
VERO ENERGY INC.

Balance Sheet

(in thousands of Canadian dollars) (unaudited)

| | September 30, 2011 | December 31, 2010 | January 1, 2010 |
|--|-----------------------|----------------------|--------------------|
| ASSETS | | | |
| CURRENT | | | |
| Accounts receivable | 24,291 | 27,458 | 29,541 |
| Prepaid expenses and deposits | 3,304 | 3,241 | 4,566 |
| Derivative contracts (Note 18) | 2,018 | - | 2,289 |
| | 29,613 | 30,699 | 36,396 |
| Derivative contracts (Note 18) | 280 | - | - |
| Property, plant and equipment (Note 6) | 410,285 | 352,007 | 272,343 |
| Exploration and evaluation assets (Note 7) | 14,474 | 19,495 | 15,302 |
| Goodwill | 19,913 | 19,913 | 19,913 |
| | 474,565 | 422,114 | 343,954 |
| LIABILITIES | | | |
| CURRENT | | | |
| Accounts payable and accrued liabilities | 56,998 | 60,349 | 49,574 |
| Derivative contracts (Note 18) | - | 1,422 | 1,132 |
| Bank debt (Note 8) | 137,919 | 94,164 | 77,719 |
| Deferred liability (Note 9) | - | 5,062 | - |
| | 194,917 | 160,997 | 128,425 |
| Derivative contracts (Note 18) | - | - | 113 |
| Decommissioning liabilities (Note 10) | 11,693 | 9,346 | 7,960 |
| Deferred taxes (Note 14) | 27,357 | 18,013 | 13,422 |
| | 233,967 | 188,356 | 149,920 |
| SHAREHOLDERS' EQUITY | | | |
| Share capital (Note 11) | 216,678 | 216,174 | 180,617 |
| Contributed surplus (Note 12) | 13,243 | 11,204 | 9,610 |
| Retained earnings | 10,677 | 6,380 | 3,807 |
| | 240,598 | 233,758 | 194,034 |
| | 474,565 | 422,114 | 343,954 |

Commitments (Note 16)

See accompanying notes.

APPROVED BY THE BOARD

“Signed” Paul R. Baay, Director

“Signed” Douglas J. Bartole, Director

VERO ENERGY INC.

Statement of Comprehensive Income (Loss)

For the three and nine month periods ended September 30,

(in thousands of Canadian dollars, except per share data)(unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|----------------|------------------------------------|----------------|
| | 2011 | 2010 | 2011 | 2010 |
| REVENUE | | | | |
| Petroleum and natural gas sales | 31,365 | 24,295 | 97,097 | 81,250 |
| Royalties | (4,646) | (2,610) | (11,217) | (8,827) |
| | 26,719 | 21,685 | 85,880 | 72,423 |
| EXPENSES | | | | |
| Operating | 7,308 | 5,750 | 20,971 | 19,000 |
| Transportation | 1,153 | 1,245 | 3,631 | 3,614 |
| (Gains) losses on derivative contracts (Note 18) | (2,902) | 1,067 | (2,879) | (2,239) |
| General and administrative | 1,581 | 1,902 | 4,548 | 5,004 |
| Share based compensation (Note 11(c),(d)) | 538 | 636 | 1,867 | 2,357 |
| Loss on disposal of assets | 1,436 | - | 1,436 | 476 |
| Exploration and evaluation | 2,324 | 680 | 5,357 | 2,292 |
| Depletion and depreciation | 12,105 | 10,904 | 37,169 | 32,030 |
| | 23,543 | 22,184 | 72,100 | 62,534 |
| NET EARNINGS (LOSS) BEFORE FINANCE AND TAXES | 3,176 | (499) | 13,780 | 9,889 |
| FINANCE | | | | |
| Finance income | 17 | - | 35 | 190 |
| Finance expenses (Note 13) | (1,807) | (1,517) | (5,223) | (4,387) |
| | (1,790) | (1,517) | (5,188) | (4,197) |
| NET EARNINGS (LOSS) BEFORE TAXES | 1,386 | (2,016) | 8,592 | 5,692 |
| TAXES (Note 14) | | | | |
| Deferred tax expense (recovery) | 527 | (442) | 4,295 | 3,336 |
| NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS) | 859 | (1,574) | 4,297 | 2,356 |
| NET EARNINGS (LOSS) PER SHARE (Note 15) | | | | |
| Basic | 0.02 | (0.04) | 0.09 | 0.05 |
| Diluted | 0.02 | (0.04) | 0.09 | 0.05 |

VERO ENERGY INC.

Statement of Changes in Shareholders' Equity For the nine months ended September 30, 2011 and 2010

(in thousands of Canadian dollars) (unaudited)

| | Share Capital \$ | Contributed Surplus \$ | Retained Earnings \$ | Total Equity \$ |
|---------------------------------------|------------------------|------------------------------|----------------------------|-----------------------|
| Balance, Jan. 1, 2011 | 216,174 | 11,204 | 6,380 | 233,758 |
| Comprehensive income for the period | - | - | 4,297 | 4,297 |
| Issued on exercise of options | 491 | (143) | - | 348 |
| Share based compensation expensed | - | 1,825 | - | 1,825 |
| Share based compensation capitalized | - | 357 | - | 357 |
| Tax rate changes on share issue costs | 13 | - | - | 13 |
| Balance, September 30, 2011 | 216,678 | 13,243 | 10,677 | 240,598 |

| | Share Capital \$ | Contributed Surplus \$ | Retained Earnings \$ | Total Equity \$ |
|---------------------------------------|------------------------|------------------------------|----------------------------|-----------------------|
| Balance, Jan. 1, 2010 | 180,617 | 9,610 | 3,807 | 194,034 |
| Comprehensive income for the period | - | - | 2,356 | 2,356 |
| Issued on exercise of options | 1,448 | (414) | - | 1,034 |
| Share based compensation expensed | - | 2,357 | - | 2,357 |
| Asset acquisition for shares | 900 | - | - | 900 |
| Tax rate changes on share issue costs | 25 | - | - | 25 |
| Balance, September 30, 2010 | 182,990 | 11,553 | 6,163 | 200,706 |

VERO ENERGY INC.

Statement of Cash Flows

For the three and nine months ended September 30,

(in thousands of Canadian dollars) (unaudited)

| | Three months ended | | Nine months ended | |
|--|--------------------|----------|-------------------|----------|
| | September 30 | | September 30 | |
| | 2011 | 2010 | 2011 | 2010 |
| CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES: | | | | |
| OPERATING | | | | |
| Net earnings (loss) | 859 | (1,574) | 4,297 | 2,356 |
| Adjustments for: | | | | |
| Unrealized (gain) loss on derivative contracts (Note 18) | (2,970) | 1,716 | (3,721) | (1,608) |
| Share based compensation | 687 | 636 | 1,825 | 2,357 |
| Depletion and depreciation | 12,105 | 10,904 | 37,169 | 32,030 |
| Accretion of decommissioning liabilities (Note 13) | 117 | 81 | 318 | 239 |
| Exploration and evaluation expense | 2,324 | 680 | 5,357 | 2,292 |
| Loss on disposal of assets | 1,436 | - | 1,436 | 476 |
| Deferred tax expense (recovery) | 527 | (442) | 4,295 | 3,336 |
| | 15,085 | 12,001 | 50,976 | 41,478 |
| Decommissioning costs incurred | (1) | (23) | (7) | (288) |
| Changes in non-cash working capital (Note 17(a)) | 622 | 4,247 | 5,992 | 6,736 |
| | 15,706 | 16,225 | 56,961 | 47,926 |
| FINANCING | | | | |
| Increase in bank debt | 5,111 | 911 | 43,755 | 30,559 |
| Loans to officers / directors | - | - | - | 2,289 |
| Proceeds from stock option exercises | 20 | 54 | 348 | 1,035 |
| | 5,131 | 965 | 44,103 | 33,883 |
| INVESTING | | | | |
| Additions to petroleum and natural gas properties | (32,043) | (29,752) | (98,638) | (74,536) |
| Additions to exploration and evaluation assets | (109) | (284) | (1,053) | (6,431) |
| Purchase of petroleum and natural gas assets | - | (2,270) | (40) | (8,021) |
| Additions to administrative assets | (39) | - | (45) | (3) |
| Proceeds on sale of petroleum properties | 4,951 | 171 | 4,951 | 3,699 |
| Changes in non-cash working capital (Note 17(a)) | 6,403 | 14,945 | (6,239) | 3,483 |
| | (20,837) | (17,190) | (101,064) | (81,809) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | | | | |
| | - | - | - | - |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | | | | |
| | - | - | - | - |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | | | | |
| | - | - | - | - |

Supplementary cash flow information (Note 17(b))

See accompanying notes.

VERO ENERGY INC.

Notes to the Interim Financial Statements

For the three and nine month periods ended September 30,

(thousands, except per share data) (unaudited)

1. CORPORATE INFORMATION

Vero Energy Inc. (“Vero” or “the Company”) was incorporated in Canada on September 23, 2005 and commenced oil and gas operations on November 2, 2005. Vero is engaged in the exploration, development and production of crude oil, natural gas and natural gas liquids in the province of Alberta. The registered address of Vero is 900, 520- 3rd Avenue SW Calgary, Alberta, Canada.

2. BASIS OF PRESENTATION

These interim financial statements are unaudited and have been prepared using accounting policies consistent with International Financial Reporting Standards (“IFRS”) and are in accordance with International Accounting Standard (“IAS”) 34 – “Interim Financial Reporting” and IFRS 1 – “First Time Adoption of IFRS”, as they are part of the period covered by the Company’s first IFRS financial statements for the year ended December 31, 2011. The interim financial statements of the Company were authorized by the Board on November 10, 2011. Any subsequent changes to IFRS that are given effect in the Company’s annual financial statements for the year ended December 31, 2011 could result in restatement of these interim financial statements, including the transition adjustments recognized on change over to IFRS.

Previously the Company prepared its annual and interim financial statements in accordance with Canadian Generally Accepted Accounting Principles (“Canadian GAAP”). Canadian GAAP differs in some areas from IFRS. Certain information and footnote disclosure which are considered material to the understanding of the Company’s interim financial statements and which are normally included in annual financial statements prepared in accordance with IFRS are provided in Note 20 along with reconciliation and descriptions of the effect of the transition from Canadian GAAP to IFRS on equity, earnings and comprehensive income for the three and nine month periods ended September 30, 2010. The impact on the Company’s previously reported financial statements for the year ended December 31, 2010, and the opening balance sheet at January 1, 2010 is disclosed in the Company’s interim financial statements for the three months ended March 31, 2011.

