Management, Discussion and Analysis

The following discussion and analysis was prepared on March 10, 2006 and is management's assessment of the Company's financial and operating results and should be read in conjunction with the audited Financial Statements for the ninety-nine days ended December 31.

Additional information related to the Company, including the Company's Annual Information Return can be found on SEDAR at www.sedar.com as well as the Company's website at *www.veroenergy.ca.*

READER ADVISORIES

Forward Looking Statements

Information provided herein contains estimates and assumptions which management is required to make regarding future events and may constitute forward-looking statements within the meaning of applicable securities laws. Forward looking statements may include estimates, plans, expectations, opinions, forecasts, projections, guidance or other statements that are not statements of fact. Although the Company believes the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will be realized. These statements are subject to certain risks and uncertainties and may be based on assumptions that could cause actual results to differ materially from those anticipated or implied in the forward-looking statements. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement.

Non-GAAP Terms

Non-GAAP terms: this press release contains the terms "cash flow from operations" and "netbacks" which are terms not recognized under Generally Accepted Accounting Policies ("GAAP"). The Company uses these measures to help evaluate its performance. The Company considers corporate netbacks as a key measure as it demonstrates its profitability relative to current commodity prices. The Company considers cash flow from operations a key measure as it demonstrates the Company's ability to generate funds necessary to repay debt and to fund future growth through capital investment. Funds generated from operations should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian GAAP as an indicator of Vero's performance. Vero's determination of cash flow from operations may not be comparable to that reported by other companies. The reconciliation between net income and cash flow from operations can be found in the statement of cash flows in the financial statements. Vero also presents funds generated from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of net earnings per share, which per share amount is calculated under GAAP and is more fully described in the notes to the financial statements.

Barrel of Oil Equivalents

Where amounts are expressed in a barrel of oil equivalent ("boe"), or barrel of oil equivalent per day ("boed"), natural gas volumes have been converted to barrels of oil equivalent at 6 thousand cubic feet ("mcf") to one barrel. Use of the term boe may be misleading particularly if used in isolation. The boe conversion ratio of 6 Mcf to 1 barrel ("bbl") of oil or natural gas liquids is based on an energy equivalency conversion methodology primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. This conversion conforms to the Canadian Securities Regulators' National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities.

Dollar amounts

All dollar amounts below are in thousands of Canadian dollars except for share and per share data or as specifically elsewhere noted.

Incorporation and Commencement of Operations

Vero Energy Inc. ("Vero" or "the Company") was incorporated on September 23, 2005 and commenced active oil and gas operations on November 2, 2005 after the closing of the Plan of Arrangement (the "Plan") between True Energy Inc. ("True"), TKE Trust and Vero Energy Inc. As a result of that transaction, Vero was conveyed certain producing and non-producing assets. Accordingly, these financial statements relate solely to the operations between September 23, 2005 and December 31, 2005 with no comparable analysis available. The acquired assets included 89,760 (61,634 net) acres of undeveloped lands and approximately 850 boed of producing properties. The consideration given for the assets acquired was $27,365. The Plan resulted in the distribution of 9,836 common shares of Vero to the former shareholders of True as well as a cash payment to True in the amount of $6,052 in consideration for the assets.

Comparative Information

Oil and gas operations of Vero commenced on November 2, 2005 concurrent with the completion of the Plan. Consequently, comparative data for the Company is not available.

FINANCIAL REVIEW

PRODUCTION REVENUE

Vero started its operations on November 2 with approximately 850 barrels of oil equivalent per day of production. Completion of several tie-ins and the drilling of 6 (3.8 net) wells during its first two months yielded average production of 980 boed. In the first reporting quarter for Vero natural gas contributed 64% of company production volumes; light and medium oil was 28% and natural gas liquids resulted in 8% of total volumes.

Aggregate Sales Volumes

	2005
Natural gas (mcf)	**227,188**
Light/medium oil (bbl)	**16,231**
Natural gas liquids (bbl)	**4,687**
Barrels of oil equivalent (boe)	**58,783**

Daily Sales Volumes

Daily sales volumes are based on the number of days between when the assets were acquired under the Plan (November 2, 2005) through to the end of the year.

