of period	\$ (6,876,926)	-	-	-	6,876,926	\$ -
Currency translation adjustments	-	-	-	-	-	-
Balance, end of period	<u>\$ (6,876,926)</u>	-	-	-	<u>6,876,926</u>	<u>\$ -</u>

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Statement of Changes in Shareholders' Equity for the six months ended June 30, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Share capital:						
Balance, beginning of period	\$ 138,272,250	-	-	-	-	\$ 138,272,250
Exercise of stock options, share repurchase	(2,216,920)	-	-	-	-	(2,216,920)
Balance, end of period	\$136,055,330	-	-	-	-	\$136,055,330
Contributed surplus:						
Balance, beginning of period	\$ 6,098,296	-	-	-	-	\$ 6,098,296
Stock options amortized, granted, exercised & forfeited	567,707	-	-	-	-	567,707
Balance, end of period	\$ 6,666,003	-	-	-	-	\$ 6,666,003
Deficit						
Balance, beginning of period	\$ (56,787,577)	-	-	(6,225)	(6,876,926)	\$ (63,670,728)
Net Earnings	1,040,653	(737,392)	92,815	(6,083)	-	389,993
Balance, end of period	\$ (55,746,924)	(737,392)	92,815	(12,308)	(6,876,926)	\$ (63,280,735)
Accumulated other comprehensive income:						
Balance, beginning of period	\$ (6,876,926)	-	-	-	6,876,926	\$ -
Currency translation adjustments	128,369	-	-	-	-	128,369
Balance, end of period	\$ (6,748,557)	-	-	-	6,876,926	\$ 128,369

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

5. Reconciliation from Canadian GAAP to IFRS (continued)

Consolidated Statement of Changes in Shareholders' Equity for the twelve months ended December 31, 2010

	IFRS Adjustments					IFRS
	Previous GAAP	E&E Note 5 (a)	DD&A Note 5 (b)	ARO Note 5 (c)	Foreign currency translation adjustment Note 5 (d)	
Share capital:						
Balance, beginning of period	\$ 138,272,250	-	-	-	-	\$ 138,272,250
Exercise of stock options, share repurchase	(2,271,030)	-	-	-	-	(2,271,030)
Balance, end of period	\$136,001,220	-	-	-	-	\$136,001,220
Contributed surplus:						
Balance, beginning of period	\$ 6,098,296	-	-	-	-	\$ 6,098,296
Stock options amortized, granted, exercised & forfeited	225,480	-	-	-	-	225,480
Balance, end of period	\$ 6,323,776	-	-	-	-	\$ 6,323,776
Deficit						
Balance, beginning of period	\$ (56,787,577)	-	-	-	-	\$ (56,787,577)
Net Earnings	4,027,323	(1,069,261)	110,972	(7,986)	(6,876,926)	(3,815,878)
Balance, end of period	\$ (52,760,254)	(1,069,261)	110,972	(7,986)	(6,876,926)	\$ (60,603,455)
Accumulated other comprehensive income:						
Balance, beginning of period	\$ (6,876,926)	-	-	-	6,876,926	\$ -
Currency translation adjustments	648,860	-	-	-	-	648,860
Balance, end of period	\$ (6,228,066)	-	-	-	6,876,926	\$ 648,860

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

6. Intangible exploration and evaluation assets

The following table summarizes the Corporation's intangible exploration and evaluation assets as at June 30, 2011 and December 31, 2010:

	\$
Balance, January 1, 2010	20,099,107
Additions to exploration and evaluation assets	21,183,581
Impairments	-
Transfers to property and equipment	-
Balance, December 31, 2010	41,282,688
Balance, January 1, 2011	41,282,688
Additions to exploration and evaluation assets	2,383,610
Impairments	-
Transfers to property and equipment	-
Balance, March 31, 2011	43,666,298
Balance, April 1, 2011	43,666,298
Additions to exploration and evaluation assets	5,657,869
Impairments	(1,048,735)
Transfers to property and equipment	(18,441,752)
Balance, June 30, 2011	29,833,681

	June 30, 2011	December 31, 2010	June 30, 2010	January 1, 2010
Intangible exploration and evaluation assets				
United States	21,789,518	35,325,005	20,738,928	16,748,727
Canada	5,456,677	3,569,122	1,355,380	1,009,423
Ethiopia	2,587,485	2,388,561	2,537,883	2,340,957
Total	\$ 29,833,681	\$ 41,282,688	\$ 24,632,191	\$ 20,099,107