The interim financial statements are presented in Canadian Dollars, the Company’s functional currency and all amounts are rounded to the nearest thousand (Canadian \$’000) except where otherwise indicated. Share data is presented in thousands except for per share data. The financial statements have been prepared on the basis of historical cost, except as disclosed in the accounting policies Note 3. The financial statements have, in management’s opinion, been prepared using careful judgment within the framework of the significant policies summarized in Note 3. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 5.

The disclosures included below exceed the minimum requirements under IAS 34. For the 2011 interim financial statements, the Company has elected to exceed these minimum requirements in order to present the Company’s accounting policies in accordance with IFRS and the additional disclosures under IFRS, which highlight the changes from the Company’s 2010 annual financial statements previously prepared in accordance with Canadian GAAP. In 2012 and beyond, the Company may not provide the same amount of disclosure in its interim financial statements. These interim financial statements should be read in conjunction with the financial statements prepared in accordance with Canadian GAAP and the notes thereto in the Company’s annual report for the year ended December 31, 2010.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Joint arrangements

A jointly controlled operation involves the use of assets and other resources of the Company and other venturers rather than the establishment of a corporation, partnership or other entity. The Company accounts for its proportionate share of jointly controlled assets, any liabilities it has incurred, its share of any liabilities jointly incurred with other ventures, income from the sale or use of its share of the joint venture's output, together with its share of the expenses incurred by the joint venture, and any expenses it incurs in relation to its interest in the joint venture.

b) Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of natural gas and oil products in the ordinary course of the Company's activities and is recognized when the amount can be reliably measured, and it is probable that future economic benefits will flow to the entity.

c) Oil and natural gas exploration, evaluation and development expenditure

i) Pre-exploration expenditures

Expenditures made by the Company during the geological and geophysical evaluation phase and before acquiring the legal right to explore in a specific area do not meet the definition of an asset and therefore are expensed by the Company as incurred.

ii) Exploration and evaluation expenditures ("E&E")

Costs incurred after obtaining the rights to explore are capitalized as E&E intangible assets until the drilling of the well is complete and the results have been evaluated. These costs include, but are not limited to, exploration license expenditures, leasehold acquisition costs, evaluation costs including drilling costs directly attributable to an identifiable well and directly attributable general and administrative costs. These costs are accumulated in cost centres by property and are not subject to depletion until technical feasibility and commercial viability has been determined. If no reserves are found, the exploration asset is tested for impairment and if necessary, an impairment charge recognized as exploration and evaluation expense in the statement of comprehensive income may be taken. If extractable hydrocarbons are found and likely to be commercially developed, the costs will continue to be carried as an intangible asset while sufficient/continued progress is made in assessing the commerciality of the hydrocarbons. The technical feasibility and commercial viability of extracting a hydrocarbon is considered to be determinable when proven and probable reserves are determined to exist. A review of each exploration license or field is carried out, at least annually, to ascertain whether proven and probable reserves have been discovered and to confirm the continued intent to develop or otherwise extract value from the discovery. Upon determination of proven and probable reserves, exploration and evaluation assets attributable to those reserves are tested for impairment and reclassified from exploration and evaluation assets to oil and natural gas interests within property, plant and equipment. Expired lease costs are expensed as part of exploration and evaluation expense as they occur.

iii) Development and production costs

Expenditures on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalized within oil and gas properties in property, plant and equipment, as long as the facts and circumstances indicate that the field has commercially viable reserves.

Oil and gas properties and other property, plant and equipment are stated at cost, less accumulated depreciation and any accumulated impairment losses. Development and production assets are grouped into Cash Generating Units (“CGU’s”) for impairment testing. A CGU’s recoverable amount is the greater of its fair market value less costs to sell and its value in use. Where the carrying amount of a CGU exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount.

Gains and losses on the disposal of an item of property, plant and equipment, including oil and gas interests are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized within the statement of comprehensive income as additional depletion and depreciation expense.

iv) Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized as oil and natural gas interest only when they increase future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in the statement of comprehensive income as incurred. Such capitalized oil and natural gas interests generally represent costs incurred in developing proven 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 component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in the statement of comprehensive income as incurred.

v) Depletion and depreciation

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of decommissioning obligation, and for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

The depletion provision for oil and natural gas assets is calculated for each major area using the unit-of-production method based on the area’s production for the period divided by the Company’s estimated total proved and probable oil and natural gas reserve volumes (before royalties) for that area. Production and reserves for natural gas are converted at the energy equivalent of six thousand cubic feet of natural gas to one barrel of oil. Estimates of future development costs for developing the proved and probable reserves are included in each area’s depletion base.

Depreciation of office furniture and equipment is provided for on a 20% declining balance basis while computers and ancillary equipment use a 30% declining balance basis.

vi) Dispositions

Gains or losses are recognized on dispositions of PP&E and certain E&E assets including asset swaps, farm-out transactions and complete dispositions. The gain or loss is measured as the difference between the fair value of the proceeds received and the carrying value of the assets disposed, including capitalized asset decommissioning costs.

d) Impairment

I. Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if the evidence indicates that one or more events have had a negative impact on the estimated future cash flow of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

All impairment losses are recognized in profit or loss in the period that the impairment is determined to have occurred. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the statement of comprehensive income.

In relation to trade receivables, a provision for impairment is made and an impairment loss is recognized in the statement of comprehensive income when there is objective evidence (such as financial difficulty or the probability of default by the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through the use of an allowance account. Impaired debts are written off against the allowance account when they are assessed as uncollectible.

II. Non-financial assets

Carrying values of goodwill, exploration and evaluation assets, oil and gas properties and other property, plant and equipment are reviewed regularly to determine if indicators of impairment exist. If any indication of impairment exists an estimate of the asset's recoverable amount is calculated. The recoverable amount is determined as the greater of the fair value of the asset less costs to sell and the asset's value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. The Company has organized its assets into CGU's, which are the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.

If the carrying amount of the CGU exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the statement of comprehensive income so as to reduce the carrying amount of the CGU to its recoverable amount.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company makes an estimate of the recoverable amount. A previously recognized impairment loss is reversed only if objective

evidence exists to support that there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of comprehensive income. Impairment losses recognized in relation to goodwill are not reversed for subsequent increases in its recoverable amount.

e) Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of comprehensive income net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

Decommissioning liability

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. A provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

A decommissioning liability is recognized when the Company has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made as at the balance sheet date by management. A corresponding amount equivalent to the provision is also recognized as part of the cost of the related property, plant and equipment. The amount recognized is the estimated cost of decommissioning, discounted to its present value. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to property, plant and equipment. The unwinding of the discount on the decommissioning provision is recognized as a finance cost. Actual costs incurred upon settlement of the decommissioning liabilities are charged against the provision to the extent that the provision was recognized.

f) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying capital asset or project under construction are capitalized and added to the asset or project cost during construction until such time as the asset or project is substantially ready for its intended use. Where funds are specifically borrowed to finance an asset or project, the amount capitalized represents the actual amount of borrowing costs incurred. Where funds used to finance an asset or project form part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognized in the statement of comprehensive income in the period in which they are incurred.

g) Share based compensation

The Company operates a stock option plan under which the entity grants employees, directors and certain consultants the option to purchase common shares of the Company. The Board of Directors has approved, and the Company's shareholders have ratified, a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. All options awarded have a maximum term of five years and vest in equal one-third increments on each anniversary of the grant.

The Company accounts for its stock options using the fair value method. The options have an exercise price equal to the fair value of the security at the date of grant. The fair value of each option is estimated on the date of grant using a modified Black-Scholes option-pricing model. The fair value is charged to earnings over the vesting period with a corresponding increase to contributed surplus. The Company estimates a forfeiture rate on the grant date and the rate is adjusted to reflect the actual number of options that actually vest. The expected life of the options granted is adjusted, based on the Company's best estimate, for the effects of non-transferability, exercise restrictions and behavioral patterns. Upon the exercise of options, the consideration received, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

In addition, the Company has a Directors Compensation Plan which includes compensation units granted only to directors of the Company. These units vest annually over a three year period and expire three years from the date of grant. Upon vesting, the holder is entitled to exercise the units for cash equal to the amount by which the exercise price (the fair value of a Vero common share on the date of exercise) exceeds the grant price (the fair value of a Vero common share on the day preceding the date of grant). These units are fair valued each reporting period grant using a modified Black-Scholes option-pricing model. The fair value change is charged to share based compensation expense over the vesting period with a corresponding change to accrued liabilities.

h) Finance income and expenses

Finance income is recognized as it accrues in profit or loss, using the effective interest method. Finance expense is comprised of: interest expense on borrowings, accretion of the discount rate on provisions, and impairment losses recognized on financial assets.

i) Income taxes

I. Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted as at the balance sheet date. Current income tax relating to items recognized directly in equity is recognized in equity and not in the statement of comprehensive income.

II. Deferred income tax

Deferred income tax is recognized, using the liability method, on temporary differences arising between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or

substantively enacted by the reporting date and are expected to apply when the related deferred tax asset is realized or the deferred income tax liability settled. The tax expense on income in the interim periods is accrued using the tax rate that would be applicable to expected total annual earnings.

Deferred income tax assets are recognized to the extent that it is probable that the future taxable profit will be available against which the temporary differences can be utilized and the carry forward of unused tax credits and unused tax losses can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

j) Flow through shares

“Flow through shares” permit an investor to claim deductions for tax purposes related to expenditures incurred by the issuer. The issuer explicitly renounces the right to claim these deductions in favour of the investor.

The proceeds from the issuance are allocated between the offering of shares and the sale of tax benefits when the shares are offered. The allocation is made based on the difference between the quoted price of the existing shares and the amount the investor pays for the flow through shares. A deferred liability is recognized for this difference. The liability is reversed when the qualifying expenditures are incurred. At the time the renunciation documents are filed with the taxing authorities and the qualifying expenditures have been incurred, a deferred tax liability is recognized. Any difference between the deferred liability set up for the premium on the flow-through shares and the tax effect on the renounced expenditures is recognized in profit or loss.

k) Obligations under lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

l) Basic and diluted per share calculations

Basic per share amounts are calculated using the weighted average number of shares outstanding during the period. The Company uses the treasury stock method to determine the dilutive effect of share options. Under the treasury stock method, only “in-the-money” dilutive instruments impact the diluted calculations in computing diluted per share amounts.

m) Financial assets and liabilities

Financial assets and financial liabilities are recognized on the Company’s balance sheet when the Company becomes party to the contractual provisions of the instrument. Financial assets are de-recognized when the contractual rights to the cash flows from the financial asset expire or when the contractual rights to those assets are transferred to a third party. Financial liabilities are de-recognized when the obligation specified in the contract is discharged, cancelled or expired.

