Management's discussion and analysis ("MD&A") of the financial condition and the results of operations should be read in conjunction with the audited consolidated financial statements of Yangarra Resources Ltd. (the "Company") for the years ended December 31, 2007 and 2006, together with the accompanying notes. The MD&A has been prepared using information that is current to April 22, 2008.

The financial information presented herein has been prepared on the basis of Canadian generally accepted accounting principles ("GAAP"). Throughout this discussion, percentage changes are calculated using numbers rounded to the decimal to which they appear. All references to dollar amounts are in Canadian dollars.

BOE Presentation – *Production information is commonly reported in units of barrel of oil equivalent ("boe"). For purposes of computing such units, natural gas is converted to equivalent barrels of oil using a conversion factor of six thousand cubic feet to one barrel of oil. This conversion ratio of 6:1 is based on an energy equivalent wellhead value for the individual products. Such disclosure of boe may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.*

Special Note Regarding Non-GAAP Measures *– This MD&A includes references to financial measures commonly used in the oil and gas industry. The terms "**net petroleum and natural gas revenue**" (petroleum and natural gas sales less royalties, production expenses and transportation costs) and "**funds flow from operations**" (net loss for the period adjusted for non-cash items in the statement of operations) are not GAAP measures and do not have standardized meanings prescribed by GAAP.*

Forward-looking Statements – *Certain information regarding the Company set forth in this report, including management's assessment of the Company's future plans and operations, contain forward-looking statements that involve substantial known and unknown risks and uncertainties. These risks and uncertainties, many of which are beyond the Company's control, include the impact of general economic conditions and specific industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, the lack of available qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. The Company's actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements, and accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur, or if any of them do, what benefits the Company can derive such events.*

Company Description and Outlook

Yangarra Resources Ltd. ("Yangarra" or the "Company") was formed by the amalgamation on November 9, 2005, under the Business Corporations Act (Alberta), of Yangarra Resources Inc. and TriOil Ltd. The Company is involved in the production, exploration and development of resource properties in the Ferrier, Medicine Hat, Mega, Viking, Jaslan and Bigstone areas of Alberta and in Bayhurst, Saskatchewan.

During 2007, management focused its efforts on managing costs and making strategic changes to its drilling program and practices. Results of these efforts can be seen in the $4.8 million improvement in the Company's working capital deficit through the reduction of debt levels and internal overhead. In addition Yangarra was able to increase the value of its reserve base while minimizing capital expenditures.

The Company changed its exploration focus in 2007 from a geological model to an engineering-driven exploration model. This change has resulted in reduced exploration risk and capital expenditures and lower finding and development costs. Yangarra is now working primarily in 100% working interest situations which give the Company significant leverage on internal effort.

The main focus going forward will be in the Medicine Hat and Jaslan areas, where the Company has extensive infrastructure and land holdings, as well as in Ferrier which has deeper oil and gas potential. The Company's non-core areas will be sold as appropriate opportunities arise.

In Medicine Hat, the Company will continue to develop the shallow horizons, with technological advances in completion techniques playing a large role. Yangarra has extensive land holdings and very little competition as the Company's plant is 16 kilometres from the closest competitor. The Company has also been active in developing the deeper horizons in the area with its first successful pool adding reserves and production at very low cost.

In Jaslan, a new pool is in the early stages of development with a new plant to be built and additional wells drilled into this discovery. Additional wells are also planned for the existing facility on Yangarra's 100% owned land base.

In Ferrier, a Cardium re-completion performed early in 2008 shows very good oil potential and more recently, Colorado Shales have begun to receive increased interest in the area. With recent advancements in horizontal fracing technology, Yangarra's considerable land base and company-owned infrastructure coupled with the multi-zone, tight, deep reservoir nature of this region of Alberta, the Company is well positioned to add reserves and production.

Management believes its plans and initiatives for 2008 will enable the Company to continue to reduce debt levels and improve its financial position.

Results of Operations

During 2007, the Company's drilling program resulted in one successful gas well drilled and cased in Jaslan, two successful gas wells in Medicine Hat, one dry and abandoned well drilled in Ferrier, and one re-entry well successfully completed and tied in at Ferrier.