Epsilon Energy Ltd.
Notes to the Interim Unaudited Condensed Consolidated Financial Statements
For the three and six months ended June 30, 2011 and 2010

7. Property and Equipment

The following table summarizes the Corporation's oil and natural gas property and other equipment as at June 30, 2011 and December 31, 2010:

	\$
Cost	
Balance, January 1, 2010	46,591,967
Additions	1,148,428
Disposals	(16,627)
Transfers from E&E	-
Balance, December 31, 2010	47,723,768
Balance, January 1, 2011	47,723,768
Additions	8,226,159
Disposals	(94,572)
Transfers from E&E	-
Balance, March 31, 2011	55,855,355
Balance, April 1, 2011	55,855,355
Additions	22,461,891
Disposal on farmout asset	(13,884,444)
Transfers from E&E	18,441,752
Balance, June 30, 2011	82,874,554
Depletion, amortization and impairments	
Balance, January 1, 2010	-
Depletion and depreciation for the period	4,738,643
Impairment	296,423
Disposals	61,212
Balance, December 31, 2010	5,096,278
Balance, January 1, 2011	5,096,278
Depletion and depreciation for the period	832,288
Impairment	-
Disposals	5,601
Balance, March 31, 2011	5,934,167
Balance, April 1, 2011	5,934,167
Depletion and depreciation for the period	650,047
Impairment	-
Disposals	-
Balance, June 30, 2011	6,584,214
Carrying amounts	
At January 1, 2010	46,591,967
At December 31, 2010	42,627,490
At June 30, 2011	76,290,340

Epsilon Energy Ltd.

Notes to the Interim Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2011 and 2010

7. Property and Equipment (continued)

Capitalized General and Administrative Costs ("G&A")

Capitalized G&A costs consist of wages, travel and other G&A costs directly associated with specific capital projects. Capitalized G&A costs for each country cost center for the three and six months ended June 30, 2011 and 2010, December 31, 2010 and on transition date were as follows:

	Three months ended		Six months ended		December 31, 2010
	June 30,		June 30,		
	2011	2010	2011	2010	
Capitalized G&A Costs:					
United States	\$ 113,630	\$ 156,766	\$ 211,255	\$ 264,408	\$ 456,031
Canada	9,754	15,927	43,709	17,296	44,250
Yemen	-	-	-	-	-
Oman	-	-	-	-	-
Ethiopia	12,077	10,594	34,657	14,142	53,239
Other	-	6,000	-	17,117	17,117
Total	<u>\$ 135,461</u>	<u>\$ 189,287</u>	<u>\$ 289,621</u>	<u>\$ 312,963</u>	<u>\$ 570,637</u>

During period ended June 30, 2011, Chesapeake, Epsilon's joint venture partner in Pennsylvania, fulfilled its first earning period carry obligation benchmark by spending \$50.0 million in development costs on Epsilon's behalf in accordance to the executed Farmout Agreement. Epsilon derecognized 25% of its assets pertaining to the Farmout Agreement assignable to Chesapeake in the amount of \$13,884,444, and recognized a net gain on disposal of the assets for \$24,281,556.

8. Restricted Cash

	June 30, 2011	December 31, 2010	January 1, 2010
Restricted Cash:			
Current portion:			
Amegy Bank - letter of credits	\$ 140,000	\$ 200,000	\$ -
TD Bank – Yemen letter of credit	-	398,036	-
TD Bank – Ethiopia letter of credit	204,820	-	-
	<u>\$ 344,820</u>	<u>\$ 598,036</u>	<u>\$ -</u>
Long-term portion:			
Northwestern Bank	\$ -	\$ -	\$ 65,000
TD Bank – Yemen letter of credit	-	-	378,233
Amegy Bank - letter of credit	-	40,000	-
TD Bank – Ethiopia letter of credit	-	202,024	289,007
	<u>\$ -</u>	<u>\$ 242,024</u>	<u>\$ 732,240</u>

Epsilon Energy Ltd.**Notes to the Interim Unaudited Condensed Consolidated Financial Statements***For the three and six months ended June 30, 2011 and 2010***9. Asset Retirement Obligations**

	June 30, 2011	December 31, 2010	January 1, 2010
Balance, beginning	\$ 347,338	\$ 220,618	\$ 319,762
Liabilities incurred	10,094	-	-
Liabilities acquired	88,773	111,775	32,274
Change in estimates	-	(57,369)	(143,261)
Accretion expense	5,745	72,314	11,843
Balance, end	\$ 451,950	\$ 347,338	\$ 220,618

10. Shareholders' Equity*(a) Authorized shares*

The Corporation is authorized to issue an unlimited number of Common Shares with no par value and an unlimited number of Preferred Shares with no par value.

