



British Columbia Securities Commission

QUARTERLY AND YEAR END REPORT
BC FORM 51-901F
(previously Form 61)

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INCORPORATED AS PART OF [X] SCHEDULE A
[X] SCHEDULE B & C

(place X in appropriate category)

ISSUER DETAILS
NAME OF ISSUER: MONTELLO RESOURCES LTD.
FOR QUARTER ENDED: 04 | 07 | 31
DATE OF REPORT: 04 | 12 | 15
ISSUER ADDRESS: 2833 - 595 BURRARD STREET, P.O. BOX 49057
CITY/PROVINCE: VANCOUVER/BC
POSTAL CODE: V7X 1C4
ISSUER FAX NO.: 604-689-8199
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CONTACT PERSON: PATRICK POWER
CONTACT'S POSITION: PRESIDENT
CONTACT TELEPHONE NO.: 604-689-1799
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CERTIFICATE

The three schedules required to complete this Report are attached and the disclosure contained therein has been approved by the Board of Directors. A copy of this Report will be provided to any shareholder who requests it.

DIRECTOR'S SIGNATURE: "PATRICK POWER"
PRINT FULL NAME: PATRICK POWER
DATE SIGNED: 04 | 12 | 15
DIRECTOR'S SIGNATURE: "JEANNINE DAVIES"
PRINT FULL NAME: JEANNINE DAVIES
DATE SIGNED: 04 | 12 | 15

MONTELLO RESOURCES LTD.

FINANCIAL STATEMENTS

AND AUDITORS' REPORT

JULY 31, 2004 AND 2003

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charlton

Charlton &

CHARTERED ACCOUNTANTS

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AUDITORS' REPORT

To: the Shareholders of
Montello Resources Ltd.

We have audited the balance sheets of Montello Resources Ltd. as at July 31, 2004 and 2003 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at July 31, 2004 and 2003 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

“Charlton & Company”

CHARTERED ACCOUNTANTS

Vancouver, British Columbia
December 15, 2004

Montello Resources Ltd.
Balance Sheets
As at July 31, 2004 and 2003

	<u>ASSETS</u>	<u>2004</u>	<u>2003</u>
Current			
Cash		\$ -	\$ 303
Marketable securities (Note 4)		10,163	8,162
Accounts receivable		<u>17,841</u>	<u>13,899</u>
		28,004	22,364
Investments (Note 5)		18,004	36,005
Resource properties (Notes 7 and 17 (b))		<u>2,698</u>	<u>1,186,240</u>
		\$ <u>48,706</u>	\$ <u>1,244,609</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)</u>			
Current			
Bank indebtedness		\$ 2,853	\$ -
Accounts payable and accrued liabilities (Note 9 (f))		525,008	425,356
Advances from related party (Note 9 (g))		6,297	6,197
Debenture		<u>-</u>	<u>190,000</u>
		534,158	621,553
Accounts payable (Note 17 (a))		65,000	-
Advances from affiliated company (Note 6)		<u>313,412</u>	<u>181,494</u>
		<u>912,570</u>	<u>803,047</u>
Shareholders' equity (deficiency)			
Share capital (Notes 8 and 17)		14,208,680	14,208,680
Deficit, per accompanying statements		<u>(15,072,544)</u>	<u>(13,767,118)</u>
		<u>(863,864)</u>	<u>441,562</u>
		\$ <u>48,706</u>	\$ <u>1,244,609</u>

Continuing operations (Note 1)

Contingent liability (Note 12)

Approved by the directors:

"Patrick Power"
 Director – Patrick Power

"Jeannine Davies"
 Director – Jeannine Davies

See accompanying notes.