Financial assets at fair value through comprehensive income

“Financial assets at fair value through comprehensive income” includes financial assets held for trading and financial assets designated upon initial recognition at fair value through the statement of comprehensive income.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separate embedded derivatives are also classified as held for

trading unless they are designated as effective hedging instruments or a financial guarantee contract. Gains or losses on financial assets held for trading are recognized in profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, loans and receivables are subsequently carried at amortized cost using the effective interest method less any allowance for impairment. Amortized cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognized in the statement of comprehensive income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Fair value

The fair value of financial assets that are actively traded in organized financial markets is determined by reference to quoted market prices at the close of business on the balance sheet date. For financial assets where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis or other valuation models.

Interest bearing loans and borrowings

All loans and borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in the statement of comprehensive income when the liabilities are derecognized as well as through the amortization process.

n) Financial instruments

All financial instruments, including all derivatives, are recognized on the balance sheet initially at fair value. Subsequent measurement of all financial assets and liabilities except those held-for-trading and available for sale are measured at amortized cost determined using the effective interest rate method. Held-for-trading financial assets are measured at fair value with changes in fair value recognized in income. Available-for-sale financial assets are measured at fair value with changes in fair value recognized in comprehensive income and reclassified to income when derecognized or impaired. The Company uses the following classifications for its financial instruments:

| Financial asset or liability | Category | Subsequent Measurement |
|--|-----------------------|--|
| Accounts receivable | Loans and receivables | Amortized cost |
| Derivative contracts | Held-for-trading | Fair value through statement of comprehensive income |
| Accounts payable and accrued liabilities | Other liabilities | Amortized cost |
| Bank debt | Other liabilities | Amortized cost |

Transaction costs attributable to financial instruments classified as other than held-for-trading are included in the recognized amount of the related financial instrument and recognized over the life of the resulting financial instrument using the effective interest rate method.

The Company uses, from time to time, financial derivatives and non-financial derivatives, such as commodity sales contracts requiring physical delivery, to manage the price risk attributable to anticipated sale of petroleum and natural gas production and foreign exchange exposures. The Company does not enter into derivative financial instruments for trading or speculative purposes. Vero has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting, even though the Company considers all commodity contracts to be economic hedges. As a result, financial derivatives are classified as fair value through the statement of comprehensive income and are recorded on the balance sheet at fair value.

The Company accounts for any physical sales and purchase contracts as executory contracts and as such are not recorded at fair value on the balance sheet. Settlements on these physical sales contracts are recognized in petroleum and natural gas sales.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract. Contracts are assessed for embedded derivatives when the Company becomes a party to them, including at the date of a business combination.

Financial instruments measured at fair value on the balance sheet require classification into one of the following levels of the fair value hierarchy:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3 – Inputs for the asset or liability that are not based on observable market data.

The fair value hierarchy level at which a fair value measurement is categorized is determined on the basis of the lowest level input that is significant to the fair value measurement of in its entirety. The Company has categorized its financial instruments that are fair valued on the balance sheet according to the fair value hierarchy above (Note 18).

o) Business combinations and goodwill

Business combinations are accounted for using the acquisition method of accounting. The cost of an acquisition is measured as the cash paid and the fair value of other assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired is recognized as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the statement of comprehensive income. Any transaction costs incurred on a business combination are expensed.

Goodwill is stated at cost less any impairment and is not amortized. Goodwill is assessed for impairment annually at year-end or more frequently if events or changes in circumstances indicate that the asset may be impaired. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash generating units or groups of cash generating units that are expected to benefit from the acquisition. Any loss recognized is equal to the difference between the recoverable amount and the carrying value of the applicable CGU or group of CGU's. Recoverable amounts are determined annually based on the greater of its fair value less costs to sell or the value in use.

Fair value less costs to sell is determined by estimating the discounted after-tax future net cash flows for the cash generating units. Discounted future net cash flows are based on forecasted commodity prices and costs over the expected economic life of the proved and probable reserves and then discounted using market-based rates. Value in use is determined by estimating the present value of future net cash flows expected to be derived from the continued use of the cash generating units. Any impairment loss is first applied against goodwill and then against the other assets in the CGU on a pro-rata basis. Impairment losses are recognized, as identified, in the statement of comprehensive income and cannot be reversed.

4. ACCOUNTING STANDARDS ISSUED BUT NOT YET ADOPTED

IFRS 9, as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. For financial assets, IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, and replaces the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. For financial liabilities, although the classification criteria for financial liabilities will not change under IFRS 9, the approach to the fair value option for financial liabilities may require different accounting for changes to the fair value of a financial liability as a result of changes to an entity's own credit risk.

IFRS 9 is effective for annual periods beginning on or after January 1, 2013 with different transitional arrangements depending on the date of initial application. However, in August 2011, the IASB issued an exposure draft which proposed changing this effective date to annual periods beginning on or after January 1, 2015. The Company is monitoring the status of this exposure draft. The Company is currently evaluating the impact of adopting IFRS 9 on its financial statements.

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, *Consolidated Financial Statements* ("IFRS 10"), IFRS 11, *Joint Arrangements* ("IFRS 11"), IFRS 12, *Disclosure of Interests in Other Entities* ("IFRS 12"), IAS 27, *Separate Financial Statements* ("IAS 27"), IFRS 13, *Fair Value Measurement* ("IFRS 13") and amended IAS 28, *Investments in Associates and Joint Ventures* ("IAS 28"). Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet assessed the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

Following is a brief summary of the new standards:

IFRS 10 – Consolidated Financial Statements

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation-Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IFRS 11 – Joint Arrangements

IFRS 11 requires a venture to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venture will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or

equity account for interest in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures* and SIC-13, *Jointly Controlled Entities, Non-Monetary Contributions by Venturers*.

IFRS 12 – Disclosure of Interest in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interest in other entities.

IFRS 13 – Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is 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. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurement and in many cases does not reflect a clear measurement basis or consistent disclosures.

5. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be material. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can materially differ from these estimates.

In the process of applying the Company's accounting policies, management has made the following judgements, estimates, and assumptions which have the most significant effect on the amounts recognized in the financial statements:

I. Accounts receivable

Accounts receivable are recorded at the estimated recoverable amount which involves an estimate of uncollectible amounts.

II. Derivatives

The fair value of derivative contracts are based on published market prices as at the balance sheet date and may differ from what will eventually be realized. Changes in the fair value of the derivative contracts are recognized in statement of comprehensive income (loss). The actual gains and losses realized on eventual cash settlement can vary due to subsequent fluctuations in commodity prices.

III. Oil and gas reserves

Oil and gas development and production properties are depreciated on a unit of production basis at a rate calculated by reference to proved and probable reserves determined in accordance with the Society of Petroleum Engineers rules and incorporating the estimated

future cost of developing and extracting those reserves. Commercial reserves are determined using estimates of oil and natural gas in place, recovery factors and future prices. Future development costs are estimated using assumptions as to the number of wells required to produce the commercial reserves, the cost of such wells and associated production facilities, and other capital costs. There are numerous uncertainties inherent in estimating oil and gas reserves. Estimating reserves is very complex, requiring many judgements based on geological, geophysical, engineering and economic data. These estimates may change, having either a positive or negative impact on net earnings as further information becomes available and as the economic environment changes.

IV. Depletion and depreciation

Depletion of oil and gas properties is provided using the unit-of-production method and is based on production volumes (before royalties) in relation to total estimated proved and probable reserves as determined by internal reserve evaluations for the first three quarters of the year and then at year-end by the Company's independent engineers. Natural gas reserves and production are converted at the energy equivalent of six thousand cubic feet to one barrel of oil. Calculations for depletion of oil and gas properties including production equipment and facilities, are based on total capitalized costs plus estimated future development costs of proved and probable reserves less the estimated net realizable value of production equipment and facilities after the reserves are fully produced. Exploration and evaluation costs are excluded from depletion calculations.

The calculation of the unit-of-production rate of amortization could be impacted to the extent that actual production in the future is different from current forecast production. This would generally result from significant changes in any of the factors or assumptions used in estimating reserves.

These factors could include:

- Changes in proved and probable reserves.
- Changes in estimates of future development costs.
- The effect on proved and probable reserves of differences between actual production as compared to forecasts as well as commodity price assumptions.
- Unforeseen operational issues.

V. Exploration and evaluation ("E&E") assets

The decision to transfer assets from E&E to property, plant and equipment is based on the estimated proved and probable reserves which are in part used to determine a project's technical feasibility and commercial viability.

VI. Impairment indicators

The recoverable amounts of CGU's and individual assets have been determined based on the higher of value-in-use calculations and fair values less costs to sell. These calculations require the use of estimates and assumptions. It is possible that oil and gas price assumptions may change which may then impact the estimated life of fields and may then require a material adjustment to the carrying value of goodwill, E&E assets and property, plant and equipment. The Company monitors internal and external indicators of impairment relating to its tangible and intangible assets.

VII. CGU definition

The determination of CGU's requires judgement in defining the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. CGU's are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risk and materiality.

VIII. Decommissioning costs

Decommissioning costs will be incurred by the Company at the end of the operating life of certain facilities and properties. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors including changes to relevant regulatory requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing and amount of expenditure can also change, for example in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the provisions established which would affect future financial results.

IX. Share based compensation

The fair value of both the stock options and the Directors Compensation Units granted are measured using the Black-Scholes option pricing model. Measurement inputs include the Company's share price on the measurement date, the exercise price of the option, the expected volatility of the Company's shares, the expected life of the options, expected dividends and the risk-free rate of return. The Company estimates volatility based on the historical share price in the publicly traded markets. The expected life of the options is based on historical experience and estimates of the holder's behaviour. Dividends are not factored in as the Company does not expect to pay dividends in the foreseeable future. Management also makes an estimate of the number of options that will be forfeited and the rate is adjusted to reflect the actual number of options that actually vest.

X. Income taxes

The Company recognizes the net future tax benefit related to deferred income tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred income tax assets requires significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction in which the Company operates. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the balance sheet date could be materially impacted.