	2005
Natural gas (mcf/d)	**3,786**
Light/medium oil (bbl/d)	**271**
Natural gas liquids (bbl/d)	**78**
Barrels of oil equivalent (boe/d)	**980**

Production revenue

Natural gas revenue is the largest contributor to corporate revenue at 68%. Most of this revenue comes from production in the Rosevear and Whitecourt areas.

Production Revenue	2005	%
Natural gas	**2,863**	**68**
Light/medium oil	**1,036**	**25**
Natural gas liquids	**313**	**7**
Production revenue	**4,212**	**100**

The commodity prices realized by the Company were as follows:

Commodity Prices Realized	2005
Natural gas ($/mcf)	**12.60**
Light/medium oil ($/bbl)	**63.84**
Natural gas liquids ($/bbl)	**66.83**
Barrels of oil equivalent ($/boe)	**71.65**

The Company has experienced a weakening of gas prices at the beginning of 2006. We anticipate that these prices will continue to weaken throughout the spring as storage levels increase and with North America coming off a mild winter. The intermediate to longer-term fundamentals for natural gas suggest price strengthening during the summer of 2006. Since weather is quite unpredictable gas prices can fluctuate widely. Oil prices have been consistently at or above $60 US per barrel. Therefore, Vero made a concerted effort to diversify its product mix. The corporate acquisition at the end of February 2006 will contribute more to the oil mix and thereby reduce somewhat the company's dependency on the continental gas markets.

ROYALTIES

Net royalties were $1,083 for the period. On a per boe basis the amount was $18.42. Royalty expense averaged 26% of production revenue. Because most of the production of Vero for the two months in 2005 was acquired from a restricted entity, ARTC is limited and therefore the Crown royalty rate is higher than expected. We anticipate that during 2006 we will maximize our ARTC entitlement due to new drilling on Crown lands and therefore the effective royalty rate is anticipated to decrease.

	2005	
Royalties	**$**	**$/boe**
Crown – gross	**1,112**	**18.92**
Gross over-riding	**2**	**0.03**
Total royalties	**1,114**	**18.95**
ARTC	**(31)**	**(0.53)**
Royalty expense, net of ARTC	**1,083**	**18.42**
Percent of production revenue	**26%**	

DEPLETION, DEPRECIATION AND ACCRETION ("DD&A")

As a result of the Plan of arrangement, the Company was transferred a proportionate amount of the net book values of True that were associated with the conveyed properties. This net book value base plus additional capital incurred during the two-month period in 2005 yielded the depletion base. The resulting depletion and depreciation was $876 or $14.89 per boe. As discoveries and extensions of our producing pools are made, it is anticipated that the per boe numbers will be lowered throughout 2006.

DD&A	**2005**	
	$	**$/boe**
Depletion and depreciation	**871**	**14.81**
Asset retirement obligation accretion	**5**	**0.08**
Total DD&A	**876**	**14.89**

OPERATING

Net operating costs were $401 or $6.82 per boe. The Company enjoys a low operating cost environment due to the concentration of operations in the same geographic area. Economies of scale are also realized through contract operatorship by significant industry partners who operate numerous wells in the area. Going forward, the per boe expense will remain consistent with current levels as increased operating costs due to inflation and increased competitiveness for services will offset the expected decline in operating costs per boe that would normally be experienced as new production is added.

Operating	**2005**
Gross expense	**401**
Operating expense ($ per boe)	**6.82**
Net expense (% revenue)	**9.5%**

TRANSPORTATION

Transportation expenses were $90 and amounted to 2.1% of the total revenue for the period. Transportation costs are dependent on a variety of factors such as: the type of production facilities; the method of transportation; the distances covered; the rates charged by the carriers; quantities shipped; the type of service offered (interruptible versus firm service) as well as ownership of the transportation facilities. Most of the transportation costs are variable and the cost per boe should stay consistent with this period, or if additional gas production is added the per boe rate should decline.