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Montello Resources Ltd.
Statements of Operations and Deficit
Years Ended July 31, 2004 and 2003

	2004	2003
Expenses		
Accounting and audit	\$ 18,321	\$ 20,324
Amortization	-	1,752
Bank charges and interest (recovery)	2,545	(7,422)
Consulting fees	60,000	106,749
Filing fees	6,285	4,636
Interest on long-term debt	12,045	16,680
Legal fees	5,202	18,722
Management fees	150,000	73,500
Office	1,226	4,965
Property examination	15,339	-
Reclamation	-	39,600
Rent	29,569	42,076
Shareholders' information	11,050	8,234
Transfer agent fees	6,205	5,474
Travel and public relations	2,087	15,643
Website hosting	1,702	-
	<u>321,576</u>	<u>350,933</u>
Loss before undernoted items	(321,576)	(350,933)
Rent expense recovery	-	38,500
Interest income	44	7
Foreign exchange	565	1,742
Gain on sale of investments (Note 9 (c))	223,626	79,589
Loss on disposal of investment (Note 9 (e))	-	(155,500)
Write-off of loans and advances (Notes 7 (d) and 9 (e))	-	(147,471)
Write-off of resource properties	<u>(1,208,085)</u>	<u>(791,448)</u>
Loss for the year	(1,305,426)	(1,325,514)
Deficit, beginning of year	<u>(13,767,118)</u>	<u>(12,441,604)</u>
Deficit, end of year	\$ <u>(15,072,544)</u>	\$ <u>(13,767,118)</u>
Loss per share	\$ <u>(0.02)</u>	\$ <u>(0.02)</u>

See accompanying notes.

Montello Resources Ltd.
Statements of Cash Flows
Years Ended July 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash provided by (used in)		
Operating activities		
Loss for the year	\$ (1,305,426)	\$ (1,325,514)
Items not affecting cash:		
Amortization	-	1,752
Gain on sale of investments	(223,626)	-
Loss on disposal of investment	-	155,500
Write-off of loans and advances	-	147,471
Write-off of resource properties	<u>1,208,085</u>	<u>791,448</u>
	(320,967)	(229,343)
Changes in non-cash working capital items, net	<u>210,436</u>	<u>176,810</u>
	<u>(110,531)</u>	<u>(52,533)</u>
Investing activities		
Sale of property and equipment	-	19,278
Resource property expenditures	(24,543)	(24,460)
Deposit	<u>-</u>	<u>2,125</u>
	<u>(24,543)</u>	<u>(3,057)</u>
Financing activities		
Shares issued	-	87,640
Share subscriptions	-	(49,140)
Advances from affiliated company	<u>131,918</u>	<u>6,455</u>
	<u>131,918</u>	<u>44,955</u>
Decrease in cash during the year	(3,156)	(10,635)
Cash, beginning of year	<u>303</u>	<u>10,938</u>
Cash (bank indebtedness), end of year	\$ <u><u>(2,853)</u></u>	\$ <u><u>303</u></u>
Changes in non-cash working capital items consist of:		
Decrease in marketable securities	\$ -	\$ 12,240
Increase in accounts receivable	(3,942)	(7,099)
Decrease in advances to related party	-	30,025
Increase in accounts payable and accrued liabilities	214,278	135,447
Increase in advances from related party	<u>100</u>	<u>6,197</u>
	\$ <u><u>210,436</u></u>	\$ <u><u>176,810</u></u>

Supplemental disclosure with respect to cash flows (Note 10)

See accompanying notes.

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1. **Continuing Operations**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern which assume that the Company will realize its assets and discharge its liabilities in the normal course of business. Realization values may be substantially different from the carrying values as shown in the financial statements should the Company be unable to continue as a going concern.

2. **Nature of Operations**

The Company in the process of exploring its mineral properties and oil and gas properties and has not determined whether these properties contain reserves which are economically recoverable.

The recoverability of amounts shown for resource properties and related deferred costs is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development and future profitable production from the properties or proceeds from disposition.

3. **Significant Accounting Policies**

(a) **Resource properties**

(i) **Mineral properties**

Acquisition costs of mineral properties together with direct exploration and development expenditures thereon are deferred in the accounts. When production is attained these costs will be amortized. When deferred expenditures on individual producing properties exceed the estimated net realizable value, the properties are written down to the estimated value. Costs relating to properties abandoned are written off when the decision to abandon is made.

(ii) **Oil and Gas Properties**

The Company follows the full cost method of accounting for oil and gas operations in accordance with Canadian guidelines. Under this method, all costs associated with the acquisition, exploration and development of oil and gas reserves are capitalized in cost centers on a country-by-country basis. Such costs include property acquisition costs, geological and geophysical studies, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells and overhead expenses directly related to these activities.