6. PROPERTY, PLANT AND EQUIPMENT

| | Oil and natural gas properties | Administrative | Total |
|--|-----------------------------------|----------------|----------------|
| Deemed cost (Note 20) | | | |
| Balance, January 1, 2010 | 418,933 | 291 | 419,224 |
| Additions | 127,980 | 27 | 128,007 |
| Transfer from exploration and evaluation assets | 312 | - | 312 |
| Disposals | (4,085) | - | (4,085) |
| Balance, December 31, 2010 | 543,140 | 318 | 543,458 |
| Additions | 101,364 | 45 | 101,409 |
| Disposals | (9,135) | - | (9,135) |
| Transfer from exploration and evaluation assets | 306 | - | 306 |
| Balance, September 30, 2011 | 635,675 | 363 | 636,038 |

| | Oil and natural gas properties | Administrative | Total |
|--|-----------------------------------|----------------|------------------|
| Accumulated Depletion, Depreciation and Impairment losses | | | |
| Balance, January 1, 2010 (Note 20) | (146,711) | (170) | (146,881) |
| Provision for the period | (44,061) | (33) | (44,094) |
| Disposals | (476) | - | (476) |
| Balance, December 31, 2010 | (191,248) | (203) | (191,451) |
| Provision for the period | (37,146) | (23) | (37,169) |
| Disposals | 2,867 | - | 2,867 |
| Balance, September 30, 2011 | (225,527) | (226) | (225,753) |

| | Oil and natural gas properties | Administrative | Total |
|---------------------------|-----------------------------------|----------------|----------------|
| Carrying Amounts | | | |
| January 1, 2010 | 272,222 | 121 | 272,343 |
| December 31, 2010 | 351,892 | 115 | 352,007 |
| September 30, 2011 | 410,147 | 138 | 410,285 |

Future development costs on proved plus probable undeveloped reserves of \$238,114 (December 31, 2010 - \$160,527) were included in the depletion calculation. Salvage values excluded from the depletion calculation as at September 30, 2011 were \$5,157 (December 31, 2010 - \$4,768). During the nine months ended September 30, 2011, the Company capitalized \$957 (September 30, 2010 - \$991) in general and administrative expenses directly related to geological and geophysical salaries, wages and benefits and \$357 related to share based compensation. For the three months ended September 30, 2011 the Company capitalized \$313 (September 30, 2010 - \$328) in general and administrative expenses directly related to geological and geophysical salaries, wages and benefits and share based compensation.

7. EXPLORATION AND EVALUATION ASSETS

| | \$ |
|--|---------------|
| Deemed cost (Note 20) | |
| Balance, January 1, 2010 | 15,302 |
| Additions | 7,232 |
| Transfer to oil and natural gas properties | (312) |
| Lease expiries | (2,727) |
| Balance, December 31, 2010 | 19,495 |
| Additions | 1,166 |
| Disposals | (524) |
| Transfer to oil and natural gas properties | (306) |
| Lease expiries | (5,357) |
| Balance, September 30, 2011 | 14,474 |

Exploration and evaluation assets consist of the Company's exploration projects which are pending the determination of proven and probable reserves. For the nine months ended September 30, 2011, \$306 (September 30, 2010 - \$312) was transferred to property, plant and equipment following the successful discovery of proven and probable reserves. For the three months ended September 30, 2011, \$192 (September 30, 2010 - \$198) was transferred to property, plant and equipment following the successful discovery of proven and probable reserves.

8. BANK DEBT

The Company has a syndicated credit facility of \$170,000 which is comprised of a \$10,000 demand operating facility and a \$160,000 extendible revolving term credit facility. The revolving term credit facility is comprised of a combination of: letters of credit and bankers acceptances. The authorized limit is subject to both annual and semi-annual, borrowing base reviews by the syndicate. The facility is available to the Company at the discretion of the syndicate until April 28, 2012. At that date, Vero may request a renewal for a period of up to 364 days from that date. The facility is secured by a \$300,000 floating charge debenture over all the assets of the Company. The facility is also subject to a semi-annual review by the syndicate and re-determination if warranted.

Advances under the facility are available by way of prime rate loans with interest rates of between 1.0 percent and 2.5 percent over the bank's prime lending rate. In addition to these advances, the Company has access to banker's acceptances and LIBOR loans, which are subject to stamping fees and margins ranging from 2.0 percent to 3.5 percent depending on the debt to cash flow ratio as calculated at the Company's immediately preceding quarters' end. Standby fees are charged on the undrawn facility at rates ranging from 0.5 percent to 0.875 percent depending on the debt to cash flow ratio at the Company's previous quarter end. During the nine months ended September 30, 2011 the effective interest rate was 4.7% (September 30, 2010 - 4.4%). For the three months ended September 30, 2011 the effective interest rate was 4.3% (September 30, 2010 - 4.3%).

9. DEFERRED LIABILITY

On November 5, 2010 Vero issued 4,607 common shares on a flow through basis (Note 11(a)). The shares were issued at price of \$8.15 per share. Pursuant to the share issuance, the Company was committed to incur \$25,004 of eligible exploration expenses on or before December 31, 2011. Vero recognized a deferred liability based on the difference between the issue price of \$8.15 per share and the market price of Vero's shares on the date of issuance of \$6.50 per share. The deferred liability is derecognized as the eligible expenditures are incurred. For the nine months ended September 30,

2011 the Company satisfied the entire \$25,004 commitment and as a result the deferred liability has been reduced to nil.

10. DECOMMISSIONING LIABILITIES

The Company's decommissioning liabilities result from the net ownership interests it has in petroleum and natural gas assets, which include: well sites, gathering systems, batteries and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its decommissioning liabilities at September 30, 2011 to be \$15,120 (September 30, 2010 - \$13,714), which will be incurred at various times between 2012 and 2036. The present value of the decommissioning liabilities as at September 30, 2011 was calculated using a risk free rate of 4% (September 30, 2010 – 4.0%) and an inflation factor of 2% (September 30, 2010 – 1.6%). Settlement of the liabilities will be funded from general corporate funds at the time of retirement or removal. As at September 30, 2011, no funds have been set aside to settle these obligations. Changes to decommissioning liabilities during the periods were as follows:

| | Three months ended | | Nine months ended | |
|--|--------------------|--------------|-------------------|--------------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Balance, at beginning of period | 11,509 | 8,046 | 9,346 | 7,960 |
| Liabilities disposed of during the period | (126) | - | (126) | (46) |
| Incurred on development activities during the period | 179 | 240 | 649 | 601 |
| Liabilities settled during the period | (1) | (23) | (7) | (288) |
| Revisions to estimates | 15 | 19 | 1,513 | (103) |
| Accretion | 117 | 81 | 318 | 239 |
| Balance, at end of period | 11,693 | 8,363 | 11,693 | 8,363 |

11. SHARE CAPITAL

Vero has the following shares authorized for issuance:

- An unlimited number of preferred shares with no par value.
- An unlimited number of voting, common shares with no par value. The issued and outstanding common shares are as follows:

| Common shares issued and outstanding | September 30, 2011 | | December 31, 2010 | |
|--------------------------------------|--------------------|----------------|-------------------|----------------|
| | Shares | \$ | Shares | \$ |
| Common shares, opening balance | 48,920 | 216,174 | 43,183 | 180,617 |
| Issued on asset acquisition | - | - | 131 | 900 |
| Exercise of stock options | 72 | 491 | 999 | 6,434 |
| Private placement (a) | - | - | 4,607 | 27,598 |
| Tax benefits from issue costs | - | 13 | - | 625 |
| Balance, end of period | 48,992 | 216,678 | 48,920 | 216,174 |

a) Private placement

On November 5, 2010, the Company closed a bought deal financing of 1,539 common shares at a price of \$6.50 per share and 3,068 common shares issued on a flow-through basis at a price of \$8.15 per flow-through common share. The net cash proceeds of issuance of \$32,660 were comprised of gross proceeds of \$35,008 less expenses of the issue of \$2,348. The share capital

addition of \$27,598 is the net cash received less the amount of the flow through share premium of \$5,062. The premium is calculated as the difference between the Company's share price at the date of announcement of the financing and the share price that the flow through shares was issued at. Pursuant to the flow through share issuance the Company was required to incur eligible exploration expenditures in the amount of \$25,004 prior to December 31, 2011 (Note 16 (e)).

b) Stock options

The Company has a stock option plan under which options to purchase common shares may be granted to officers, directors, employees and consultants. The Board has approved a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. As at September 30, 2011 there were 4,899 (September 30, 2010 – 4,353) shares reserved for issuance under the plan. All options awarded have a maximum term of five years and vest in equal one-third increments on each anniversary of the grant. During the nine months ended September 30, 2011, 72 options were exercised with \$143 being charged to contributed surplus. For the three months ended September 30, 2011, 6 options were exercised with \$8 being charged to contributed surplus. The following stock options were outstanding at the end of the respective periods:

| | September 30, 2011 | | September 30, 2010 | |
|----------------------------------|--------------------|------------------------------------|--------------------|------------------------------------|
| | Stock Options | Weighted Average Exercise Price \$ | Stock Options | Weighted Average Exercise Price \$ |
| Outstanding, beginning of period | 4,276 | 5.57 | 4,203 | 5.26 |
| Granted | 1,068 | 4.12 | 176 | 6.54 |
| Exercised | (72) | 4.83 | (212) | 4.86 |
| Expired | (694) | 5.43 | (100) | 4.24 |
| Surrendered for cancellation | - | - | (200) | 9.50 |
| Outstanding, end of period | 4,578 | 5.27 | 3,867 | 5.14 |
| Exercisable, end of period | 1,604 | 5.75 | 1,918 | 5.63 |

| Exercise Price | Options Outstanding | | | | | |
|----------------|-------------------------------|------------------------------------|----------------------------------|-------------------------------|------------------------------------|----------------------------------|
| | September 30, 2011 | | | September 30, 2010 | | |
| | Number of Options Outstanding | Weighted Average Exercise Price \$ | Weighted Average Years to Expiry | Number of Options Outstanding | Weighted Average Exercise Price \$ | Weighted Average Years to Expiry |
| \$3.00 - 3.95 | 1,496 | 3.78 | 4.1 | 580 | 3.46 | 3.8 |
| \$4.00 - 5.77 | 1,082 | 4.27 | 3.0 | 2,097 | 4.46 | 2.4 |
| \$5.90 - 7.71 | 2,000 | 6.93 | 3.2 | 1,190 | 7.18 | 2.8 |
| | 4,578 | 5.27 | 3.4 | 3,867 | 5.14 | 2.7 |

c) Share based compensation

The Company accounts for its stock options granted to employees, officers, and directors using the fair value method. In accordance with the Company's incentive stock plan, these options have

an exercise price equal to the fair value of the security at the date of grant. The fair value of each option granted is estimated on the date of grant using a modified Black-Scholes option-pricing model. The following assumptions have been used:

| | Three months ended | | Nine months ended | |
|-------------------------|---------------------------|------|--------------------------|------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Risk free rate (%) | 1.5% | 2.0% | 2.1% | 2.2% |
| Expected life (years) | 5 | 5 | 5 | 5 |
| Expected volatility (%) | 47% | 48% | 47% | 48% |
| Expected dividends | - | - | - | - |

For the nine months ended September 30, 2011, 1,068 (September 30, 2010 – 176) stock options were granted to employees. During the nine months, \$2,182 (September 30, 2010 - \$2,357) was recorded as share based compensation expense with respect to the options outstanding with a corresponding credit to contributed surplus (Note 12). For the nine months ended September 30, 2011, \$357 was capitalized with respect to geological and geophysical personnel salaries, wages and benefits.