	Three months ended December 31			Year ended December 31		
	2007	2006	2005	2007	2006	2005
Statement of Operations and Deficit						
Petroleum & natural gas sales ($)	1,443,695	2,381,251	3,231,966	7,899,634	9,439,251	8,354,853
Petroleum & natural gas sales per boe ($)	43.17	44.02	64.89	45.10	43.33	55.59
Net petroleum & natural gas revenue ($)	1,072,194	1,905,553	2,211,174	5,688,637	6,238,311	5,533,369
Net petroleum & natural gas revenue per boe ($)	32.06	35.23	44.40	32.48	28.64	36.81
Daily sales volumes (boe 6:1)	362	588	541	480	597	412
Net income (loss) for the period ($)	64,089	(884,912)	134,136	(1,271,113)	(1,963,139)	(266,347)
Net income (loss) per share – basic ($)	–	(0.02)	–	(0.02)	(0.04)	(0.01)
Statement of Cash Flows						
Funds flow from operations ($)	594,704	1,222,746	1,472,621	3,504,225	4,102,713	4,008,345
Balance Sheet						
Property and equipment ($)				40,371,767	46,012,569	42,150,409
Total assets ($)				42,009,723	48,281,762	45,548,347
Weighted average number of shares – basic	61,555,766	53,989,674	42,901,182	55,896,744	53,759,207	31,228,861

Net Petroleum and Natural Gas Revenue

Fourth Quarter Results

Net petroleum and natural gas revenue for the three months ended December 31, 2007 was $1,072,194 ($32.06/boe) compared to $1,905,553 ($35.23/boe) for the 2006 comparative period. The decrease is explained by changes in the following components:

- Petroleum and natural gas sales before royalties were $1,443,695 (362 boe/day) for the three months ended December 31, 2007 compared to $2,381,251 (588 boe/day) for the same 2006 quarter. Daily production dropped due to the sale of Mundare in July 2007 and natural declines in several other areas.
- Petroleum and natural gas sales for the three months ended December 31, 2007 includes $120,905 of commodity contract revenue related to natural gas collars in place since March 2007.
- Royalties in the fourth quarter of 2007 were $130,294 ($3.90/boe or 9% of sales) as compared to $251,403 ($4.65/boe or 11% of sales) for the fourth quarter of 2006. The reduction in royalties on both a percentage and boe-basis relate to production declines in the Provost and Viking areas and on certain Medicine Hat wells with overriding and freehold burdens which resulted in lower royalty rates in the latter part of 2007.
- Production and transportation costs were $241,207 ($7.21/boe) for the three months ended December 31, 2007 compared to $224,295 ($4.15/boe) for the same 2006 quarter. Lower costs in 2006 are due to a $214,000 recovery of prior year(s) operating costs resulting from the settlement of a joint venture audit of Ferrier operating costs performed by the Company in 2005. Excluding the recovery, fourth quarter 2006 production and transportation costs were $8.10/boe. 2007 fourth quarter operating costs continue to reflect recoveries and adjustments in the Ferrier area offset by increased costs per boe in Provost and Viking, where production has declined.

Annual Results

Net petroleum and natural gas revenue for the year ended December 31, 2007 was $5,688,637 ($32.48/boe) compared to $6,238,311 ($28.64/boe) for 2006. The variance is explained by changes in the following components:

- Petroleum and natural gas sales before royalties were $7,899,964 (480 boe/day) for the year ended December 31, 2007 compared to $9,439,251 (597 boe/day) for 2006. The decrease in sales is attributed to a decrease in production volumes due to the sale of Mundare in July 2007 and natural declines in the Ferrier and Viking areas and limited production from the Bigstone well due to plant capacity issues. These reductions were partially offset by new production in the Jaslan area.
- The average price earned in 2007 was $45.10/boe compared to $43.33/boe earned in 2006 which can be attributed to slightly higher pricing for all commodities plus $270,508 of commodity contract revenue related to natural gas collars in place since March 2007.
- Royalties for 2007 were $1,039,249 compared to $1,335,695 for 2006, which were net of the Alberta Royalty Tax Credit. As a percentage of sales, royalties decreased from 14% in 2006 to 13% in 2007 due to reduced production levels on certain wells with higher royalty burdens.
- Production and transportation costs were $1,172,078 ($6.69/boe) for the year ended December 31, 2007 compared to $1,865,245 ($8.56/boe) for the year ended December 31, 2006. Both 2007 and 2006 operating costs include adjustments to Ferrier costs related to joint venture audit results and/or

facility equalization adjustments. Removing the effects of these adjustments, production and transportation costs for 2007 were $9.46/boe compared to $9.54/boe for 2006. Lower costs in 2007 on this adjusted basis can be attributed to the Jaslan area, where the increase in production reduced costs per boe.