(b) Issued

The following table summarizes the components of share capital for the six months and year ended June 30, 2011 and December 31, 2010, respectively:

	Number of Shares Issued	Amount
Balance at December 31, 2009	50,325,998	\$ 138,272,250
Exercise of stock options	300,000	497,582
Buy back of shares	(1,125,000)	(3,068,482)
Exercise of stock options	215,254	299,870
Balance at December 31, 2010, and June 30, 2011	49,716,252	\$ 136,001,220

Epsilon Energy Ltd.
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10. Shareholders' Equity (continued)

(c) Stock Options

The following table summarizes stock option activity for the six months ended June 30, 2011 and the year ended December 31, 2010 (exercise price in Canadian dollar):

	As at June 30, 2011		As at December 31, 2010	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Stock Options Outstanding:				
Balance at beginning of period	1,920,491	\$ 2.43	3,017,727	\$ 2.35
Granted	821,740	\$ 3.58	700,000	\$ 2.84
Exercised	-	-	(515,254)	\$ 0.96
Forfeited	(125,000)	\$ 2.62	(1,281,982)	\$ 3.05
Balance at period-end	2,617,231	\$ 2.78	1,920,491	\$ 2.43
Exercisable at period-end	1,373,731	\$ 2.26	1,168,991	\$ 2.03

The average share price during the six months ended June 30, 2011 was \$3.72 (December 31, 2010: \$2.92).

The following table summarizes information about stock options outstanding at June 30, 2011 and December 31, 2010 (exercise price in Canadian dollars):

Exercise Price	Number of Options Outstanding	Number of Options Exercisable	Black-Scholes Option Pricing Model Valuation	Weighted Average Remaining Contractual Life (in years)
As at June 30, 2011:				
\$ 0.85	10,675	10,675	\$ 24,667	2.45
\$ 1.00	481,000	481,000	310,790	4.38
\$ 1.34	100,000	50,000	57,832	1.17
\$ 1.45	65,000	32,500	63,621	8.12
\$ 2.00	140,000	140,000	145,740	0.08
\$ 2.50	227,316	224,916	785,686	5.98
\$ 2.80	75,000	-	6,014	2.47
\$ 3.04	250,000	50,000	283,022	8.57
\$ 3.35	100,000	50,000	152,438	2.62
\$ 3.61	721,740	46,740	277,614	9.96
\$ 4.00	436,500	281,900	977,813	6.58
\$ 6.10	10,000	6,000	55,857	6.95
Total	2,617,231	1,373,731	\$ 3,141,094	6.45

Epsilon Energy Ltd.**Notes to the Interim Unaudited Condensed Consolidated Financial Statements***For the three and six months ended June 30, 2011 and 2010***10. Shareholders' Equity (continued)***(c) Stock Options (continued)*

<u>Exercise Price</u>	<u>Number of Options Outstanding</u>	<u>Number of Options Exercisable</u>	<u>Black-Scholes Option Pricing Model Valuation</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>
As at December 31, 2010:				
\$ 0.85	10,675	10,675	\$ 24,667	2.95
\$ 1.00	481,000	481,000	310,790	4.88
\$ 1.34	100,000	50,000	57,831	1.67
\$ 1.45	65,000	32,500	63,620	8.61
\$ 2.00	140,000	140,000	145,740	0.58
\$ 2.42	75,000	-	29,642	2.55
\$ 2.50	227,316	224,916	785,686	6.48
\$ 2.80	75,000	-	6,013	2.96
\$ 2.93	50,000	-	49,013	4.17
\$ 3.04	250,000	-	283,022	9.07
\$ 4.00	436,500	225,900	977,813	7.07
\$ 6.10	10,000	4,000	55,857	7.45
Total	<u>1,920,491</u>	<u>1,168,991</u>	<u>\$ 2,789,694</u>	<u>5.05</u>

The weighted average fair value of options granted during the six months ended June 30, 2011 was \$3.58 (June 2010: \$2.93) per option calculated using a risk-free rate of 4.3%, dividend yield of 0%, historical volatility factor of 100%, and expected life ranging from .1 to 9.9 years. The value of the options was recorded as stock based compensation expense, with an offsetting amount to contributed surplus based on the vesting terms.