For the three months ended September 30, 2011, 972 (September 30, 2010 - 69) stock options were granted to employees. During the three months ended September 30, 2011, \$782 (September 30, 2010 - \$636) was recorded as share based compensation expense with respect to the options outstanding with a corresponding credit to contributed surplus (Note 12). The option grants during the period had a weighted average fair value expense attributed to them of \$1.66 (September 30, 2010 - \$2.91) per share. Volatility was calculated using historical trading values for the past five years up to a maximum of 1,100 trading days.

d) Directors Compensation Unit Plan

Vero has a Directors Compensation Plan comprised of compensation units granted only to directors of the Company. These units vest annually over a three year period and expire three years from the date of grant. Upon vesting, the holder is entitled to exercise the units for cash equal to the amount by which the exercise price (the fair value of a Vero common share on the date of exercise) exceeds the grant price (the fair value of a Vero common share on the day preceding the date of grant). At each reporting period the units are fair valued using a modified Black-Scholes option-pricing model. The assumptions used at September 30, 2011 are: a risk-free rate of 0.91%; volatility of 47% and an expected life of the term remaining in the grant. As at September 30, 2011 there were 480 units outstanding. Included in accounts payable and accrued liabilities is the amortized fair value of \$269 (September 30, 2010 - \$268) pertaining to these grants. During the nine months ended September 30, 2011, \$42 was recorded as share based compensation expense with respect to the units outstanding.

12. CONTRIBUTED SURPLUS

The following table reconciles the Company's contributed surplus as at:

| | Three months ended September 30, | | Nine months ended September 30, | |
|--------------------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2011 | 2010 | 2011 | 2010 |
| Balance at beginning of period | 12,469 | 10,941 | 11,204 | 9,610 |
| Share based compensation expense | 686 | 636 | 1,825 | 2,357 |
| Share based compensation capitalized | 96 | - | 357 | - |
| Exercise of stock options | (8) | (24) | (143) | (414) |
| Balance at end of period | 13,243 | 11,553 | 13,243 | 11,553 |

13. FINANCE EXPENSES

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|-------|------------------------------------|-------|
| | 2011 | 2010 | 2011 | 2010 |
| Interest and bank charges | 1,636 | 1,360 | 4,744 | 3,921 |
| Losses on derivative interest rate contracts | 54 | 76 | 161 | 227 |
| Accretion on decommissioning liabilities | 117 | 81 | 318 | 239 |
| Balance at end of period | 1,807 | 1,517 | 5,223 | 4,387 |

14. DEFERRED TAXES

The provision for deferred income tax reflects an effective rate which differs from the expected, statutory, federal and provincial tax rates. Differences for the three and nine periods ended September 30, 2011 and 2010 are accounted for as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|-------|
| | 2011 | 2010 | 2011 | 2010 |
| Net earnings (loss) before income taxes | 1,386 | (2,017) | 8,592 | 5,692 |
| Expected income tax at the statutory rate of 26.5% (2010 – 28.0%) | 367 | (565) | 2,277 | 1,594 |
| Tax effect of non-deductible and non-taxable amounts related to: | | | | |
| Share based compensation | 139 | 184 | 498 | 670 |
| Changes in expected timing of reversals of temporary differences | 13 | (63) | 333 | (120) |
| Flow through share premium | - | - | 1,189 | 1,191 |
| Other | 8 | 2 | (2) | 1 |
| | 527 | (442) | 4,295 | 3,336 |

The components of the net deferred tax liability are as follows:

| | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| Deferred income tax liabilities: | | |
| Temporary differences relating to capital assets | 31,103 | 22,394 |
| Deferred income tax assets: | | |
| Derivative contract liability | 575 | (377) |
| Future decommissioning liabilities | (2,923) | (2,337) |
| Financing costs | (893) | (1,165) |
| Non-capital losses | (475) | (475) |
| Other | (30) | (27) |
| Deferred tax liability | 27,357 | 18,013 |

15. PER SHARE AMOUNTS

The following table summarizes the shares used in calculating net earnings per share for the periods ended:

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|--------|
| | 2011 | 2010 | 2011 | 2010 |
| Basic earnings (loss) per share computation | | | | |
| Net earnings (loss) | 859 | (1,574) | 4,297 | 2,356 |
| Weighted average shares outstanding - basic | 48,990 | 43,515 | 48,972 | 43,409 |
| Basic earnings per share | 0.02 | (0.04) | 0.09 | 0.05 |

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|--------|
| | 2011 | 2010 | 2011 | 2010 |
| Diluted earnings (loss) per share computation | | | | |
| Net earnings (loss) | 859 | (1,574) | 4,297 | 2,356 |
| Weighted average shares outstanding - basic | 48,990 | 43,515 | 48,972 | 43,409 |
| Dilutive stock options outstanding | 2,394 | - | 2,468 | - |
| Shares notionally repurchased with proceeds from dilutive stock options and returned to treasury | (2,394) | - | (2,468) | - |
| Weighted average shares outstanding - diluted | 48,990 | 43,515 | 48,972 | 43,409 |
| Diluted earnings per share | 0.02 | (0.04) | 0.09 | 0.05 |

During the respective three and nine month periods ended September 30, 2011, 2,183 (September 30, 2010 – 3,867) and 2,110 (September 30, 2010 - 3,867) of the issued stock options were excluded from the calculation of diluted weighted average shares outstanding as to include them would have been anti-dilutive.

16. COMMITMENTS

In addition to the commitments listed below, the Company has various indemnifications in place in the ordinary course of business, none of which, as assessed by management, are expected to have a significant impact on the Company's financial statements.

a) Transportation costs

The Company has committed to firm-service contracts for the transportation of its natural gas. The amounts below are the minimum cash obligations that the Company must pay under the terms of the contract. The combined minimum future costs are as follows:

| | As at September 30, | |
|-------------------------------|----------------------------|--------------|
| | 2011 | 2010 |
| 2010 | - | 389 |
| 2011 | 389 | 1,557 |
| 2012 | 1,542 | 1,402 |
| 2013 | 1,272 | 1,047 |
| 2014 | 1,009 | 774 |
| 2015 | 633 | 360 |
| 2016 | 235 | - |
| 2017 | 96 | - |
| Total minimum payments | 5,177 | 5,529 |

b) Office lease costs

The Company has committed to future minimum payments under an operating lease that covers the rental of office space and a proportionate share of operating costs as follows:

| | As at September 30, | |
|-------------------------------|----------------------------|-------------|
| | 2011 | 2010 |
| 2010 | - | 263 |
| 2011 | 248 | 660 |
| 2012 | 1,060 | - |
| 2013 | 1,053 | - |
| 2014 | 1,045 | - |
| 2015 | 1,045 | - |
| 2016 | 609 | - |
| Total minimum payments | 5,060 | 923 |

c) Indemnifications

From time to time, the Company may become involved in litigation or have claims sought against it in the normal course of business operations. Management of the Company is not currently aware of any claims or actions that would materially affect the Company's reported financial position or results from operations.

Under the terms of certain agreements and the Company's by-laws the Company indemnifies individuals who have acted at the Company's request to be a director and/or officer of the Company, to the extent permitted by law, against any and all damages, liabilities, costs, charges or

expenses suffered by or incurred by the individuals as a result of their service. The Company has no outstanding claims having a potentially material adverse effect on the Company as a whole.

d) Drilling commitments

As at September 30, 2011 Vero is committed to drill and complete a total of 3 (3.0 net) (September 30, 2010 – 3 gross (2.4 net)) wells with a commencement date in 2011 pursuant to farm-in agreements with industry partners. The Company expects to satisfy their net portion of these drilling commitments at an estimated cost of \$9,200 (September 30, 2010 – \$3,167).

(e) Flow-through shares

Pursuant to the flow-through share private placement entered into on November 5, 2010, (Note 11(a)), the Company was obligated to incur \$25,004 in eligible exploration costs by December 31, 2011. As at September 30, 2011, the Company had fulfilled the entire commitment.

17. SUPPLEMENTARY INFORMATION

a) Changes in non-cash working-capital

| | Three months ended | | Nine months ended | |
|--|--------------------|--------|-------------------|--------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Accounts receivable | (772) | 3,878 | 3,167 | 1,415 |
| Prepaid expenses and deposits | 379 | 211 | (63) | 1,283 |
| Accounts payable and accrued liabilities | 7,418 | 15,103 | (3,351) | 7,521 |
| Net change in non-cash working capital | 7,025 | 19,192 | (247) | 10,219 |
| Relating to: | | | | |
| Investing activities | 6,403 | 14,945 | (6,239) | 3,483 |
| Operating activities | 622 | 4,247 | 5,992 | 6,736 |
| | 7,025 | 19,192 | (247) | 10,219 |

b) Supplementary cash flow information

| | Three months ended | | Nine months ended | |
|---------------|--------------------|-------|-------------------|-------|
| | September 30, | | September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Interest paid | 1,483 | 1,260 | 4,238 | 3,182 |

18. FINANCIAL INSTRUMENTS

The Company holds various forms of financial assets and liabilities. The fair values of financial assets and liabilities and a discussion of the risks associated with these assets and liabilities are presented as follows:

A) Fair Value of Financial Assets and Liabilities

The carrying value of financial instruments, which include accounts receivable, deposits, loans receivable, derivative contracts, accounts payable, accrued liabilities and bank debt approximates amounts at which these instruments could be exchanged in a transaction between knowledgeable and

willing parties. Assets and liabilities that are measured at fair value are classified into levels, reflecting the method used to make the measurements. Level 1 fair value measurements are based on unadjusted quoted market prices. Level 2 fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices. The Company's derivative financial instruments are classified as Level 2. The fair value of derivative financial instruments is determined by taking the difference between the contracted price and published forward curves as at the balance sheet date, and then multiplying the price differential by the contracted commodity volumes. The actual amounts realized may differ from these estimates. Level 3 fair value measurements are based on unobservable information. Assessment of the significance of a particular input to fair value measurement requires judgment and may affect the placement within the fair value hierarchy level. Vero's bank debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

Derivative contract assets and liabilities are recorded at their estimated fair value based on the mark-to-market method of accounting, using quoted market prices or, in their absence, third party market indications and forecasts. The carrying and fair values of the Company's financial instruments as at September 30, 2011 and December 31, 2010 were as follows:

| | September 30, 2011 | | | December 31, 2011 | |
|-------------------------------------|--------------------|-----------------|------------|-------------------|------------|
| | Level | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| <u>Financial Assets</u> | | | | | |
| Loans and receivables: | | | | | |
| Accounts receivable | - | 24,291 | 24,291 | 27,458 | 27,458 |
| Deposits | - | 2,716 | 2,716 | 2,880 | 2,880 |
| Derivative contract asset | 2 | 2,298 | 2,298 | - | - |
| <u>Financial Liabilities</u> | | | | | |
| Held-for-trading: | | | | | |
| Derivative contract liabilities | 2 | - | - | 1,422 | 1,422 |
| Other financial liabilities | | | | | |
| Accounts payable and accrued | | | | | |
| Liabilities | - | 56,998 | 56,998 | 60,349 | 60,349 |
| Bank debt | - | 137,919 | 137,919 | 94,164 | 94,164 |

B) Risks Associated with Financial Assets and Liabilities

The nature of these instruments and the Company's operations expose the Company to commodity price, credit and interest rate risks. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure.