General and administrative expenses

General and administrative expenses for the three months and year ended December 31, 2007 were $330,902 and $1,106,879, respectively, compared to $445,555 and $1,287,103, respectively, for the three months and year ended December 31, 2006. The decrease in general and administrative expenses in 2007 is due to management's efforts to monitor and reduce costs.

Interest and financing fees

Interest and financing fees for the three months and year ended December 31, 2007 were $211,400 and $1,423,942, respectively, compared to $365,011 and $1,082,204 for the same 2006 periods. Interest and financing fees include interest on the revolving operating demand loan for which the amount drawn increased from September 2006 to July 2007. Interest and financing fees also include charges related to the credit facility at an interest rate of 9% of which $3,000,000 was obtained in June 2006 and then increased to $5,000,000 in September 2006 and decreased to $4,500,000 in July 2007. Additional fees were paid in the latter part of 2007 in conjunction with the renewal signed in December 2007. A portion of these fees were originally expensed when incurred, however, as a consequence of new financial instrument accounting standards, these costs were net against the facility in the fourth quarter and amortized to interest and financing fees using the effective interest rate method.

Stock-based compensation

Stock-based compensation ("SBC") for the three months and year ended December 31, 2007 was $52,565 and $177,942 of expense, respectively, compared to a $143,372 credit and $251,168 of expense, respectively for the same 2006 periods. The $143,372 credit in the fourth quarter of 2006 was due to a year-end adjustment to capitalize SBC related to field personnel consistent with the treatment by peer companies. The decrease in SBC for 2007 compared to 2006 is due to the reversal of certain SBC combined with the capitalizing of $58,802 related to field personnel. In addition, for certain options that fully vested in 2006, no further SBC is recorded after the vesting date.

Depletion, depreciation and accretion

Depletion and depreciation expense for the three months and year ended December 31, 2007 was $1,026,331 ($30.69/boe) and $5,743,923 ($32.79/boe), respectively, compared to $1,791,362 ($33.12/boe) and $6,241,307 ($28.65/boe), respectively, for the three months and year ended December 31, 2006. The decrease in the fourth quarter depletion rate is due to an increase in the Company's proved reserves based on the Company's drilling program as reflected in the December 31, 2007 reserve report.

Accretion expense for the three months and year ended December 31, 2007 was $25,691 and $104,310, respectively, compared to $24,029 and $91,118, respectively, for the same 2006 periods. The increase in the 2007 amounts is due to an increase in the undiscounted cash flows associated with the retirement of the Company's assets resulting from the increase in the number of properties and changes to certain reserve life and cost estimates.

2006 impairment loss on goodwill

Goodwill was acquired through the November 9, 2005 amalgamation between Yangarra Resources Inc. and TriOil Ltd. and represented the excess of the cost over the net of the amounts assigned to assets acquired and liabilities assumed through the August 13, 2004 amalgamation between TriOil and Entrada

Energy Inc. As at December 31, 2006, the Company determined that the $396,208 carrying value of goodwill was not recoverable and consequently wrote-off the carrying value as an impairment loss on goodwill in the statement of operations and deficit.

Gain on investment

The Company holds a minority equity position in a public company. In November 2007, the Company disposed of a portion of its investment for proceeds of $126,160, resulting in a gain of $59,490. As at December 31, 2007, the fair value of the Company's investment was $125,620. As a consequence of adopting new financial instruments standards, the $83,032 difference between the pro-rata carrying value reported at December 31, 2006 and the December 31, 2007 fair value has been recognized as a gain on investment.

Future income tax recovery

During the year ended December 31, 2007, the Company recorded a $1,209,924 recovery of future income taxes compared to the $1,137,199 recovery recorded in 2006. The increase in the recovery is due to a reduction in the future tax rate resulting from lower tax rates announced in the 2007 federal and provincial budgets and to the effect of the federal reduction related to the non-deductibility of crown charges and the calculation of resource allowance.