Depletion is calculated for producing properties by using the unit-of-production method based on proved or estimated reserves, before royalties, as determined by management of the Company or independent consultants. Sales or dispositions of oil and gas properties are credited to the respective cost centers and any gain or loss is recognized when all properties in a cost center have been disposed of, unless such sale or disposition significantly alters the relationship between capitalized costs and proved reserves of oil and gas attributable to the cost center. Costs of abandoned oil and gas properties are accounted for as adjustments of capitalized costs and written off to expense.

3. Significant Accounting Policies

A ceiling test is applied to each cost center and to the aggregate of all cost centers by comparing the net capitalized costs to the estimated future net revenues from production of proved reserves without discount, plus the costs of unproved properties net of impairment. In addition, the ceiling test for the aggregate of all cost centers is required to include the effects of future site restoration costs, general and administrative expenses, financing costs and income taxes. Any excess capitalized costs are written off in the current year as additional depletion. The calculation of future net revenues is based upon prices, costs and regulations in effect at each year-end.

The Company may write off an unproved property under one or more of the following conditions:

- (i) there are no firm plans for further drilling on the unproved property;
- (ii) negative results were obtained from studies of the unproved property;
- (iii) negative results were obtained from studies conducted in the vicinity of the unproved property;
- (iv) the remaining term of the unproved property does not allow sufficient time for further studies or drilling; or
- (v) unproved properties are assessed for impairment on an annual basis by applying factors that rely on historical experience.

(b) Values

The amounts shown for oil and gas properties, mineral properties, and deferred exploration costs represent costs to date, and do not necessarily represent present or future values, as they are entirely dependent upon the economic recovery of current and future reserves.

(c) Cost of maintaining resource properties

The Company does not accrue the estimated future costs of maintaining its resource properties in good standing.

(d) Marketable securities

Marketable securities are stated at lower of cost or market.

(e) Property and equipment

Property and equipment are reported at cost. Amortization is provided using the declining balance method at the rate of 20% per annum. Only one-half of the rate is used in the year of acquisition.

(f) Investments

The Company accounts for its investments using the cost method. Where in management's opinion there has been a loss in value that is other than a temporary decline, the carrying value is reduced to the estimated realizable value.

3. **Significant Accounting Policies** (continued)

(g) **Stock- based compensation plan**

The Company accounts for options granted under its fixed stock option plan using the fair value based method of accounting for stock-based compensation. Accordingly, the fair value of the options at the date of the grant is accrued and charged to operations, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

(h) **Environmental expenditures**

The operations of the Company may in the future be affected from time to time in varying degrees by changes in environmental regulations, including those for future removal and site restoration costs. Both the likelihood of new regulations and their overall effect upon the Company are not predictable.

(i) **Use of estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates.

(j) **Loss per share**

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on earnings per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the year. For diluted loss per share, the dilutive effect has not been presented separately as it proved to be anti-dilutive.

Loss per share is calculated using the weighted-average number of shares outstanding during the year.

(k) **Income taxes**

Future income taxes are recorded using the asset and liability method. Using the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that substantive enactment occurs. To the extent that the Company does not consider it more likely than not a future tax asset will be recovered, it provides a valuation allowance against the excess.

Montello Resources Ltd.
Notes to the Financial Statements
July 31, 2004 and 2003

3. **Significant Accounting Policies** (continued)

(l) **Foreign currency translation**

Monetary items are translated at the exchange rate in effect at the balance sheet date; non-monetary items are translated at historical exchange rates. Income and expense items are translated at the average exchange rate for the year. Translation gains and losses are reflected in loss for the year.

4. **Marketable Securities**

Marketable securities consist of shares in a public company related by a common director, which as at July 31, 2004 had a quoted market value of \$106,709 (2003: \$142,828).

5. **Investments**

During the year ended July 31, 2001, the Company received 1,500,000 special warrants of Arctic Star Diamond Corp. ("Arctic Star"), a company related by a common director, at a deemed value of \$60,000 as part of the consideration for the sale of a resource property. During the year ended July 31, 2002, the Company exchanged these special warrants, for no additional consideration, into 1,500,000 common shares of Arctic Star (Notes 4 and 6). As at July 31, 2004, the Company has sold 796,000 (2003: 396,000) of these shares (Note 9 (c)).