Market risk

Market risks are generally those risks that are outside of the control of the Company. These are: commodity prices, foreign exchange rates and interest rates. The objective of the Company is to mitigate exposure to these risks, while maximizing returns to the Company.

Commodity price risk

Due to the volatility of commodity prices the Company is exposed to adverse consequences of declining prices. The Company may enter into future related oil and natural gas contracts in order to protect its cash flow on future sales from the potential adverse impact of declining prices. The contracts reduce the fluctuation in sales revenue by locking in prices with respect to future deliveries

of oil and natural gas. The use of these derivative contracts is governed by a formal policy and is subject to maximum limits established by the Board of Directors. From time to time, the Company has entered into a variety of derivative contracts. As at September 30, 2011, the Company had the following commodity based derivative contracts outstanding:

| Contract | Amount | Term | Price (Canadian \$/bbl) | Type |
|-----------------|---------------|------------------------------|--------------------------------|-------------|
| Costless collar | 500 bbl/day | Jan. 1, - Dec.31, 2011 | \$80.00-\$100.00 | Financial |
| Crude oil swap | 500 bbl/day | Jan. 1, - Dec. 31, 2011 | \$89.00 | Financial |
| Costless collar | 500 bbl/day | Jan. 1, - Dec. 31, 2012 | \$85.00-\$109.25 | Financial |
| Costless collar | 500 bbl/day | April 1, 2011- Mar. 31, 2012 | \$85.00-\$104.00 | Financial |

The gain (loss) on commodity derivative contracts for the three and nine months ended September 30, 2011 and 2010 were as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|------------|-------------------------------------|-------|------------------------------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Realized | 68 | (649) | 842 | (631) |
| Unrealized | (2,970) | 1,716 | (3,721) | (1,608) |
| | (2,902) | 1,067 | (2,879) | (2,239) |

Commodity Price Sensitivities

The following table summarizes the sensitivities of the fair value of the Company's derivative contracts to fluctuations in commodity price changes while holding all other variables constant. The Company believes that a ten percent change in commodity prices is a reasonable measure of volatility. Based on the contracts outstanding at September 30, 2011 and 2010, fluctuations in commodity prices could have resulted in unrealized gains (losses) that would impact after-tax net earnings (loss) as follows:

| | 2011 | | 2010 | |
|--------------------|---------------------------|---------------------------|--------------------|--------------------|
| | 10% Price Increase | 10% Price Decrease | 10% Price Increase | 10% Price Decrease |
| Crude oil prices | (21) | (541) | 816 | (816) |
| Natural gas prices | - | - | 45 | (45) |

Credit risk

Credit risk arises from the potential loss resulting from a counterparty failing to meet its obligations in accordance with the agreed terms. Substantially all of the accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, counterparties and partners. Wherever possible, the Company requires cash calls be paid from its partners on capital projects before they commence. Receivables related to the sale of the Company's petroleum and natural gas production are mainly from major marketing companies who have solid credit ratings. The majority of Vero's sales revenues are normally collected on the 25th day of the month following delivery.

The counter-party with which the Company maintains its derivative contracts is a major Canadian chartered bank, which has an investment grade rating. The carrying amounts of accounts receivable plus the loans receivable represent the Company's maximum credit exposure.

As at September 30, 2011, accounts receivable and their respective aging were comprised of the following:

| | Not past due | | | Past due | Total |
|---------------------------------------|----------------------|-----------------|-----------------|----------------------|---------------|
| | Less than 30 days | 31 – 60 days | 61 – 90 days | More than 90 days | |
| Sales and accrued revenue receivables | 11,416 | 22 | - | 2,839 | 14,277 |
| Joint interest billings with partners | 1,820 | 5,323 | 1,530 | 525 | 9,198 |
| Other receivables | 761 | - | - | 55 | 816 |
| Total accounts receivable | 13,997 | 5,345 | 1,530 | 3,419 | 24,291 |

The carrying amount for accounts receivable represents the maximum credit exposure. Accounts payable due to the same partners are amounts which may be available for offset, or are being held for future offset with certain joint venture receivables. No amounts in the greater than ninety day category are considered to be uncollectible and consequently no allowance has been recorded in respect of those receivables.

Liquidity risk

Liquidity risk would occur if the Company is not able to meet its financial obligations as they come due. The Company has established a standard of ensuring that it has enough resources available to withstand any downturn in the industry. As our industry is very capital intensive, the majority of our spending is related to our capital programs. As disclosed in Note 19, a key measure that the Company utilizes in evaluating its capital structure is the ratio of total net debt to funds flow from operating activities (before changes in non-cash working capital and expenditures on decommissioning obligations) and the current funds flow and credit available.

The Company's goal is to prudently spend its capital while maintaining its credit reputation amongst its suppliers. All of the financial liabilities of the Company excluding bank debt are estimated to be settled within one year of the balance sheet date. The Company has a committed facility of \$170,000 which matures on April 28, 2012 and may be extended for an additional 364 days with the consent of the lenders. The Company will manage its capital spending to stay within its expected and revised borrowing base limits for the duration of the current term of the facility.

As at September 30, 2011 the timing of cash outflows relating to financial liabilities are outlined in the table below:

| | Less than 1 Year | 1-3 Years | 4-5 Years | There- after | Total |
|--|---------------------|--------------|--------------|-----------------|---------|
| Accounts payable and accrued liabilities | 56,998 | - | - | - | 56,998 |
| Bank debt | 137,919 | - | - | - | 137,919 |

Interest rate risk

Interest rate risk arises from changes in market interest rates that may affect the future cash flows from the Company's financial assets or liabilities. The Company's revolving demand loan facility is subject to floating rates and is therefore exposed to fluctuations in the market rates of interest. Periodically, the Company will enter into a variety of derivative contracts to mitigate exposure to interest rate risk. The Company had the following interest rate swap in place at September 30, 2011.

| Contract | Notional Quantity | Term | Reference | Strike Price | Type |
|----------|----------------------|--------------------------------------|------------------|-----------------|------|
| BA Rate | \$25,000/year | January 4, 2010 – January 3, 2012 | CAD-BA - CDOR | 2.05% | Swap |

The above contract resulted in an unrealized gain for the period ended September 30, 2011 of \$43 (2010-\$24).

Based on the interest rate financial instrument that was outstanding at September 30, 2011, fluctuations in interest rates could have resulted in unrealized gains (losses) that would impact after-tax net earnings as at September 30, 2011 and 2010 as follows:

| | 2011 | | 2010 | |
|--------------------|------------------|------------------|------------------|------------------|
| | 1% rate increase | 1% rate decrease | 1% rate increase | 1% rate decrease |
| Interest rate swap | 47 | (47) | 203 | (203) |

The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. As a result, the Company is exposed to similar fluctuations in its net earnings. The Company's assessment of the sensitivity of net earnings to interest rate changes while holding all other variables constant and utilizing a one percent change in interest rates is considered by Vero to be a reasonable measure of volatility. At September 30, 2011 the increase or decrease in net earnings, on an after-tax basis, for a one percent change in interest rates on the floating rate debt amounts to \$47 (2010 - \$203).

Foreign currency exchange risk

Although all of Vero's petroleum and natural gas sales being denominated in Canadian dollars, the underlying market prices for these commodities are impacted by the exchange rate between Canada and the United States. In addition, the fair value of our derivative contracts will fluctuate as a result of changes in foreign exchange rates as most derivative contracts are traded in US dollars and then converted to the Canadian dollar equivalent for settlement purposes on a monthly basis. As the effects of foreign exchange fluctuations are embedded in the Company's results from operations, the aggregate effect of foreign exchange rate fluctuations are not separately identifiable. As at September 30, 2011, the Company had no forward, foreign exchange contracts in place.

19. CAPITAL MANAGEMENT

Maintaining a strong capital structure is paramount to Vero so as to ensure that investor and creditor confidence in the Company is at a high level. The Company considers its capital structure to include shareholders' equity, bank debt and working capital. The Company will adjust its capital structure to manage its current and projected debt through the issuance of shares, increasing its bank line of credit and/or adjusting its capital spending. Vero continually monitors its capital structure and makes adjustments to it with respect to, drilling successes, general economic conditions in the petroleum industry and global events that may affect commodity prices.

Vero's objectives in managing its capital structure are to:

- a) create and maintain flexibility to enable the Company to meet its financial obligations; and
- b) finance growth either through internally generated projects, joint venture relationships or asset/corporate acquisitions.

The Board of Directors reviews and approves any material transactions out of the ordinary course of business, including acquisitions, financing arrangements, and transactions with related parties if any.

The Company monitors its capital structure using primarily the non-GAAP financial metric of net debt to annualized, most recent quarters' funds flow from operations. Vero's objective is to achieve or maintain a net debt to funds flow from operations ratio of one and one half times to two times. This ratio is calculated as total net debt, defined as outstanding bank debt, plus or minus working capital (excluding bank debt, derivative contract assets and liabilities and deferred tax liabilities), divided by funds flow from operations (cash flow from operating activities before changes in non-

cash working capital and deductions for decommissioning costs) for the most recent calendar quarter, annualized (multiplied by four).