Liquidity and Capital Resources

During the three months and year ended December 31, 2007, the Company generated $594,704 and $3,504,225, respectively, of funds flow from operations compared to $1,222,746 and $4,102,713, respectively, generated in the 2006 comparative periods. The decline in the 2007 funds flow figures is due to the decrease in net petroleum and natural gas revenues and increase in interest and financing fees which offset the decrease in general and administrative expenses.

As at December 31, 2007, the Company's revolving operating demand loan was available to a maximum of $8,400,000, of which the Company had drawn $7,600,000. In February 2008, the available maximum was increased to $8,500,000. The Company is subject to a working capital covenant for the revolving operating demand loan which was met at December 31, 2007.

As at December 31, 2007, the Company had a $4,500,000 credit facility (2006 – $5,000,000) bearing interest at 9% (2006 – 9%) per annum calculated and payable monthly and maturing on December 31, 2008. Pursuant to the renewal of the credit facility in December 2007, the interest rate was revised to 12%. In addition, the Company is required to pay a 4% deferred fee upon partial or full repayment of outstanding balances under the credit facility. In conjunction with the 2007 credit facility and renewal, the Company paid fees of $225,000 including $45,000 recorded as a long-term payable settled through the issuance of 450,000 common shares upon receipt of regulatory approval in January 2008.

In June 2007, certain shareholders, who are also officers and directors of the Company, advanced the Company $880,000. In September 2007, $400,000 of advances were repaid in cash and the remaining $480,000 was converted to 2,990,909 common shares in conjunction with the private placements described below.

In October 2007, the Company closed two non-brokered unit private placements for total gross proceeds of $1,132,000. All units subscribed for were issued on October 18, 2007 as follows:

i. 6,163,636 common share units at $0.11 per unit for gross proceeds of $678,000. Each unit is comprised of one common share of the Company and one-half of a share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one common share at $0.17

per share at anytime prior to June 30, 2008.

ii. 3,242,857 flow-through units at $0.14 per unit for gross proceeds of $454,000. Each flow-through unit is comprised of one common share issued on a flow-through basis and one-half of a share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one common share at $0.17 per share at anytime prior to June 30, 2008.

Officers and directors of the Company subscribed for common share units and flow-through units for aggregate proceeds of $933,000.

As at December 31, 2007, the Company had a working capital deficit of $12.8 million compared to a deficit of $17.6 million at December 31, 2006. The $4.8 million improvement in the working capital deficit was due to $3.5 million of funds flow generated by operating activities, $3.4 million of disposition proceeds related to the Mundare properties sold in July and equipment sold in December, $1.1 million of private placement proceeds and $0.1 million of investment proceeds offset by $3.3 million of capital spending.

Capital Spending

During the three months and year ended December 31, 2007, the Company spent $1,056,487 and $3,267,994, respectively, on its capital spending program compared to $3,032,046 and $9,757,009, respectively, for the three months and year ended December 31, 2006.

Capital spending is summarized as follows:

	Three months ended December 31		Year ended December 31	
	2007	2006	2007	2006
Land and lease rentals	$ 55,970	$ 39,074	$ 167,480	$ 486,168
Drilling and completion	655,171	1,439,301	1,565,066	4,947,363
Geological and geophysical	8,955	279,229	204,603	768,177
Equipment	336,391	1,273,770	1,330,845	3,548,150
Other	–	672	–	7,151
	1,056,487	3,032,046	3,267,994	9,757,009
Dispositions	(577,000)	–	(3,430,734)	(207,000)
	$ 479,487	$ 3,032,046	$ (162,740)	$ 9,550,009

2007 drilling activity

	Three months ended December 31, 2007		Year ended December 31, 2007	
	Gross	Net	Gross	Net
Natural gas	2	2	3	2.375
Re-entry (gas)	–	–	1	0.244
Dry	–	–	1	0.500
	2	2	5	3.119

Asset retirement obligation

As at December 31, 2007, the undiscounted fair value of the asset retirement obligation associated with the Company's existing properties was estimated to be $3,965,076 for which $1,740,366 has been recorded using a discount rate of 7%, an inflation rate of 2% and an estimated weighted average timing of cash flows of 12.8 years.