During the year ended July 31, 2000, the Company purchased 4,243,000 common shares of Canadian All.ca Online Inc., a private company related by a common director, for \$155,500. During the year ended July 31, 2003, the Company disposed of the shares for \$Nil proceeds (Note 9 (e)).

6. **Advances from Affiliated Company**

Advances from affiliated company, related by a common director and in which the Company holds a minority interest, are non-interest bearing and have no specified terms of repayment.

7. **Resource Properties**

	<u>2004</u>	<u>2003</u>
Fentress	\$ 2,698	\$ 2,698
Tennessee Gas Project	-	1,082,592
Otish Mountain	<u>-</u>	<u>100,950</u>
	<u>\$ 2,698</u>	<u>\$ 1,186,240</u>

Montello Resources Ltd.
Notes to the Financial Statements
July 31, 2004 and 2003

7. **Resource Properties** (continued)

Acquisition costs and deferred exploration expenditures during the years ended July 31 were as follows:

	<u>2004</u>	<u>2003</u>
Property acquisition costs		
Balance, beginning of year	\$ 162,240	\$ 812,740
During year		
Additions	20,772	-
Written off	<u>(183,012)</u>	<u>(650,500)</u>
Balance, end of year	<u>-</u>	<u>162,240</u>
Deferred exploration expenditures		
Balance, beginning of year	1,024,000	1,140,488
During year		
Camp	7,413	13,927
Consulting fees	-	7,423
Drilling (recovery)	(3,642)	10,809
Geophysics, geochemical and field (recovery)	-	(7,699)
Written off	<u>(1,025,073)</u>	<u>(140,948)</u>
Balance, end of year	<u>2,698</u>	<u>1,024,000</u>
Total resource properties costs	\$ <u><u>2,698</u></u>	\$ <u><u>1,186,240</u></u>

(a) Fentress

During the year ended July 31, 2003, the Company acquired a five year oil and gas lease covering lands located in Fentress County, Tennessee. To acquire the lease the Company paid US \$1,880 (Cdn \$2,698).

The property is subject to a 12.5% production royalty.

(b) Tennessee Gas Project

During the year ended July 31, 2001, the Company entered into agreements with Capital East Ventures ("Capital") whereby the Company could earn a 66.6% interest, subject to a 15% overriding royalty, in two separate properties. The properties are certain oil and gas leases in Rogersville and Sneedville in Eastern Tennessee. For each property, the Company advanced US\$18,000 for seismic surveys, and was required to spend an additional US\$350,000 in drilling costs and additional completion costs to earn the 66.6% interest.

7. **Resource Properties** (continued)

During the year ended July 31, 2002, the Company earned its interest in the Rogersville lease by incurring the required expenditures.

During the year ended July 31, 2003, the Company elected not to proceed with the Sneedville lease and wrote off the associated costs of \$38,081. During the year ended July 31, 2004, the Company abandoned the Rogersville lease and wrote off the associated costs of \$1,083,364.

The Company agreed to pay a finder's fee of 5% of the funds expended by the Company on the exploration of each property, and the issuance of 200,000 common shares. During the year ended July 31, 2002, the Company issued the 200,000 shares at a deemed value of \$20,000 and paid \$23,632. As at July 31, 2004, the Company has accrued a liability of \$29,379 (2003: \$28,607) for the remaining cash portion due.

(c) Otish Mountain

During the year ended July 31, 2002, the Company entered into an agreement to acquire a 50% joint venture interest in certain mineral claims located in Quebec. The Company acquired its interest by paying cash of \$100,000.

During the year ended July 31, 2003, the agreement was amended such that the Company could earn an additional 40% interest (90% total interest) in the property by payment of a further \$40,000 (not paid as at July 31, 2003).

During the year ended July 31, 2004, the claims lapsed and the Company wrote off all associated costs.

(d) Swan Hills

During the year ended July 31, 2000, the Company acquired a 100% interest in Swan Hills, a Petroleum and Natural Gas Lease, with the issuance of 2,250,000 shares at a deemed price of \$0.35 per share. The Company then entered into an agreement with 868846 Alberta Ltd. ("868846"), which allowed 868846 to earn a 50% working interest. 868846 was required to pay 100% of the costs to drill. During the year ended July 31, 2001, the Company entered into an agreement with ASC Industries Ltd. ("ASC") to acquire from the Company a 7% interest in the property in exchange for \$250,000 (\$200,000 received).