This ratio may temporarily increase as a result of an acquisition or as a result of negative commodity price movements. Given the continued low natural gas prices, this ratio has moved beyond Vero's target ratio. The Company continues to explore various alternatives to bring this back to the desire level including: sales of non-core assets and financing alternatives.

To facilitate the management of this ratio, the Company prepares an annual budget, which is updated monthly for any significant acquisitions, changes in economic circumstances outside the control of the Company; and the success or failure of recently deployed capital. Each of the annual budget and quarterly updates used for Board meetings are approved by the Board of Directors and capital spending adjusted accordingly. As at September 30, 2011, the net debt to adjusted funds flow (annualized) was 2.8 (2010 – 2.7) times calculated as follows:

| | Three months ended | |
|--|---------------------------|-----------|
| | September 30, | |
| | 2011 | 2010 |
| Current assets | 27,595 | 31,754 |
| Accounts payable and accrued liabilities | (56,998) | (55,109) |
| Bank debt | (137,919) | (108,278) |
| Net debt | (167,322) | (131,633) |
| Net earnings | 859 | (1,574) |
| Add (deduct): | | |
| Unrealized (gain)\loss on derivative contracts | (2,970) | 1,716 |
| Depletion and depreciation | 12,105 | 10,904 |
| Exploration and evaluation costs written off | 2,324 | 680 |
| Deferred taxes | 527 | (442) |
| Share based compensation | 687 | 636 |
| Loss on disposal of assets | 1,436 | - |
| Accretion on decommissioning liabilities | 117 | 81 |
| Funds flow from operations | 15,085 | 12,001 |
| Annualized funds flow | 60,340 | 48,004 |
| Net debt to annualized funds flow | 2.8x | 2.7x |

The Company's capital is not subject to any external restrictions as to how it is deployed.

20. TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

The interim financial statements for the quarter ended September 30, 2011 have been prepared under IFRS. The Company has prepared reconciliations of equity as at September 30, 2010 and reconciliations of comprehensive income for the three and nine months ended September 30, 2010 using the accounting policies in Note 3 and the following IFRS 1 – “First-time Adoption of International Financial reporting Standards” (“IFRS 1”) exemptions:

First Time Adoption Exemptions Applied and Comparative Period Restatements

IFRS 1 is the standard that governs mandatory exceptions and optional exemptions that an entity may elect for its transition to IFRS in order to assist the entity with the transition process. This standard is only applicable to the opening balance sheet of the entity on the transition date of January 1, 2010. All adjustments made as a result of adoption of IFRS are offset against Vero's January 1, 2010 retained earnings. The Company has taken the following exemptions:

Business combinations

Under IFRS 3 – “Business Combinations”, the determination of the fair value of share consideration differs from the determination under Canadian accounting standards. Any difference in the fair value calculation would have a resulting impact on the carrying amount of net assets acquired, non-controlling interest and any goodwill. The Company has taken advantage of this election, thereby allowing Vero to be exempt from restating business combinations prior to the transition date to IFRS.

Property, Plant and Equipment (“PP&E”)

For PP&E a Company has the option to elect fair value at the date of transition as the deemed cost for its PP&E or to use a revalued amount according to its previous Canadian GAAP if the revaluation, at the date of revaluation, is comparable to fair value or depreciated cost in accordance with IFRS or to measure oil and gas assets at the date of the transition to IFRS at the amount previously determined under previous Canadian GAAP.

Vero has elected to value its PP&E as previously determined under Canadian GAAP. The measurement upon transition to IFRS is as follows: 1) exploration and evaluation assets were reclassified from the full cost pool method to exploration and evaluation (“E&E”) assets at the amount that was previously recorded under Canadian GAAP and 2) the remaining full cost pool of costs was allocated to development and producing assets on a pro-rata basis using reserve values for its proved plus probable company interest reserves. This resulted in \$15,302 in exploration and evaluation assets and \$272,343 in PP&E as at January 1, 2010.

Share based compensation

IFRS 2 – “Share-based Payments”, requires the Company to estimate the number of options expected to vest when a grant of equity instruments do not vest immediately. IFRS 2 does not allow the recognition of the expense on a straight-line basis and requires the Company to estimate the number of options expected to vest when a grant of equity instruments do not vest immediately. IFRS 2 further requires each installment to be treated as a separate arrangement. In addition, Vero previously recognized share-based compensation expense using the graded vesting method, which is the same method required under IFRS. IFRS 1 provides an elective exemption, which allows Vero to apply IFRS 2 only to the unvested options outstanding on the transition date. As a result of the consistency Vero had with the new IFRS standard, there were no changes necessary to retained earnings on the transition date.

Decommissioning liabilities

The Company has elected to apply the exemption from full retrospective application of decommissioning liabilities as allowed under IFRS 1. As such the Company has re-measured the provisions as at January 1, 2010 under IAS 37, “Provisions, Contingent Liabilities and Contingent assets” which was known as Asset Retirement Obligations under Canadian GAAP. Under Canadian GAAP the Company discounted its liability using a credit-adjusted risk free rate. Under IFRS, the Company has chosen to use a risk-free discount rate. Therefore under IFRS the decommissioning liabilities are higher due to the lower discount rates used. IFRS 1 provides an exemption, which the Company has elected, and allows Vero to measure decommissioning liabilities as at the date of transition and to recognize directly in the Company’s retained earnings any difference between that amount and the carrying amount of those liabilities at the date of transition to IFRS. As a result of applying this exemption, an increase of \$2,581 has been made to decommissioning liabilities and Vero’s retained earnings and deferred tax liability decreased by \$1,936 and \$645 respectively, on January 1, 2010.

Under IFRS, the liability is to be re-measured each reporting period in order to reflect changes in interest rates. As a result of lower interest rates used for the discounting and unwinding of

decommissioning liabilities, accretion expense for the three months ended September 30, 2010 decreased by \$19 when compared to accretion expense under Canadian GAAP. For the entire year of 2010, accretion expense decreased by \$90.

Depletion Policy

Previous Canadian GAAP provided specific guidelines on the calculation of depletion for oil and natural gas properties. Previously, depletion was calculated on the unit-of-production method using proved reserves as their base. Under IFRS, the Company had a choice as to the reserve base used in its depletion calculations. Vero has adopted the policy of depleting its oil and natural gas properties using its proved plus probable reserve base. Also, depletion calculations under previous GAAP were done on a cost centre basis. Under Canadian GAAP, Vero had only one cost centre. Under IFRS, the Company is required to calculate depletion based on individual components for which the Company has identified to be at the geographic area level. The adoption of this policy was effective as of the transition date. As a result of using proved plus probable reserves for its depletion base, depletion and depreciation expense decreased by \$3,132 and \$14,292 for the three months ended September 30, 2010 and the year ended December 31, 2010 respectively.

Impairment Test

IFRS requires an asset impairment test to be conducted on the transition date and subsequently when indicators of impairment are present. Under Canadian GAAP, impairment of long-lived assets is assessed on the basis of an asset's estimated undiscounted future cash flows compared with the asset's carrying amount and if impairment is indicated, discounted cash flows are prepared to quantify the amount of impairment. The impairment test under previous Canadian GAAP was done at the cost centre level. Vero had only one cost centre and no impairments were ever recorded.

IFRS requires the impairment test to occur at the asset level or the CGU level when long-lived assets exist that do not generate independent cash inflows. The carrying amount of the asset or CGU is compared to its recoverable amount which is the higher of the value-in-use or the fair value of the assets less the costs to sell it.

Vero performed an impairment test on transition to IFRS as at January 1, 2010 based on fair value less estimated costs to sell. Fair value was based on the most recent reserve report as evaluated by the Company's independent engineers. The Company did not experience any impairment on the transition date. For each of the quarters ended in 2010, Vero performed additional impairment tests as determined by internal estimates of revisions to the most recent engineering evaluation of its reserves and concluded that at no time during 2010 were any of the CGU's considered to be impaired.

Asset Divestitures

Under Canadian GAAP, proceeds from oil and gas property divestitures were deducted from the country cost centre pool without recognition of any gain or loss unless the deduction of the proceeds from the pool resulted in a change to the depletion rate of 20% or greater. Under IFRS, proceeds from a divestiture are deducted from the carrying value of the asset and a gain or loss is recognized in the statement of comprehensive income. As a result of a divestiture in 2010, Vero recognized a loss on the disposition of \$476 for the year ended December 31, 2010.

Flow-through Shares

Under previous Canadian GAAP, the accounting treatment for flow-through shares was contained in EIC 146 “Flow-Through Shares”. Under Canadian GAAP the proceeds received for the flow-through shares were credited to shareholders capital and a future tax liability was recognized when the Company filed the renunciation documents with the tax authorities to renounce the tax deductions associated with qualifying expenditures.

Under IFRS, the issuance of flow-through shares is treated as a sale of tax benefits in a separate transaction. As a result, the Company sets up a liability for the difference between the proceeds received on the share issuance and the market price of the shares on the date of the transaction. As the expenditures are made, the Company records the related tax liability associated with the renunciation of the tax benefits and de-recognizes the deferred liability that was originally set up. The difference between the deferred tax liability and the original liability recorded is recognized as a deferred tax expense in the statement of comprehensive income.

As a result of the flow-through share issuance in November of 2010, the Company recorded a deferred liability of \$5,062 as at December 31, 2010 with an offsetting adjustment to share capital.

Income Taxes

IFRS does not use the term “future income taxes” as was the case under previous Canadian GAAP. IFRS uses the term “deferred income taxes”. Under IFRS, all deferred tax assets and liabilities are classified as non-current. Certain of the IFRS conversion adjustments as discussed in this transition note have related effects on deferred income taxes. The tax impact of the above changes increased (decreased) the deferred tax liability as follows:

| | As at January 1, 2010 | As at December 31, 2010 |
|---|--------------------------|----------------------------|
| Depletion and depreciation | (1,219) | 2,800 |
| Decommissioning liabilities | (645) | (927) |
| Loss on divestiture | - | (133) |
| Increase (decrease) in deferred tax liability | (1,864) | 1,740 |

Presentation

Interest and finance charges presentation and classification differs under IFRS than what was previously done under Canadian GAAP. The net finance income or expense is presented separately from operating expenses. The charges included here also include the unwinding of the discount rate on decommissioning liabilities that was previously presented as part of depletion, depreciation and accretion under Canadian GAAP.

As a result of adoption of IFRS there have been no material changes to the statement of cash flows.