Related Party Transactions

During the years ended December 31, 2007 and 2006, the Company's related party transactions consisted of:

a)

		2007		*2006*
Administration and consulting fees	$	123,498	$	164,330
Production and capital expenditures	$	148,326	$	324,649

The above amounts were charged or invoiced by certain of its officers and directors and by companies controlled by certain of the Company's officers and directors.

b) $29,960 (2006 – $32,299) of legal fees charged by a law firm in which a director of the Company is a partner.

Share Capital

Common shares

The Company commenced 2007 with a total of 53,989,674 issued and outstanding shares with a book value of $31,474,785. In October 2007, the Company issued 9,406,493 shares in conjunction with a unit private placement. As at December 31, 2007, there were 63,396,167 issued and outstanding shares with a book value of $32,533,251.

In January 2008, the Company issued 450,000 common shares as settlement of a long-term payable in respect of certain credit facility fees. In April 2008, the Company issued 750,000 common shares on the exercise of warrants.

As of the date of this MD&A, the Company had 64,596,167 common shares outstanding.

Warrants

In October 2007, the Company issued 4,703,247 warrants in conjunction with a unit private placement, all of which were outstanding at December 31, 2007. In April 2008, 750,000 warrants were exercised resulting in 3,953,247 warrants outstanding as of the date of this MD&A.

Stock options

At the beginning of 2007, there were 4,572,950 stock options outstanding, of which 2,872,113 were exercisable. During the year a total of 1,580,000 options were granted and 2,015,675 options were cancelled. The resulting number of options outstanding at December 31, 2007 was 4,137,275 of which 2,412,275 were exercisable.

In January 2008, the Company granted 1,750,000 options, increasing the number of options outstanding as of the date of this MD&A to 5,887,275 of which 4,162,275 are exercisable.

Commitments

The Company has commitments for leased office premises and equipment with estimated minimum annual payments of $234,508 in 2008, $160,800 in 2009 and $31,123 in 2009.

The Company has until December 31, 2008 to incur the $454,000 of qualifying flow-through expenditures of which approximately $9,410 had been incurred as at December 31, 2007.

Commodity contracts

a) During 2007, the Company engaged in the following European commodity collars for the sale of natural gas:

i) 1,000 GJ per day from March 1 to December 31, 2007 at a ceiling price of $10.00 per GJ and a floor price of $7.00 per GJ with a floor premium cost of $0.12 per GJ; and

ii) 1,000 GJ per day from March 1 to December 31, 2007 at a ceiling price of $8.45 per GJ and a floor price of $7.25 per GJ with a floor premium cost of $0.10 per GJ.

In July 2007, the Company settled the contract described in (ii) and received proceeds of $244,800 based on the value of the contract remaining at that date. As at December 31, 2007, the Company had fulfilled the terms of the contract described in (i).

b) In February 2008, the Company committed to the following commodity collars for the sale of natural gas:

i) 500 GJ per day from April 1 to December 31, 2008 at a ceiling price of $8.46 per GJ and a floor price of $7.25 per GJ;

ii) 500 GJ per day from April 1 to December 31, 2008 at a ceiling price of $8.31 per GJ and a floor price of $7.75 per GJ;

iii) 500 GJ per day from April 1 to December 31, 2008 at a ceiling price of $8.25 per GJ and a floor price of $7.00 per GJ; and

iv) 500 GJ per day from April 1 to December 31, 2008 at a ceiling price of $8.15 per GJ and a floor price of $7.50 per GJ.

Contingency

The Company has filed a Statement of Claim against the operator of certain jointly held properties for which the operator has filed a defense and counterclaim. The lawsuit is subject to a Standstill Agreement while the parties attempt to negotiate a resolution. As the likely outcome of this litigation cannot be determined while the Standstill Agreement is in effect, no provision was been made in the December 31, 2007 consolidated financial statements.

Other financial instruments

At December 31, 2007 and 2006, the carrying amounts of accounts receivable, bank indebtedness, bank debt, credit facility and accounts payable and accrued liabilities approximated their fair value due to the short-term maturities of these items. As at December 31, 2007, the reported amount for the investment was at fair value with changes in fair value recognized in income in the period in which the change occurs.