Transportation	**2005**
Expense	**90**
Expense ($ per boe)	**1.53**
Expense (% revenue)	**2.1%**

GENERAL AND ADMINISTRATIVE (G&A)

Aggregate G&A expense was $553 for the period. On a per boe basis, the net G&A was $7.48. While the per boe rate is somewhat high, it was expected during the start up phase. As Vero just commenced operations in November, a portion of the G&A costs relate to start up costs. Vero anticipates adding staff in addition to moving to its newly leased premises on April 1, 2006. The staff and space are required to accommodate both the Vero properties and the corporate acquisition that closed on February 24, 2006. Despite the increased G&A costs, we anticipate this rate will decline significantly in the first quarter of 2006 and throughout the year as we add new production. G&A cost per boe will also be mitigated with the added production from the acquisition of the private company, which closed on February 24, 2006.

Overhead recoveries are a function of field operating activity as well as the number of wells drilled during the year for which the Company is the operator. The Company capitalizes a portion of its G&A for the salaries of its technical staff, which are directly related to exploration and development. G&A capitalized for the year-to-date in 2005 was $36.

G&A	**2005**
Gross expense	**553**
Less:	
Overhead recoveries	**(78)**
Capitalized G&A	**(36)**
Net expense	**439**
Average cost ($ per boe)	
Gross expense	**9.41**
Net expense	**7.48**

INTEREST AND BANK CHARGES

Vero started its operations with cash reserves and consequently no bank debt. The cash generated from warrant exercises ($14,338) generated an immediate surplus cash position for the Company. The interest expense relates solely to commitment and standby fees on the credit facility with the bank. Vero commenced using its bank facility to partially fund the corporate acquisition on February 24, 2006.

Interest and bank charges	**2005**
Expense	**11**
Average interest cost ($ per boe)	**0.19**

STOCK BASED COMPENSATION

Stock based compensation expense was $103 in 2005. This amount relates to the expensing of the fair value of the stock options issued during the period. 1,600,000 stock options were issued to officers, directors and employees of Vero in December. The resulting fair value of the stock options is amortized over the options’ vesting period.

Stock Based Compensation	**2005**
Expense	**103**
Expense ($ per boe)	**1.75**

INCOME TAXES

Vero obtained more aggregate tax pools on the conveyance of assets under the Plan of Arrangement than the associated net book values. Consequently, a future tax asset was created. Due to the low rates of deductibility for the tax pools obtained on the purchase from True (68% of all tax pools are the 10% COGPE pool) a current tax provision was created. Taking into account projected spending for 2006 as well as anticipated production levels and prices realized, it is likely that the Company will be cash taxable in 2006 as well.

Income taxes	**2005**	**$ per boe**
Current income tax	**292**	**4.97**
Future income tax	**252**	**4.29**
Total income taxes	**544**	**9.26**

The estimated income tax pools available at each year-end were as follows:

Tax Pools	**Rate %**	**2005**
Canadian development expenses	30	**4,674**
Canadian oil and gas property expenses	10	**23,709**
Undepreciated capital costs	10 - 30	**6,049**
Attributed Canadian Royalty Income	100 (Alberta)	**228**
Total		**34,660**

NETBACKS

Below is a breakdown of the netbacks for the Company. Cash flow netbacks are lower than expected due to the higher initial G&A costs. The largest non-cash expense, DD&A reduces the netbacks significantly. It is anticipated that as production volumes increase and more emphasis is placed on drilling gas locations, the netbacks will increase accordingly.

Netbacks ($ per boe)	**Natural Gas**	**Light Oil**	**Liquids**	**2005 Total**
	($/mcf)	**($/boe)**	**($/boe)**	**($/boe)**
Realized price	12.60	63.84	66.83	**71.65**
Royalties (net of ARTC)	(3.49)	(14.07)	(13.00)	**(18.42)**
Operating expenses	(1.14)	(8.79)	-	**(6.82)**
Transportation expenses	(0.24)	(1.87)	(1.21)	**(1.53)**
Field operating	7.73	39.11	52.62	**44.88**
General and administrative				**(7.48)**
Interest				**(0.19)**
Current income taxes				**(4.97)**
Cash flow				**32.24**
Stock based compensation				**(1.75)**
DD&A				**(14.89)**
Future income taxes				**(4.29)**
Net earnings				**11.31**

CASH FLOW AND RETAINED EARNINGS

Cash flow from operations in 2005 was $1,896. The higher commodity prices enjoyed by the industry have been of large benefit to Vero in our start-up phase.