On May 12, 2011, the Corporation awarded 46,740 to directors and 675,000 options to employees in accordance with Epsilon's Stock Option Plan. These stock options are exercisable at the closing price of \$3.61 on May 12, 2011. The directors' options will vest immediately. The employees' options will vest only after the common shares trade at or above \$8.00 per share on the Toronto Stock Exchange for a period of 20 consecutive trading days at any time in the 36 months from the date of grant of the options.

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10. Shareholders' Equity (continued)

(d) Contributed Surplus

The following table summarizes contributed surplus for the six months ended June 30, 2011, the year ended December 31, 2010 and on transition date:

	<u>June 30, 2011</u>	<u>December 31, 2010</u>	<u>January 1, 2010</u>
Contributed surplus:			
Balance, beginning of period	\$ 6,323,776	\$ 6,098,296	\$ 5,401,361
Buy back of shares	-	271,828	
Stock options:			
<i>Amortized</i>	649,925	911,914	1,108,699
<i>Exercised</i>	(98,418)	(309,332)	(4,746)
<i>Forfeited</i>	-	(648,930)	(407,018)
Balance, end of period	<u>\$ 6,875,283</u>	<u>\$ 6,323,776</u>	<u>\$ 6,098,296</u>

11. Commitments and Contingencies

Yemen

The Corporation has withdrawn from Yemen and is currently negotiating final settlements with contractors. Management is of the opinion that no additional accrual or disclosure is required for any possible settlements.

Oman – Block 55 Exploration and Production Sharing Agreement (“EPSA”)

On January 26, 2009, the Corporation was awarded a 100% operated working interest in Block 55, an onshore oil and natural gas concession in Oman, in return for a \$25.5 million work commitment over three years and sharing in commercial production, if any, over a 20-year contractual term.

In an effort to conserve its capital, during 2009, the Corporation did not pay any up-front costs for Block 55 to the government of Oman. In November 2009, the Corporation notified the Ministry of Oil and Gas, Sultanate of Oman, that the Corporation was withdrawing from previously signed Exploration and Production Sharing Agreement (“EPSA”) covering Block 55 in Oman where it was the official operator. The Corporation has reversed a capital accrual of \$2,250,000 in up-front costs pertaining to Block 55 in Oman and is of the opinion that no additional accrual or disclosure for exit costs is required.

Saskatchewan - Bakken Shale Drilling Commitment

The Corporation entered into an agreement with an unrelated public Canadian company on August 28, 2008, whereby the Corporation agreed to pay 100% of the costs to drill a minimum of two horizontal wells in the Bakken shale in order to earn a 50% working interest in acreage controlled by the unrelated public company. As of June 30, 2011, the Corporation paid \$2,252,029 for the cost to drill and complete the first of the two aforementioned earning wells. The second well obligation of \$2.4 million has been partially substituted for a 3D seismic program, which resulted in expenditures to the Corporation of \$1,429,648. The remaining balance after the completion of 3D seismic program of \$1,062,601 has been committed to the next well. As of June 30, 2011, the Corporation has fulfilled its cost obligation. The first well, the Torquay, was drilled horizontally, fractured and is currently in production. The second well is being drilled, is expected to reach its targeted depth on August 6, 2011 and a review of the logs will then ensue. Once the second well is completed and results can be analyzed, Epsilon then has 90 days to decide whether to participate in the third and fourth earning wells, totaling an estimated cost of \$2.36 million (C\$2.5 million).

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11. Commitments and Contingencies (continued)

New York – Trenton-Black River Well Units

During 2006, the Department of Environmental Conservation (“DEC”) classified the Corporation’s interest in several wells drilled prior to a statute change as an integrated non-participating owner. As a result, the Corporation was charged a non-consent penalty (300% of 100% of the total drilling and completion costs) on its pro-rata share of costs to drill and complete various wells by Talisman Energy Inc. (formerly Fortuna Energy Inc.), the operator. The Corporation believes its interest in the subject wells should have been classified as an integrated participating owner upon payment of its pro-rata share of costs, effectively negating the non-consent penalty the operator could charge prior to disbursing the Corporation’s pro-rata share of profits. The Corporation formally appealed the DEC’s ruling, and, if successful, will require the non-consent penalty withheld by the operator to be disbursed to the Corporation. As a result, there is no anticipated effect on the Corporation’s established working interest. As a non-operator, the Corporation is not liable to make any non-consent payments.