During the year ended July 31, 2003, the claims lapsed and the Company wrote off all associated property costs and advances to 868846.

(e) Valemont

During the year ended July 31, 2001, the Company entered into two agreements with Commerce Resources Corp. whereby the Company could acquire a 100% interest in four mineral claims located in the Cariboo and Kamloops Mining Division, British Columbia. To acquire the interest the Company was required to pay cash of \$25,000 (paid) and staking costs of approximately \$35,000, and issue 400,000 shares. During the year ended July 31, 2002, the Company issued the 400,000 shares at a deemed value of \$28,000.

Montello Resources Ltd.
Notes to the Financial Statements
July 31, 2004 and 2003

7. **Resource Properties** (continued)

During the year ended July 31, 2003, the claims lapsed and the Company wrote off all associated costs. The Company reimbursed \$20,000 of staking costs during the year ended July 31, 2004, and wrote off the amount during the year then ended.

8. **Share Capital**

	<u>2004</u>	<u>2003</u>
Authorized:		
100,000,000 Common shares without par value		
Issued:		
65,407,130 Common shares	\$ <u>14,208,680</u>	\$ <u>14,208,680</u>

(a) Changes in issued common shares during the years ended July 31 were as follows:

	<u>2004</u>		<u>2003</u>	
	Number of Shares	\$ Amount	Number of Shares	\$ Amount
Beginning of year	65,407,130	14,208,680	64,722,630	14,121,040
Shares issued for cash				
pursuant to private placement (Note 8 (b))	-	-	409,500	49,140
Shares issued for cash				
pursuant to exercise of stock options	-	-	275,000	38,500
End of year	<u>65,407,130</u>	<u>14,208,680</u>	<u>65,407,130</u>	<u>14,208,680</u>

(b) During the year ended July 31, 2003, the Company issued 409,500 units for cash of \$49,140 pursuant to a private placement. Each unit consists of one share and one non-transferable share purchase warrant. Each warrant entitles the holder to purchase an additional share at a price of \$0.14 per share, exercisable until August 19, 2004 (Note 17(d)).

(c) As at July 31, 2004, outstanding warrants are as follows:

<u>Number of warrants</u>	<u>Exercise price</u>	<u>Expiry date</u>
409,500	\$0.14	August 19, 2004
3,449,666	\$0.15	February 8, 2006

Montello Resources Ltd.
Notes to the Financial Statements
July 31, 2004 and 2003

8. **Share Capital** (continued)

During the year ended July 31, 2004, the Company agreed to extend the expiry date of 3,449,666 warrants initially expiring on February 8, 2004 by a period of two years to February 8, 2006.

- (d) (i) As at July 31, 2004, outstanding stock options to directors, consultants, and employees are as follows:

<u>Number of shares</u>	<u>Exercise price</u>	<u>Expiry date</u>
400,000	\$0.10	November 16, 2004
2,000	\$0.10	December 15, 2004
2,372	\$0.10	June 15, 2005
266,000	\$0.16	November 16, 2005
3,725,000	\$0.14	July 18, 2006

- (ii) A summary of the Company's stock options as at July 31, 2004 and the changes for the year then ended is presented below:

	<u>Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life</u>
Balance, beginning of year	5,395,372	\$0.14	2.33 years
Expired	<u>(1,000,000)</u>		
Balance, end of year	<u>4,395,372</u>	\$0.14	1.74 years
Number of options exercisable, end of year	<u>4,395,372</u>	\$0.14	1.74 years

9. **Related Party Transactions**

- (a) During the year ended July 31, 2004, the Company incurred management fees and consulting fees of \$150,000 (2003: \$91,049) with directors of the Company. Additionally, the Company incurred automobile expenses of \$311 (2003: \$7,482) with a director of the Company.
- (b) During the year ended July 31, 2004, the Company incurred accounting fees of \$8,571 (2003: \$13,074) with an officer of the Company.
- (c) During the year ended July 31, 2004, the Company sold 400,000 shares (2003: 306,000 shares) of Arctic Star Diamond Corp., a company related by a common director (Note 5). As a result, the Company recorded a gain on sale of investment of \$223,626 (2003: \$79,589).
- (d) During the year ended July 31, 2003, the Company sold furniture and fixtures, office equipment, and machinery and equipment to a company related by a common director. The Company received consideration equal to the estimated fair market value at the time of the sale.