Cash flow from operations is calculated as follows:

	2005
Net earnings	**665**
Adjustments for:	
Depletion, depreciation and accretion	**876**
Future income tax expense	**252**
Stock based compensation expense	**103**
Cash flow from operations	**1,896**

On a per share basis, earnings were $0.07 per share (basic and diluted) for the first reporting quarter of 2005. Cash flow per share in 2005 was $0.20 (basic and diluted).

Per share data ($)	**2005**
Net earnings	
Basic weighted average	**0.07**
Diluted	**0.07**
Cash flow	
Basic weighted average	**0.20**
Diluted	**0.20**

CAPITAL EXPENDITURES

Vero spent $7,823 on its capital program for the two months in 2005. In addition to tie-ing in 3 wells acquired from True, the Company drilled 6 (net 3.8) wells with 4 (net 2.5) being successful and two (net 1.3) dry and abandoned.

Capital expenditures	**2005**
Transfer of assets pursuant to Plan of Arrangement	**27,198**
Land acquisitions and lease rentals	**656**
Geological and geophysical	**61**
Drilling and completions	**5,632**
Well equipment and facilities	**1,446**
Other	**28**
Capital expenditures	**35,021**
Capitalized asset retirement obligations	**57**
Total capital additions	**35,078**

	2005	
Wells drilled	**Gross**	**Net**
Exploration	**-**	**-**
Development	**4**	**2.5**
Dry holes	**2**	**1.3**
Standing wells	**-**	**-**
Total wells	**6**	**3.8**
Success rate	**67%**	**66%**

For 2006, the Company’s capital plan (revised to take into account the February, 2006 acquisition) is to spend $40 million in the following categories: drilling and completions - $29 million; equipping/tie-in/facilities - $6 million; land acquisitions - $3 million; seismic - $2 million. At this level of spending it is projected that 40 gross (25 net) wells will be drilled during the year. This spending will be dependent on many factors such as: weather, commodity prices, rig and services availability and success rates on exploratory wells.

FINDING AND DEVELOPMENT COSTS

Finding and development (“F&D”) and finding, development and acquisition (“FD&A”) costs associated with the 2005 capital program are presented in the below table. The costs used in the F&D calculation are the capital costs related to land acquisition and retention, drilling, completions, tangible well site, tie-ins, facilities, and the change in estimated future development costs as per the independent reserve report. For the acquisition from True under the Plan of Arrangement, the cost base was the aggregate of the cash paid to True and the value of the Vero shares issued to the True shareholders on closing. The reserves used in this calculation are all reserve additions net of revisions.

F&D Costs ($/boe)	F&D	True Acquisition	Total
Capital costs			
Incurred in 2005	7,795	27,198	34,993
Future costs – proved	6,469	-	6,469
	14,264	27,198	41,462
Future costs – probable	887	-	887
Total capital	15,151	27,198	42,349
Reserve Additions (mboe)			
Proved	1,110	1,374	2,484
Proved F&D ($/boe)	13.65	19.79	17.05
Proved and Probable	1,501	2,016	3,517
P + P F&D ($/boe)	10.09	13.49	12.04

UNDEVELOPED LAND

The Company's undeveloped land holdings (acres) at the end of the year were as follows:

	2005		
Acres	**Gross**	**Net**	**Avg WI**
Alberta	**108,640**	**69,894**	**64%**

Vero had its undeveloped lands evaluated by an independent evaluator as at December 31, 2005. The aggregate value of the net acres is estimated to be $13,372 or an average of $191/acre.

NET ASSET VALUE

The following net asset value calculation takes into account the net present value of Vero's reserves as calculated by the independent evaluators. It does not take into account any of Vero's ability to add reserves through extensions to its existing properties beyond what is included in the 2005 year-end report.