Due to this contingency, there were no amounts initially recorded on the Corporation’s consolidated financial statements prior to payout. In the case where payout has occurred, the Corporation recorded its share of costs and revenues on a prospective basis beginning with the month that each well had been determined to have achieved payout. As at June 30, 2011, the Corporation was classified as an integrated non-participating owner in 7 gross (0.10 net) wells, including 3 gross (0.06 net) for which the non-consent penalty had been paid out. In 2011, the Corporation received a favorable decision on its Soderblom well appeal from the NY DEC commissioner. The decision was not appealed by Talisman Energy Inc. (formerly Fortuna Energy Inc.) and the Corporation is currently awaiting final settlement numbers. This decision will result in reimbursement of the non-consent penalty charged to the Corporation for that well. There has been no decision issued for the remaining wells that the Corporation has appealed.

Mississippi

On October 1, 2010, the Corporation signed Participation Agreement (the “Agreement”) with a large US-based private land owner (“land owner”) to explore for and produce oil and gas. Under the principal terms of the Agreement, Epsilon is committed to drill a minimum of two horizontal wells within one year from the effective date of the agreement at an estimated cost of \$10.0 million and, in turn, Epsilon will earn 60% of the land owner’s available mineral interests in the approximate 15,800 gross/13,600 net acres it owns or controls. Should the Corporation fail to drill the two wells within the time period specified, the Corporation will pay a sum of \$1.0 million within ten days after the end of that year. On November 1, 2010, the Corporation entered into a joint venture agreement with Rockefeller Hughes (USA), LLC (“RHC”), a party related by common directorship, pursuant to which the Corporation agreed to assign 9% of its 60% working interest in the land owner’s available mineral interests to RHC. Since Epsilon and RHC are carrying the cost of the first two wells, the Epsilon’s proportionate share of the commitment has become \$8.5 million. As of June 30, 2011, Epsilon spent \$4,355,084 towards the first well of its two well commitment.

Ethiopia

On May 14, 2009, the Corporation announced that it had signed a Production Sharing Agreement (“PSA”) with the Ministry of Mines and Energy in Democratic Republic of Ethiopia (the “Ministry”). Terms of the PSA comprise of an initial three-year exploration period that includes a commitment to drill one exploratory well and to acquire a minimum of 200 kilometers of 2D seismic. The Corporation is also committed to make three annual payments \$40,000 each for training and community development, three annual payments of \$82,500 for land rentals and a work commitment of \$3,000,000 to be spent by the end of the PSA term.

In the event the Corporation makes a commercial discovery, the initial percentage split of profit oil and/or gas will be 80% for the Corporation and 20% for the Ministry. To June 30, 2011, the Corporation had incurred \$2,587,485 (2010: \$2,388,561) under the terms of this agreement mainly for a high resolution airborne gravity and magnetic survey.

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11. Commitments and Contingencies (continued)

The Corporation's future commitments are summarized in the following table:

	Payments Due by Period			
	Total	Less than 1 Year	1 – 3 Years	4 Years and After
Future Commitments:				
Accounts payable and accrued liabilities	\$ 3,509,469	\$ 3,509,469	\$ -	\$ -
Operating leases	194,067	77,627	116,440	-
Purchase obligations - US	4,144,916	4,144,916	-	-
Purchase obligations - Canada	2,355,430	2,355,430	-	-
Other obligations - International	412,515	412,515	\$ -	-
Total future commitments	\$ 10,616,397	\$ 10,499,957	\$ 116,440	\$ -

Litigation

The Corporation is involved in litigation and claims arising in the normal course of operations. Management is of the opinion that any pending litigation is remote, without merit and would not have a material adverse impact on the Corporation's financial position or results of operations.

12. Financial Instruments

Risk Management

The Corporation is exposed to the following risks related to financial assets and liabilities:

Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. Liquidity describes a Corporation's ability to access cash. Companies operating in the upstream oil and natural gas industry require sufficient cash in order to fund capital programs necessary to explore, develop and produce oil and natural gas, and to repay debt. The Corporation actively monitors its cash requirements to ensure it has sufficient available funds to meet current and foreseeable financial requirements at a reasonable cost. The Corporation prepares annual capital expenditure budgets, which are regularly monitored and updated as warranted. The Corporation also utilizes authorizations for expenditures to further manage capital expenditures.