Montello Resources Ltd.
Notes to the Financial Statements
July 31, 2004 and 2003

9. **Related Party Transactions** (continued)

- (e) During the year ended July 31, 2003, the Company disposed of its investment in Canadian All.ca Online Inc. (“All.ca”), a private company related by a common director, for \$Nil proceeds (Note 5). The Company also wrote off all advances to All.ca. As a result, the Company recorded a loss on disposal of investment of \$155,500 and a write-off of advances of \$77,521.
- (f) As at July 31, 2004, accounts payable and accrued liabilities include \$180,124 (2003: \$29,124) due to directors and \$26,837 (2003: \$22,491) due to an officer of the Company.
- (g) As at July 31, 2004, advances from related party of \$6,297 (2003: \$6,197) is due to a company related by a common director.

10. **Supplemental Disclosure of Non-Cash Operating, Investing and Financing Activities**

Significant non-cash transaction during the year ended July 31, 2004:

The Company sold 400,000 shares of Arctic Star Diamond Corp., a company related by a common director (Note 5), in retirement of a \$190,000 debenture and settlement of accounts payable totalling \$49,626. As a result, the Company recorded a gain on sale of investment of \$223,626.

There were no significant non-cash transactions during the year ended July 31, 2003.

11. **Income Taxes**

A reconciliation of income taxes at Canadian statutory rates with the reported income taxes is as follows:

	2004	2003
Loss for the year	\$ <u>(1,305,426)</u>	\$ <u>(1,325,514)</u>
Income tax recovery at statutory rates of 35.62%	\$ (464,993)	(472,148)
Non-deductible expenses	460,370	311,985
Unrecognized benefits of non-capital losses	90,152	83,843
Other	<u>(85,529)</u>	<u>76,320</u>
Total income tax recovery	\$ <u>-</u>	\$ <u>-</u>

Montello Resources Ltd.
Notes to the Financial Statements
July 31, 2004 and 2003

11. **Income Taxes** (continued)

The significant components of the Company's future income tax assets are as follows:

	2004	2003
Future income tax assets		
Non-capital losses available for future periods	\$ 1,206,290	\$ 1,402,989
Resource deductions	<u>1,676,801</u>	<u>1,668,059</u>
	2,883,091	3,071,048
Valuation allowance	<u>(2,883,091)</u>	<u>(3,071,048)</u>
	<u>\$ -</u>	<u>\$ -</u>

The Company has not recorded the potential future income tax benefits of approximately \$3,387,000 in non-capital losses which, if unutilized, expire through 2014.

Subject to certain restrictions, the Company has resource development and exploration expenditures of approximately \$4,700,000 available to reduce taxable income of future years. Future tax benefits which may arise as a result of these losses and resource deductions have not been recognized in these financial statements and have been offset by a valuation allowance.

As at July 31, 2004, the Company also has \$140,828 in capital loss carryforward.

12. **Contingent Liability**

During the year ended July 31, 1997, the Company with other parties (the "Companies"), entered into an agreement with Supra Oil and Gas Corporation ("Supra") whereby the Companies were allowed to view certain geophysical data pertaining to various properties in Alberta.

If the Companies decided to proceed to field operations, consideration was to be paid in two stages. Upon notification that they intended to go forward, the Companies would have to issue collectively \$150,000 of their shares pro-rata based on the October 29, 1997 closing market price of each of the Companies' shares and fund (pro-rata) a \$250,000 exploration program which was to include drilling. Upon completing the drill program, had the Companies wished to continue work on the properties, they were to issue a further collective \$450,000 of their shares (pro-rata) and transfer a 10% interest in the properties to the private corporation.