	Discounted at 10% - Before Income Tax	
	Forecast Prices	**Constant Prices**
Proved plus probable reserves	76,116	84,590
Undeveloped land	13,372	13,372
Working capital surplus	8,411	8,411
Option exercises	7,792	7,792
Net asset value	105,691	114,165
Fully diluted shares	20,621	20,621
Net asset value per share	$5.13	$5.54

LIQUIDITY AND CAPITAL RESOURCES

The Company paid $6,052 as partial consideration for the transfer of assets from True pursuant to the Plan of Arrangement. The cash for this payment was derived from the two private placements on November 2, 2005. The Company funded its $7,823 in net capital expenditures (excludes the True acquisition and capitalized asset retirement obligations) with a combination of its resources. First, Vero realized $14,338 in cash proceeds from the exercise of warrants issued to the former shareholders of True. This was done as part of the Plan of Arrangement and gave Vero a strong opening cash position to move forward with its drilling and acquisitions programs. Second, the Company realized $1,896 in cash flow for 2005. Vero ended 2005 with a net working capital surplus position of $8,411. The major drawdown on the beginning cash position was due to accounts payable and accrued expenses related to Vero's capital program.

The Company's bank operating facility was authorized at $7,000 at the end of 2005. Available borrowings are limited by the borrowing base, which is established by the bank. The amount of available credit is based mainly upon the value of petroleum and natural gas assets. The external engineers of Vero determined these reserve values. The bank facility is subject to periodic borrowing base reviews. The credit facility originally entered into in November with the bank was subject to an interim review at April 30, 2006. As at December 31, 2005 no amounts were drawn on the facility. Corporate working-capital liquidity is maintained by drawing from the unutilized facility as needed and then repaying it periodically through production revenues. On February 24, 2006 the bank facility was increased to facilitate the acquisition of Ledge Resources Inc., a private oil and gas company. The total acquisition price was approximately $69,000 and was paid for with cash payments to Ledge shareholders in the aggregate of $18,250 and the balance was funded by the issuance of 4,754,945 Vero shares. The bank facility is currently under review to further enhance our flexibility under the capital program.

Below is a summary of the trading history of the Company for 2005.

	2005
High	**5.70**
Low	**4.02**
Close	**5.31**
Volume (000's)	**5,867**

OFF BALANCE SHEET TRANSACTIONS

There were no off-balance sheet transactions entered into during the period.

CONTRACTUAL OBLIGATIONS

The Company is obligated, at December 31, 2005 to make the following payments under the terms of long-term contracts it has entered into:

		Payments Due by Period		
	Total	**Less than 1 year**	**1-3 Years**	**4-5 Years**
Transportation obligations	5	1	4	-
Total contractual obligations	5	1	4	-

The transportation obligations are comprised of firm service natural gas commitments with a gas transmission company. In the event of a shortfall in gas deliveries to the pipeline, the Company must pay the carrier the difference between volumes delivered and the contracted volumes in cash at the contracted rate.

SHARE CAPITAL

The Company had 19,020,939 class A common shares outstanding at December 31, 2005 and 23,775,884 Class A common shares outstanding as of the date of these MD&A. The 4,754,945 share increase from the year-end was the result of the issuance of shares as partial consideration for the acquisition of Ledge Resources Inc., which closed on February 24, 2006.

SELECTED ANNUAL AND QUARTERLY INFORMATION

This is the first quarter of reporting for the Company. Therefore the first quarter's results are the same as the annual results for 2005.

	2005
Production revenue	4,212
Net earnings	665
Basic per share	0.07
Diluted per share	0.07
Total assets	53,130
Long term financial liabilities	-
Dividends paid	-

TRANSACTIONS WITH RELATED PARTIES

On November 2, 2005 the Company completed a private placement with officers, directors and employees who are considered related parties. 2,252,253 common shares were issued at a price of $2.22 per share for aggregate proceeds of $5,000. Concurrent with this placement a second private placement was done with a subsidiary of True. 473,817 shares were issued at the price of $2.22 for cash proceeds of $1,052. This private placement was part of the Plan of Arrangement with True and the proceeds of this second private placement were used to partially fund the acquisition of assets from True. The price of $2.22 per share was based on a net asset value calculation, which was effective November 2, 2005. The main component of this calculation was the reserves values. The reserves were evaluated by an independent, third party engineering report of the reserves of the Company.