At June 30, 2011, the Corporation had a working capital surplus of \$14,078,695 (December 31, 2010 - \$20,269,153). The Corporation has commitments under existing agreements as described in Note 11, Commitments and Contingencies. Given the Corporation's working capital position and its outlook on future capital requirements, management assesses liquidity risk to be low.

Commodity Price Risk

The Corporation sells its current oil and natural gas production primarily at market rates. Fluctuations in oil and natural gas prices can materially impact the current and future profitability of the Corporation.

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12. Financial Instruments (continued)

Interest Rate Risk

The Corporation maintains its short-term deposits in instruments that are redeemable within three months without penalty, and thereby has limited exposure to short term interest rate fluctuations. The Corporation does not utilize any interest rate based derivatives. The Corporation analyzes interest rate risk by calculating the effect of percent changes in the interest earned on its cash, cash equivalents and restricted cash. At June 30, 2011 and December 31, 2010, the Corporation had no debt.

Foreign Currency Risk

The Corporation is exposed to risks arising from fluctuations in foreign currency exchange rates, primarily between Canadian and U.S. dollars. The Corporation does not utilize any foreign currency based derivatives. In order to manage this risk and to defer the realization of any resulting currency loss from converting Canadian dollars to US dollars, the Corporation retains cash balances in both US and Canadian dollars.

The Corporation regularly analyzes foreign currency risk between Canadian dollars and US dollars by calculating the effect of percent changes in the foreign currency exchange rates against period end cash, cash equivalents and restricted cash balances. For example, applying a 5% plus or minus change in the period end conversion rate (1.0241) of Canadian to US dollars against the Corporation's Canadian denominated cash, cash equivalents and restricted cash balances of \$15,839,398 at June 30, 2011 would have affected the value of such balances by approximately +/- \$791,970. Substantially all of the Corporation's business operations are conducted in either US dollars or Canadian dollars and there are no significant outstanding foreign currency accounts receivable or accounts payable balances.

Credit Risk

Credit risk arises from the possibility that the entities which the Corporation has receivables from or has invested in may experience difficulties and be unable to fulfill their obligations. The Corporation mitigates this risk of credit loss by taking a security interest in underlying assets of the investment. Accounts receivable are assessed on a regular basis by management to ensure the credit worthiness of debtors and the ultimate collection thereof. The Corporation's accounts receivable balances consist of receivables pertaining to its natural gas and oil production in Pennsylvania and New York from one marketer and for pro-rata share of costs of operations from its joint interest partners in New York. The Corporation's maximum credit exposure is approximately two months of oil and natural gas production for revenue receivables. The Corporation has the right to offset the amount owed by its joint interest partners against any revenue it disburses to them. As at June 30, 2011 there were no provisions for doubtful accounts pertaining to accounts receivable balances for its oil and natural gas revenues or its joint interest partners. The maximum credit risk that the Corporation is exposed to is the current carrying value of its accounts receivable and cash and cash equivalent balances.

The Corporation considers any amounts greater than 90 days to be overdue. An aging of accounts receivable at June 30, 2011, December 31, 2010 and on transition date is:

	June 30, 2011	December 31, 2010	January 1, 2010
Current	\$ 903,495	\$ 1,654,132	\$ 1,244,500
31 - 60 days	-	544,954	160,216
61 - 90 days	-	70,577	80,795
Over 90 days	2,130	476,743	2,918
Total accounts receivable	<u>\$ 905,625</u>	<u>\$ 2,746,406</u>	<u>\$ 1,488,429</u>

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12. Financial Instruments (continued)

Fair Value

The Corporation's carrying value of cash and cash equivalents, accounts receivable, restricted cash, and accounts payable and accrued liabilities approximates their fair value due to the immediate or short-term maturity of these instruments.

13. Related Party Transactions

The Corporation reports its related party transactions on an exchange amount basis in equivalent US dollars. A summary of such transactions follows:

Executive Chairman

The Corporation utilizes administrative services provided by 706147 Ontario, Inc., a company owned by the Executive Chairman's spouse. The Corporation utilizes consultation services provided by Capital Z Corporation, a company owned by the Executive Chairman and the Corporation shares office space with Capital Z Corporation at no charge. The Executive Chairman is the Chairman and CEO of Rockefeller Hughes, a company that rents office space from the Corporation. The following G&A transactions arose in the normal course of business and have been accounted for at the exchange amount being the amount agreed to by the related parties, which approximates the arms length equivalent value:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2011	2010	2011	2010
706147 Ontario, Inc.	\$ 11,145	\$ 10,414	\$ 22,093	\$ 20,672
Capital Z Corporation	9,681	4,054	17,080	37,194
Rockefeller Hughes	(4,800)	(4,800)	(9,600)	(8,000)