During the year ended July 31, 1998, Supra filed a claim in the amount of \$150,000 and further damages against the Companies for payments not yet received. The Companies claim that the geophysical data was misrepresentational and induced the Companies to expend considerable costs in developing the properties. The Company has filed a Statement of Defence denying any liability. As at July 31, 2004, the lawsuit is still ongoing and the merit of the claim cannot be assessed.

13. **Segmented Information**

The Company operates in one segment. As at July 31, 2004, the Company has resource properties totalling \$2,698 (2003:\$1,085,290) located in the United States. All other assets and operations are in Canada.

14. **Environmental Protection Practices**

The Company is subject to the laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. The Company may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest. The Company is not aware of any existing environmental problems related to any of its current or former properties that may result in material liability to the Company.

15. **Financial Instruments**

The Company's financial instruments consist of cash, marketable securities, accounts receivable, accounts payable and accrued liabilities, advances and debenture. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest or credit risks arising from these financial instruments. As at July 31, 2004 and 2003, the fair value of receivables and payables approximate their carrying value due to the immediate short-term maturity of these instruments.

16. **Comparative Figures**

Certain figures presented for comparative purposes have been reclassified to conform with the current year's presentation.

17. **Subsequent Events**

Subsequent to July 31, 2004:

- (a) The Company issued 1,300,000 common shares at a deemed price of \$0.05 per share in settlement of accounts payable totalling \$65,000;
- (b) The Company paid \$155,089 towards the acquisition of various oil and gas leases covering lands and equipment located in central Tennessee;
- (c) The Company agreed to issue 12,730,000 units at a price of \$0.05 per unit pursuant to a private placement. Each unit will consist of one common share and one non-transferable share purchase warrant. Each warrant will entitle the holder to purchase an additional common share at an exercise price of \$0.10 per share, exercisable for a period of two years; and
- (d) Warrants to purchase 409,500 common shares at an exercise price of \$0.14 per share, exercisable until August 19, 2004, expired unexercised.

MONTELLO RESOURCES LTD.
SCHEDULE B – SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JULY 31, 2004

DEFERRED RESOURCE PROPERTY EXPENDITURES

Balance, August 1, 2003	\$ 1,186,240
Acquisition costs	20,772
Camp	7,413
Drilling (recovery)	(3,642)
Written off	<u>(1,208,085)</u>
Balance, July 31, 2004	\$ <u>2,698</u>

EXPENDITURES TO NON-ARM'S LENGTH PARTIES

Management fees	\$ 150,000
Accounting fees	8,571
Automobile expense	<u>311</u>
Total	\$ <u>158,882</u>

SECURITIES ISSUED DURING THE QUARTER ENDED JULY 31, 2004

<u>Date of Issue</u>	<u>Type of Security</u>	<u>Type of Issue</u>	<u>Number of Shares</u>	<u>Price</u>	<u>Total Proceeds</u>	<u>Type of Consideration</u>	<u>Commission</u>
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No securities were issued during the quarter ended July 31, 2004.

OPTIONS GRANTED DURING THE QUARTER ENDED JULY 31, 2004

No options were granted during the quarter ended July 31, 2004.

AUTHORIZED AND ISSUED SHARE CAPITAL AS AT JULY 31, 2004

<u>Class</u>	<u>Par Value</u>	<u>Authorized</u>	<u>Number Issued</u>	<u>Amount</u>
Common	N.P.V.	100,000,000	65,407,130	\$14,208,680

OPTIONS AND WARRANTS OUTSTANDING AS AT JULY 31, 2004

<u>Security</u>	<u>Number or amount</u>	<u>Exercise or Convertible Price</u>	<u>Expiry Date</u>
Warrants	409,500	\$0.14	August 19, 2004
Warrants	3,449,666	\$0.15	February 8, 2006 (Note 1)
Options	400,000	\$0.10	November 16, 2004
Options	2,000	\$0.10	December 15, 2004
Options	2,372	\$0.10	June 15, 2005
Options	266,000	\$0.16	November 16, 2005
Options	3,725,000	\$0.14	July 18, 2006

Note 1: The Company agreed to extend the expiry date of these warrants by two years from February 8, 2004 to February 8, 2006.