RISK MANAGEMENT

The risks in the oil and gas industry are varied and wide-ranging. The primary risks and how the Company mitigates them are as follows:

<u>Commodity price and exchange rate volatility</u>
Revenues and consequently cash flows fluctuate with commodity prices and the US/Canadian dollar exchange rate. While the industry as a whole is experiencing strong commodity prices there is no certainty as to whether these price levels are sustainable. Commodity prices are determined on a global basis and circumstances that occur in various parts of the world are outside of the control of the Company. The Company protects itself from fluctuations in prices by determining and maintaining an appropriate hedging strategy, diversifying its asset mix and strengthening its balance sheet in order to take advantage of low price environments by making strategic acquisitions.

<u>The maturing Western Canadian Sedimentary Basin</u>
Land and producing assets are becoming increasingly scarce and expensive. The Company mitigates these risks by developing core areas to gain efficiencies. For riskier, exploration projects, the Company will solicit partner participation to limit the downside exposure.

<u>Operating and finding and development costs are increasing each year</u>
Generally all companies are experiencing increased costs for services that are becoming more and more strained under demands for them. The Company mitigates these risks by entering into joint ventures to reduce exposure to high costs and diversify drilling risks. The Company employs experienced and motivated staff to evaluate and generate high quality drilling prospects. In addition the Company seeks to utilize appropriate technology and responsible operating practices in operating its wells. The Company utilizes appropriate safety programs and insurance coverage to guard against potential losses. Concentrating on core areas wherein Vero has high degrees of ownership and operatorship mitigates increasing operating costs.

<u>Administrative risks</u>
The increased transparency required by the securities regulators and constantly evolving accounting guidelines dictate significant resources be devoted to these areas. Vero maintains processes designed to comply with the required disclosures; develops a strong

Board of Directors and engages technical advisors to assist in meeting securities guidelines. In addition the industry is experiencing increased competitiveness with respect to finding and retaining qualified employees. Retention is mitigated with the judicious use of its stock option program.

Environmental regulations

The industry is subject to both heightened environmental awareness and regulation. We continually review our environmental risks and to the best of our knowledge the Company is in compliance with all regulations. Also, the Company takes a responsible attitude to abandoning unproductive assets. Each year, we identify certain of these assets and commence the abandonment process. In addition, if during the drilling of a new well it is determined that it is unproductive, immediate plans are made for a full abandonment of that well.

CRITICAL ACCOUNTING ESTIMATES

Management is often required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. Following is a discussion of the accounting estimates that are critical in determining the Company's financial results.

Full cost accounting

The Company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized on a country-by-country cost centre basis. Such costs include land acquisition costs, costs of drilling both productive and non-productive wells, well equipment, flow-line and facility costs, geological and geophysical expenses and overhead expenses directly related to exploration and development activities. Gains or losses on sales of properties are recognized only when crediting the proceeds to the recorded costs would result in a change of 20% or more in the depletion and depreciation rate. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs are amortized using the unit-of-production method based on estimated proved reserves of petroleum and natural gas before royalties as determined by independent petroleum engineers. Changes in estimated proven reserves or future development costs have a direct impact on depletion and depreciation expense.

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly to determine if proved reserves should be assigned to them. If proved reserves are assigned to the properties, or if the costs are determined to have become impaired, the costs or any applicable write-downs are added to the depletion base as the case may be.

Oil and natural gas reserves

Estimates of oil and natural gas reserves are projections based on geological and engineering data. There are uncertainties inherent in these projections including the interpretation of data and the projection of future rates of production and the timing of developmental expenditures. Reserve engineering is an analytical process of estimating below ground accumulations of oil and natural gas that are difficult to measure. The accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. The Company’s proved oil and gas reserves are evaluated and reported on annually by an independent petroleum-engineering consultant. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to a number of uncertainties and various interpretations. The Company expects that over time its reserve estimates will be revised upward or downward based on updated information such as the results of future drilling, testing and production levels. Reserve estimates can have a significant impact on net earnings, as they are a key component in the calculation of depletion. A revision to the reserves estimate could result in a higher or lower D, D & A charge to net earnings. Downward revisions to reserve estimates could also result in a write-down of oil and natural gas property, plant and equipment under the ceiling test described below.