The following balances are included in accounts payable and accrued liabilities and are unsecured, non-interest bearing and due on demand:

	Six months	December 31,	January 1,
	June 30,	2010	2010
	2011	2010	2010
706147 Ontario, Inc.	\$ 4,411	\$ 56	\$ 48,618
Capital Z Corporation	1,380	735	2,181

The following balances are included in accounts receivable and are unsecured, non-interest bearing and due on demand:

	Six months	December 31,	January 1,
	June 30,	2010	2010
	2011	2010	2010
Rockefeller Hughes	\$ 252,189	\$ -	\$ -

Epsilon Energy Ltd.**Notes to the Interim Unaudited Condensed Consolidated Financial Statements***For the three and six months ended June 30, 2011 and 2010***13. Related Party Transactions (continued)****Director**

On February 7, 2007, the Corporation obtained a 25% undivided participating interest in Gastem Inc.'s undeveloped oil and natural gas interests covering approximately 1,184,000 acres (249,000 net) in the St. Lawrence Lowlands and in the Gaspé Peninsula of Quebec. Under terms of the agreement, the Corporation may elect to participate on a well-by-well basis with a 25% working interest in any current or future oil and natural gas property Gastem Inc. may acquire in Quebec. In return, the Corporation granted Gastem Inc. the right to participate for 25% of the Corporation's interest in certain future wells to be drilled in the Corporation's Amber Bank project in West Virginia by spending up to \$1.05 million. The Corporation's carrying value of the portion of its Amber Bank project's leasehold attributable to Gastem Inc.'s participation was nominal. The agreement was consummated with the expectation that Raymond Savoie, Gastem Inc.'s President, would become a director of the Corporation. Mr. Savoie became a director of the Corporation on July 16, 2007. On June 16, 2009, the Corporation, along with Gastem Inc., sold all of its oil and natural gas property interests in West Virginia to an unrelated third party for a gross amount of \$14,000,000 (\$779,802 net to Gastem Inc.). A summary of Gastem's joint venture share of related party transactions between the Corporation and Gastem Inc. follows:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Gastem Inc.				
Joint venture costs	\$ 8,122	\$ 75,987	\$ 58,215	\$ 76,037
	Six months June 30, 2011		December 31, 2010	
	2011		January 1, 2010	
Accounts payable	\$ 87,715	\$ 151,059	\$ 296,678	

Cash remuneration of key management personnel of the Corporation, which includes officers and other key personnel, is set out below in aggregate:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Salaries and wages	\$ 187,262	\$ 152,157	\$ 377,318	\$ 315,653
Short-term benefits	1,625	1,505	3,521	3,260
Total compensation	\$ 188,887	\$ 153,662	\$ 380,839	\$ 318,913

These transactions arose in the normal course of business and have been accounted for at the exchange amount being the amount agreed to by the related parties, which approximates the arms length equivalent. The balances are unsecured, non-interest bearing and due on demand.

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14. Supplementary Cash Flow Information

Non-cash changes to the *Changes in Non-cash Balances Related to Operations* component of cash flows provided by/used in operations at June 30, 2011 and December 31, 2010 were comprised of the following:

	Six months ended		December 31, 2010
	June 30,		
	2011	2010	
Changes in non-cash balances:			
Other current assets	\$ 89,968	\$ 17,306	\$ (146,697)
Other	-	-	10,494
Accounts payable and accrued liabilities	<u>(1,241,301)</u>	<u>(33,198)</u>	<u>(257,976)</u>
Total changes to non-cash balances	<u>\$ (1,151,333)</u>	<u>\$ (15,892)</u>	<u>\$ (394,179)</u>

Non-cash charges relating to the *Property and equipment* component of cash used in investing activities at June 30, 2011 and 2010, and December 31, 2010, respectively, were comprised of the following:

	Six months ended		December 31, 2010
	June 30,		
	2011	2010	
Additions to Oil and Natural Gas Properties:			
Change in gross property for the period	\$ (7,171,747)	\$ (3,473,871)	\$ (5,750,117)
Non-cash changes:			
Accounts receivable	1,840,780	(1,344,298)	(1,257,977)
Notes receivable	(724,029)	-	-
Asset retirement obligations	45,980	(12,216)	(35,023)
Accounts payable and accrued liabilities	1,985,918	(1,502,554)	(1,006,611)
Currency translation effect	<u>(161,292)</u>	<u>34,016</u>	<u>209,995</u>
Total changes to Oil and Gas Properties	<u>\$ (4,184,389)</u>	<u>\$ (6,298,924)</u>	<u>\$ (7,839,733)</u>