The Company's commodity contracts do not meet the criteria for the use of hedge accounting. When such contracts extend over an interim or year end balance sheet date, they are recorded on the balance sheet at the mark-to-market value. Changes in fair value are recognized in income in the period in which the change occurs.

The Company had no off-balance sheet arrangements at December 31, 2007 and 2006.

Selected Historical Financial Information

2007	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Petroleum and natural gas sales	2,606,074	2,256,132	1,594,063	1,443,695
Net petroleum and natural gas revenue	1,889,356	1,796,580	930,507	1,072,194
Net income (loss)	(868,562)	(32,886)	(433,754)	64,089
Net income (loss) per share	(0.02)	–	(0.01)	–
Funds flow from operations	1,281,607	1,138,801	489,113	594,704
Net capital expenditures (proceeds)	1,378,362	430,456	(2,451,045)	479,487

2006	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Petroleum and natural gas sales	3,086,261	2,035,958	1,935,781	2,381,251
Net petroleum and natural gas revenue	2,035,418	1,304,724	992,616	1,905,553
Net loss	(295,158)	(109,182)	(673,887)	(884,912)
Net loss per share	(0.01)	–	(0.01)	(0.02)
Funds flow from operations	1,620,312	861,194	398,461	1,222,746
Net capital expenditures	3,383,412	772,324	2,362,227	3,032,046

Business Risks and Uncertainties

The Company is exposed to several operational risks inherent in exploring, developing, producing and marketing crude oil and natural gas. These inherent risks include: economic risk of finding and producing reserves at a reasonable cost; financial risk of marketing reserves at an acceptable price given current market conditions; cost of capital risk associated with securing the needed capital to carry out the Company's operations; risk of environment impact and credit risk of non-payment for sales contracts and joint venture partners.

The Company attempts to control operating risks by maintaining a disciplined approach to implementation of its exploration and development programs. Exploration risks are managed by hiring experienced technical professionals and by concentrating the exploration activity on specific core regions that have multi-zone potential where the Company has experience and expertise. The Company also generates internal prospects and participates in projects where ownership interest is considered sufficient to minimize risk. Operational control allows the Company to manage costs, timing and sales of production and to ensure new production is brought on-stream in a timely manner.

The Company maintains a comprehensive insurance program to reduce risk to an acceptable level and to protect it against significant losses. The Company's risk in regards to financial instruments is detailed in note 19 to the annual consolidated financial statements.

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of December 31, 2007, that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Company, is made known to them by others with the entity. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that our disclosure controls and procedures provide a reasonable level of assurance and that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal Controls over Financial Reporting

The Chief Executive Officer and Chief Financial Officer of the Company are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. We have assessed the design of our internal control over financial reporting and during this process we have identified certain weaknesses in internal controls over financial reporting which are follows:

- Due to the limited number of staff at the Company, it is not possible to achieve complete segregation of duties; and
- Due to the size of the Company and the limited number of staff, the Company does not have the technical accounting expertise and knowledge to address all complex and non-routine accounting transactions that may arise.

These weaknesses in the Company's internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected. Management and the board of directors work to mitigate the risk of material misstatement in financial reporting. In addition, when complex accounting and technical issues arise during preparation of the quarterly financial statements outside consulting expertise is engaged. In spite of management's best efforts, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement.

Critical Accounting Estimates

The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles. A comprehensive discussion of the Company's significant accounting policies is contained in Notes 2 and 3 to the audited consolidated financial statements for the year ended December 31, 2007. The Company's significant accounting policies are subject to estimates and key judgments about future events, many of which are beyond management's control.

The Company believes the following are the most critical accounting estimates used in the determination of its financial results:

Petroleum and natural gas properties – depletion and ceiling test

The Company follows the full cost method of accounting by initially capitalizing all costs related to the acquisition, development and exploration of petroleum and natural gas reserves. Costs capitalized include land acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties, costs of drilling productive and non-productive wells, together with overhead directly related to exploration and development activities and lease and well equipment. Costs capitalized are deleted using the unit-of-production method based on gross proved petroleum and natural gas reserves as determined by independent qualified reserve evaluators. Production and reserves of petroleum and natural gas are converted to common units of measure based on their relative energy content where one barrel of oil is equivalent to six thousand cubic feet of natural gas. The depletion base excludes the cost of significant unproved properties until it is determined whether proved reserves are attributable to the properties or impairment has occurred.