Ceiling test

The carrying value of property, plant and equipment is reviewed annually for impairment. Impairment will occur when the carrying amount of the property, plant and equipment minus the sum of the undiscounted cash flows expected to result from the Company’s proved reserves yields a negative result. The cash flows are calculated based on third party quoted forward prices and adjusted for the Company’s contract and/or hedged prices as well as quality differentials. If there were impairment, the magnitude of it would be calculated by comparing the carrying amount of property, plant and equipment to the estimated net present value of future cash flows from proved plus risked probable reserves. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying value above the net present value of future cash flows would be recorded as a permanent impairment and charged as additional depletion expense in the Consolidated Statement of Earnings. No write-down was required at December 31, 2005.

Asset retirement obligations

The Company recognizes the fair value of an asset retirement obligation (”ARO”) in the period in which it is incurred when a reasonable estimate of fair value can be made. The obligations recognized are estimates of statutory, contractual or legal obligations that the Company will reasonably be expected to incur and then discounted to its present value using the Company’s credit adjusted risk-free interest rate. The fair value of the estimated ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on a unit-of-production basis over the life of the reserves. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period through charges to accretion expense. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the ARO. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which the settlement occurs. Determination of the original undiscounted costs is based on engineering estimates using current costs in accordance with existing legislation and industry practice. The estimation of these costs can be affected by factors such as the number of wells drilled, well depth, estimated future salvage values, location of the well and current environmental legislation.

Future income tax

The Company follows the liability method of accounting for income taxes. Under this method the Company records future income tax assets and liabilities based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities) and are measured using the substantively enacted tax rates and laws expected to apply when these differences reverse. The effect of a change in substantively enacted income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs.

During 2003 the Federal Government introduced legislation, which will result in a gradual reduction of the general corporate income tax rate over a five-year period starting January 1, 2003. The impact of the new Federal legislation requires the Company to schedule out all existing temporary differences identify the accounting and tax values during the five year phase-in period for the declining tax rates and calculate the future income tax balance using tax rates in effect when the temporary differences are expected to reverse. The forecasts of estimated net revenue streams as determined by independent engineering consultants are utilized to calculate the future tax provision and, as such, are subject to revisions, both upwards and downwards, that are not known at the effective date of each calculation. In addition to these revisions, future capital spending of the Company can impact the timing of the reversal of any temporary differences. As a result the charge against earnings for future income taxes can be affected over time and the changes can be significant.

The determination of the Company's income tax liability requires interpretation of complex laws and regulations involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment. The actual income tax liability may differ significantly from the liability estimated or recorded.

Stock-based compensation

The Company has a stock based compensation plan enabling officers, directors and employees to purchase common shares at exercise prices equal to the market price on the date the option is granted. The Company uses the fair value method for valuing stock option grants. Compensation costs attributable to share options granted are measured at their fair value at the grant date and expensed over the expected exercise time period with a corresponding increase to contributed surplus. Upon exercise of the stock options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is credited to share capital. The assumptions used in calculating its stock based compensation expense are: the volatility of the stock price, risk-free rates of return and the expected lives of the options given that some will be forfeited upon termination of employment.

Other estimates

The accrual method of accounting will require management to incorporate certain estimates of revenues, royalties, and production costs as at a specific reporting date but for which actual revenue, royalties and other costs have not yet been received. In addition, the Company must estimate capital expenditures on capital projects that are in progress or recently completed where actual costs have not been received as of the reporting date.

Disclosure Controls and Procedures

As at the financial year ended December 31, 2005, an evaluation was carried out under the supervision of and with the participation of the Company’s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as at December 31, 2005 to provide reasonable assurance that material information relating to the Company and would be made known to them by others within the entity. It should be noted that while the Corporation’s Chief Executive Officer and Chief Financial Officer believe that the Corporation’s controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.