Reconciliation of equity as at September 30, 2010

| | Notes | September 30, 2010 CDN GAAP \$ | Effect of transition to IFRS \$ | September 30, 2010 IFRS \$ |
|---|-------|---|--|-------------------------------------|
| ASSETS | | | | |
| Current | | | | |
| Accounts Receivable | | 28,126 | - | 28,126 |
| Prepaid expenses & deposits | | 3,283 | - | 3,283 |
| Current portion of derivative contracts | | 345 | - | 345 |
| | | 31,754 | | 31,754 |
| Property, plant and equipment | b | 332,158 | (11,796) | 320,362 |
| Exploration and evaluation assets | a | - | 19,129 | 19,129 |
| Goodwill | | 19,913 | - | 19,913 |
| Derivative contracts | | 17 | - | 17 |
| | | 383,842 | 7,333 | 391,175 |
| LIABILITIES | | | | |
| Current | | | | |
| Accounts payable & accrued liabilities | | 55,109 | - | 55,109 |
| Bank debt | | 108,278 | - | 108,278 |
| | | 163,387 | | 163,387 |
| Decommissioning liability | f | 5,378 | 2,985 | 8,363 |
| Deferred taxes | c | 17,651 | 1,068 | 18,719 |
| | | 186,416 | 4,053 | 190,469 |
| SHAREHOLDERS' EQUITY | | | | |
| Share capital | d | 180,519 | 2,470 | 182,989 |
| Contributed surplus | | 11,553 | - | 11,553 |
| Retained earnings | e | 5,354 | 810 | 6,164 |
| | | 197,426 | 3,280 | 200,706 |
| | | 383,842 | 7,333 | 391,175 |

Explanation of the effect of the transition to IFRS

The following explains the material adjustments to the balance sheet as at September 30, 2010:

| | |
|---|---------------|
| Exploration and evaluation assets | \$ |
| (a) | |
| Reclassification of cost from property, plant and equipment to exploration and evaluation assets. The Company reallocated certain costs relating to unproved properties from property and plant to exploration and evaluation assets. | 21,421 |
| Exploration and evaluation costs written off | (2,292) |
| Net effect- increase in exploration and evaluation assets | 19,129 |

\$

Property, plant and equipment**(b)**

| | |
|---|-----------------|
| Reclassification of cost from property, plant and equipment to exploration and evaluation. In accordance with IFRS 1, the Company reallocated certain costs relating to unproved properties from property and plant to exploration and evaluation assets. | (15,302) |
| Reclassification of cost from property, plant and equipment to exploration and evaluation assets (nine months ended September 30, 2010) | (6,431) |
| Reclassification of cost from exploration and evaluation assets to property, plant and equipment | 312 |
| Increase to decommissioning asset | 473 |
| Decrease in accumulated depletion on oil and gas properties | 9,152 |
| Net effect- decrease to property, plant and equipment | (11,796) |

Deferred taxes**(c)**

| | |
|---|--------------|
| Cumulative tax effect of opening balance sheet adjustments and period adjustments | |
| Net effect- increase to the liability | 1,068 |

Share capital**(d)**

| | |
|---|--------------|
| Regarding the November, 2009 flow through share issue, a charge was taken against share capital with a corresponding credit to deferred liabilities as a result of the difference between the market value and the value the shares were offered at. | (1,986) |
| A charge was taken against retained earnings with a corresponding credit to share capital regarding the April 2007 and February 2008 flow through share offering. This is the income statement impact regarding the deferred income tax expense associated with these issuances | 1,323 |
| A charge was taken against share capital with a corresponding credit to retained earnings as a result of backward tracing of share issue costs. | (69) |
| A credit was taken against share capital for the tax effect of the November, 2009 flow through shares and the current period cumulative tax effect adjustments | 3,202 |
| Net effect- increase to share capital | 2,470 |

Retained earnings**(e)**

| | |
|--|---------|
| Increase in the carrying value of the decommissioning liability | (1,935) |
| A charge was taken against retained earnings with a corresponding credit to share capital. This is the income statement impact regarding the future income tax expense associated with the April, 2007 and February, 2008 flow through share issuances | (1,323) |
| A charge was taken against share capital with a corresponding credit to retained earnings as a result of backward tracing of share issue costs. | 61 |
| A charge was taken against future income tax liability and a corresponding credit to retained earnings as a result of tax effecting first quarter adjusting entries | 1,219 |
| Increase to current period income due to reduction in depletion | 9,628 |
| Decrease to income due to exploration and evaluation adjustments | (2,291) |
| Increase to income due to reduction in accretion of decommissioning liability | 69 |
| Decrease to income due deferred tax adjustments | (4,142) |
| Loss on sale of assets | (476) |

Decommissioning liability

(f)

| | | |
|---|--|--------------|
| Increase in the carrying value of the decommissioning liability | | 2,581 |
| Increase in the carrying value due to changes to a change in the discount rate applied from a credit adjusted rate as required by Canadian GAAP to a risk-free rate that reflects the current market assessments of the time value of money | | 404 |
| Net effect- increase to the liability | | 2,985 |

Reconciliation of comprehensive income (loss) for the nine months ended September 30, 2010

| | Notes | Canadian GAAP \$ | Effect of transition to IFRS \$ | IFRS \$ |
|--|-------|------------------------|--|----------------|
| REVENUE | | | | |
| Oil & gas sales | | 81,250 | - | 81,250 |
| Royalties | | (8,827) | - | (8,827) |
| Revenue, net | | 72,423 | - | 72,423 |
| Finance Income | | 190 | - | 190 |
| Total Revenues | | 72,613 | - | 72,613 |
| EXPENSES | | | | |
| Operating | | 19,000 | - | 19,000 |
| Transportation | | 3,614 | - | 3,614 |
| General & administrative | | 5,004 | - | 5,004 |
| Share based compensation | | 2,357 | - | 2,357 |
| Finance costs | (b) | 3,922 | 465 | 4,387 |
| Exploration and evaluation costs written off | (c) | - | 2,292 | 2,292 |
| (Gains)/losses on derivatives | (d) | (2,012) | (227) | (2,239) |
| Depletion & depreciation | (a) | 41,966 | (9,936) | 32,030 |
| Loss on disposal of assets | (f) | - | 476 | 476 |
| | | 73,851 | (6,930) | 66,921 |
| INCOME (LOSS) BEFORE INCOME TAXES | | | | |
| Deferred income tax (recovery) | (e) | (808) | 4,144 | 3,336 |
| NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS) | | | | |
| | | (430) | 2,786 | 2,356 |
| NET EARNINGS PER SHARE | | | | |
| Basic | | (0.01) | 0.06 | 0.05 |
| Diluted | | (0.01) | 0.06 | 0.05 |

The nature of the adjustments are explained as follows:

| | |
|--|----------------|
| Depletion and depreciation | \$ |
| (a) | |
| Reduction in depletion expense for the period | (9,628) |
| Reclassification of decommissioning liability accretion to finance cost | (239) |
| Reduction in accretion related to decommissioning liability | (69) |
| Net effect- reduction in depletion and depreciation expense | (9,936) |
| | |
| Finance costs | |
| (b) | |
| Reclassification of realized loss on interest rate swap to finance costs | 227 |
| Reclassification of accretion on decommissioning liability | 238 |
| Net effect- increase in finance costs | 465 |
| | |
| Exploration and evaluation costs | |
| (c) | |
| Expiries of exploration and evaluation assets | 2,292 |
| Net effect- increase in exploration and evaluation costs | 2,292 |
| | |
| Gains and losses on derivatives | |
| (d) | |
| Reclassification of realized loss on interest rate swap to finance costs | (227) |
| Net effect- increase in gains and losses on derivatives | (227) |
| | |
| Deferred taxes | |
| (e) | |
| Cumulative effect of deferred tax adjustments for current period | 4,144 |
| Net effect- increase to deferred tax | 4,144 |
| | |
| Loss on disposal of assets | |
| (f) | |
| Loss on disposal of assets in current period | 476 |
| Net effect- increase to loss on disposal | 476 |

Reconciliation of comprehensive income (loss) for the three months ended September 30, 2010

| | Notes | Canadian GAAP \$ | Effect of transition to IFRS \$ | IFRS \$ |
|--|-------|------------------------|--|----------------|
| REVENUE | | | | |
| Oil & gas sales | | 24,295 | - | 24,295 |
| Royalties | | (2,610) | - | (2,610) |
| Revenue, net | | 21,685 | - | 21,685 |
| EXPENSES | | | | |
| Operating | | 5,750 | - | 5,750 |
| Transportation | | 1,245 | - | 1,245 |
| General & administrative | | 1,902 | - | 1,902 |
| Share based compensation | | 636 | - | 636 |
| Finance costs | (b) | 1,361 | 156 | 1,517 |
| Exploration and evaluation | (c) | - | 680 | 680 |
| (Gains)/losses on derivatives | (d) | 1,144 | (77) | 1,067 |
| Depletion & depreciation | (a) | 14,036 | (3,132) | 10,904 |
| | | 26,074 | (2,373) | 23,701 |
| INCOME (LOSS) BEFORE INCOME TAXES | | | | |
| | | (4,389) | 2,373 | (2,016) |
| Deferred income tax (recovery) | (e) | (1,073) | 631 | (442) |
| | | (1,073) | 631 | (442) |
| NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS) | | | | |
| | | (3,316) | 1,742 | (1,574) |
| NET EARNINGS PER SHARE | | | | |
| Basic | | (0.08) | 0.04 | (0.04) |
| Diluted | | (0.08) | 0.04 | (0.04) |

The nature of the adjustments are explained as follows:

| | | |
|---|--|----------------|
| Depletion and depreciation | | \$ |
| (a) | | |
| Reduction in depletion expense for the period | | (3,033) |
| Reclassification of decommissioning liability accretion to finance cost | | (80) |
| Reduction in accretion related to decommissioning liability | | (19) |
| Net effect- reduction in depletion and depreciation expense | | (3,132) |

Finance costs

| | | |
|--|--|------------|
| (b) | | |
| Reclassification of realized loss on interest rate swap to finance costs | | 76 |
| Reclassification of accretion on decommissioning liability | | 80 |
| Net effect- increase in finance costs | | 156 |

Exploration and evaluation

| | | |
|-----------------------------------|--|-----|
| (c) | | |
| Expense expiries of unproved land | | 680 |

| | |
|--|-------------|
| Net effect- increase to exploration and evaluation cost | 680 |
| (Gains) and losses on derivatives | |
| (d) | |
| Reclassification of realized loss on interest rate swap to finance costs | (77) |
| Net effect- increase in gain on derivatives | (77) |
| Deferred taxes | |
| (e) | |
| Cumulative effect of future income tax adjustments for current period | 631 |
| Net effect- increase to deferred taxes | 631 |