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14. Supplementary Cash Flow Information (continued)

Changes to the *Proceeds from Issuance of Common Shares and Warrants, Net of Issuance Costs* component of cash provided by financing activities at June 30, 2011 and 2010, and December 31, 2010, respectively, were comprised of the following:

	Six months ended		December 31, 2010
	2011	June 30, 2010	
Share capital, beginning of period	\$ 136,001,220	\$ 138,272,250	\$ 138,272,250
Cash-based changes:			
Options exercised, cash portion	-	317,085	488,119
Sale of shares, net of issuance costs			
Buy back of shares	-	(2,469,250)	(2,796,654)
Non-cash changes:		-	-
Stock options exercised	-	207,073	309,333
Buy back of shares	-	(271,828)	(271,828)
Share capital, end of period	<u>\$ 136,001,220</u>	<u>\$ 136,055,330</u>	<u>\$ 136,001,220</u>

Epsilon Energy Ltd.**Notes to the Interim Unaudited Condensed Consolidated Financial Statements***For the three and six months ended June 30, 2011 and 2010***15. Reportable Geographical Segments**

As at June 30, 2011, the Corporation's operations by geographical area included the United States, Canada, and Ethiopia. Summarized reportable geographical segment data follows:

Reportable Segments:	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
United States:				
Revenues	\$ 1,676,705	\$ 3,864,482	\$ 3,496,262	\$ 7,847,743
Operating costs	104,015	1,052,344	444,378	1,576,220
Capital expenditures	4,877,557	987,596	5,649,101	7,352,288
Canada:				
Revenues	- 795	4,943	191,161	17,806
Operating costs	8,427	3,171	103,873	1,544
Capital expenditures	715,599	1,290,247	2,195,129	1,395,358
Ethiopia:				
Revenues	-	-	-	-
Operating costs	-	-	-	-
Capital expenditures	176,344	176,067	198,924	179,803
Other International:				
Revenues	-	-	-	-
Operating costs	-	-	-	-
Capital expenditures	-	5,818	-	17,124
Total Reportable Segments				
Revenues	\$ 1,675,910	\$ 3,869,425	\$ 3,687,423	\$ 7,865,549
Operating costs	\$ 112,442	\$ 1,055,515	\$ 548,251	\$ 1,577,764
Capital expenditures	\$ 5,769,499	\$ 2,459,728	\$ 8,043,154	\$ 8,944,573

The numbers above exclude asset sales and impairments.

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16. Capital Disclosures

The Corporation as at June 30, 2011 defines its capital as follows:

- Debt
- Shareholders' equity

The amounts included in the Corporation's capital are as follows:

	<u>June 30, 2011</u>	<u>December 31, 2010</u>	<u>January 1, 2010</u>
Capital:			
Debt	\$ -	\$ -	\$ -
Shareholders' equity	\$ 105,928,729	\$ 82,370,401	\$ 80,669,818

The Corporation's strategy is designed and formulated to maintain a flexible capital structure to allow the Corporation the ability to respond to changes in economic conditions, additional capital requirements, and the risk characteristics of the underlying assets of the Corporation. The Corporation considers the cash flows from the underlying assets and future capital needs when assessing the need for additional capital, if any. Depending on future liquidity requirements, the Corporation may invest its excess cash in short or long-term financial instruments.

17. Subsequent Event

In New York, Epsilon signed a Memorandum of Understanding with a joint venture partner, effective July 31, 2011, in which all jointly-held properties are to be divided in half. Two asset lists were prepared containing the following split in properties:

Asset List A – contains all Trenton Black River wells producing and non-producing, and its associated reserves and leasehold being held by those wells, and all claims to participation rights on certain wells/pipeline systems.

Asset List B – contains all remaining Trenton Black River and Marcellus undeveloped acreage leasehold and right of ways, all shut in Oriskany wells, one Trenton Black River well with associated claim to participation rights, tap site property and purchased seismic data.

Epsilon has selected Asset List B, and will be assigning its interest (approx. 50%) of the assets in list A to its joint-venture partners, while receiving the remaining interest (approx. 50%) of the assets in list B.