The Company performs a ceiling test the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved and probable reserves and the cost, less any impairment of unproved properties. Estimated cash flows are discounted at the Company's risk-free rate of interest using forecast prices and costs. The carrying amount of undeveloped properties and seismic excluded from the ceiling test are compared to independent evaluations of fair value. Any impairment is recorded as additional depletion expense.

Estimates are the basis for amounts recorded as depletion and the ceiling test. These estimates include proved and probable reserves, production rates, future petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates could be material in future periods.

Asset retirement obligation

The Company recognizes the liability for the asset retirement obligation associated with the abandonment of petroleum and natural gas wells, related facilities, compressors and plants and the removal of equipment from leased acreage and returning such land to its original condition. The fair value the Company's asset retirement obligation is recorded in the period a well or related asset is drilled, constructed or acquired. Fair value is estimated using the present value of the estimated future cash outflows to abandon the assets at the Company's credit-adjusted risk-free interest rate based on the expected timing of such cash outflows. Future costs and their expected timing are estimates that are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates could be material in future periods.

Income taxes

The Company records future tax assets and liabilities to account for the expected future tax consequences of events that have been recorded in its consolidated financial statements and its tax returns. These amounts are estimates and the actual tax consequences may differ from the estimates due to changing tax rates and regimes, as well as changing estimates of cash flows and capital expenditures in current and future periods. A valuation allowance is recorded to the extent that there is uncertainty regarding utilization of future tax assets.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations, often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability and expense may differ from that estimated and recorded.

Stock-based compensation

Stock-based compensation expense is recorded in the statement of loss and deficit for all options granted based on the estimated fair value at the time of the grant and recognized as expense over the vesting period of the option. The fair value of options is estimated using the Black-Scholes pricing model based on estimates and assumptions for expected life of the options, expected volatility, risk-free interest rate and dividend yield. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates could be material in future periods.

Pending Accounting Pronouncements

The Canadian Institute of Chartered Accountants ("CICA") has issued a number of accounting pronouncements which may impact the Company's reported results and financial position in future periods. The Company is currently assessing the impact of these following new standards on its consolidated financial statements:

Capital Disclosures and Financial Instruments – Disclosures and Presentation

On December 1, 2006 three new accounting standards were issued by the CICA. These were Section 1535 Capital Disclosures, Section 3862 Financial Instruments – Disclosure and Section 3863 Financial Instruments – Presentation. These new standards will be effective on January 1, 2008.

Section 1535 specifies the disclosure of (i) an entity's objectives, policies, and processes for managing capital, (ii) quantitative data about what the entity regards as capital, (iii) whether the entity has complied with any capital requirements, and (iv) if it has not complied, the consequences of such non-compliance.

The new Sections 3862 and 3863 replace Section 3861 Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

International Financial Reporting Standards ("IFRS")

In 2005, the Accounting Standards Board of Canada ("AcSB") announced that accounting standards in Canada are to converge with IFRS. The AcSB has indicated that Canadian entities will need to begin reporting under IFRS by the first quarter of 2011 with appropriate comparative data from the prior year. Under IFRS, the primary audience is capital markets and as a result, there is significantly more disclosure required, specifically for quarterly reporting. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy which must be addressed.

Inventories

In March 2007, Section 3031 Inventories was adopted which aligns Canadian GAAP with IFRS. This standard will be effective on January 1, 2008.

Goodwill and intangible assets

In January 2008, Section 3064 Goodwill and Intangible Assets was issued to replace Section 3062 Goodwill and Other Intangible Assets and Section 3450 Research and Development Costs. This standard aligns Canadian GAAP with IFRS and will be effective on October 1, 2008.

Recent Developments

Based on current properties and commodity prices, the new royalty regime is expected to have only a minimal impact on the Company's current production and cash flow. Management is reviewing the Company's strategy on a project-by-project basis and has formulated a 2008 capital budget that considers the impact of the new royalty framework on project economics.