**SHARES IN ESCROW OR SUBJECT TO
POOLING RESTRICTIONS AS AT JULY 31, 2004**

Number of shares

Nil

LIST OF OFFICERS AND DIRECTORS AS AT JULY 31, 2004

JEANNINE DAVIES - Director
GLENN GREIG - Secretary
DAVID KERR - Director
DANIEL POWER - Director
PATRICK POWER – President and Director

MONTELLO RESOURCES LTD.

(the “Company”)

SCHEDULE C

MANAGEMENT DISCUSSION FOR THE YEAR ENDED JULY 31, 2004

The Company is engaged in the business of acquiring and exploring natural resource properties.

Properties of the Company

Tennessee Oil and Gas Leases

Central Tennessee

In November and December 2004 the Company acquired various oil and gas leases covering lands and equipment located in central Tennessee. To acquire the leases the Company paid approximately \$155,000.

Fentress County Property, Tennessee

In October 2002 the Company acquired a 230-acre oil and gas lease located in Fentress County, Tennessee.

To acquire the lease the Company paid \$US1,880 (\$Cdn.2,698).

Rogersville Prospect, Tennessee

During the year ended July 31, 2004, the Company abandoned this property and wrote off all associated costs.

Otish Mountain, Quebec Property

The Company allowed the claims to lapse and wrote off all associated costs during the year ended July 31, 2004.

Financings, Principal Purposes and Milestones

In April 2002 the Company issued a convertible debenture in the principal amount of \$190,000. The debenture, bearing interest at the rate of 8% per annum payable quarterly in arrears, was due April 15, 2004. The debenture was secured by a general pledge of the Company’s assets.

The debenture was to be convertible, at the option of the holder, until maturity, into units on the basis of one unit for each \$0.10 of the principal amount converted. On exercise of the conversion feature, each unit was to consist of one share and one non-transferable share purchase warrant entitling the holder to purchase an additional share at an exercise price of \$0.10 per share, exercisable until April 15, 2004.

The Company had also agreed to pay a finder's fee of \$17,100 in connection with this transaction. The fee was to be payable through issuance of an additional convertible debenture of this amount, with the same terms as those described above.

Regulatory acceptance of the conversion feature of the debenture and of the finder's fee was not obtained. Accordingly, the debenture did not include a conversion privilege, nor was a finder's fee payable. The payment and interest terms of the \$190,000 debenture remained unchanged.

In April 2004 the Company retired the debenture (including the related accrued interest due of \$32,525) by the sale of 400,000 shares of Arctic Star Diamond Corp. ("Arctic Star"), a company related by a common director. The Company recorded a gain on the sale of the Arctic Star shares of \$223,626.

During the year ended July 31, 2004, the Company did not issue any shares.

In February 2004 the Company agreed to extend the expiry date of 3,449,666 warrants initially expiring on February 8, 2004 by a period of two years to February 8, 2006. The exercise price remains unchanged at \$0.15 per share.

The Company is still a party to an action commenced by Supra Oil and Gas Corporation in 1997. The claim is described in the attached annual audited financial statements and no steps have been taken on the action during the year ended July 31, 2004 or to the date of this report.

During the year ended July 31, 2004 and to the date of this report there were no material differences in the actual use of proceeds from previous disclosure regarding the intended use of proceeds.

Administrative Services Contract and Investor Relations

The Company has a consulting agreement with Brahma Communications Inc. ("Brahma") for the provision of general office administration services, which include investor relations services. The agreement with Brahma provides that Brahma is paid \$6,000 per month. The principal of Brahma is Thomas Yingling. The Company did not enter into any new investor relations agreements during the quarter or to the date of this report.

Subsequent Events

Subsequent to July 31, 2004:

- (a) The Company issued 1,300,000 common shares at a deemed price of \$0.05 per share in settlement of accounts payable totalling \$65,000;
- (b) The Company paid \$155,089 towards the acquisition of various oil and gas leases covering lands and equipment located in central Tennessee;
- (c) The Company agreed to issue 12,730,000 units at a price of \$0.05 per unit pursuant to a private placement. Each unit will consist of one common share and one non-transferable share purchase warrant. Each warrant will entitle the holder to purchase an additional common share at an exercise price of \$0.10 per share, exercisable for a period of two years; and
- (d) Warrants to purchase 409,500 common shares at an exercise price of \$0.14 per share, exercisable until August 19, 2004, expired unexercised.